17. Monopolistic Competition

Q:1 Explain Features of Monopolistic Competition?

(A) Monopolistic Competition :-

The Monopolistic Competition was introduced by Prof. Chamberlin and Prof. (Mrs.) Robinson. It is a form of Imperfect market in this market both the elements of Monopoly and Perfect Competition is Present.

(B) Meaning :- According to Chamberlin—

" Monopolistic Competition means Competition among a Large Number of Sellers Producing but not Perfect Substitutes. "

(C) Features of Monopolistic Competition :-

1. **Large Number of Sellers :-** In monopolistic market, we find Large number of sellers Competing With each other. Each seller Follows an independent Price and Output Policy. The number of sellers are So Large that no one has Complete Control over market Supply.

2. **Close-Substitutes :-** As Large number of Sellers are available in monopolistic market so there are Close-Substitutes available in the market.

Example :- There are many Close-Substitutes available For Soaps, Oil, Garments T.V, mobile etc.

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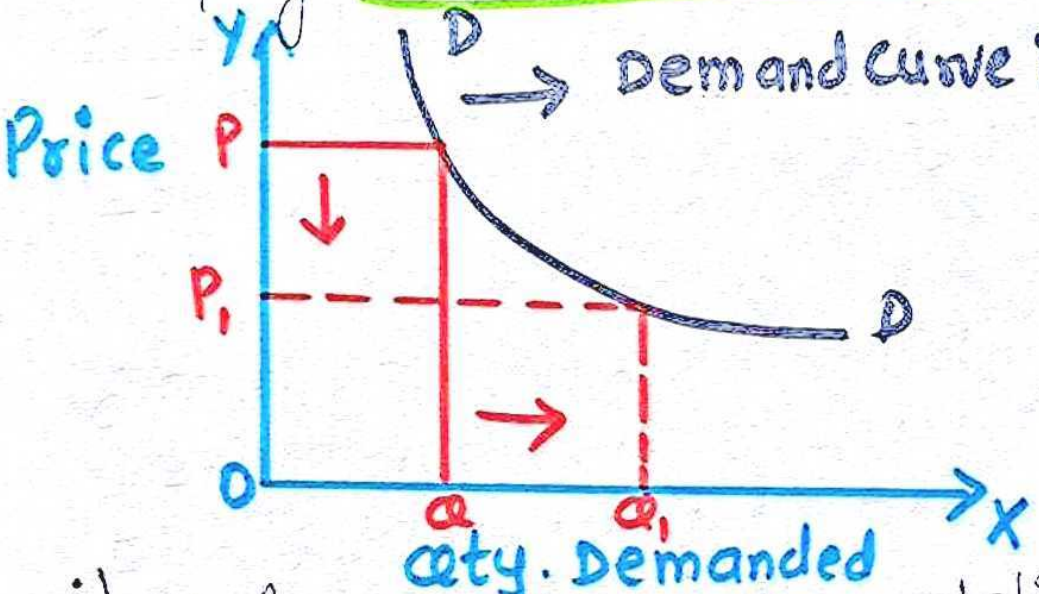
3. Free Entry and Exit :- Every Firm has freedom of Entry and Exit in monopolistic market. A Firm is free to enter in the market which is Producing Close-Substitutes for existing Products. IF firm is Unable to Face the Competition due to Losses, then they can move out from the market.

4. Product Differentiation :- The Product of different Firms are differentiated through Shape, Size, Colour, design, Quality, Package, brand etc. Each Seller will try to create its own identity and good will for its own brand.

5. Selling Cost :- Selling Cost is the Unique and Special Feature of Monopolistic Competition. Selling Costs are the cost incurred by every Seller for Sales Promotion. Selling Cost is important for Marketing goods.
Example - Cost incurred on Advertisement, Window display, Hoardings, Distribution of free samples etc.

6) Group :- Existance of Group is another important Feature of monopolistic Competition. This Concept was well-developed by Chamberlin.
A Group is a Cluster of Firms Producing Closely related goods. In monopolistic market every Firm is Producing Similar but not identical goods. So these Firms make Groups to Protect their rights and Powers.

7. Nature OF Demand Curve :- In this market, Demand Curve is more elastic in nature. It is Sloping downward from Left to right.



i) DD is Demand Curve in monopolistic market.
ii) When Price Fall From OP to OP_1, Producer is able to Sell more Quantity from OQ to OQ_1.

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Q:2 How an Individual Firm attain Equilibrium Under Monopolistic Competition in Short-Run?

