

* JUST A GUIDE

Monopolistic Competition Guide

Examine the key features of a monopolistically competitive industry.

- Contrast the output and pricing decisions of monopolistically competitive firms with those of perfectly competitive firms.
- Explain why brand names and advertising are important characteristics of monopolistically competitive industries.
- Analyze economics from a Christian worldview perspective.

Readings

- 1) Websites:
- 2) *Microsoft*. (2007). Retrieved July 31, 2007, from <http://www.microsoft.com/>
- 3) Peters, T. (1986). *Uniqueness*. Retrieved April 20, 2005, from http://www.tompeters.com/col_entries.php?note=005140&year=1986
- 4) Peters, T. (1986). *Word-of-mouth marketing*. Retrieved July 31, 2007, from http://www.tompeters.com/col_entries.php?note=005139&year=1986
- 5) Scheffman, D., Coate, M., and Silvia, L. (n.d.). *20 years of merger guidelines enforcement at the FTC: An economic perspective*. Retrieved July 31, 2007, from <http://www.usdoj.gov/atr/hmerger/12881.htm>
- 6) Winslow, L. (2007). *Starbucks Monopoly*. Retrieved July 16, 2007 from <http://ezinearticles.com/?Starbucks-Monopoly&id=41253>

Exercises

- 1) Individual:
Chapter 11 Problem Questions
Complete the following problems from the problem set of your textbook: Chapter 11, Problems 2 and 4.

This Exercise has 6 items

Chapter 11, Problem 2 (4 Items)

a.	Short-Run EQ =	See p 233 Fig 11.1
b. i.	Price =	The intersection of demand and Q
b. ii.	Output =	
b. iii.	Total Profit =	TP = Profit Per Unit * Q; Profit per Unit = Price - ATC; You will have to eyeball ATC to be about.

c.	Long-Run EQ =	The point where the demand curve will be tangent to the ATC at which point Price = ATC and no economic profit exists (p. 233 Fig 11.1)
d. i.	Price =	The demand curve shifts left and see above
d. iii.	Output =	The demand curve shifts left and see above
d. iii.	Total Profit =	At L-R EQ TP = 0

Chapter 11, Problem 4 (2 Items)

a.		Page 231 Starbucks has market power and this independent production decisions.
b.		Price Elasticity of Demand = $\% \Delta$ in Q Demanded divided by $\% \Delta$ in Price (see page 98-99). We know that Price Elasticity of Demand = .10 and we know $\% \Delta$ in Price = 3.9% so we solve for the unknown so $.10 = X/3.9\%$.

monopoly, there are no other firms. In monopolistic competition, *each firm has a monopoly only on its brand image; it still competes with other firms offering close substitutes.* This implies that the extent of power a monopolistically competitive firm has depends on how successfully it can differentiate its product from that of other firms. The more brand loyalty a firm can establish, the less likely consumers are to switch brands when price is increased. In other words, *brand loyalty makes the demand curve facing the firm less price-elastic.*

Brand loyalty exists even when products are virtually identical. Gasoline of a given octane rating is a very standardized product. Nevertheless, most consumers regularly buy one particular brand. Because of that brand loyalty, Texaco can raise the price of its gasoline by a penny or two a gallon without losing its customers to competing companies. Brand loyalty is particularly high for cigarettes, toothpaste, and even laxatives. Consumers of those products say they'd stick with their accustomed brand even if the price of a competing brand was cut by 50 percent. In other words, *brand loyalty implies low cross-price elasticity of demand.* Brand loyalty is less strong (and cross-price elasticity higher) for paper towels and virtually nonexistent for tomatoes.

In the computer industry, product differentiation has been used to establish brand loyalty. Although virtually all computers use identical microprocessor "brains" and operating platforms, the particular mix of functions performed on any computer can be varied, as can its appearance (packaging). Effective advertising can convince consumers that one computer is "smarter," more efficient, or more versatile than another. Also, a single firm may differentiate itself by providing faster or more courteous customer service. If successful in any of these efforts, *each monopolistically competitive firm will establish some consumer loyalty.* With such loyalty a firm can alter its own price somewhat, without fear of great changes in unit sales (quantity demanded). In other words, the demand curve facing each firm will slope downward, as in Figure 11.1a.

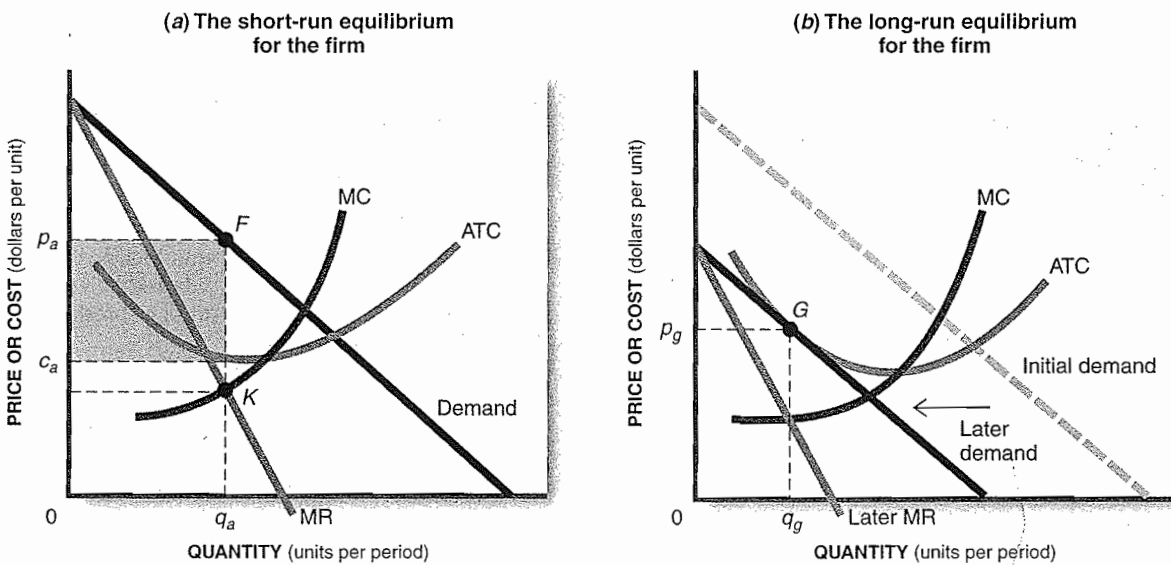


FIGURE 11.1
Equilibrium in Monopolistic Competition

(a) **Short run** In the short run, a monopolistically competitive firm equates marginal revenue and marginal cost (point *K*). In this case, the firm sells the resulting output at a price (point *F*) above marginal cost. Total profits are represented by the shaded rectangle.

(b) **Long run** In the long run, more firms enter the industry. As they do so, the demand curve facing each firm *shifts* to the left, as all market shares decline. Firms still equate MR and MC. Ultimately, however, the demand curve will be tangent to the ATC curve (point *G*), at which point price equals average total cost and no economic profits exist.