

Topic: Monopolistic / Imperfect Competition

- **Monopolistic Competition** is a market structure where many firms compete by selling products that are **close substitutes** but **differentiated** in some way.
- Examples of Firms in Monopolistic Competition:
 - **Fast Food Chains:** Firms like McDonald's, Burger King, Supermac's, and KFC offer similar products (burgers, fries, etc.) but differentiate through branding, menu variety, and pricing.
 - **Clothing Retailers:** Stores such as Zara, H&M, Penneys, and New Look sell similar clothing items but attract customers with different styles, quality, and marketing strategies.

Characteristics of a Monopolistically Competitive Market

Characteristic	Explanation
Many buyers & sellers	<ul style="list-style-type: none"> • An individual buyer, by his/her own actions, can't influence the market price of the goods. • An individual seller can influence the quantity sold by the price it charges for its output in the industry.
Product differentiation exists	<ul style="list-style-type: none"> • The goods, supplied by the producer, are not homogenous but are close substitutes. • Firms use branding to distinguish their products from one another.
Freedom of entry and exit	<ul style="list-style-type: none"> • Low barriers to entry exist within the industry. It is possible for firms to enter/leave the industry as they wish.
Reasonable knowledge exists	<ul style="list-style-type: none"> • Within the industry each firm has reasonable knowledge of profits made by other firms. • Consumers have a reasonable knowledge of the prices being charged for different products.
Each firm attempts to maximise profits	<ul style="list-style-type: none"> • Firms produce where MC = MR. Each firm will attempt to minimise costs of production.

Short Run Monopolistic Competition - SNP / Abnormal Profits

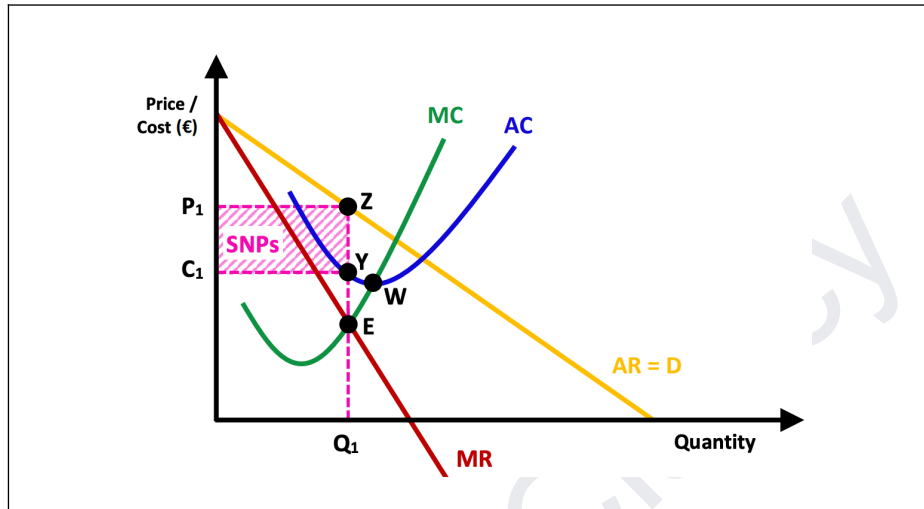


Diagram Analysis

E – Equilibrium	<ul style="list-style-type: none"> The firm produces at the profit-maximising level of output, where: $MC = MR$ at Q_1. At this output: $AR(P_1) > AC(C_1)$
P – Price and output	<ul style="list-style-type: none"> Price is P_1 and Quantity produced is Q_1
C – Costs	<ul style="list-style-type: none"> Since $AC > AR$, the firm covers its total costs and is making a SNP.
S – Supernormal profits / losses	<ul style="list-style-type: none"> The firm is making SNP because $AR > AC$ at the profit-maximising level of output.
S – Scarce resources	<ul style="list-style-type: none"> The firm is not producing at the minimum point of the AC curve and is therefore productively inefficient.

