



Monopolistic Competition

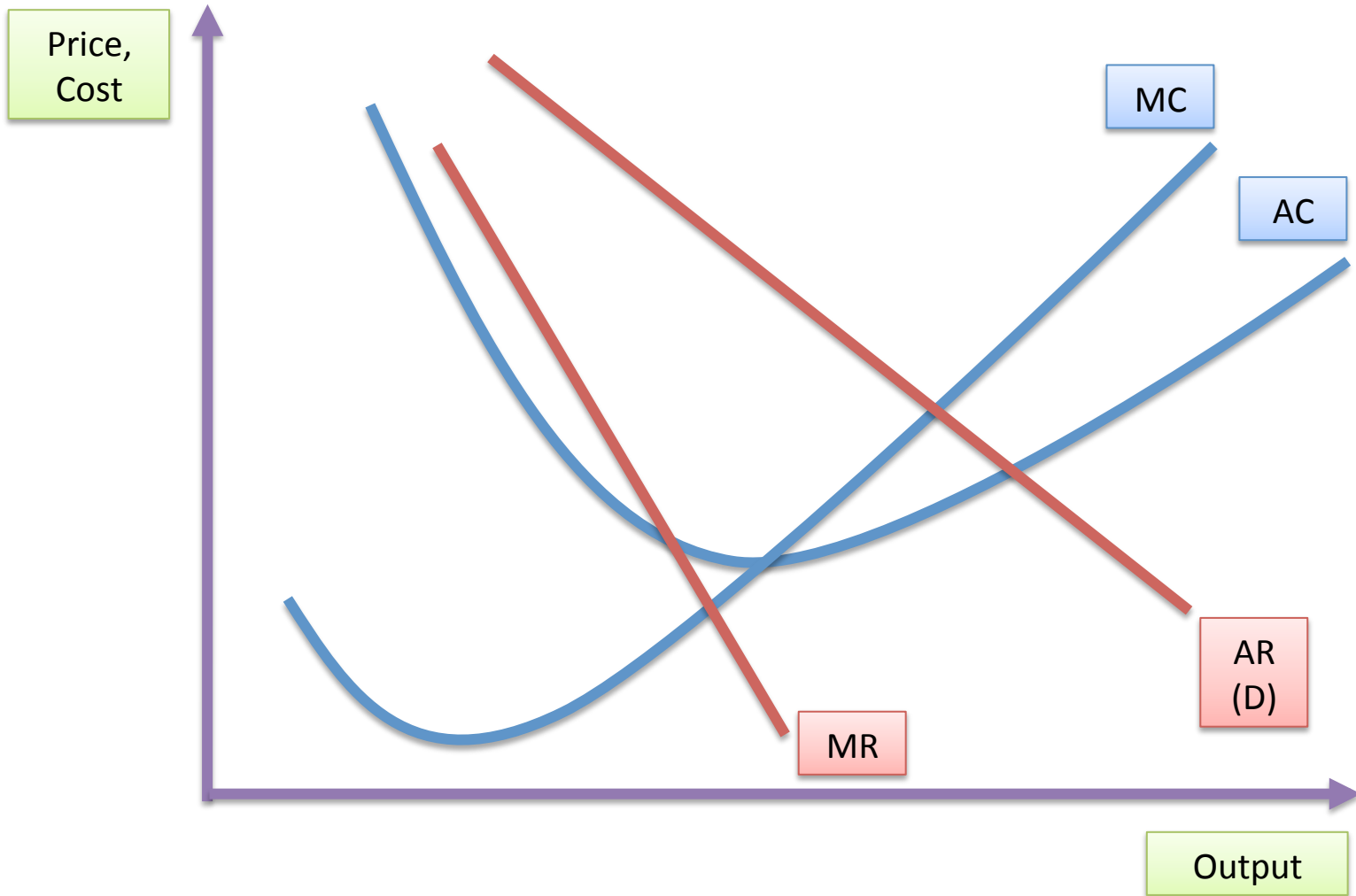
Monopolistic Competition

- Monopolistic competition is a form of imperfect competition.
- It can be found in many real world markets, including fast food and coffee shops, gas stations or salons.
- Monopolistic competition is similar to perfect competition, but is more realistic, because the products are differentiated.