(A) Equilibrium OF Firm in Short-Run :-

An Equilibrium of a Firm in Short-run is based on Following assumptions

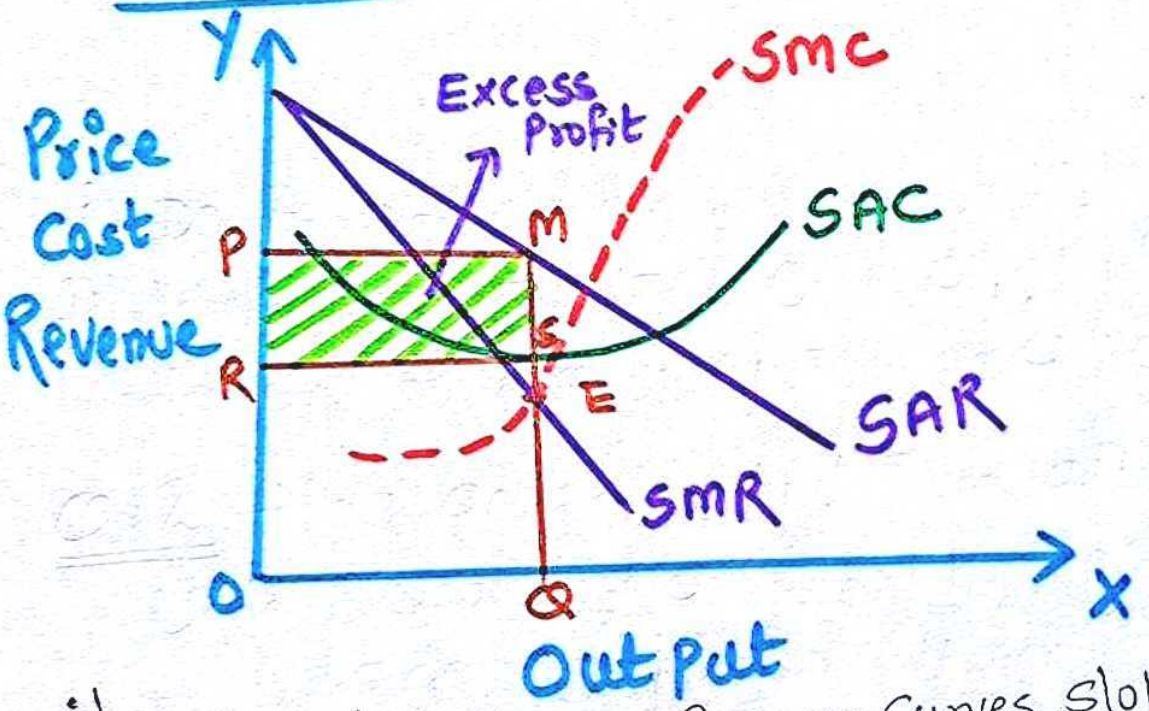
i) A Firm must be rational which try to earn maximum Profit
ii) A Firm is working Under 'U' Shaped Avg. Cost Curve.
iii) The demand Curve of Firm must be Sloping downward which Shows inverse relationship between Price and Quantity demanded.
iv) Firm is working Under Product differentiation.

(B) Conditions of Equilibrium in Short-Run :-

1) SMC = SMR
2) SMC curve intersect SMR curve from below.

There are Three Situations of Equilibrium :-

1) **Excess Profit :-** A firm Under Monopolistic Market enjoys Excess profit where SMR > SMC and SAR > SAC shown in following diagram :-



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i) SAR and SMR are Revenue Curves sloping downward and SAC Curve is 'U' shaped.

ii) Producer get Equilibrium where SMR = SMC at Point E. Here firm sell OQ Output at OP Price. A Producer cannot increase the Price than OP because Customer will divert to Cheap Substitutes.

