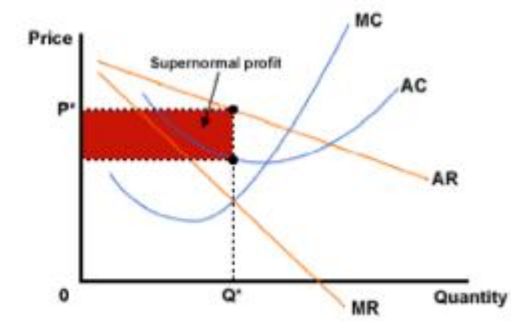

Figure 1 Equilibrium in monopolistic competition in the short-run

MR = MC → Profit maximisation

MR = 0 → Revenue maximisation

AC = AR → Break even

- When it comes to evaluation, we start with profit maximisation as the main assumption.
- A firm might want to use other objectives, (revenue max / breakeven)
    - Often because of conflict between short and long term goals
        - E.g. In long term, a firm might want to profit maximise, however in order to do so, in the short term it needs to drive out competition/ they want growth – sales maximisation

Barriers to entry (sources of monopoly power)

Barrier to entry – something that prevents a new firm from entering the industry
Barrier to exit – something that prevents a firm from leaving the industry

1. Structural – technical barriers (start-up/capital costs)
    a. Very high cost of starting up
    b. It's a barrier that is specific to the industry

2. Strategic – anti-competitive practices
    a. Firms already operating can pursue anticompetitive practices such as predatory pricing

3. Statutory – legal barriers (licenses, patents, regulations, health and safety standards etc…)

Types of barriers to entry:

1. Economies of scale
    a. New firms can't compete with large firms that are benefiting from economies of scale

2. Start-up costs very high e.g. capital costs (machinery)
3. Legal barriers (licenses, patents, regulations, health and safety standards etc…)
4. Branding/Advertising
    a. Easier for larger firms to do so than smaller firms
    b. New firms have to compete with already established brands which have a massive brand loyalty etc…

5. Sunk costs
    a. Costs that are not recoverable when a firm shutdowns e.g. specific machinery cost – machines that are only specific to your business and no one else can use them because it is useless for them
    b. Again, specific to industry

6. Anti-competitive practices – e.g. predatory pricing

<u>Types of barriers to exit (prevent a firm from entering if it is difficult to leave):</u>

1. Re-sale of assets – if high cost of assets that will lose a lot of value once you want to sell them if you leave

2. Redundancy costs – as a firm leaving the industry, you have to pay employees a redundancy, which can be very costly

3. Costs for ending licence agreements/contracts – high price if want to end a contract early – e.g. rent

<u>Efficiency</u>

Allocative – are resources being allocated at a point where consumer satisfaction is maximised

- Demand = Supply
- For firms: where P (AR) = MC

Productive – firms maximising production and minimising their costs, exploiting all economies of scale in doing so

- Minimum point on AC curve (point B)
- Potentially also good for consumers if lower costs are passed on via higher prices

Dynamic – occurs over time – supernormal profits made by a firm

- If a monopoly is making supernormal profits,
- Can be reinvested in firm – unit costs will be lowered

X efficiency – occurs at any point on AC (e.g. point B or C)

- X inefficiency – e.g. producing at point A where costs are much higher than could have been if the firm was efficient and produced at point B instead