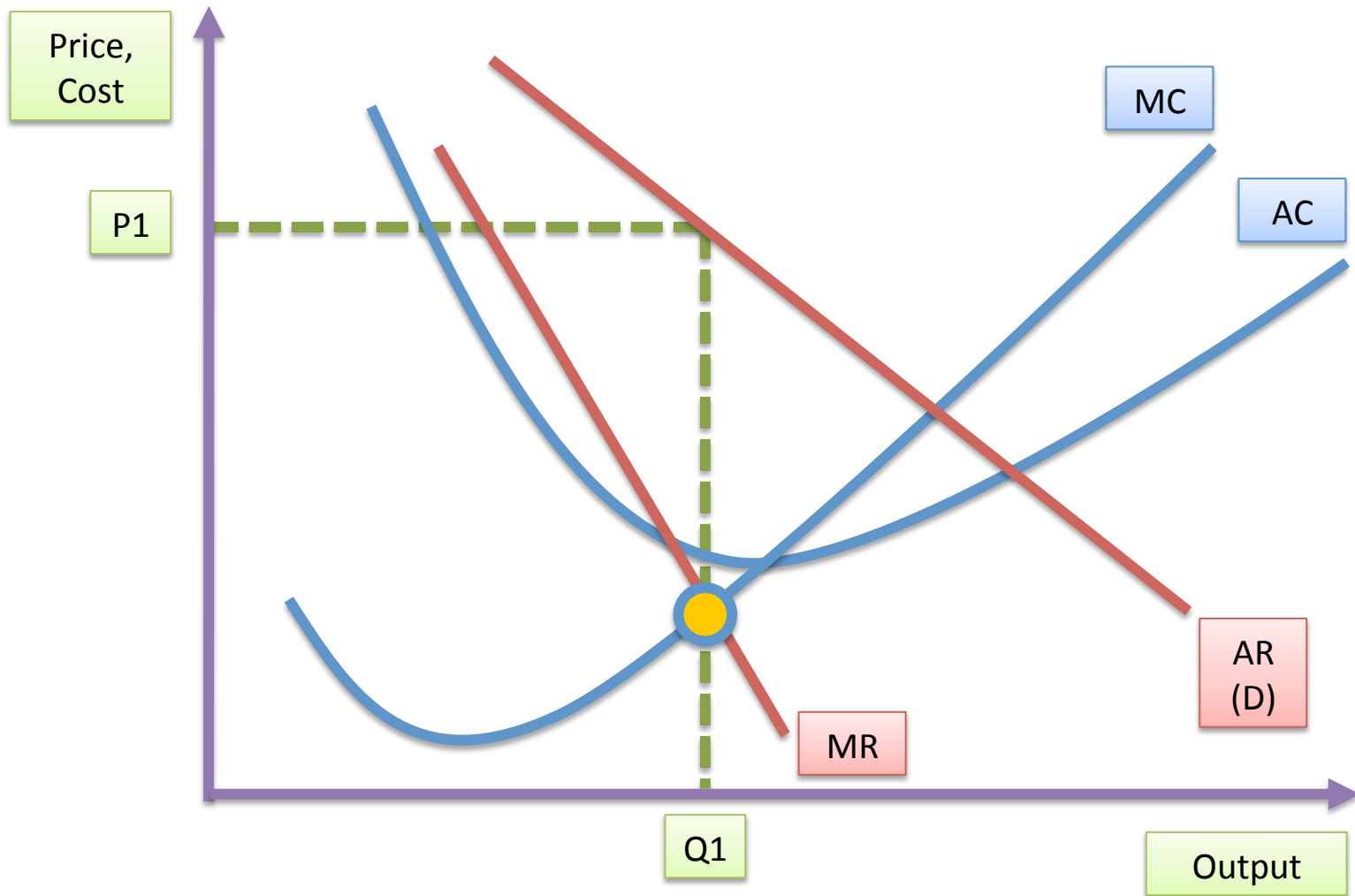
Assumptions of the Market

1. There are many producers and many consumers.
2. Consumers perceive non-price differences among products (product differentiation), and competition is strong – plenty of consumer switching takes place.
3. Producers have some control over price – they are “price makers” not “price takers,” but the price elasticity of demand is higher than it would be under a situation of monopoly.
4. The barriers to entry and exit into and out of the market are low.

