

HOW THE MARKETS WORK SUBTLETIES OF “SUPPLY”



SUPPLY

*VERY IMPORTANT
WARNING !!*



*IN THE DEMAND CHAPTER WE LOOK AT
GOODS AND SERVICES FROM A
CONSUMPTION PERSPECTIVE*

*IN THIS CHAPTER WE MUST THINK LIKE
PRODUCERS , OR MANAGERS OF
BUSINESSES !!!! WE LOOK AT GOODS
AND SERVICES FROM A PRODUCTION
PERSPECTIVE*

SUPPLY

CHAPTER CONTENTS

É WHAT IS SUPPLY ?

É THE LAW OF SUPPLY

É UNDERSTANDING THE “SUPPLY CURVE”

É THE “ELASTICITY” OF SUPPLY

É UNDERSTANDING MORE ABOUT BUSINESS COSTS

É WHAT CAUSES CHANGES IN SUPPLY ?



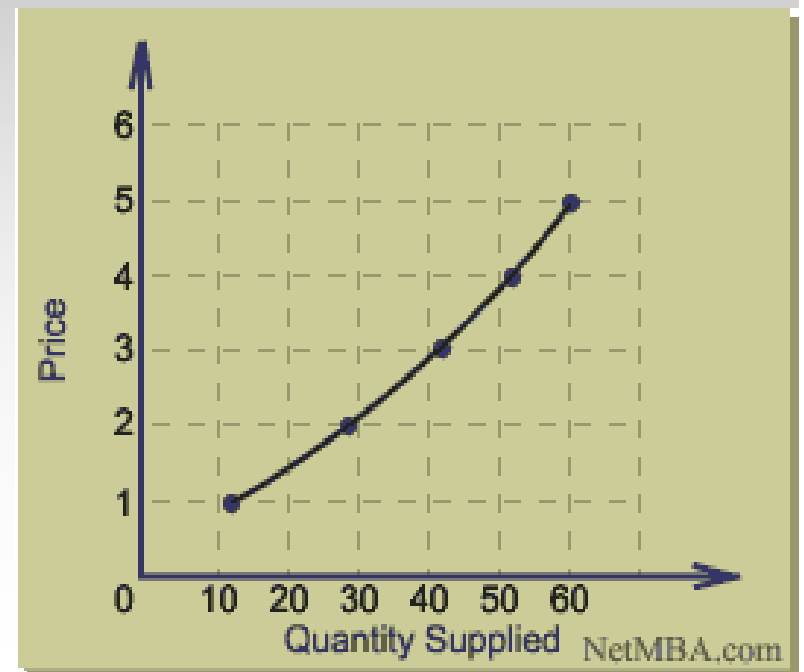


SUPPLY

*WHAT IS **SUPPLY** ?*

*THE RELATIONSHIP BETWEEN PRICE &
QUANTITY OF GOODS AND SERVICES
THAT ARE PRODUCED*

***AGAIN NOTE :**
“ **CETERIS PARIBUS** ”*





SUPPLY

THE LAW OF SUPPLY

*THE HIGHER THE PRICE THAT CAN BE
OBTAINED THE LARGER THE QUANTITY
THAT WILL BE PRODUCED !!*

*COROLLARY: IF PRICES FALL, SOME
PRODUCERS WILL PRODUCE LESS AND
OTHERS WILL STOP PRODUCING
COMPLETELY - WHERE DO THEY GO ??*

OPPORTUNITY COSTS !!!!



SUPPLY

5 CAUSES OF CHANGES IN SUPPLY :

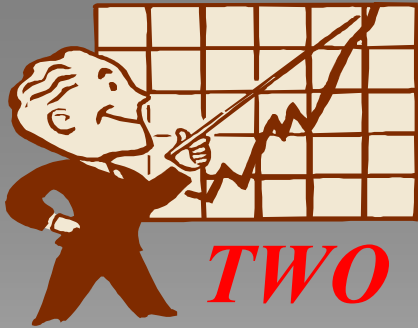
*É # 1 - CHANGE IN PRICES > BUT
REMEMBER , IT CHANGES QUANTITY
SUPPLIED , NOT TOTAL SUPPLY !!*

ELASTICITY OF SUPPLY

*IT IS THE MEASURE OF THE WAY
SUPPLIERS RESPOND TO A CHANGE IN
PRICE > HIGHER = MORE PRODUCTION !*

% CHANGE (Δ) IN QUANTITY SUPPLIED (s)

*-----
% CHANGE (Δ) IN PRICE (p)*



SUPPLY

TWO GENERAL FACTS ABOUT SUPPLY ELASTICITY:

*É THE SUPPLY OF GOODS ARE
GENERALLY INELASTIC IN THE SHORT
RUN BECAUSE PRODUCTION AND
DISTRIBUTION TIME PLAYS A
SIGNIFICANT ROLE*

