The Four Types of Market Structure

<table>
<thead>
<tr>
<th>Number of Firms?</th>
<th>Type of Products?</th>
</tr>
</thead>
<tbody>
<tr>
<td>One firm</td>
<td>Differentiated products</td>
</tr>
<tr>
<td>Few firms</td>
<td>Identical products</td>
</tr>
<tr>
<td>Many firms</td>
<td></td>
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</tbody>
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- **Monopoly**
  - Tap water
  - Cable TV

- **Oligopoly**
  - Tennis balls
  - Crude oil

- **Monopolistic Competition**
  - Novels
  - Movies

- **Perfect Competition**
  - Wheat
  - Milk

Types of Imperfectly Competitive Markets

- **Monopolistic Competition**
  - Many firms selling products that are similar but not identical.

- **Oligopoly**
  - Only a few sellers, each offering a similar or identical product to the others.
Monopolistic Competition

Markets that have some features of competition and some features of monopoly.

Attributes of Monopolistic Competition

- Many sellers
- Product differentiation
- Free entry and exit

Monopolistic Competitors in the Short Run...

(a) Firm Makes a Profit

Price

Average total cost

Profit

Quantity

Profit-maximizing quantity

MC

ATC

Demand

Price
Monopolistic versus Perfect Competition

There are two noteworthy differences between monopolistic and perfect competition—excess capacity and markup.

Excess Capacity

- There is no excess capacity in perfect competition in the long run.
- Free entry results in competitive firms producing at the point where average total cost is minimized, which is the efficient scale of the firm.
Excess Capacity

- There is excess capacity in monopolistic competition in the long run.
- In monopolistic competition, output is less than the efficient scale of perfect competition.

Excess Capacity...

Markup Over Marginal Cost

- For a competitive firm, price equals marginal cost.
- For a monopolistically competitive firm, price exceeds marginal cost.
**Markup Over Marginal Cost**

Because price exceeds marginal cost, an extra unit sold at the posted price means more profit for the monopolistically competitive firm.

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**Monopolistic versus Perfect Competition...**

(a) Monopolistically Competitive Firm

(b) Perfectly Competitive Firm
Advertising

When firms sell differentiated products and charge prices above marginal cost, each firm has an incentive to advertise in order to attract more buyers to its particular product.

Advertising

- Firms that sell highly differentiated consumer goods typically spend between 10 and 20 percent of revenue on advertising.
- Overall, about 2 percent of total revenue, or over $100 billion a year, is spent on advertising.

Advertising

- Critics of advertising argue that firms advertise in order to manipulate people’s tastes.
- They also argue that it impedes competition by implying that products are more different than they truly are.
Advertising

- Defenders argue that advertising provides information to consumers.
- They also argue that advertising increases competition by offering a greater variety of products and prices.
- The willingness of a firm to spend advertising dollars can be a signal to consumers about the quality of the product being offered.

Brand Names

- Critics argue that brand names cause consumers to perceive differences that do not really exist.

Brand Names

- Economists have argued that brand names may be a useful way for consumers to ensure that the goods they are buying are of high quality.
  - providing **information** about quality.
  - giving firms **incentive** to maintain high quality.