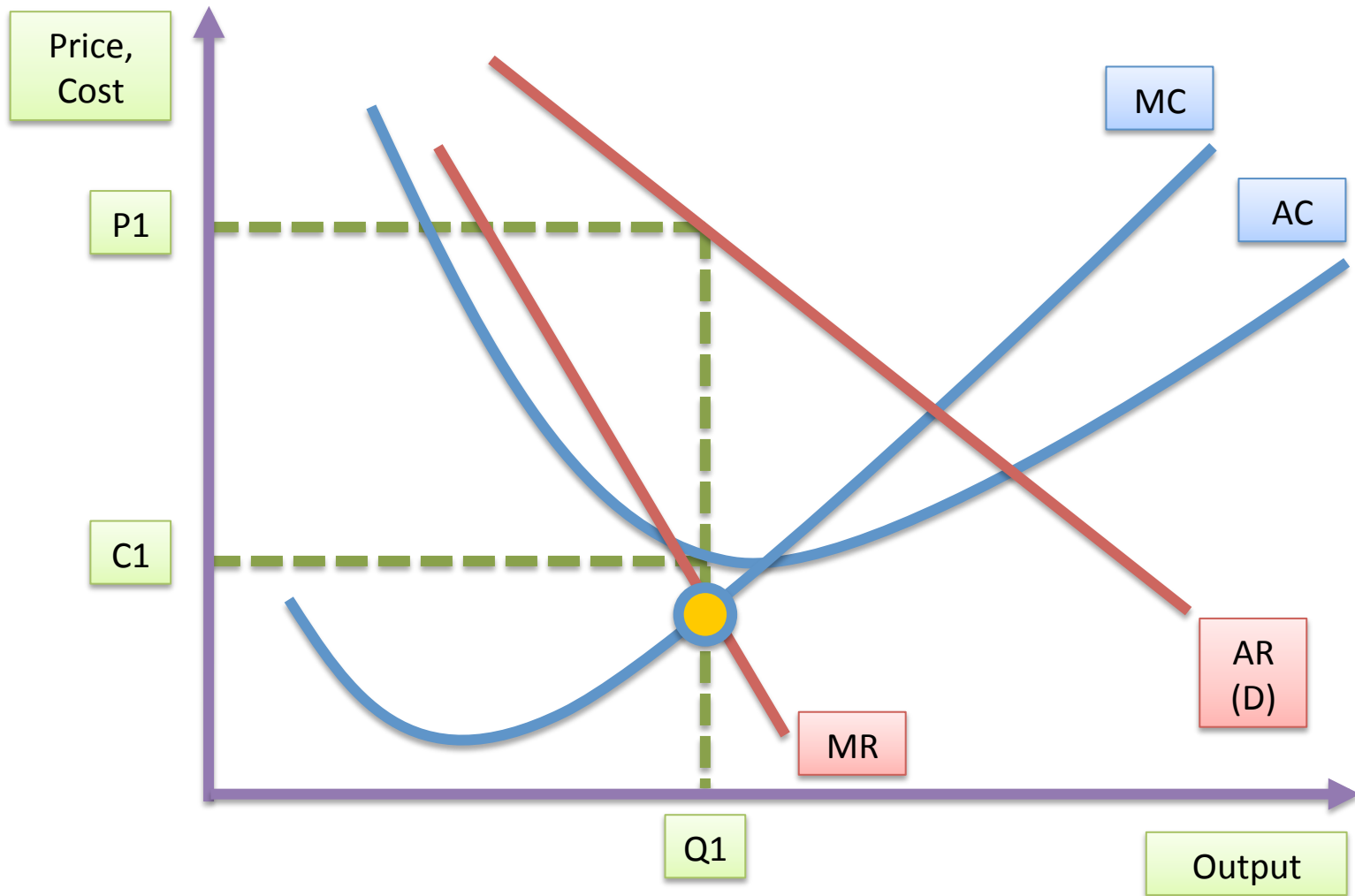
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