

**DISCUSSION QUESTION**

Name:

Instructor:

Course:

In most supermarkets in the U.S., consumers are given the option of purchasing name brand products or store brand products. The name brand products are always priced higher than the store brand products, but in taste or quality tests, there is typically little to no difference between the two types.<sup>1</sup> In fact, many store brand products are actually produced by name brand producers, but sold with the store's label at a lower price.<sup>2</sup>

- a) Suppose the store brand and the name brand for a product, bread, for example, are made by the same producer and are identical in every way except for the label and price. The price of the store brand is significantly less than the name brand. Why would any consumer purchase the name brand?
  
  
  
  
  
  
  
  
  
  
- b) What do you think has happened to the market shares of store brand products over the past 10 years? Why has this happened?
  
  
  
  
  
  
  
  
  
  
- c) Consumer name brand products spend more than \$20 billion/year on media advertising.<sup>2</sup> Are these advertising expenditures wasteful from society's perspective? Do consumers receive any benefits from this form of product differentiation?

<sup>1</sup> For example, <http://www.consumerreports.org/cro/magazine/2012/10/store-brand-vs-name-brand-taste-off/index.htm>

<sup>2</sup> <http://plma.com/storeBrands/facts13.html>

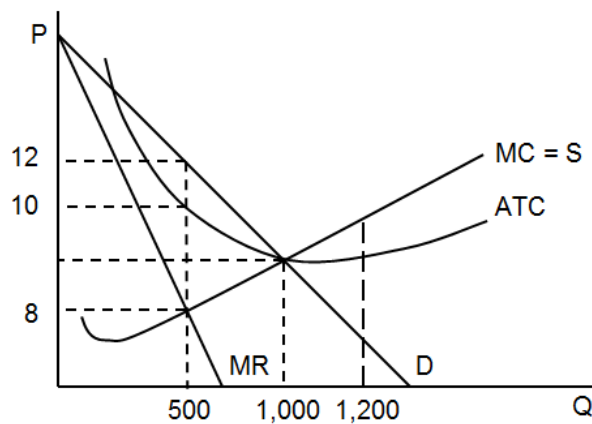
## PEER GROUP PROBLEM SOLVING

Name:

Instructor:

Course:

Use the following diagram representing a monopolistically competitive firm to answer the following questions.



- What is the current profit maximizing price and quantity for this firm?
- What are the current profits of this firm?
- Given that this represents a monopolistically competitive firm, explain what happens in the long run. Illustrate this on the graph above.

**IN-CLASS EXPERIMENT / ACTIVE EXERCISE**

The purpose of this exercise is to have students consider how actual monopolistically competitive markets operate and how firms compete in these markets.

Have students form groups of 3 or 4. Each student can select any 2 markets then answer the following questions about these markets.

Consider the following 8 monopolistically competitive markets:

- 1) Sit down restaurants
  - 2) Retail clothing stores
  - 3) Hair salons
  - 4) Pizza parlors
  - 5) Fast food restaurants
  - 6) Bars
  - 7) Tanning salons
  - 8) Ice cream/yogurt shops
- a) List 3 – 4 specific firms in the local area that compete in this market.
  - b) Among these firms, which one do you think charges the highest prices? Which one do you think charges the lowest prices?
  - c) What do you think accounts for the difference in these prices?
  - d) Provide an example of product differentiation for a particular firm in one market.
  - e) Do you believe the number of firms operating in this market has changed in the past 5 years? If so, has the number increased or decreased? What do you think accounts for the differences in these prices?

**SOLUTIONS AND INSTRUCTOR NOTES**Discussion Question

In most supermarkets in the U.S., consumers are given the option of purchasing name brand products or store brand products. The name brand products are always priced higher than the store brand products, but in taste or quality tests, there is typically found to be little to no difference between the two. In fact, many store brand products are actually produced by name brand producers, but sold with the store's label at a lower price.

- a) Suppose the store brand and the name brand for a product, say bread, are made by the same producer and are identical in every way except for the label and price. The price of the store brand is significantly less than the name brand. Why would any consumer purchase the name brand instead of the store brand?

*There are different reasons consumers purchase name brand products. Consumers may not know that these products are identical. Consumers are likely more aware of name brand products from advertising and think it is a higher quality compared to store brands.*

- b) What do you think has happened to the market shares of store brand products over the past 10 years? Why has this happened?

*Store brand products have been increasing in terms of market share.*  
*(<http://myppbrand.com/2015/03/26/private-brand-widens-growth-gap/>).*

- c) Primary reasons this has happened are that consumers are more considerate of their expenditures since the Great Recession of 2007 – 2009 and that perceptions of store brands have improved.

