Monopolistic Competition & Oligopoly

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Unit 8 – Monopolistic Competition and Oligopoly

- Monopolistic Competition

  Characteristics of a monopolistically competitive industry include:

1. Many sellers
2. Low barriers to enter
3. Differentiated products
4. Advertising on a local level

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  Examples of industries that are monopolistically competitive include:
  - Retail stores
  - Gas Stations
  - Restaurants
  - Car Dealers
  - Services (legal, financial, medical, haircuts)

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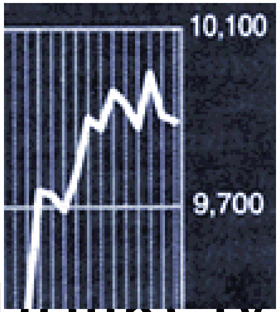
- Monopolistic Competition

  Short-run economic profits are possible.

  Long-run economic profits are unlikely because of unrestricted and relatively easy access entry into industry.

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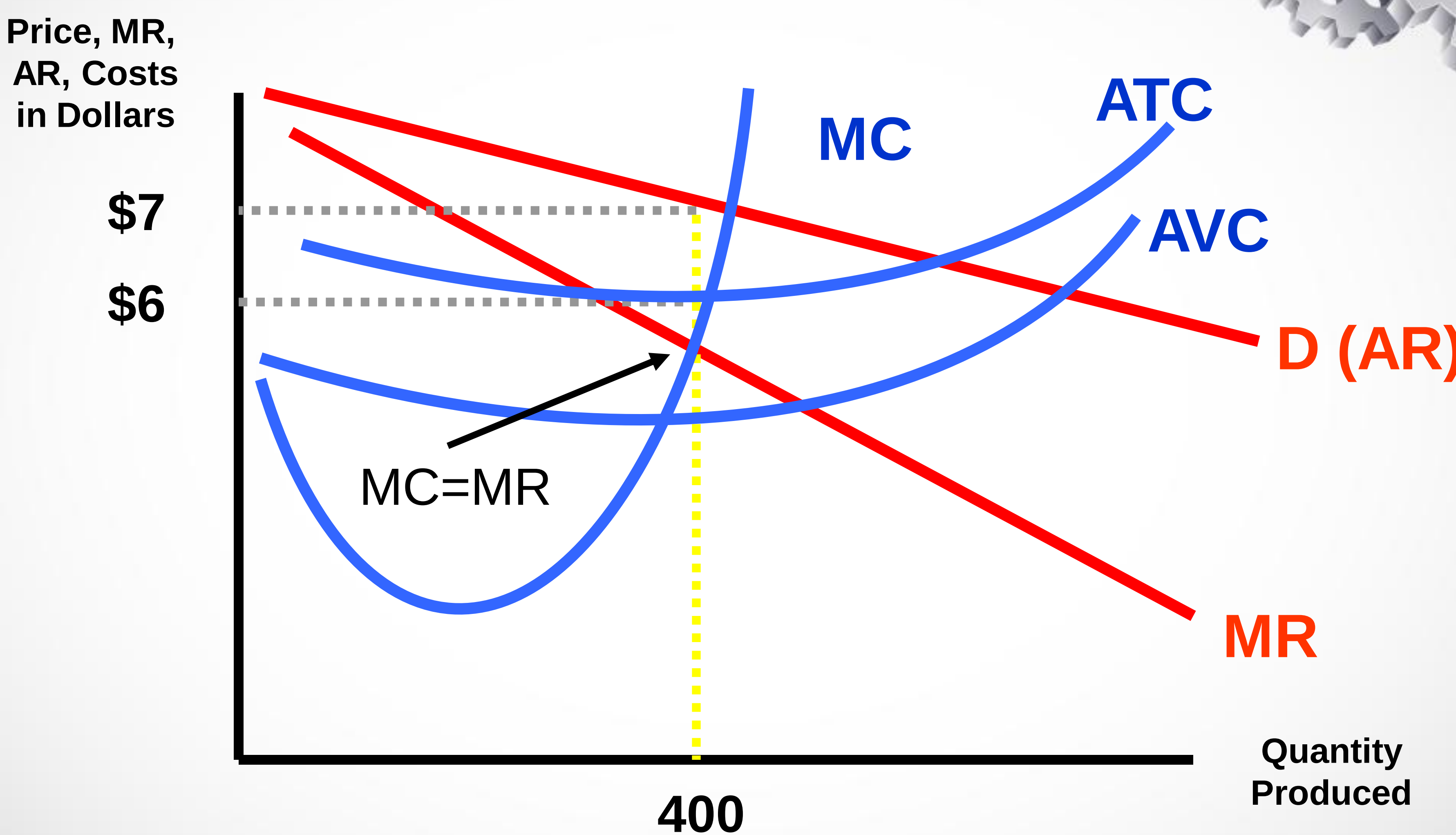
- Monopolistic Competition