*WHEN WE COMPARE THINGS , WHAT DO
WE MEAN BY “ SHORT RUN ”
AND “ LONG RUN ” ?*

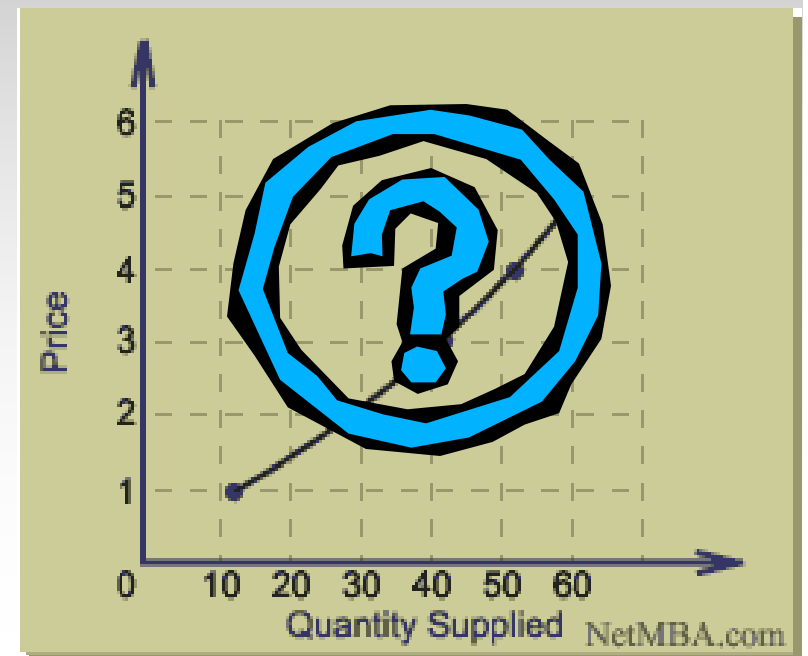


SUPPLY

*TWO GENERAL FACTS ABOUT SUPPLY
ELASTICITY:*

*É SUPPLY OF SERVICES ARE GENERALLY
ELASTIC BOTH IN THE LONG AND
SHORT RUN*

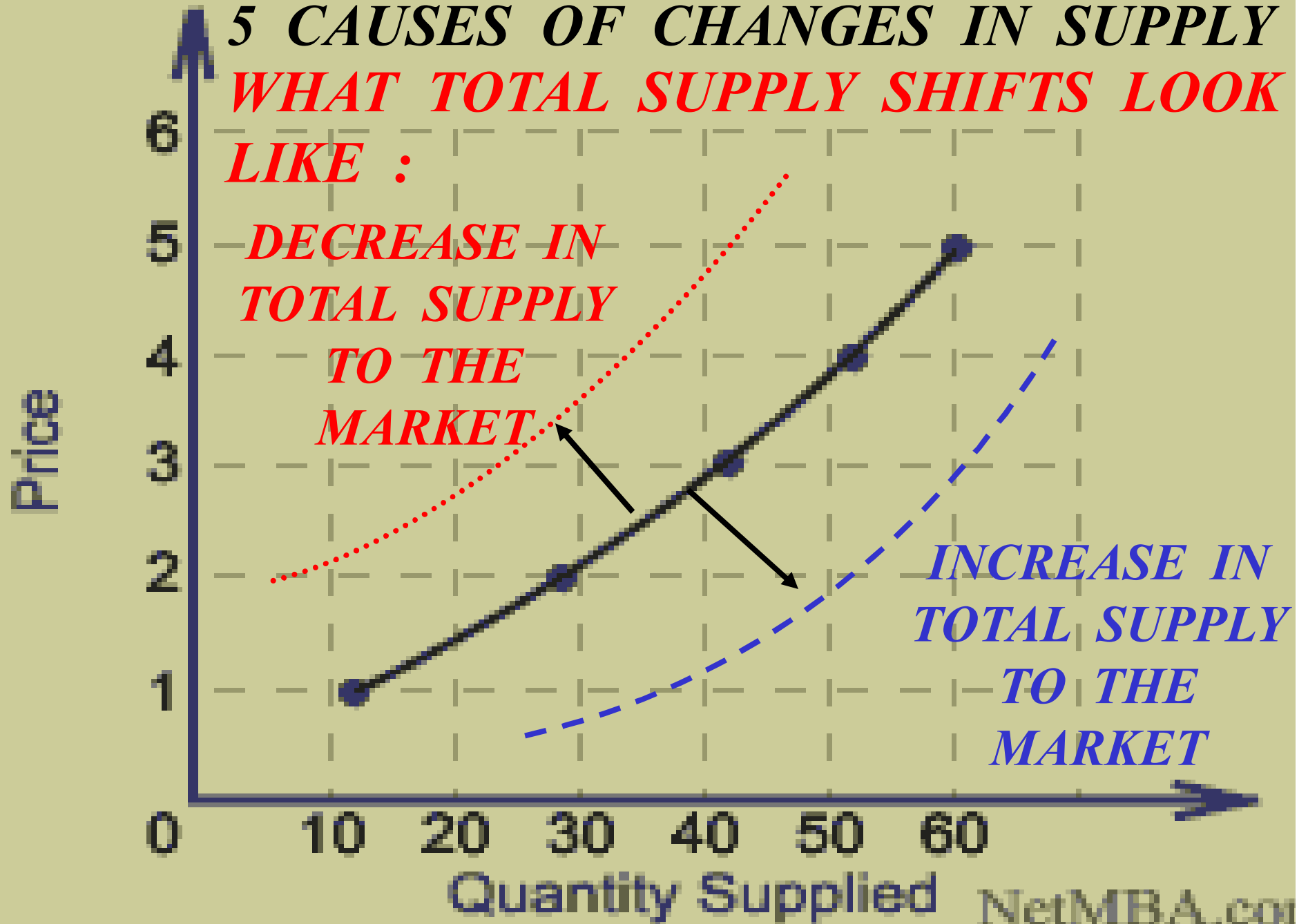
*WHAT DOES A CHANGE
IN TOTAL SUPPLY LOOK
LIKE ? = A CURVE SHIFT
AND WHAT WOULD
CAUSE A SHIFT ??*