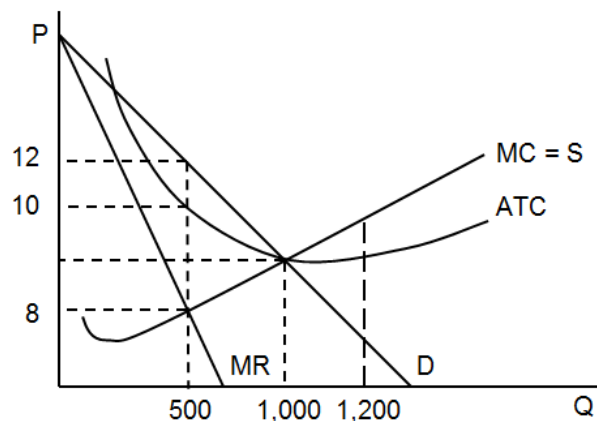
*Consumer name brand products spend more than \$20 billion/year on media advertising. Are these advertising expenditures wasteful from society's perspective? Do consumers receive any benefits from this form of product differentiation?*

*One could make the argument that media advertising is wasteful or that it is useful. Those that think it is wasteful can make the case that this money would be better spent in other areas. The most useful aspects of media advertising are that it provides information about products to consumers, has some entertainment value, and is a major source of revenue for television and radio providers.*

Peer Group Problem Solving

Use the following diagram representing a monopolistically competitive firm to answer the following questions.





- a) What is the current profit maximizing price and quantity for this firm?

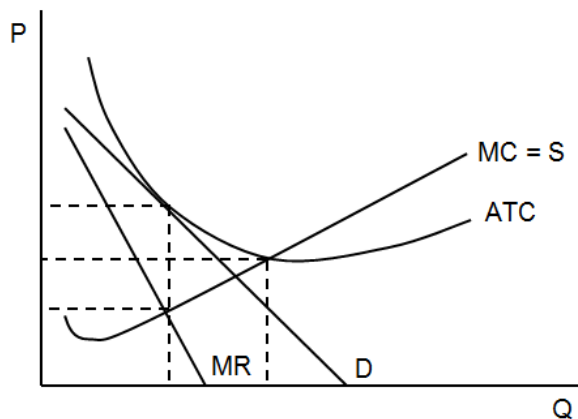
*The quantity is given by the point where  $MR = MC$ ; this happens at  $Q = 500$ . The price that corresponds to this quantity on their demand curve equals \$12.*

- b) What are current profits of this firm?

*The profits are given by  $(P - ATC) \times Q = (\$12 - \$10) \times 500 = \$1,000$ .*

- c) Given that this represents a monopolistically competitive firm, explain what happens in the long run. Illustrate this on the graph above.

*Additional firms will enter this industry, which will cause the demand curve and marginal revenue curve to shift inward. This will continue to happen until there are zero economic profits, which happens at the point where  $P = ATC$ . Note that this happens at a Q below 500 and a P below \$12. The graph will look as follows:*



### In-Class Experiment / Active Exercise

The purpose of this exercise is to have students consider how actual monopolistically competitive markets operate and how firms compete in these markets.

Have students form groups of 3 or 4. Each student can select any 2 markets then answer the following questions about these markets.

Consider the following 8 monopolistically competitive markets:

- 1) Sit down restaurants
  - 2) Retail clothing stores
  - 3) Hair salons
  - 4) Pizza parlors
  - 5) Fast food restaurants
  - 6) Bars
  - 7) Tanning salons
  - 8) Ice cream/yogurt shops
- a) List 3 – 4 specific firms in the local area that compete in this market.
  - b) Among these firms, which one do you think charges the highest prices? Which one do you think charges the lowest prices?
  - c) What do you think accounts for the difference in these prices?
  - d) Provide an example of product differentiation for a particular firm in one market.
  - e) Do you believe the number of firms operating in this market has changed in the past 5 years? If so, has the number increased or decreased? What do you think accounts for the differences in these prices?

*Answers will vary. There are lots of other markets which could be included, such as sandwich shops, tanning salons, supermarkets, gas stations, etc. Any market which has several firms in your area (or if you are in a rural area, the nearest city) will work.*

*A market which has experienced obvious changes in the number of firms in the past 5 years can be especially useful as an example of how firms have responded to changes in economic profits.*

*Students could be allowed to use their cellphones or laptops to look up firms, product differentiation examples, and prices.*

*For more in-class experiment and active learning ideas, visit [www.econedactive.com](http://www.econedactive.com).*