  Firms maximize profits where MC = MR in the upward sloping portion of the MC curve, as long as the price is greater than AVC.

  See next slide for the short-run profit-maximizing diagram.

Unit [illegible] Monopolistic Competition and Oligopoly



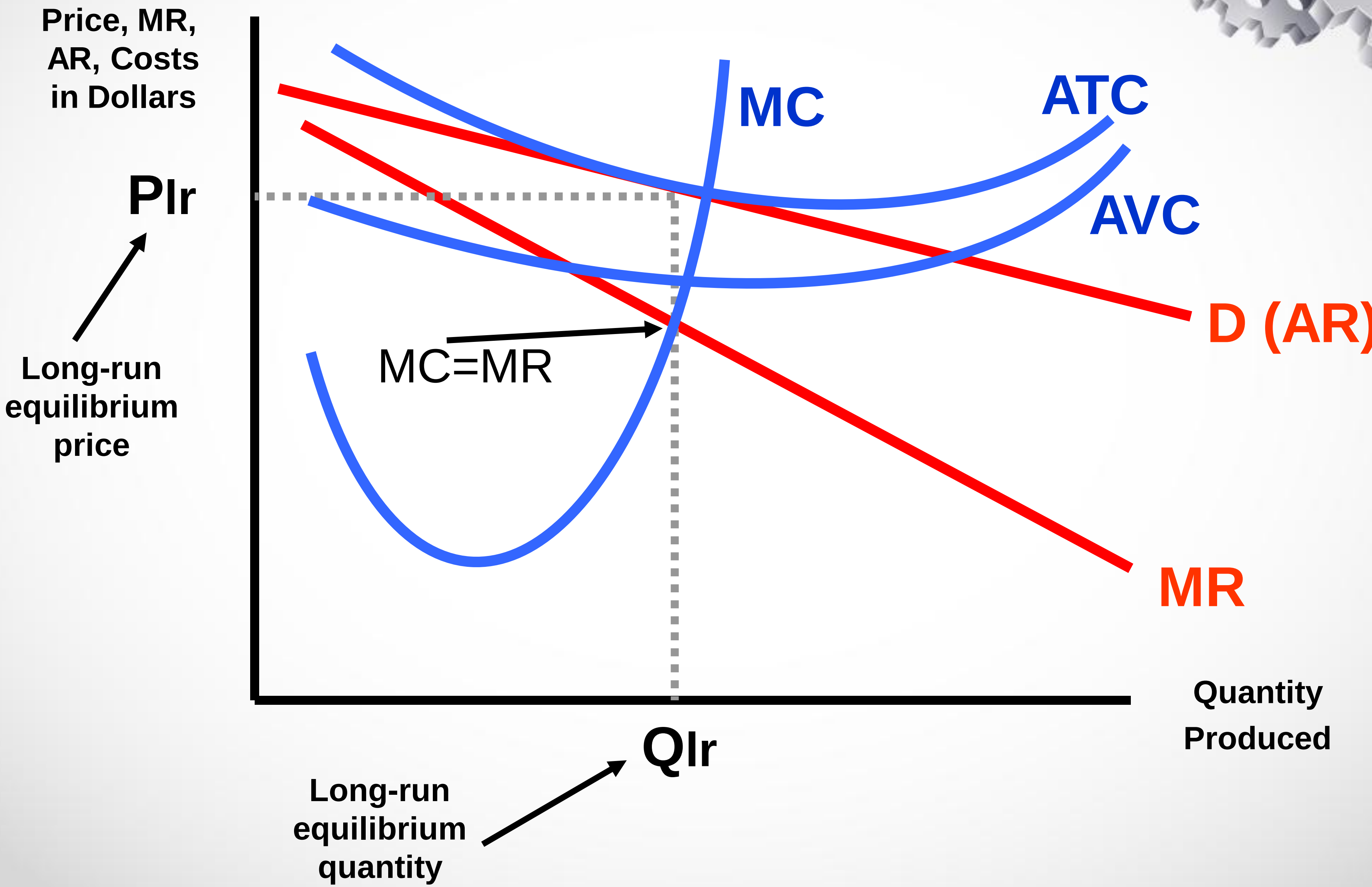
Unit [illegible] – Monopolistic Competition and Oligopoly