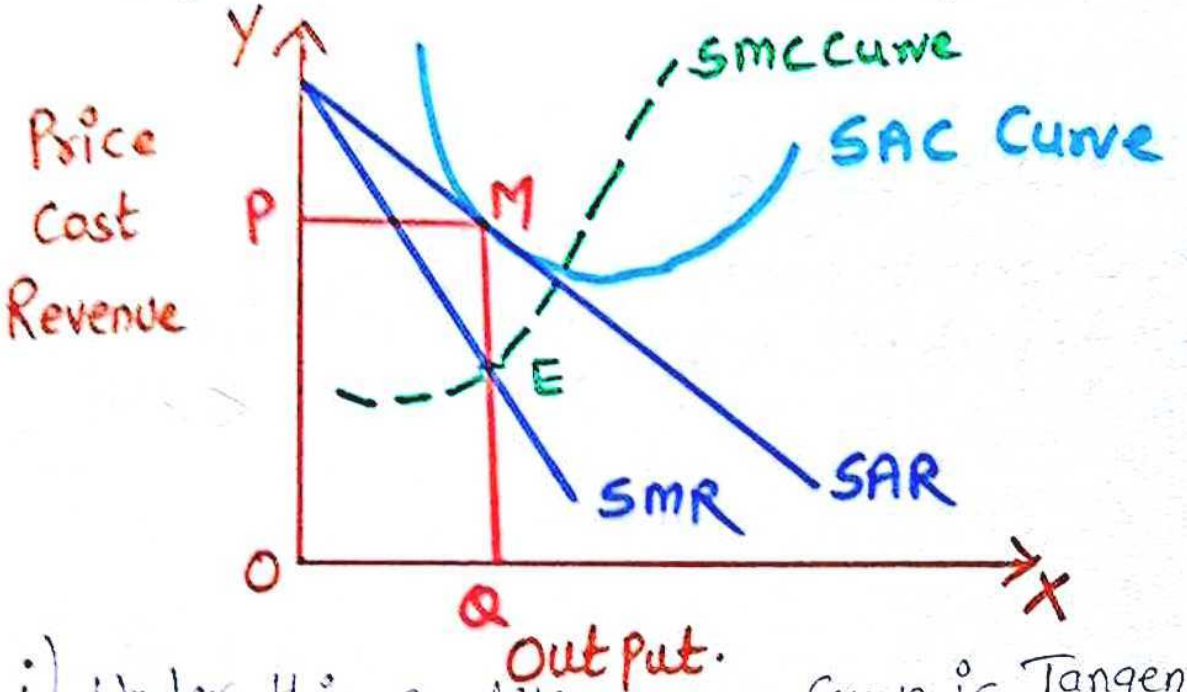
iii) TR = POQM and TC = ROQS

Excess Profit = TR - TC

Excess profit = POQM - ROQS = PRSM

(2) Normal Profit :-

A Firm under monopolistic market enjoy Normal Profit Where - SMR = SMC and SAR = SAC



i) Under this condition, SAC Curve is Tangent to SAR.

ii) A Producer enjoys equilibrium at Point E, where SMC = SMR. Here Producer sell OQ output at Price OP.

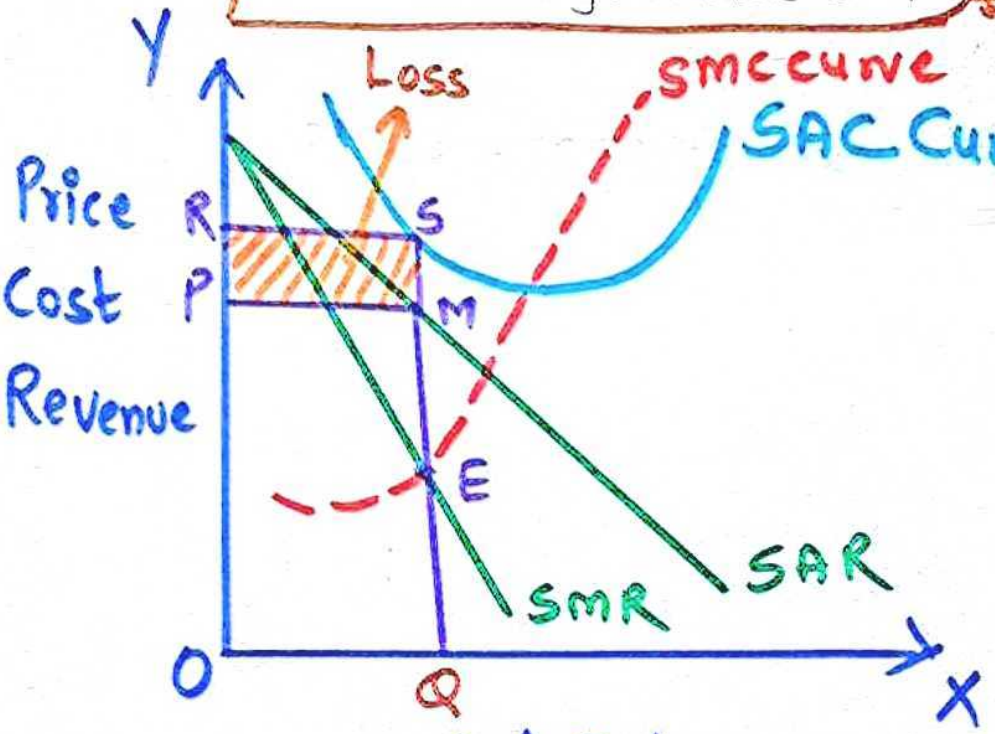
iii) TR = POQM and TC = POQM

As TR = TC = POQM

Thus here Producer enjoys Normal Profit

(3) Loss :-

A Firm Under monopolistic Competition will Suffer Losses when Producer is Unable to Cover Average Cost. Here SAC > SAR shown in the following diagram :-



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i) In the above figure, Producer is Unable to Cover Avg. Variable Cost as SAC > SAR

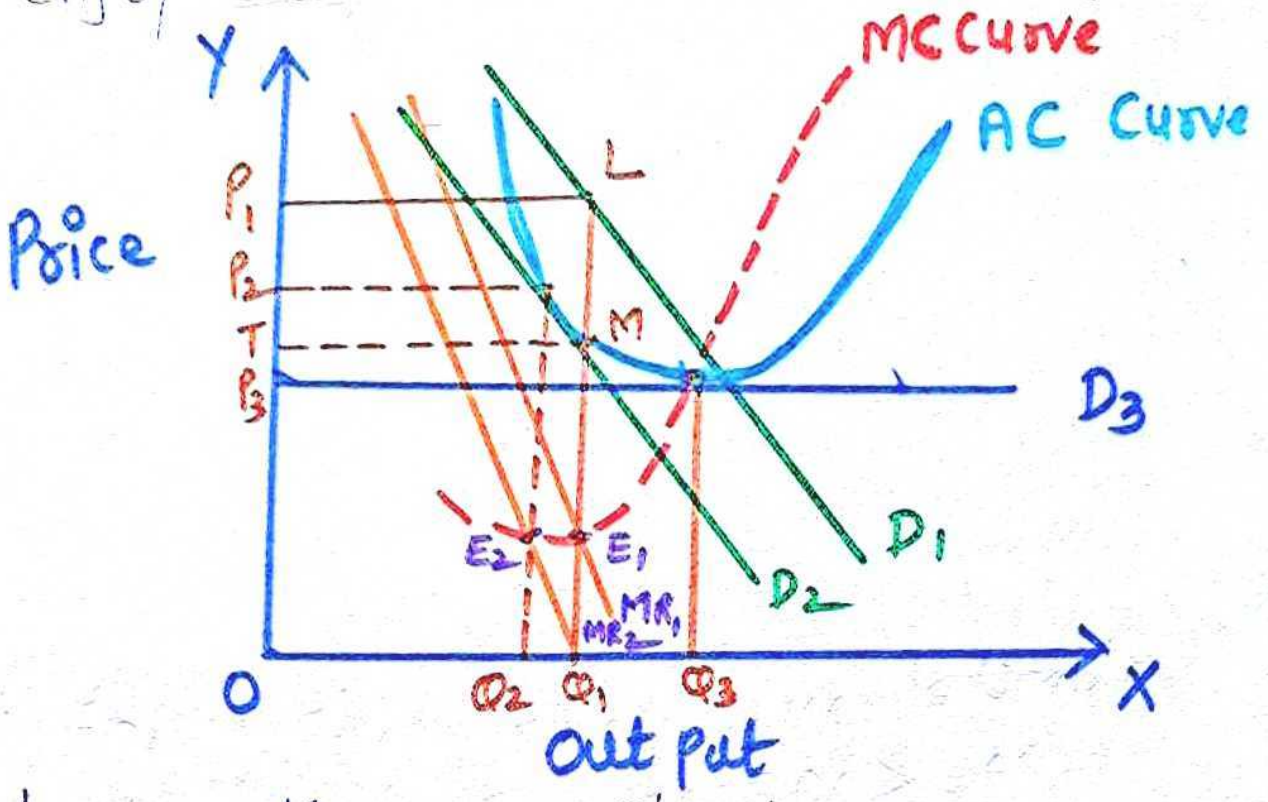
ii) Producer get Equilibrium at Point E where SMR = SMC
Producer Sell OQ output at OP Price.

iii) TR = POQM and TC = ROQS
∴ Loss = TC − TR = RPMS (shaded area)

Q:3 :- Explain the Long-Run Equilibrium of a firm Under monopolistic Competition ?

(A) **Long-Run Equilibrium :-** In monopolistic market there is Free Entry and Exit of Firms. Products have Close-Substitutes available in the market. Due to these Condition Demand curve of these firms will shift downward. It also affect the Price and Price would decline. Due to Entry of New firms, a Producer can

enjoy Normal Profit in Long-Run.