5 CAUSES OF CHANGES IN SUPPLY
WHAT TOTAL SUPPLY SHIFTS LOOK
LIKE :

DECREASE IN
TOTAL SUPPLY
TO THE
MARKET

INCREASE IN
TOTAL SUPPLY
TO THE
MARKET





SUPPLY

5 CAUSES OF CHANGES IN SUPPLY :

*É # 2 - INCREASES IN VARIABLE COSTS
OF PRODUCTION > WHY ?? BECAUSE IT
HAS A NEGATIVE SHORT TERM IMPACT
ON THE ABILITY OF A BUSINESS TO
PRODUCE > WHAT ARE VARIABLE
COSTS ??*

*WAHOOOO !!! LOOKS LIKE WE NEED TO
DO MORE ON COSTS AND PROFITS !!!!*



SUPPLY

5 CAUSES OF CHANGES IN SUPPLY :

É REVENUE - MONEY TAKEN IN BY THE SALE OF PRODUCTS AND SERVICES

É **FIXED COSTS** - COSTS THAT DO NOT CHANGE > RENT, LOAN PAYMENTS ON EQUIPMENT, LICENSES

É **VARIABLE COSTS** - COSTS THAT CHANGE > WAGES, SUPPLIES, UTILITIES

É **TOTAL COSTS** - FIXED PLUS THE VARIABLE COSTS



SUPPLY

5 CAUSES OF CHANGES IN SUPPLY :

É GROSS PROFIT - REVENUE MINUS ALL COSTS

É NET PROFIT / INCOME - GROSS PROFIT MINUS TAXES

TOTAL REVENUE - FIXED COSTS - VARIABLE COSTS = GROSS PROFITS - TAXES = NET PROFIT / INCOME



SUPPLY

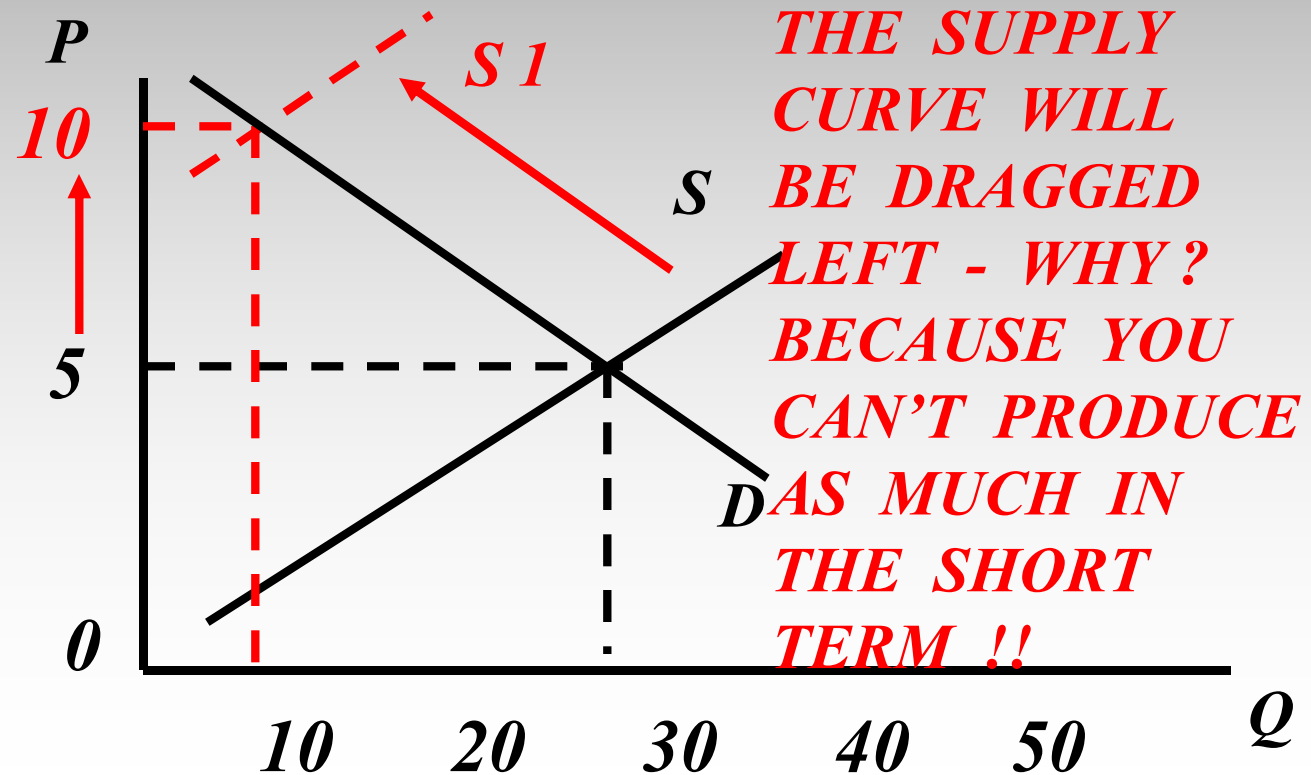
5 CAUSES OF CHANGES IN SUPPLY :

SO , HOW DOES AN INCREASE IN

VARIABLE COSTS POTENTIALLY CHANGE

SUPPLY ??