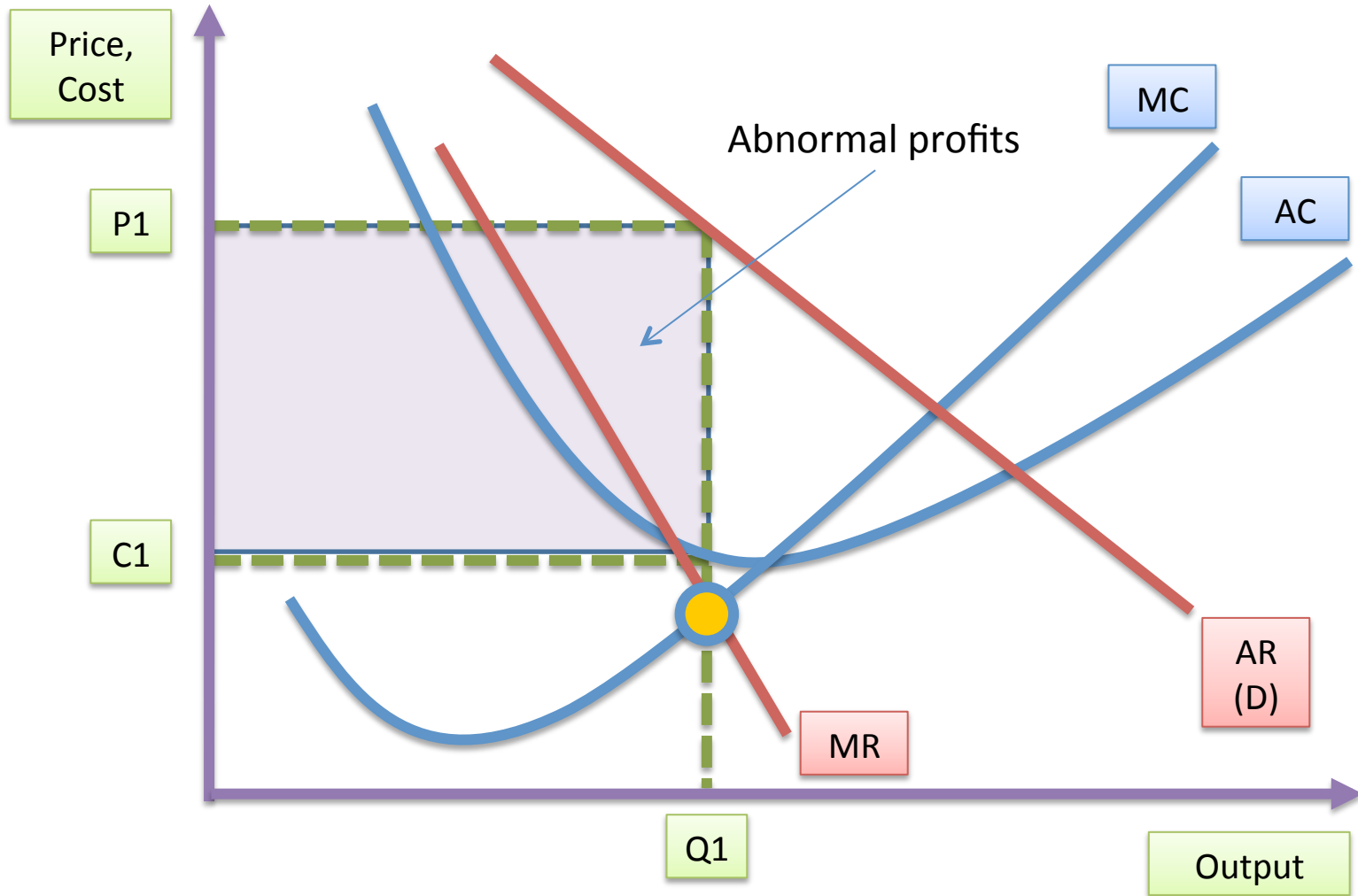
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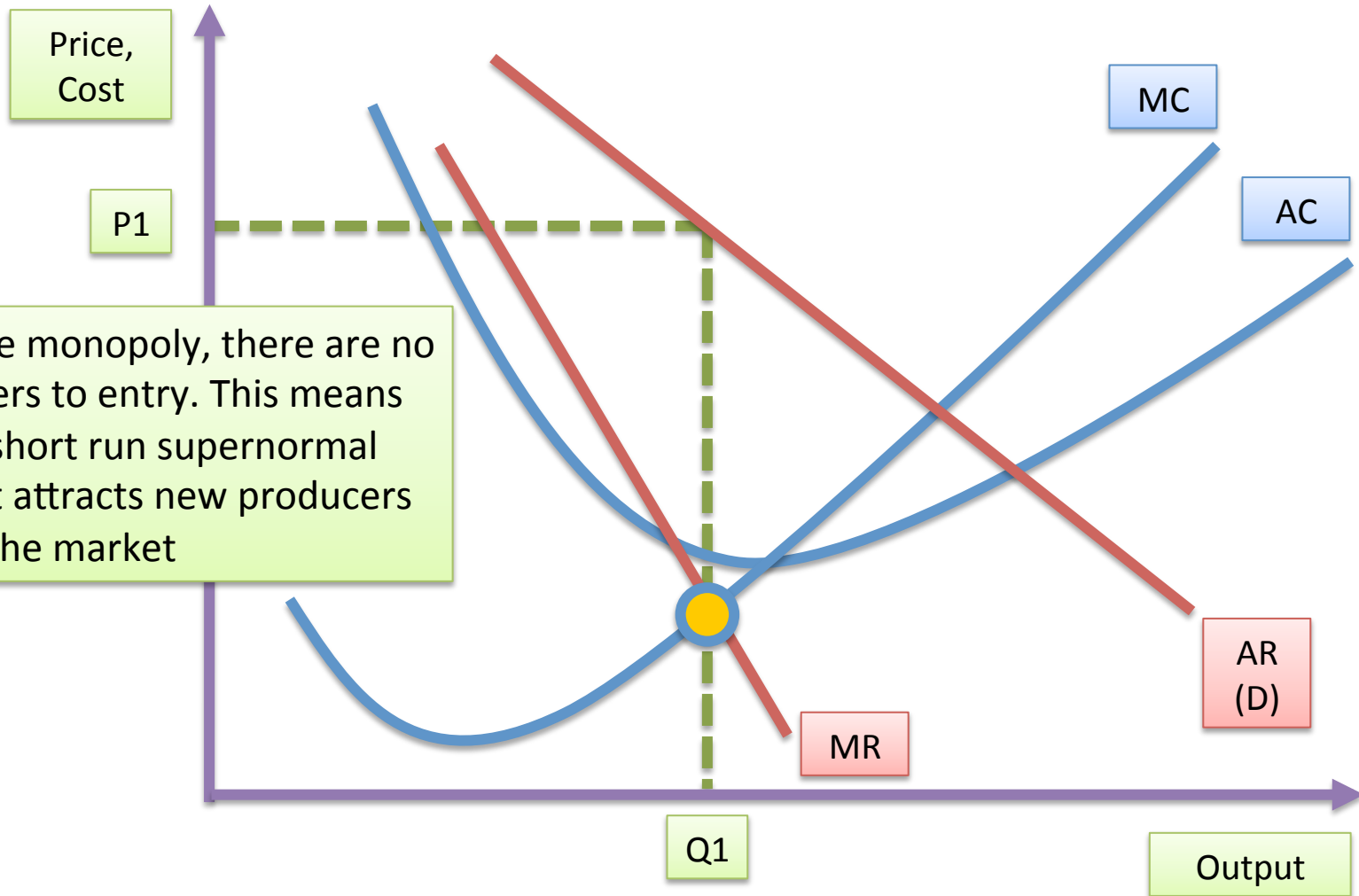
Identify three factors that affect the “pricing power” of an individual firm in monopolistic competition

