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WHAT IS MONOPOLISTIC COMPETITION?

The concept of monopolistic competition was presented by American Economist Prof. E.H. Chamberlin in his book "Theory of monopolistic Competition" published in 1933. Monopolistic competition is a market structure in which there are many sellers of a commodity, but the product of each seller differs from that of the other sellers in one respect or the other.

Defination :- According to J.S Bains, "Monopolistic competition is market structure where there is a large number of small sellers, selling differentainted but close substitue products".

- According to Leftwick, "Monopolistic competition is a market situation in which there are many sellers of a particular product, but the product of each seller is in some way differtainted in the minds of consumers from the product of every other sellers".

FEATURES OF MONOPOLISTIC COMPETITION.

(1) Large Number of firms and buyers :- Under monopolistic competition there are large numbers of firms producing the product and also large numbers of buyers as in case of perfect competition. But the size of each firm is small. It means that each firm has only limited control over the market. Each firm can decide its own price policy independently.

(2) PRODUCT Differentiation :- Product differentiation is a salient feature of monopolistic competition. Product differentiation refers to that situation wherein the buyers can distinguish one product form the other in one way or the other.

(3) Freedom of entry and Exit of firms :- As in case of perfect competition, firms are free to enter and leave the industry under monopolistic competition, but this freedom of entry into industry is not absolute on the part of new firms. They are face too many difficulties.

(4) Selling Costs :- Each firm spends a lot of funds on advertisement and publicity of its products with a view to selling more and more units of the product it gives wide publicity of its products in newspapers, cinemas, journals radio, T.V. etc. The expenses so incurred are called selling costs.

(5) Price policy :- Each firm has its own price policy. Average and marginal revenue curve of a firm under monopolistic competition slope downwards as in case of monopoly. It means if a firm wants to sell more units of its product it will have to lower the price per unit.

(6) Less Mobility :- Under monopolistic competition, neither the factors of production nor goods and service are perfectly mobile. It is so because marginal productivity of each factor is not equal.

(7) Imperfect Knowledge :- Buyers and Sellers are ignorant about the price of the product.

It is so because it is not possible to compare the products of different firms due to product differentiation. Buyers develop a liking for a particular brand of product produced by a particular firm.

(8) Non-price Competition :- Another feature of monopolistic competition is that different firms may complete with one another without changing the price of the product. Take for instance, firms producing washing powder "Surf-Excel and Tide".

(9) The price of factors and technology are assumed to be given.

(10) Demand and Cost curves of all the products are uniform throughout the group.

① Short Run Equilibriom in Monopolistic Competition :-

Short run refers to that time period in which production can be increased, only up to existing production capacity in response to increase in demand. There is no time available either to increase or decrease the fixed factors of production like machines, plants, factory building etc.

In the short run, a firm will be in equilibrum when: (i) its MC = MR, and (ii) MC curve cuts MR curve from below. The quantum of profit available to a firm in equilibriom in short period depends upon the demand for the good and the efficiency of the firms. In this time period, the firms may face three situations :- (i) Super Normal profit (ii) Normal profit and (iii) losses. short run equilibriom position of a firm under monopolistic competition can be explained with the help of the following diagrams.

3. Minimum Loss :- In the short run, a firm in equilibrium may incur loss of fixed cost. It is the minimum loss of the firm. In fig. 5, it is the minimum loss of the firm. It is evident that the firm will be in equilibrium at point E. At this point MC = MR. In equilibrium position, the firm will produce OM units of ~~od~~ output. price of equilibrium output OM is OP_1 (= AM) and average cost OP (= BM) Average cost of the firm is more than the price i.e. (AC > AR). Hence the firm suffers a loss equivalent to BM - AM = AB per unit. But the price of equilibrium output OM is equal to average variable cost (AVC) as curve AVC touches ~~ero~~ curve AR at point 'A'.

2. Long Run Equilibrium in Monopolistic Competition.

Long run is that time period in which every firm can changes its production capacity in response to charge in demand. The firm can change size of its plant and machinery and new firms can enter the industry. In the long run each firm will produce upto that limit where marginal revenue is equal to long run marginal cost. In the long run, firms earn normal profit only. No firms can get super normal profit in the long run, because of the following reasons:-

① If firms earn super normal profit, than several new firms will be attracted to the industry as entry into the industry is free. As a result of it, total supply will increase. Total supply will now be distributed among large number of firms and they will be deprived of the super normal profit.

(ii) In order to create more demand for their product new firms will lower the prices, old firms too will lower the prices of their products, if they are to exist in the market. Thus because of fall in price both - old and new firms will get only normal and not super normal profit.

(iii) Because of low cost of installation and free entry, when new firms join the industry, demand for factors of production, increase leading to increase in factor cost. Consequently, average cost of production will go up. Thus high average cost on the hand and low price of the product on the other will cause the super normal profit to disapper