*FIRMS WILL
PASS ON THE
COSTS TO
CONSUMERS =
INCREASES
PRICES*

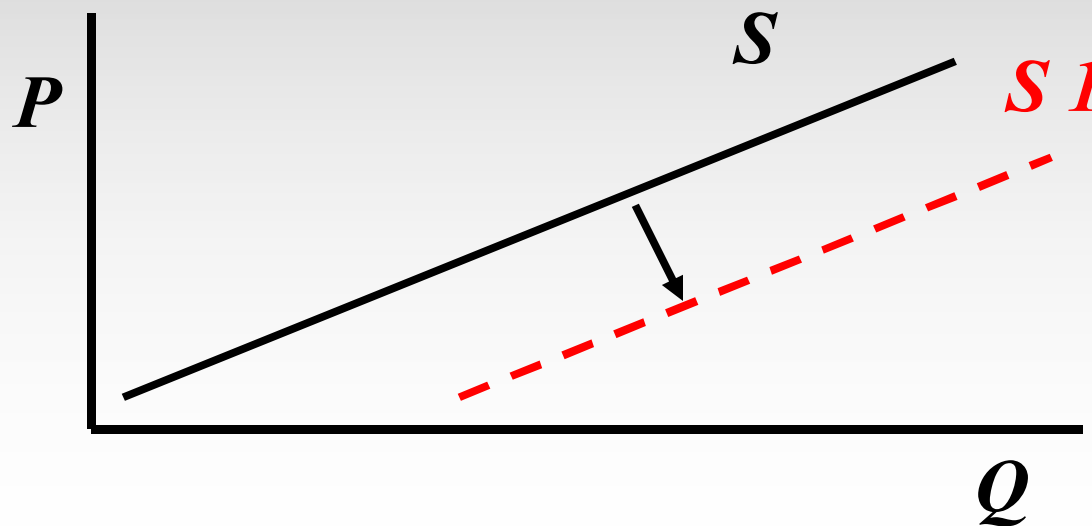




SUPPLY

5 CAUSES OF CHANGES IN SUPPLY :

*É # 3 - TECHNOLOGY ADVANCES > MAY
REDUCE VARIABLE COSTS OR ALLOW
MORE TO BE PRODUCED > MAY MOVE
THE CURVE TO THE ... **RIGHT***



*HAS TECHNOLOGY
HURT THE MUSIC
INDUSTRY ??*

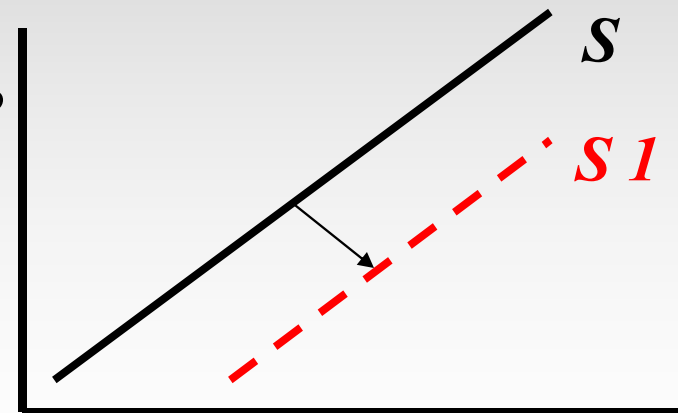


SUPPLY

5 CAUSES OF CHANGES IN SUPPLY :

É # 4 - FOUR GOVERNMENT ACTIONS :

*ó **SUBSIDY** - A GOVERNMENT PAYMENT THAT SUPPORTS A BUSINESS OR MARKET > AGRICULTURE SUBSIDIES ARE GOOD EXAMPLES > MOVES THE CURVE^P TO THE ... **RIGHT***



Q



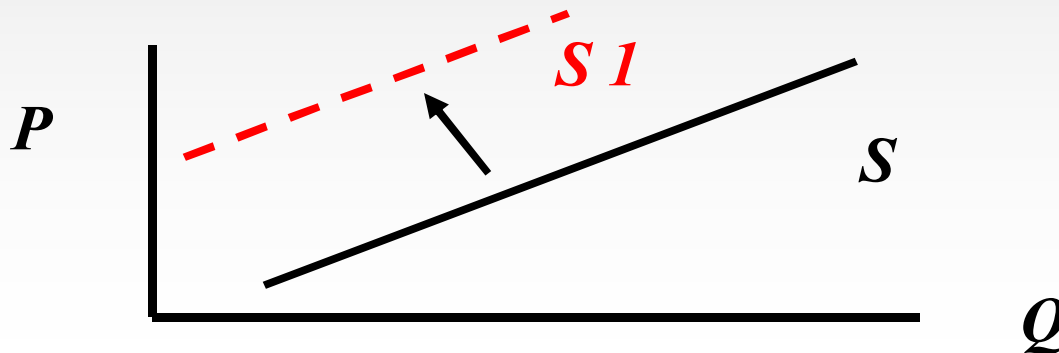


SUPPLY

5 CAUSES OF CHANGES IN SUPPLY :

É # 4 - FOUR GOVERNMENT ACTIONS :