- Incentivised by profit, **new firms** join the industry (**easy entry** and exit) and supply increases from $S_1 \rightarrow S_2$
 - Overall quantity in the industry increases from $Q_1 \rightarrow Q_2$
 - The industry price falls from $P_1 \rightarrow P_2$

Short Run Monopolistic Competition - Losses

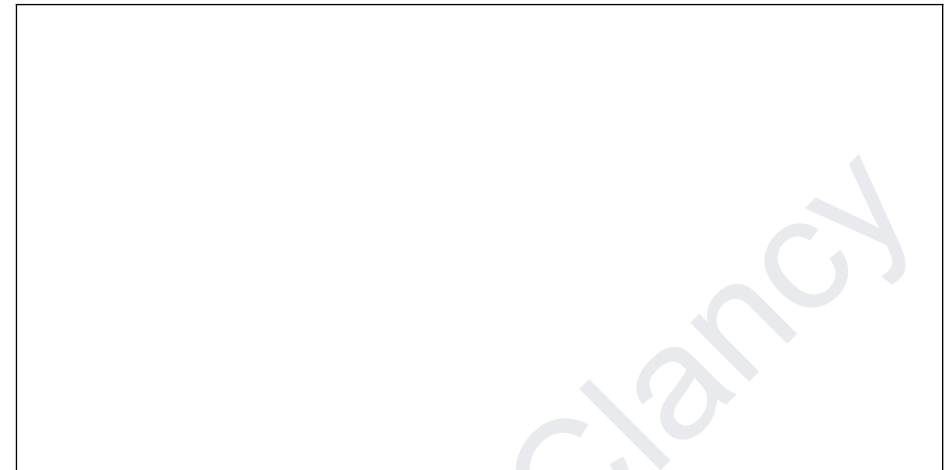


Diagram Analysis

E – Equilibrium	<ul style="list-style-type: none"> The firm produces at the profit-maximising level of output, where: $MC = MR$ at Q_1. At this output: $AR(P_1) < AC(C_1)$
P – Price and output	<ul style="list-style-type: none"> Price is P_1 and Quantity produced is Q_1
C – Costs	<ul style="list-style-type: none"> Since $AC > AR$, the firm does not cover its total costs and is making a loss.
S – Supernormal profits / losses	<ul style="list-style-type: none"> The firm is making a loss because $AC > AR$, at the profit-maximising level of output.
S – Scarce resources	<ul style="list-style-type: none"> The firm is not producing at the minimum point of the AC curve and is therefore productively inefficient.

Long Run Monopolistic Competition - Normal Profits

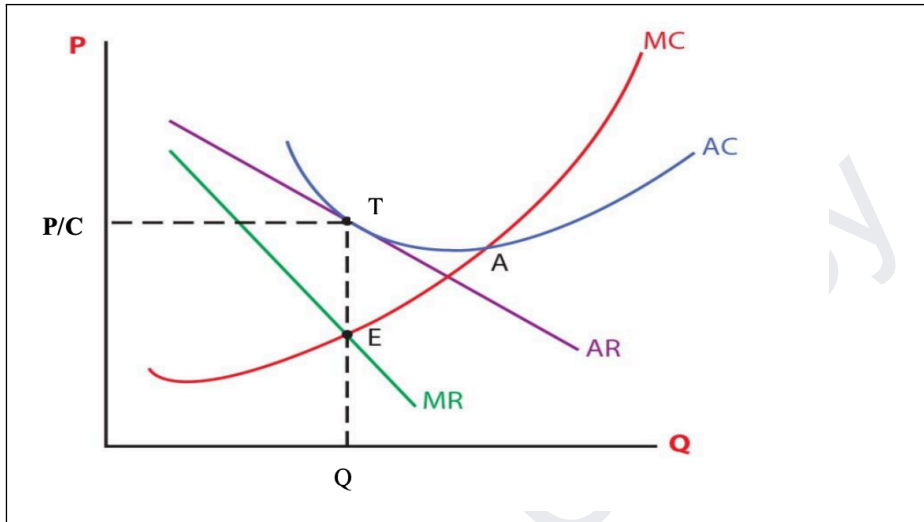


Diagram Analysis

E – Equilibrium	<ul style="list-style-type: none"> The firm produces at the profit-maximising level of output, where: MC = MR at Q. At this output: AR (P) = AC (C)
P – Price and output	<ul style="list-style-type: none"> Price is P_c and Quantity produced is Q
C – Costs	<ul style="list-style-type: none"> Since AC = AR, the firm covers its total costs and is making normal profits.
S – Supernormal profits / losses	<ul style="list-style-type: none"> The firm is making normal profits because AC = AR, at the profit-maximising level of output.
S – Scarce resources	<ul style="list-style-type: none"> The firm is not producing at the minimum point of the AC curve and is therefore productively inefficient.

Exam Q

The hair and beauty industries in Ireland are an example of a monopolistic competition market structure.



Adapted from Jim Power for HABIC, 2020

(a) (i) Outline two reasons why, in your opinion the hair and beauty industries are an example of **monopolistic competition**.

1.
2.