- Monopolistic Competition

  In the long run, due to low barriers to enter, firms in monopolistic competition earn zero economic profits.

  See next slide for the long-run profit-maximizing diagram.

Unit 3 – Monopolistic Competition and Oligopoly



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Oligopoly (Several Sellers)

Characteristics of an oligopoly industry include:

1. A Few firms (2, 3, 4, ...) control the majority of the sales
2. More difficult to start up (barriers to enter)
3. Firms are interdependent
4. Firms mostly advertise on a national scale

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- Oligopoly
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  Examples of oligopoly industries include:
  - Automobile
  - Beer
  - Breakfast Cereal
  - Soft Drinks
  - Oil (Wholesalers)
  - Steel
  - Airlines
  - Aircraft Manufacturers
  - Internet Search

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- Oligopoly

  Oligopoly firms maximize where MC = MR, in the upward sloping part of the MC curve, as long as price exceeds AVC.

  Long-run profits are possible, because of barriers to enter the industry.

- Oligopoly

  Because of interdependence, rival firms must take each other's actions into account.

  What will firm A do when firm B increases its price? What will firm A do when firm B decreases its price?

Which do you prefer?

1. Coca Cola
2. Pepsi Cola
3. Indifferent
4. Have never had a cola
5. Don’t drink colas now
6. Don’t know

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If you were the president of Coca Cola, inc. and Pepsi lowered its price, what would you do?

1. Keep the price of coke the same
2. Raise the price of coke
3. Also lower the price of coke
4. Not sure

If you were the president of Coca Cola, inc. and Pepsi raised its price, what would you do?

1. Keep the price of coke the same
2. Raise the price of coke
3. Lower the price of coke
4. Not sure

- Oligopoly

  Let’s say that when firm B increases its price, firm A does not change its price.

  And let’s say that when firm B lowers its price, firm A also lowers its price.

  The demand curve for firm A will then be a kinked demand curve.

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- Oligopoly

Firm A’s demand curve D1 is more elastic, because when firm B raises its price above the current price of $8, firm A does not raise it. Firm A gains significant market share.

Firm A’s demand curve D2 is less elastic, because when firm B lowers its price below $8, firm A lowers it as well, and sales remain relatively constant.