In above diagram we Observe—

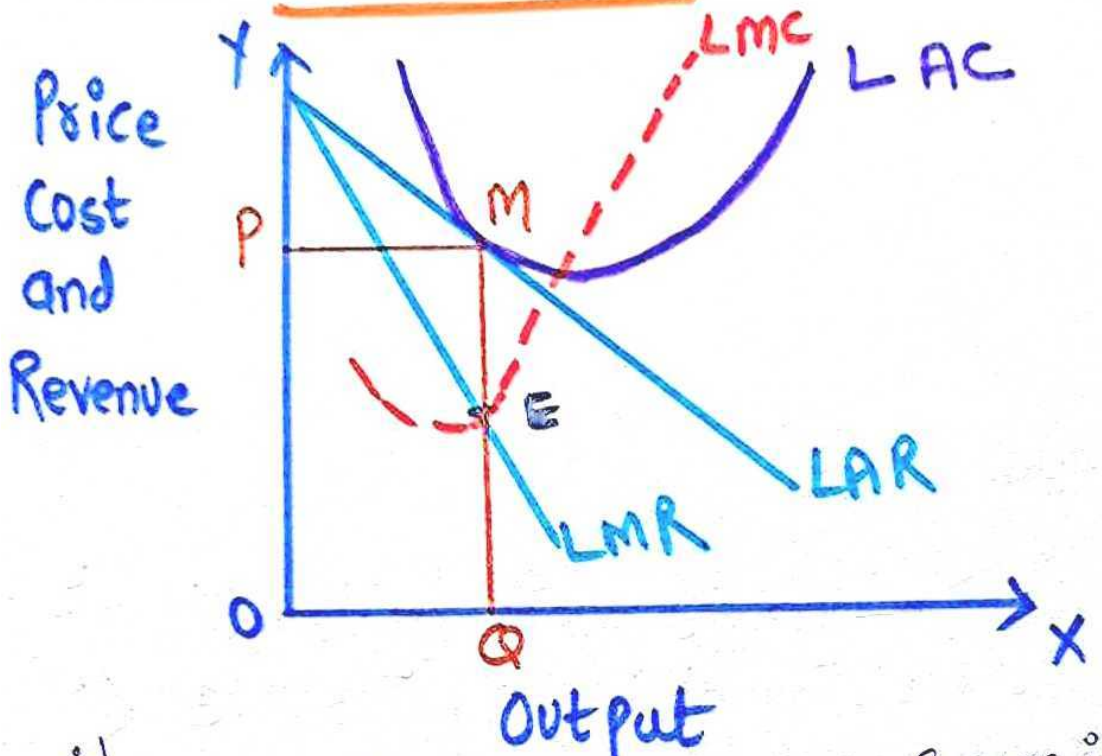
1) D_1 is the initial demand Curve of firm in monopolistic Competition. Here Producer sell OQ_1 Output at OP_1 Price where $MR_1 = MC = Price = OP_1$. Here Producer enjoy excess profit = P_1TML

2) Due to Excess Profit, New firm enter in the market which shift Demand Curve downward – D_2. Here Producer sell OQ_2 Out Put at Low price = OP_2. Here $MR_2 = MC = Price = OP_2 = AC$. So Here Producer earn Normal Profit

3) As Large Number of firms entered into the market so market becomes a Perfectly Competitive So Here firm Produces at OQ_3 and due to Perfect Competition Price still Fall to OP_3.

Here also Producer earn Normal Profit only

Thus every Producer in monopolistic Competition earns Normal Profit shown in following diagram:—



i) LAR and LMR are Revenue Curves in Long-Run.

ii) LAC curve is 'U' shaped curve and it is Tangent to LAR Curve. Here LAC = LAR.

iii) Producer enjoys Equilibrium at Point E, where LMR = LMC. Here Producer sell OQ output at OP Price.

iv) **TR = POQM and Total Cost = POQM**

As TR = TQ = POQM

Thus here firm enjoys Normal Profit in Long-Run where- **LAC = LAR = LMR = LMC = Price OP**

Q:4. What is Selling Cost? What are its effects?

(A) **Production Cost :-** "Production Cost means the total expenses incurred to Produce goods and Services" Production Cost is incurred in the Form of Rent, wages, Salaries, interest and Normal Profit. Thus expenditure spend to Produce and to Provide the Commodity to the Retailer shop is called Production Cost.

(B) **Selling Cost :-** "Selling Cost means the Cost incurred to Promote Sales" It plays a Very special Role in monopolistic market Conditions.

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Selling Cost includes :-

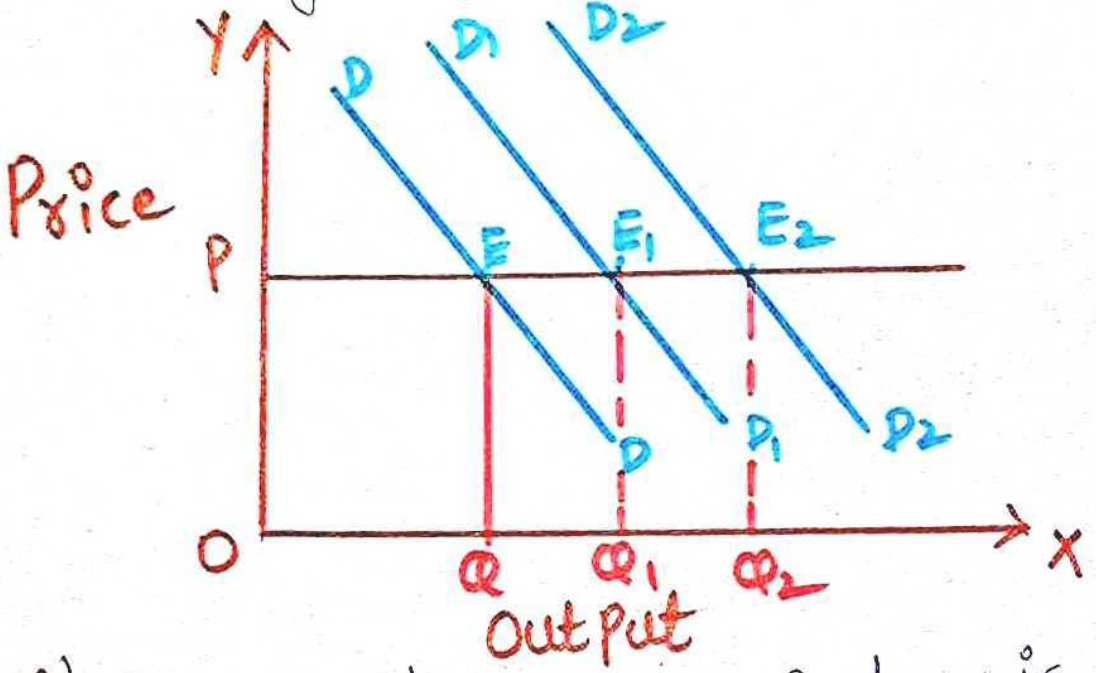
1. Advertising and Publicity Expenditure.
2. Expenditure on Sales Department.
3. Margin to dealers like- Wholesalers, Distributers etc.
4. Expenditure on Window Display, Demonstration, Distribution of Samples, Exhibitions etc.