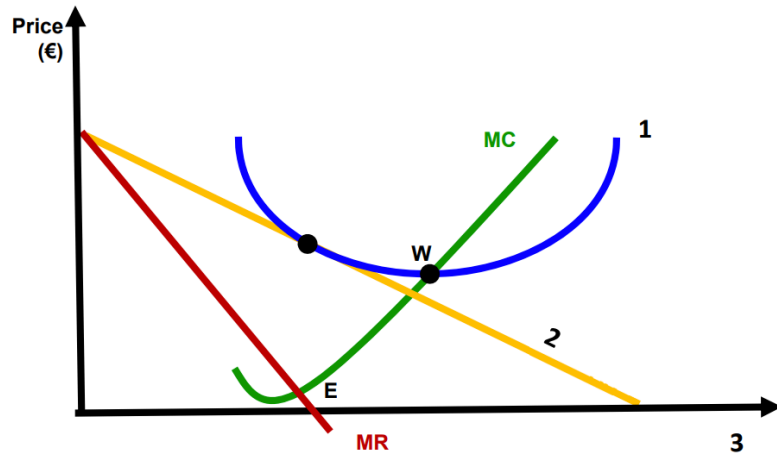
(ii) Outline two advantages for **consumers** of monopolistic competition.

1.
2.

(b) The diagram below represents the long run equilibrium of a firm in the hair and beauty industry.

(i) Write out in full what each of the three numbered items (1-3) in the diagram below represent. (Do not use abbreviations)

1.	
2.	
3.	



(ii) Equilibrium occurs at point E on the diagram above. Clearly show and label on the above diagram:

- The output the firm will produce in the equilibrium (use label Q_1)
- The price the firm will charge for its output (use label P_1)
- The average cost of producing this output (using point C_1)

(iii) Is the above firm producing efficiently? Yes: No:
Give a reason for your answer.

Reason:

Product Differentiation

- The goods which are produced are **close substitutes / similar goods / not identical goods**

Product Differentiation Strategies

Strategy	Explanation
Branding	<ul style="list-style-type: none"> • Firms establish distinctive brand identities to foster customer loyalty and create perceived differences. • Example: Nike, Adidas, Reebok.
Competitive Advertising	<ul style="list-style-type: none"> • Advertising highlights product differences in the minds of consumers, such as unique packaging or superior quality. • Example: Daz vs. Surf, Kellogg's Cornflakes vs. generic brands.
Product Innovation	<ul style="list-style-type: none"> • Firms enhance their products by adding new features or improving quality to differentiate them from competitors. • Example: Lyons pyramid tea bags, Avonmore super milk, Fairy detergent with antibacterial agents.

Efficiency / Economic Waste

Why Imperfect Competition is Considered Wasteful of Resources

1. Inefficiency in Production:

- Firms in imperfect competition (e.g., monopolistic competition) do not produce at the lowest point on their average cost curve in the long run.
- This results in **overcapacity**, meaning firms are not utilising resources efficiently, leading to higher costs and wasted potential.

2. Competitive Advertising:

- To maintain or grow market share, firms engage in costly advertising campaigns.
- These costs are passed on to consumers, resulting in higher prices without directly improving product quality.

Perfect Competition V. Monopolistic Competition

- Both earn SNPs in the short run but not in the long run
- Equilibrium positions are not the same:
 - $PC \Rightarrow MC=MR=AR=AC$
 - Monopolistic Competition $\Rightarrow MC=MR$ and $AC=AR$

Advantages of Monopolistic Competition

Advantage	Explanation
Greater Choice	<ul style="list-style-type: none"> ● Consumers benefit from a variety of goods and services because firms produce close substitutes rather than identical products. ● Examples: Different brands of breakfast cereals like Kellogg's, Weetabix, and Aldi's private label offer unique flavors, packaging, and pricing.
Normal Profit in the Long run	<ul style="list-style-type: none"> ● Firms in imperfect competition earn only normal profits in the long run, ensuring consumers are not overcharged. ● Example: The restaurant industry balances pricing as competition grows; no single restaurant can charge excessive prices without risking customer loss.
Lower Prices	<ul style="list-style-type: none"> ● Intense competition among firms drives them to lower prices to attract consumers, benefiting buyers with more affordable options. ● Examples: Supermarkets like Tesco, Lidl, and Dunnes Stores regularly offer discounts and competitive pricing to maintain their customer base.
Innovative Goods/Services	<ul style="list-style-type: none"> ● Firms are motivated to innovate and improve their products to stand out from competitors, ensuring consumers enjoy better-quality, modern goods. ● Examples: <ul style="list-style-type: none"> ● Lyons Pyramid Tea Bags introduced a unique shape to enhance tea infusion. ● Apple consistently innovates its iPhone features (e.g., advanced cameras, improved battery life) to stay ahead of rivals like Samsung. ● Fairy Detergent introduced antibacterial agents, combining dishwashing and hygiene benefits.