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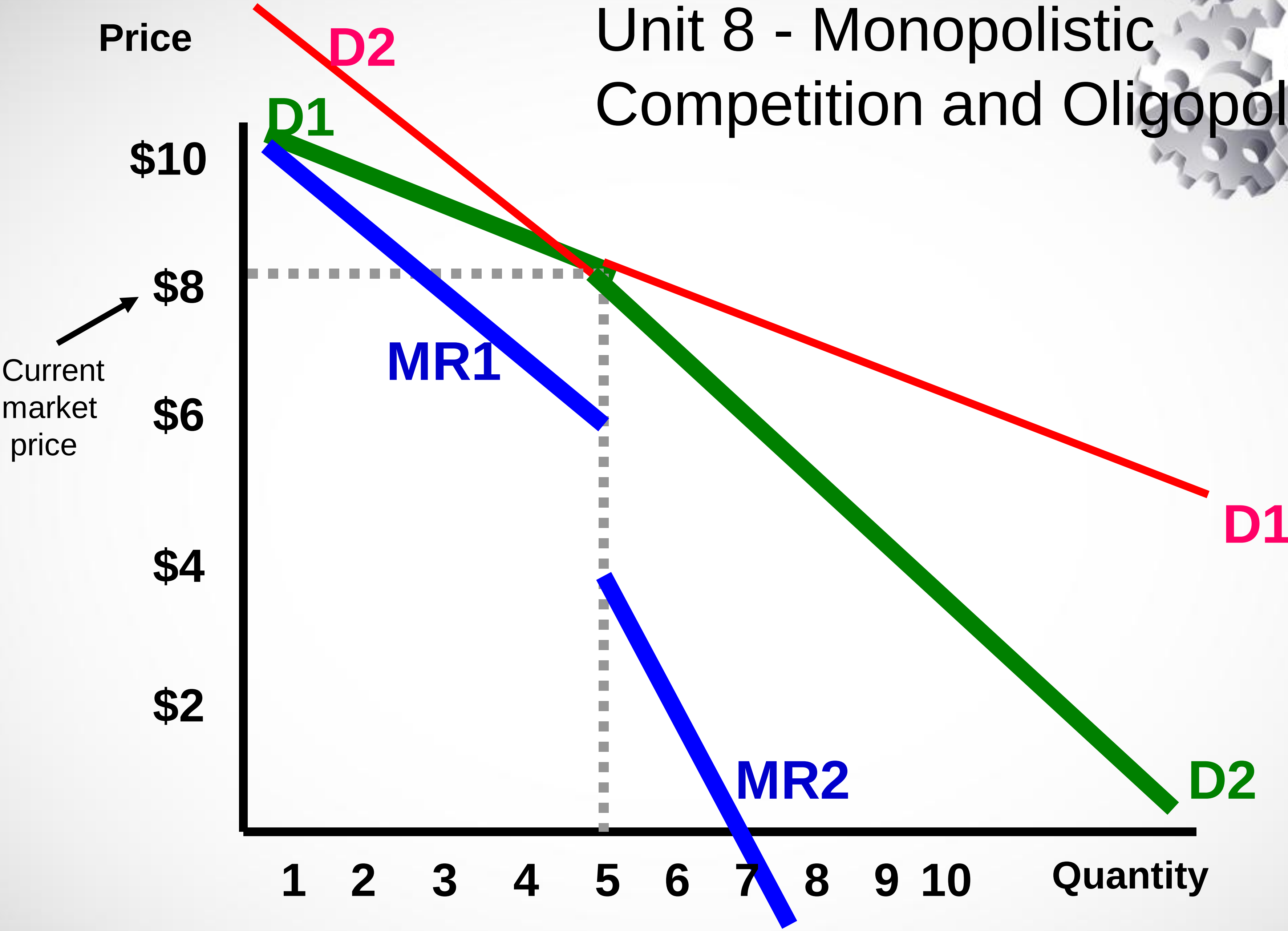

- Oligopoly and Game Theory

  Game theory has become an important study in microeconomics, particularly in explaining oligopoly behavior.

  See an example of game theory simulation on the next slide.

John Nash

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- Oligopoly and Game Theory

	B sets high price	B sets low price
A sets high price	A’s profit = \$40 B’s profit = \$40	A’s profit = \$10 B’s profit = \$60
A sets low price	A’s profit = \$60 B’s profit = \$10	A’s profit = \$15 B’s profit = \$15

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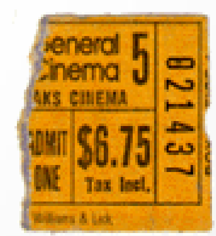
- Oligopoly and Game Theory

  What happens if firms start a price war?

  Do firms have an incentive to collude (cooperate and charge a high price)?



P&G Olay anti-wrinkle creams

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- Oligopoly and Collusion

  The temptation to collude (cartel forming) is greater in oligopoly than in other industries.

  There are also barriers to collusion:
  - High prices attract competitors from outside the cartel.
  - Rival firms can't always agree on the terms.
  - Cheating (charging a slightly lower price) is profitable.
  - There may be legal consequences.