*ó EXCISE TAXES - IMPOSED ON A
BUSINESSES TO DISCOURAGE
PRODUCTION AND CONSUMPTION =
EXTRA COST FOR EACH UNIT SOLD >
“ SIN TAXES ” AS AN EXAMPLE >
MOVES THE CURVE TO THE ... LEFT*





SUPPLY

5 CAUSES OF CHANGES IN SUPPLY :

É # 4 - FOUR GOVERNMENT ACTIONS :

*ó **TARIFFS** - TAXES IMPOSED ON FOREIGN GOODS WHICH ADDS AN EXTRA COST FOR EACH UNIT SOLD > & MOVES THE CURVE TO THE **LEFT***

*ó **REGULATION** > INTERVENTION TO CONTROL BUSINESS PRACTICES IN A MARKET THAT ADDS COST > MOVES THE CURVE TO THE **LEFT** > TWO ...*



SUPPLY

5 CAUSES OF CHANGES IN SUPPLY :

*ó ... EXAMPLES > THE TEXTILE
INDUSTRY BROWN LUNG CASE AND
THE CALIFORNIA FISHING BAN*

*É # 5 - NEW ENTRANTS INTO THE
MARKET / COMPETITION > INCREASES
SUPPLY > SHIFTS THE CURVE TO THE
RIGHT*



SUPPLY

*LETS NOW COMPLETE THE DEMAND AND
SUPPLY PICTURE AND LOOK AT A MARKET
AT “EQUILIBRIUM”*

WHAT IS EQUILIBRIUM ????

*THE COMBINATION OF PRICE AND
QUANTITY AT WHICH THE
INTENTIONS OF DEMANDERS AND
SUPPLIERS EXACTLY MATCH*





SUPPLY

WHAT EVENTS MIGHT DISRUPT A MARKET AT EQUILIBRIUM ?