Selling Cost is incurred to increase Sale in market Selling Cost helps Producer to enjoy better Position in the market in Front of rivals.

(C) **Effects of Selling Cost :-** Selling cost try to attract Consumers desire to Purchase more Commodity Main Effects of Selling Cost are :—

(1) To Increase Demand :- Selling Cost helps

Producer to increase the demand in market shown in Following diagram :-



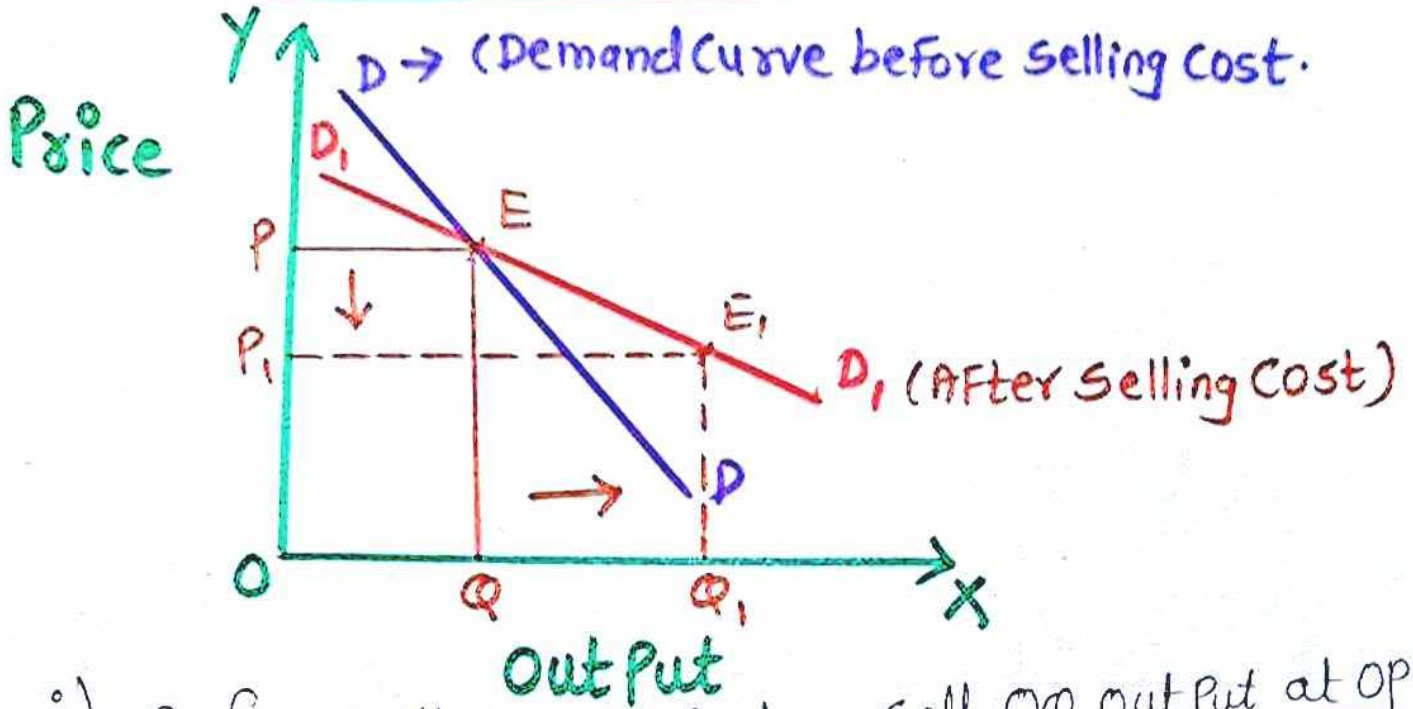
i) In monopolistic market Producer is selling OQ output at OP Price at Equilibrium E.

ii) But due to selling Cost, Demand for Commodity increase Now Demand Curve is shifted on Rightside like - D_1P_1 and D_2P_2.

iii) Selling Cost increase the Demand from OQ to OQ_1 and OQ_2.

