Note on

Monopolistic Competition

Monopolistic Competition-Monopolistic Competition is that condition of market in which there are many sellers of any commodity but commodity of every seller is different from commodities of other sellers in any way. Therefore, product differentiation is main quality of monopolistic competition.

Characteristics of Monopolistic Competition

Following are the main characteristics of Monopolistic Competition—

1.Large Number of Firms and Buyers: Firm producing differentiated product and sellers are large in numbers in monopolistic competition.

2. Product Differentiation: Product differentiation is the main feature of monopolistic competition. Product differentiation means that product of different types, brands, and qualities will be available to customers in a fixed time period. Product differentiation occurs when buyer of product can differentiate between two products. In this, firms are in large number but their products are different from each other in anyway, but these products are close substitutes of each other. Product differentiation is obtained due to characteristic of product like shape, measurement, colour, durability, quality etc. There are many examples of product differentiation like bath soaps Lux, Godrej, Camay, Rexona, etc.

3. Freedom of Entry and Exit of Firms: In the situation of monopolistic competition there is freedom of entry and exit of firms in the industry like perfect competition. It should be noticed that **Chamberlin** has used **group** at the place of **industry** for group of firms which produce differentiated products under the monopolistic competition.

4. Selling Cost: An important characteristic of monopolistic competition is that every firm spends more money in promoting its product under it. Firm gives advertisements in newspapers, cinemas, magazines, radio, T.V. etc. for selling its product in the maximum amount. The investment done on all these is called as Selling Costs.

5. Price Control: Every firm has limited control on the cost of product. Average income and limit end income curve of a firm fall down like monopoly in monopolistic competition. It means that in this situation, firm can slow down the price for selling more products and raise price for fewer products. In monopolistic competition, a firm has control on cost of its production due to the product differentiation. But due to the availability of close substitute of opposite product firms do not have full control on cost in monopolistic competition. The cost of every firm is affected by cost policy of its competitors in market up to the certain limit.

6. Limited Mobility: In monopolistic competition, sources of production and products and do not have mobility in services.

7. Imperfect Knowledge: In the situation of monopolistic competition, buyers, sellers of products, and owners of sources do not have knowledge of different prices of product. The reason is that comparison between productions of different firms is not possible due to product differentiation. Customers are fond of the production of any one specific firm. They only buy

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the production of that firm even if it costs higher than others. In this way even sources of production are not able to know fully that how much the different firms are costing to the sources of services.

8. Non-Price Competition: The main characteristic of monopolistic competition is that under it different firms without changing the costs of products compete with each other like the example of companies producing 'Surf' and 'Ariel'. If you take a box of 'Surf', you will get a glass utensil similarly, with the box of 'Ariel' you will get the steel spoon. In this way, firms, by providing different types of facilities and products etc. to customers to attracts them toward their products. This type of competition is called as Non-Price Competition.

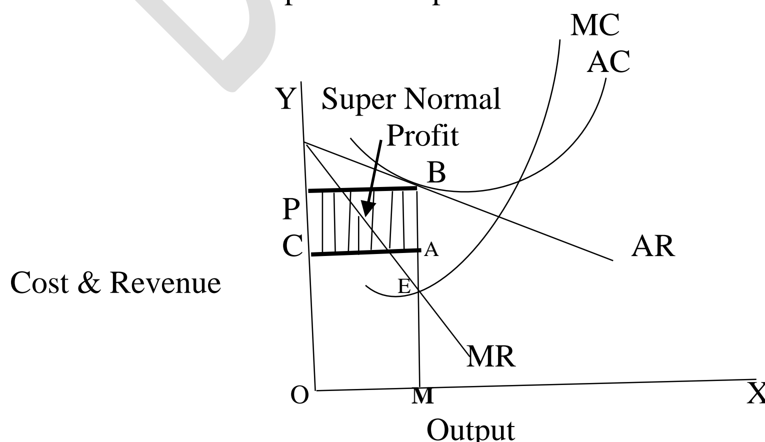
Equilibrium Under Monopolistic Competition

In the situation of monopolistic competition, if any firm wants to sell maximum quantity of its production then it has to decrease the cost. That's why, in the situation of monopolistic competition, Average Revenue Curve (AR Curve) and Marginal Revenue (MR Curve) fall down in the form of left to right. In monopolistic competition, a firm produce till the point or limit at which (*i*) Marginal Revenue is equal to Marginal Cost (MR = MC) and (*ii*) Marginal Revenue Curve cuts Marginal Cost Curve from the lower side. In this situation firm is in the condition of balancing by the production. The study of equilibrium firm in monopolistic competition can be done in two different durations—
(1) Short Run and (2) Long Run

Short Run Equilibrium in Monopolistic Competition

Short Run is that duration of time in which production can be increased only by increase in using variable resources on increasing demand. There is no time to increase or decrease constant resources of production like machine, plant, building, etc. In short run, an equilibrium of a firm will be in that situation in which (1) MC = MR and (2) MC curve will be cutting MR curve. There can be three conditions of firms in this duration of time—
(1) Super Normal Profits, (2) Normal Profits and (3) Minimum Losses.

Super Normal Profits-Firm is in equilibrium at point E because marginal cost and marginal revenue are equal (MR = MC) on point E and MC curve cut MR curve from the lower side. It is known by point E that OM will be equilibrium production of firm. The cost of equilibrium production is OC (= AM). The cost (AM) of equilibrium production will be less (AM < BM) than average Revenue BM so every unit of firm is obtained Super Normal Profits BM – AM = AB. Firm has total super normal profit ABCP.