1. There still may be **many competitors** keeping pricing ‘low’

2. Product ‘differentiation’ allows firm to charge a different price to reflect any **unique qualities** of the product/service

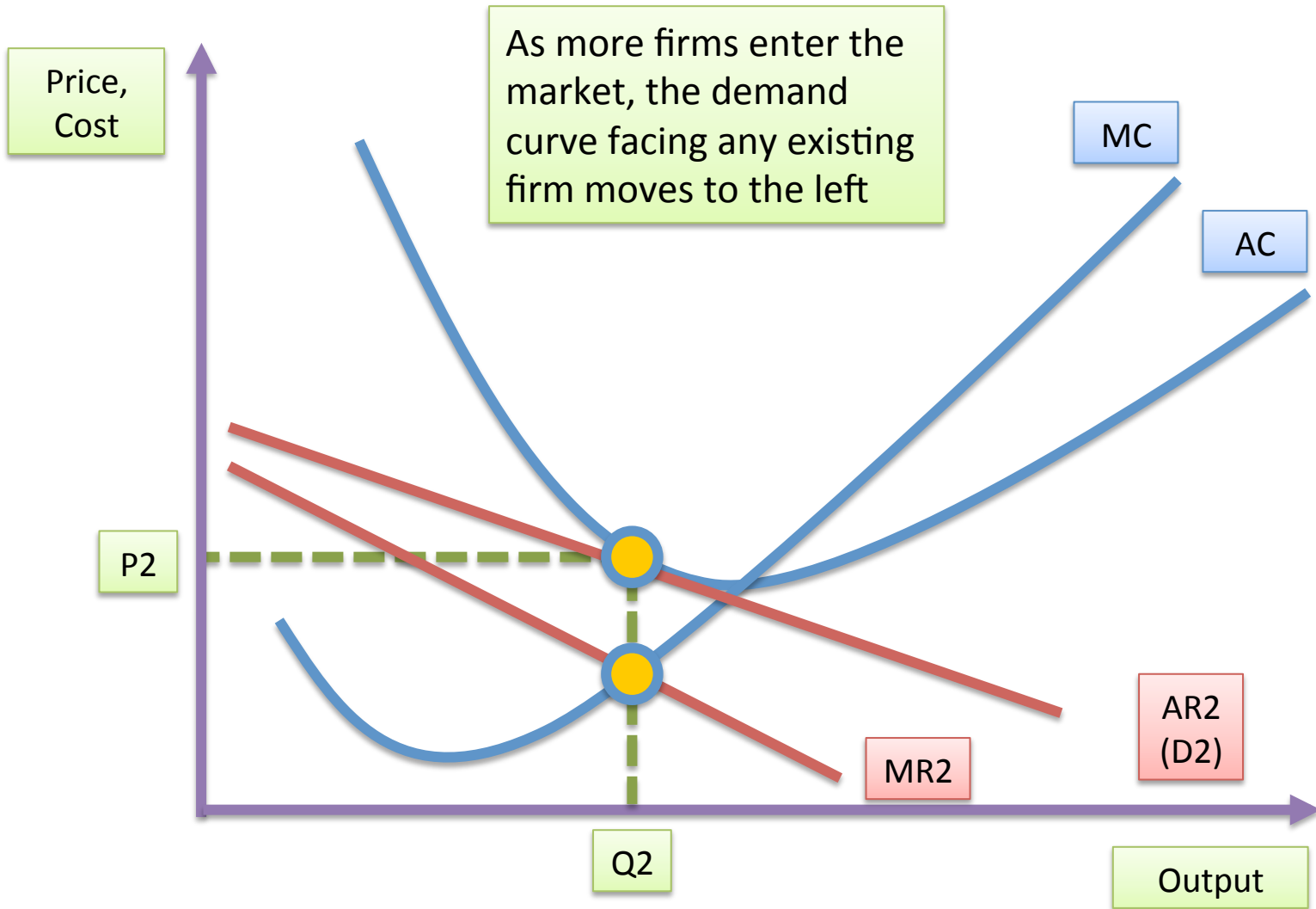
3. **Barriers to entry and exit of the market are low** so this requires firms to price competitively

