



# SNS COLLEGE OF TECHNOLOGY

## An Autonomous Institution

### Coimbatore-35



Accredited by NBA – AICTE and Accredited by NAAC – UGC with ‘A+’ Grade  
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## Department of Automobile Engineering

III YEAR/ VI SEMESTER

19MEE301 / Engineering Economics and cost Analysis

### UNIT-2

#### **Monopolistic competition.**

#### **Monopolistic Competition:**

Monopolistic Competition is a market structure in which many sell products that are similar but not identical.

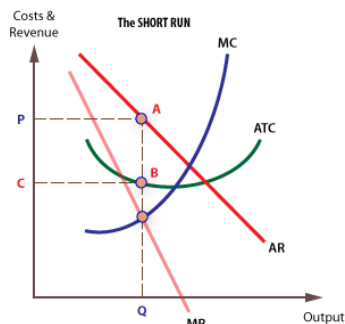
#### **Characteristics of monopolistic competition:**

1. Many Sellers => Firms compete.
2. Product Differentiation => Each firm faces downward sloping demand curve.
3. Free Entry => Economic profits are zero.

Examples of monopolistic competition: Books, CDs, movies, computer software, restaurants, furniture and so on.

#### **Monopolistic competition in the short run:**

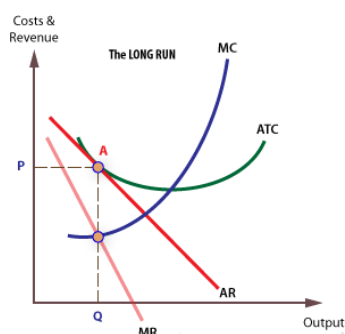
At profit maximisation  $MC = MR$  and output is  $Q$  and price  $P$ . Given that price ( $AR$ ) is above  $ATC$  at  $Q$ , supernormal profits are possible (area  $PABC$ ).



As new firms enter the market demand for the existing firm's products becomes more elastic and the demand curve shifts to the left driving down price. Eventually all super-normal profits are eroded away.

### **Monopolistic competition in the long run:**

Super-normal profits attract in new entrants which shifts the demand curve for existing firm to the left. New entrants continue until only normal profit is available. At this point firms have reached their long run equilibrium.



### **The advantages of monopolistic competition:**

Monopolistic competition can bring the following advantages:

There are no significant barriers to entry therefore markets are relatively contestable.

Differentiation creates diversity, choice and utility. For example a typical high street in any town will have a number of different restaurants from which to choose.

The market is more efficient than monopoly but less efficient than perfect competition - less allocatively and less productively efficient. However they may be dynamically efficient, innovative in terms of new production processes or new products. For example retailers often constantly have to develop new ways to attract and retain local custom.

**The disadvantages of monopolistic competition:**

There are several potential disadvantages associated with monopolistic competition including:

Some differentiation does not create utility but generates unnecessary waste such as excess packaging. Advertising may also be considered wasteful though most is informative rather than persuasive.

As the diagram illustrates assuming profit maximisation there is allocative inefficiency in both the long and short run. This is because price is above marginal cost in both cases. In the long run the firm is less allocatively inefficient but it is still inefficient.