Exam Q

- (a) (i) In the Irish economy there are many restaurants in the market. This is an example of monopolistic competition. Outline three characteristics (other than many sellers) of a firm operating in **monopolistic competition**.

1.
2.
3.

- (ii) Firms operating under monopolistic competition waste resources. Do you agree or disagree with this statement? Indicate your choice below by ticking (✓) the relevant box and justify your choice.

Agree: Disagree:

Justify:

- (b) (i) Explain, with the aid of a fully labelled diagram (including the axes), the long-run equilibrium of a firm operating in **monopolistic competition**.



Explanation:

- (ii) Outline one possible **economic advantage** to consumers of monopolistic competitive markets.

Economic advantage:

Exam Q: 2024 OL

- (a) Coffee shops in Ireland operate in **monopolistic competition**. Indicate by means of a tick (✓) whether you regard each statement below to be true or false.

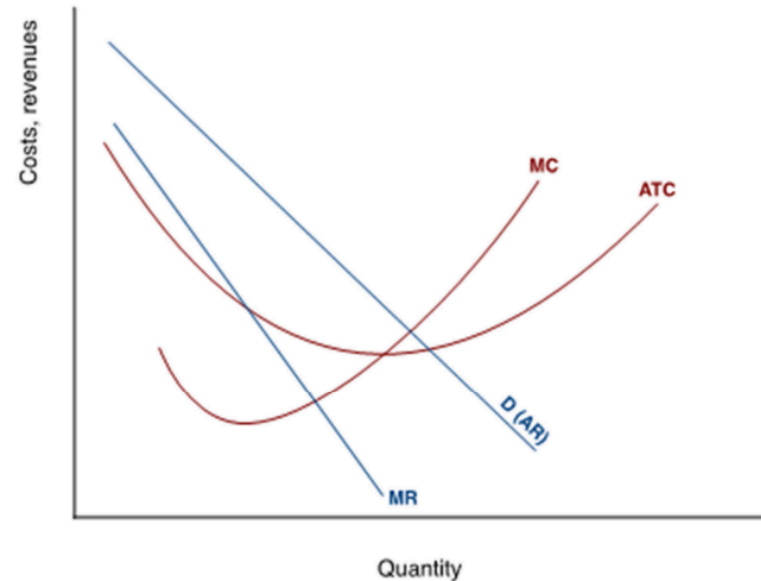
	Statement	True	False
1.	Barriers to entry exist in the Irish coffee shop market.		
2.	The demand curve / average revenue curve for coffee in an Irish coffee shop is downward-sloping from left to right.		

OR

- (b) Competitive advertising promotes the advantages of one firm's product over that of its competitors. Outline two reasons why competitive advertising may **not always** benefit the consumer.

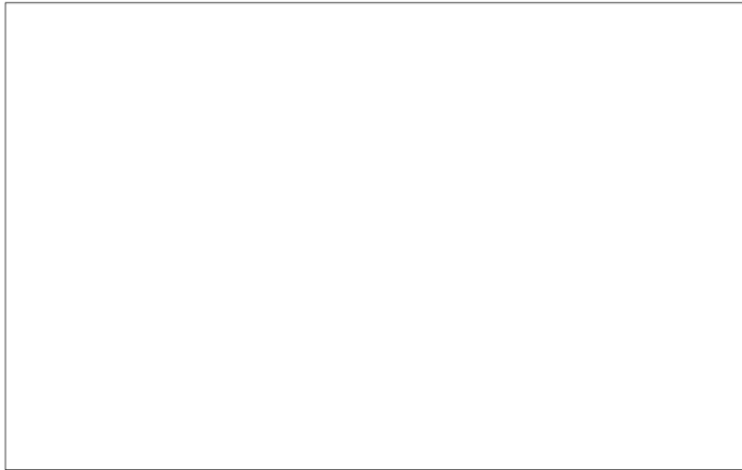
1.
2.

- (b) Fast food outlets are examples of monopolistic competition.



- (i) The diagram above shows a firm in short run monopolistic competition. Indicate on the diagram where the firm earns **abnormal profits/super normal profits**.

(ii) In the space provided below, draw and label the diagram which represents the long-run equilibrium in monopolistic competition. Explain your diagram.



Explanation:

