Chapter 12

Monopolistic Competition: The Competitive Model in a More Realistic Setting

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Learning Objectives

12.1 Explain why a monopolistically competitive firm has downward-sloping demand and marginal revenue curves.
12.2 Explain how a monopolistically competitive firm maximizes profits in the short run.
12.3 Analyze the situation of a monopolistically competitive firm in the long run.
12.4 Compare the efficiency of monopolistic competition and perfect competition.
12.5 Define marketing and explain how firms use it to differentiate their products.
12.6 Identify the key factors that determine a firm’s success.

Starbucks: Growth through Product Differentiation

The coffeehouse market is monopolistically competitive rather than perfectly competitive.
**Monopolistic Competition: The Competitive Model in a More Realistic Setting**

**Monopolistic competition**
A market structure in which barriers to entry are low and many firms compete by selling similar, but not identical, products.

**Learning Objective 12.1**

**Demand and Marginal Revenue for a Firm in a Monopolistically Competitive Market**

*The Demand Curve for a Monopolistically Competitive Firm*

![Graph](image-url)
Demand and Marginal Revenue for a Firm in a Monopolistically Competitive Market

Marginal Revenue for a Firm with a Downward-Sloping Demand Curve

Learning Objective 12.1

Table 12-1

<table>
<thead>
<tr>
<th>Caffé Lattes Sold Per Week (Q)</th>
<th>Price (P)</th>
<th>Total Revenue (TR = P x Q)</th>
<th>Average Revenue (AR = TR/Q)</th>
<th>Marginal Revenue (MR = ΔTR/ΔQ)</th>
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</table>

Learning Objective 12.1

FIGURE 12-2

How a Price Cut Affects a Firm’s Revenue

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Learning Objective 12.1

12.1 Marginal Revenue for a Firm with a Downward-Sloping Demand Curve

FIGURE 12-3
The Demand and Marginal Revenue Curves for a Monopolistically Competitive Firm

Demand and Marginal Revenue for a Firm in a Monopolistically Competitive Market

Learning Objective 12.2

12.2 How a Monopolistically Competitive Firm Maximizes Profits in the Short Run

FIGURE 12-4
Maximizing Profit in a Monopolistically Competitive Market
What Happens to Profits in the Long Run?

How Does the Entry of New Firms Affect the Profits of Existing Firms?

FIGURE 12-5 How Entry of New Firms Eliminates Profits

Don't Let This Happen to YOU!
Don't Confuse Zero Economic Profit with Zero Accounting Profit

Table 12-2
The Short Run and the Long Run for a Monopolistically Competitive Firm
What Happens to Profits in the Long Run?

Is Zero Economic Profit Inevitable in the Long Run?

A firm’s profits will be eliminated in the long run only if a firm stands still and fails to find new ways of differentiating its product or fails to find new ways of lowering the cost of producing its product.

Comparing Perfect Competition and Monopolistic Competition

Monopolistic competition and perfect competition share the characteristic that in long-run equilibrium, firms earn zero economic profits.

However, there are two important differences between long-run equilibrium in the two markets:

- Monopolistically competitive firms charge a price greater than marginal cost.
- Monopolistically competitive firms do not produce at minimum average total cost.
Learning Objective 12.4

Comparing Perfect Competition and Monopolistic Competition

Excess Capacity under Monopolistic Competition

FIGURE 12-6
Comparing Long-Run Equilibrium under Perfect Competition and Monopolistic Competition

Economists have debated whether monopolistically competitive markets being neither productively nor allocatively efficient results in a significant loss of well-being to society in these markets compared with perfectly competitive markets.

Is Monopolistic Competition Inefficient?

How Consumers Benefit from Monopolistic Competition

Consumers benefit from being able to purchase a product that is differentiated and more closely suited to their tastes.
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How Marketing Differentiates Products

Marketing All the activities necessary for a firm to sell a product to a consumer.

Brand Management

Brand management The actions of a firm intended to maintain the differentiation of a product over time.

Learning Objective 12.5

How Marketing Differentiates Products

Advertising

If the increase in revenue that results from the advertising is greater than the increase in costs, the firm’s profits will rise.

Defending a Brand Name

A firm can apply for a trademark, which grants legal protection against other firms using its product’s name.
What Makes a Firm Successful?

FIGURE 12-7
What Makes a Firm Successful?

- Differentiation from competing products
- Factors affecting the firm's market
- Value created relative to competitors
- Average cost of production relative to competing firms
- Chance events
- Profitability