Long Run Equilibrium for Monopolistic Competition

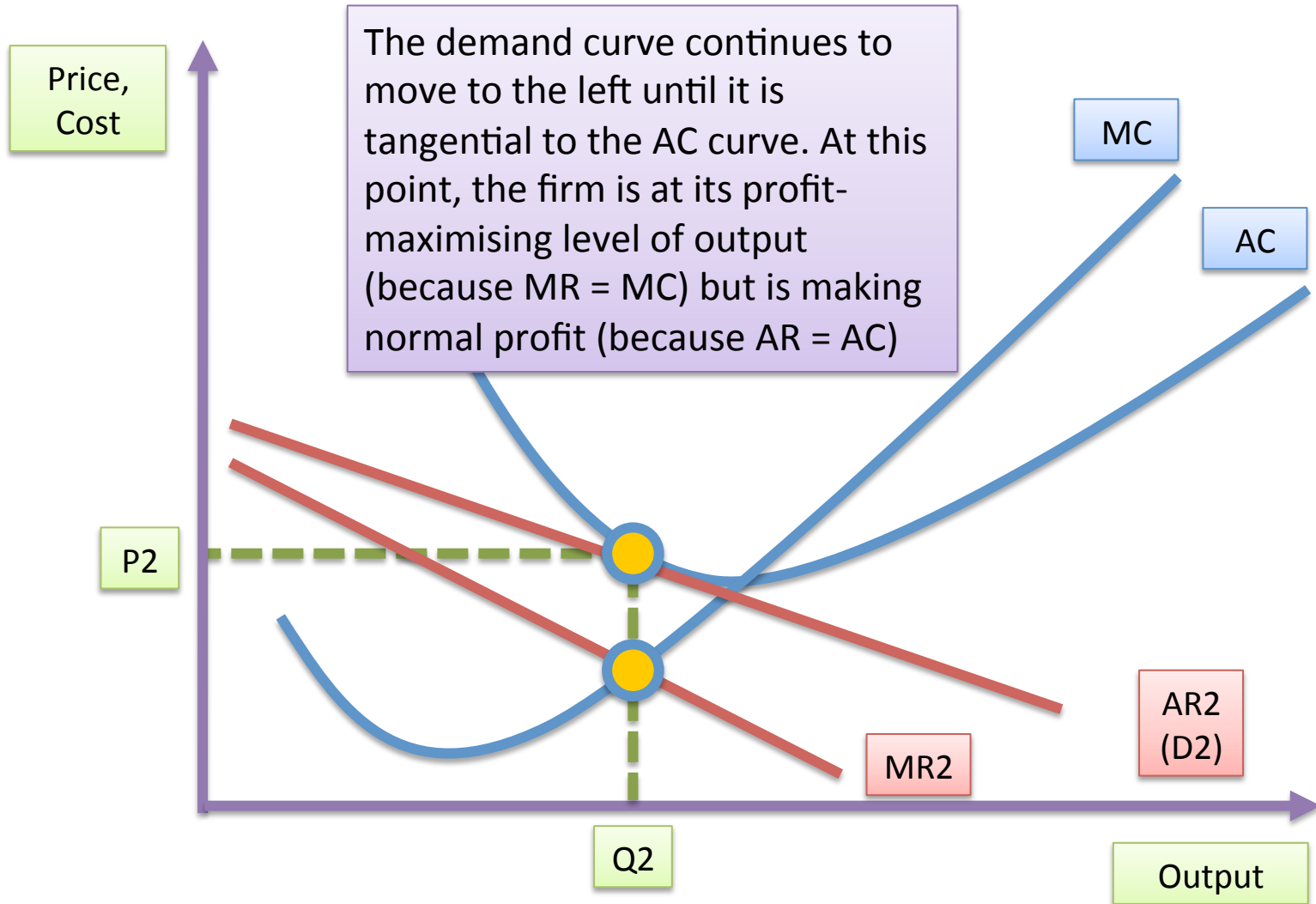


Unlike monopoly, there are no barriers to entry. This means that short run supernormal profit attracts new producers into the market

Long Run Equilibrium for Monopolistic Competition



Long Run Equilibrium for Monopolistic Competition



How does Monopolistic Competition differ from Perfect Competition?

	Perfect Competition	Monopolistic Competition
Number of producers (sellers in the market)	Many	Many
Types of goods and services available for consumers		
Does the firm have control over their own prices?		
Is branding / marketing important?		
Are entry barriers zero, low or high?		
Does this market structure lead to allocative efficiency in the long run?		
Does this market structure lead to productive efficiency in the long run?		

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Does this market structure lead to productive efficiency in the long run?	Yes – min LRAC	No – higher LRAC

Economic Efficiency?

- Prices are above marginal cost – meaning that the equilibrium is not allocatively efficient
- Saturation of the market may lead to businesses being unable to exploit fully economies of scale – causing average cost to be higher than if fewer firms and products were in the market
- Critics of heavy spending on marketing and advertising argue that much of this spending is wasted and is an inefficient use of scarce resources. The debate over the environmental impact of packaging is linked strongly to this aspect of monopolistic competition

Application: The UK Taxi and Private Hire Vehicle Industry



A fragmented market

Estimated 78,000 taxis
and 153,000 licensed
private hire vehicles in
England and Wales

An estimated 80% of UK