(2) To Make Demand Curve more Elastic :-

Selling Cost increase Demand for goods and services It will helps Producer to increase its Production Capacity. As a result Demand Curve becomes more elastic in nature shown in the following diagram :—



i) Before selling Cost, Producer sell OQ output at OP Price
ii) But after selling Cost, Demand Curve for goods become more elastic
iii) D_1D_1 is New Elastic Demand Curve where Producer sell more Quantity OQ_1 at Low Price- OP_1

(3) To increase Profit Margin :- Selling Cost helps Producer to increase Demand in market. Due to more demand Producer increase its Production Capacity. Here Producer sell more Quantity at low Price. Due to increase in Demand, Producer gets higher Total Revenue which result in Maximum Profit.

Thus Selling Cost helps every Producer to earn maximum Profit shown in the Following Diagram.

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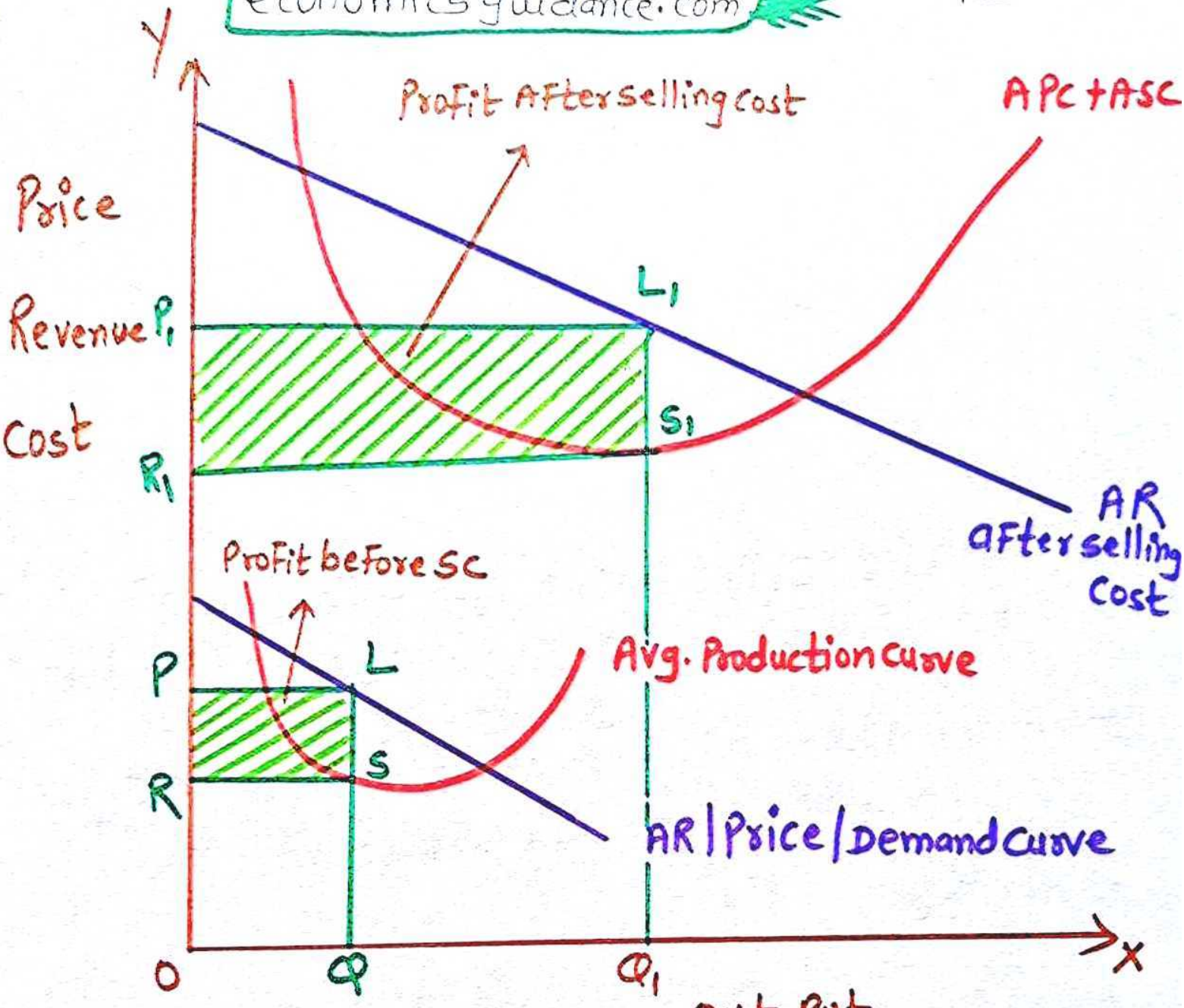