É TERRORIST ATTACKS

É WEATHER

É NATURAL DISASTERS

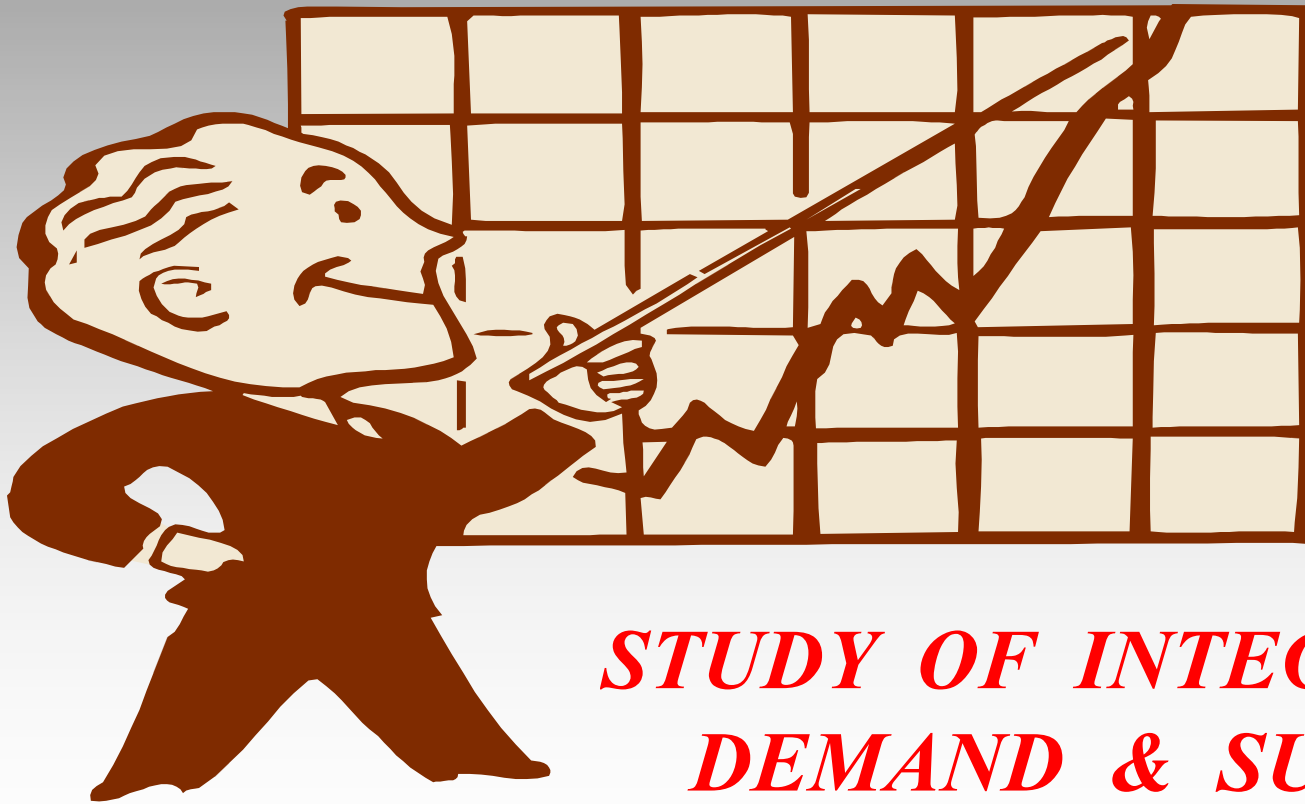
É SCANDAL

É POLITICAL STRIFE



HOW THE MARKETS WORK

DEMAND & SUPPLY



*STUDY OF INTEGRATED
DEMAND & SUPPLY*



DEMAND & SUPPLY

*THERE ARE 4 STEPS IN FIGURING
OUT DEMAND AND SUPPLY GRAPHS :*

*É DON'T THINK TOO HARD OR OVER
THINK !!!!*

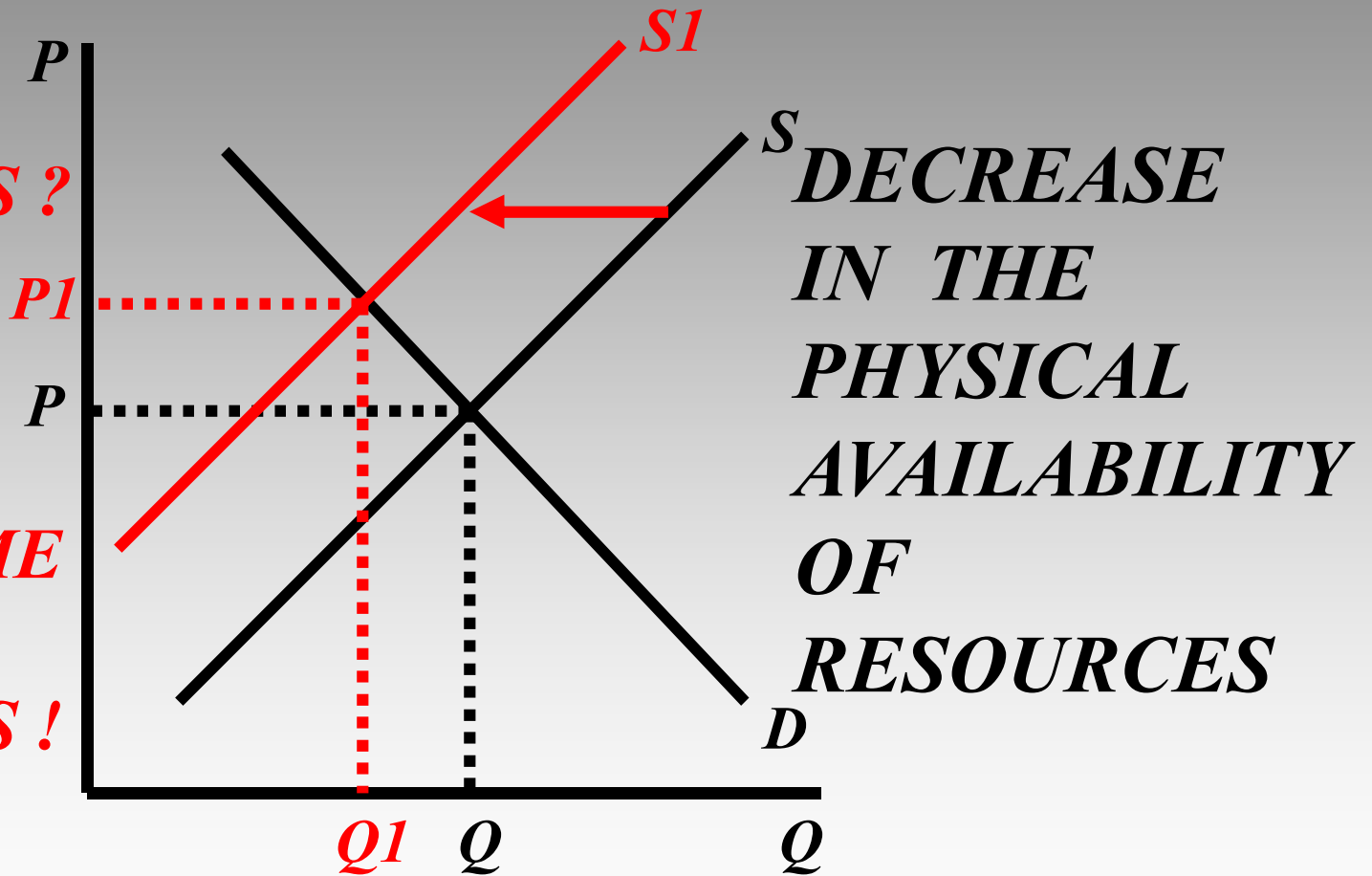
*É IDENTIFY WHICH CURVE IS EFFECTED
FIRST (SHORT TERM) AND WHY ??*

*É DETERMINE WHETHER IT IS AN
INCREASE OR DECREASE*

É THEN “ JUST DRAW IT ” !!