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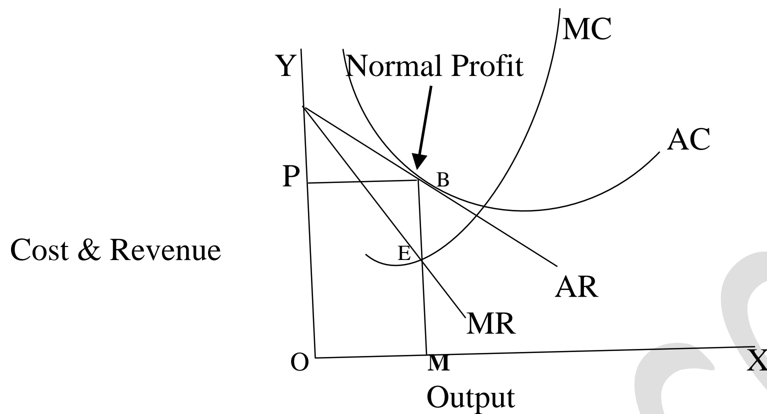
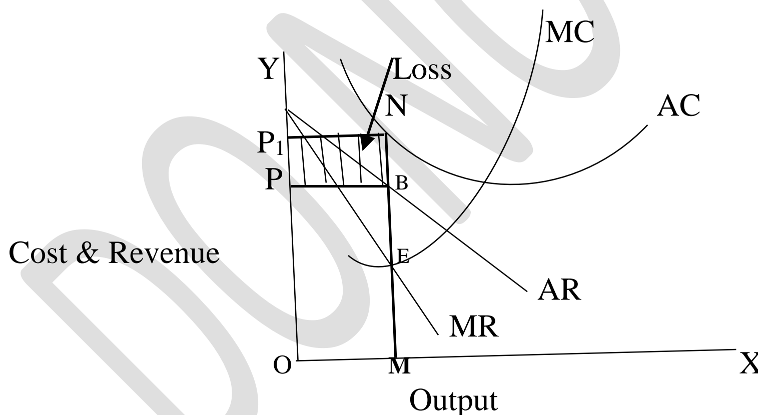
Normal Profits: In short-run, firm of monopolistic competition can have the normal profits. firm will be in equilibrium situation at point E because at point E (i) MC = MR and (ii) MC curve cuts MR from the lower side. It is known by point E that OM will be the equilibrium production. The cost of equilibrium production is OP (AM) and average cost is also OP (AM). The reason is that AR curve is touching AC curve at point A. That’s why in the situation of equilibrium cost (AR) and average cost (AC) are equal (AR = AC). Therefore, only normal profits will obtain to firm.



Minimum Loss: Firm can also have loss of fixed cost in short-run. This is the minimum loss of firm. Firm will be in equilibrium at point E. At this point, MC = MR and MC curve cuts MR curve from the lower side. In the equilibrium condition, firm will produce OM. The cost of equilibrium quantity OM is OP (= BM) and average cost OP_1 (= NM). A short-run average cost of firm more than (SAC > AR). So firm will have per unit loss of NM – BM = BN. Total loss of firm will be the area of $NBPP_1$.



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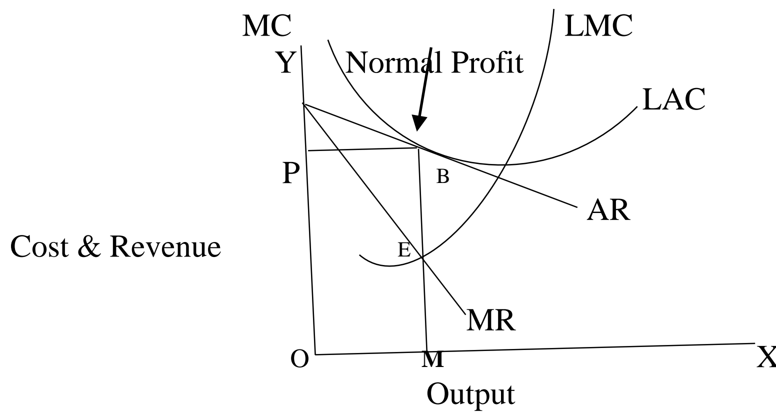
Long-Run Equilibrium in Monopolistic Competition

Long-term is that duration of time in which firms can change level of their plants, new firms can enter into the market and old firms can leave the market. It should be kept in mind that **products differentiated** in monopolistic competition are not similar. **Chamberlin** had used the word product group at the place of industry to those firms which produce differentiated product.



In Figure LAC is long-run average cost curve and LMC is long-run marginal curve. AR is lead average and MR is marginal lead curve. MR and MC at point E are equal to each other. Therefore, it will be equilibrium point. OM will be produced on this point, which costs OP(=AM). Average revenue curve on equilibrium production OM is touching long-run average cost curve at point A. So, in the equilibrium condition, cost and long-run average cost (AR = LAC) are equal to each other. Therefore, firms are earning only normal profits. There will be maximum profits of LAC and AR at 'A', Point of Tangency. The reason is that on any other cost average cost (AC) is more than average revenue (AR) of long-run average cost curve (AR) so firm will incur loss. Due to the normal profits obtained by the firm, there will be no encouragement for the entry of new firms in the group and no reason for exit of old firms from the group.

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