1) Equilibrium of Producer Before selling Cost (SC) :-

i) Out Put = OQ
ii) Price = OP
iii) TR = POQL
iv) TC = ROQS
v) Profit = TR - TC
= POQL - ROQS
Profit = PRSL

2) Equilibrium of Producer After selling Cost (SC)

i) Out Put - OQ_1
ii) Price = OP_1
iii) TR = $P_1OQ_1L_1$
iv) Tc = $R_1OQ_1S_1$
v) Maximum Profit = TR - TC
= $P_1OQ_1L_1 - R_1OQ_1S_1$
Maximum Profit = $P_1R_1S_1L_1$

Q:5 Select the correct answer from alternatives given-

1) In monopolistic Competition there are **many sellers.**

a) Few sellers b) Many sellers c) Two sellers.

2) Product Sold in monopolistic Competition is **differentiated**

a) Homogeneous b) differentiated c) Inferior.

3) A Firm in a monopolistic market requires to incur **both**

a) Production Cost b) Selling Cost c) both.

4) Nature OF Demand Curve of monopolistic Firm is **more elastic**

a) Less Elastic b) More elastic c) Perfectly inelastic

5) A monopolistic Competitive Firm Produces **Less than Optimum**

a) Less than Optimum b) Optimum c) more than optimum.

6) Which OF the following is not a Charcteristic of Monopolistic Competition? **Firms are Price-takers.**

a) Many Number of sellers b) Firms are Price-takers.
c) There is free entry into market d) Product-differentiation

7) Monopolistic Competition differs from Perfect Competition because in monopolistically competitive markets **Each of the sellers offers a some what different Product.**

a) There are no barriers to entry b) Firms are interdependent.
c) Each of the sellers offers a some what different Product.
d) All Firms can earn normal Profit in Long-Run.

8) A Similarity between monopoly and monopolistic Competition is that, in both market structures **Sellers are Price makers and not Price-takers**

a) Firms are interdependent b) There are Few sellers.
c) Sellers are Price makers and not Price takers.
d) Product differentiation is done.

9) A Firm in monopolistic Competition, faces a demand Curve that is **Negatively sloping and relatively elastic**

a) Negatively sloping and relatively elastic.
b) Negatively sloping and relatively inelastic.
c) Negatively sloping and Unitary elastic.
d) None of the above.

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10) The Profit maximising firm in a monopolistic Competition reaches equilibrium output where its **Marginal Revenue is equal to Marginal Cost.**

a) Marginal revenue is equal to Marginal Cost.
b) Average Total Cost is equal to marginal revenue.
c) Average Total Cost is equal to Price.
d) Average revenue exceeds Avg. Total Cost.

11) Due to Product differentiation, a Firm's demand Curve takes the following Shapes **Downward Sloping**

a) Horizontal b) Vertical
c) Downward sloping d) None of the above.

12) Since a firm in a monopolistically competitive market faces a **downward sloping demand Curve, it will always operate With Excess Capacity**

a) Down-ward Sloping demand Curve, it will always Operate With Excess Capacity.

b) Downward sloping demand curve, it will always operate at its efficient scale.

c) Perfectly Elastic demand Curve, it will always Operate with excess Capacity.

d) Perfectly inelastic demand Curve, it will always Operate at efficient scale.

13) In the Long-Run, a firm in monopolistic competition will earn **Normal Profit**

a) Excess Profit
b) Loss
c) Normal Profit
d) May earn any of the above.

Q:6 State With Reasons Whether the Following Statements are True or False :-

1. In a monopolistic market a Product has no close-substitutes.

Ans: **False. Q:1 - C Part - 2nd Point**

2. The Concept of Group is more relavant than Industry Under monopolistic Competition.

Ans:- **True. Reasons:-** In monopolistic competion, concept of Group is more important than Industry due to Product differentiation.

According to Chamberlin, group is the cluster of Products which are Close-Substitutes.

Example :- In Automobile Industry, all cars belong to Technological group. However it is not necessary that they are economic substitutes like Maruti and Mercedes, Honda and BMW etc.

3) In the Long-Run a monopolistic Competitive Firm Usually expected to earn Normal Profit.

True Reasons :- Q:3 - 2nd diagram.

4) Product differentiation Usually Leads to some degree of monopoly Power.

True. Reasons :- Q:1 C-Part 4th Point

5) A monopolistically competitive market is charcterized by barriers to Entry.

False. Reasons. Q:1 C-Part 3rd Point

6) A Profit-maximizing firm in monopolistically Competitive market always Prices its Product above marginal Cost.

True. Reasons :- Q:2 B Parts- 1st Point

Q87 Match the Following —

1. In monopolistic competition a commodity is → Differentiated
2. A Firm With Product Differentiation → More Elastic Demand.
3. No Further Variation in Product → Assumption of monopolistic competition