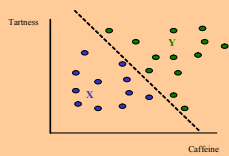


Models of Monopolistic Competition



The Hotelling Model



- Bathers scattered along the beach.

The Hotelling Model



- Bathers scattered along the beach.
- Two ice cream vendors, charging the same price for the same product.

The Hotelling Model



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- People will go to the closer vendor

The Hotelling Model



- Bathers scattered along the beach.
- Two ice cream vendors, charging the same price for the same product.
- People will go to the closer vendor
- Where should the vendors locate?

The Right Solution



- The right solution is to locate one at $\frac{1}{4}$ and the other at $\frac{3}{4}$

The Right Solution



- The right solution is to locate one at $\frac{1}{4}$ and the other at $\frac{3}{4}$
- This minimizes bathers travel costs to get a cone.

The Actual Solution



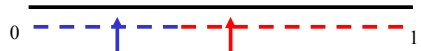
- In fact, they will locate just at the middle.

The Actual Solution



- In fact, they will locate just at the middle.
- If either vendor moves away, he will lose market share.

The Actual Solution



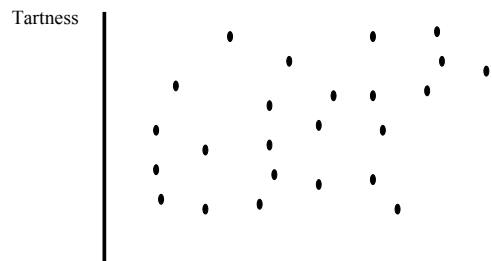
- For example, if one vendor moved back to $\frac{1}{4}$, he would lose sales.

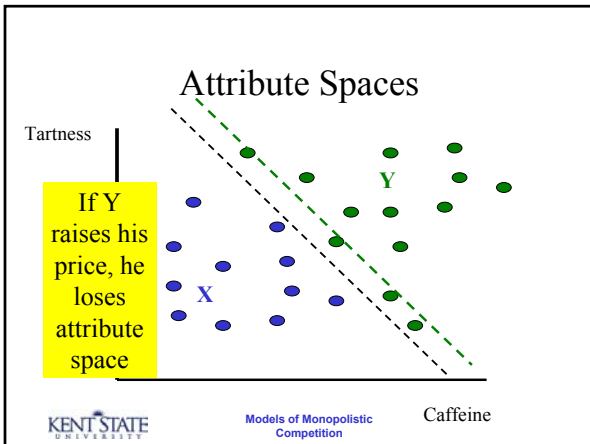
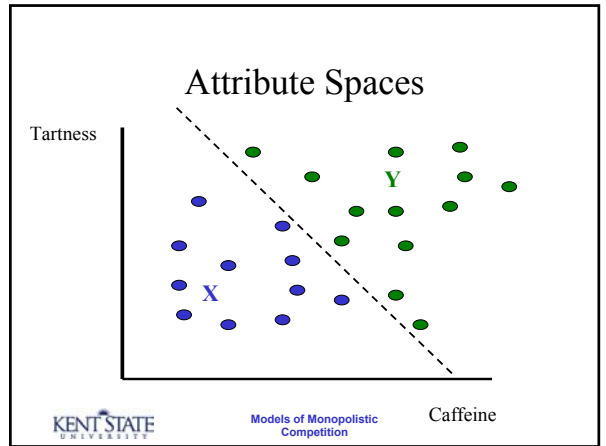
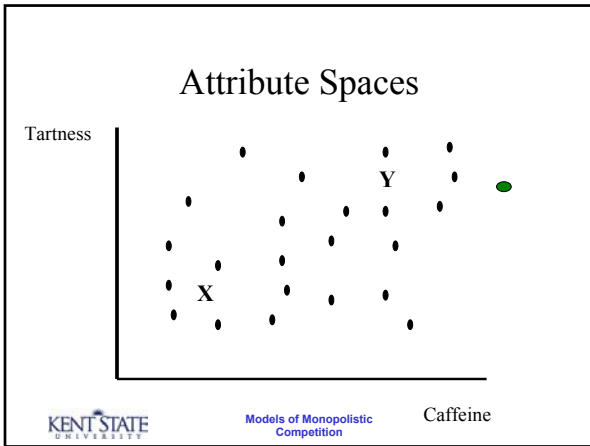
The Hotelling Model



- Also applies to political campaigns.
- Explains why politicians move to the center.

Attribute Spaces

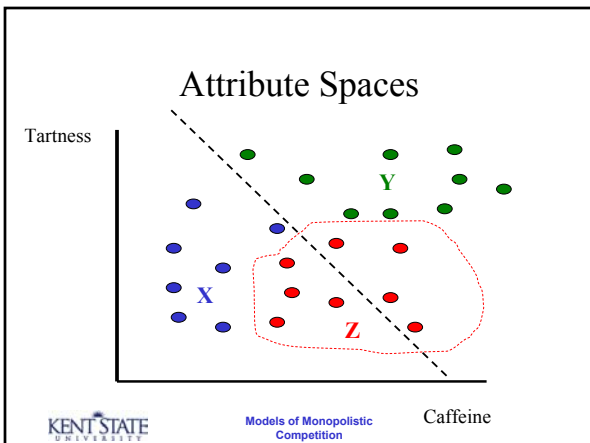




Attribute Spaces

- Other colas with different combinations of tartness and caffeine will enter the market.

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Attribute Spaces

- Other colas with different combinations of tartness and caffeine will enter the market.
 - Each time a cola enters, prices decline and fixed costs rise.

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Attribute Spaces

- Other colas with different combinations of tartness and caffeine will enter the market.
 - Each time a cola enters, prices decline and fixed costs rise.
 - This process will continue until manufacturers are earning zero profits.

Attribute Spaces

- Other colas with different combinations of tartness and caffeine will enter the market.
- Economists refer to this as non-price competition

End

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