✅ What is Monopolistic Competition?

Monopolistic competition is a market structure where:

- There are **many firms**
- Firms sell **differentiated products**
- Firms have **some price-setting power**
- There is **free entry and exit** in the long run

🔑 Key Characteristics

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1. Many Firms

- There are lots of firms in the market
- No single firm dominates the market
- Each firm has a **small market share**

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2. Product Differentiation (Very Important)

- Products are **similar but not identical**
- Differentiation can be through:
  - Branding
  - Quality
  - Design
  - Customer service

✅ Because products are different, consumers may be **loyal to a brand**

Examples:

- Coffee shops
- Clothing brands

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- Restaurants

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3. Some Price-Setting Power

- Firms are **not price takers**
- Due to brand loyalty, firms can raise prices slightly without losing all customers
- This gives firms **some control over price**

✅ As a result, firms face a **downward-sloping demand curve**

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4. Free Entry and Exit

- New firms can enter the market if profits are high
- Firms can leave if they are making losses
- There are **low barriers to entry**

☑ **Firm Diagram (Key Ideas)**

- Demand curve (AR) is **downward sloping**
- Marginal revenue (MR) lies **below AR**
- Firms maximise profit where:

👉 **MC = MR**

Why is MR below AR?

- To sell an extra unit, firms must lower price
- Lowering price reduces revenue on all previous units
- Therefore, marginal revenue falls faster than price

💰 **Short Run**

In the **short run**, firms can make:

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- Supernormal (abnormal) profit
- Normal profit
- Losses

✅ Supernormal profit occurs when **AR > AC** at the profit-maximising output.

🔁 **Long Run**

- Supernormal profit attracts **new firms**
- New firms increase competition
- Demand for existing firms falls

✅ In the long run:

- Firms earn **normal profit**
- **AR just touches AC**

⚡ **Efficiency in Monopolistic Competition**

❌ **Allocative Efficiency**

- Allocative efficiency occurs when **P = MC**
- In monopolistic competition:
  - **P > MC**

❌ Therefore, monopolistic competition is **not allocatively efficient**

❌ **Productive Efficiency**

- Productive efficiency occurs at **minimum AC**
- Firms do **not** produce at minimum AC

❌ Therefore, monopolistic competition is **not productively efficient**

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