WHAT HAPPENS TO THE MARKET FOR ORANGES WHEN A FROST HITS FLORIDA ??

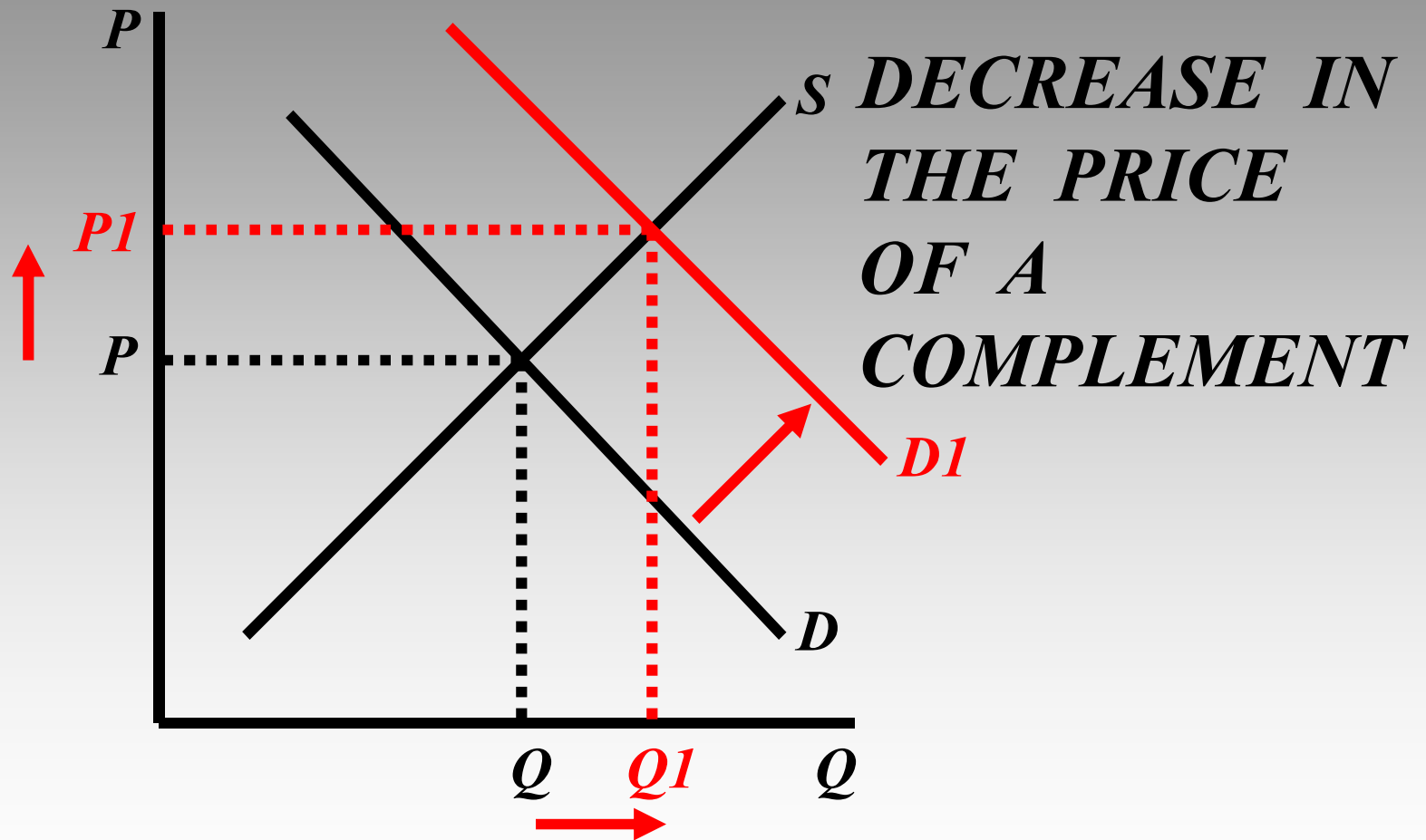
ANY QUESTIONS ?
IF THERE ARE, WE HAVE SOME SERIOUS PROBLEMS !



YOUR MARKET IS :