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The industry as a whole
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London Black Taxis

There are over 23,000 black cab drivers

Entry is restricted to those with licence and drivers who have passed "the Knowledge"

Examples of Price and Non-Price Competition in the Taxi Industry

Examples of
price
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by taxi
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- 1 Pre-arranged agreed fares
- 2 Different price per time/mile
- 3 Different price for 'hail' over 'booked' vehicles



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Examples of
**non-price
competition**
in the
licensed taxi
market

- 1 'Luxury' cars, personal driver
- 2 'Disabled-access' for car use
- 3 Later pick-up times (after 12pm)



London Taxi Fares in 2013

The table shows typical fares and journey times based on distance for three types of tariff. Fares and journey times may be higher if there are delays or heavy traffic. There is a minimum fare of £2.40 at all times. Source: Transport for London website

Distance	Approx journey time	Monday to Friday 06:00 - 20:00	Monday to Friday 20:00 - 22:00 Saturday and Sunday 06:00 - 22:00	Every night 22:00 - 06:00 Public holidays
1 mile	6 - 13 mins	£5.60 - £8.80	£5.60 - £8.80	£6.80 - £9.00
2 miles	10 - 20 mins	£8.60 - £13.80	£9.00 - £13.80	£10.40 - £14.60
4 miles	16 - 30 mins	£15 - £22	£16 - £22	£18 - £27
6 miles	28 - 40 mins	£23 - £29	£28 - £31	£28 - £33
Between Heathrow and Central London	30 - 60 mins	£45 - £85	£45 - £85	£45 - £85

How might an increase in competition impact on consumers?

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1. Lower Prices
2. More availability of taxis
3. Better quality taxis
4. Increased safety for journey home