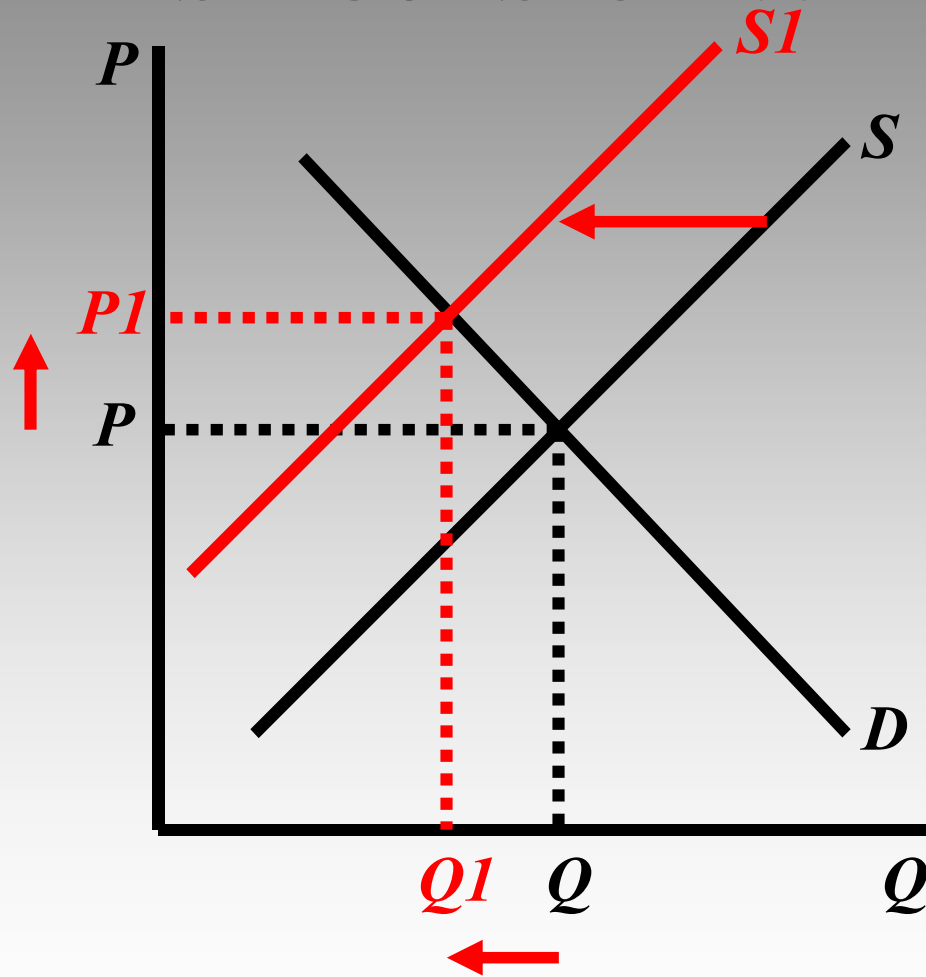
ORANGES

***WHAT HAPPENS TO THE MARKET FOR CD'S
WHEN THE PRICE OF CD PLAYERS GOES
DOWN ??***



YOUR MARKET IS : CD's

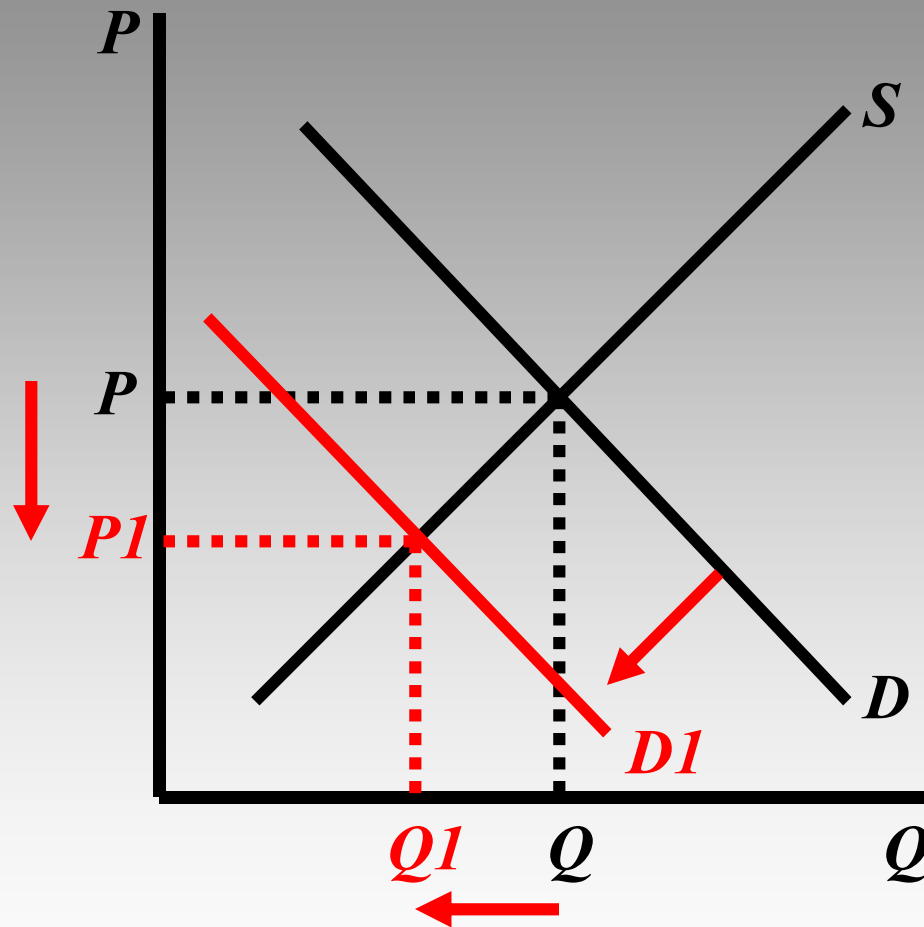
WHAT HAPPENS TO THE MARKET FOR CD'S WHEN THE ROYALTIES PAID TO THE SONG ARTIST GOES UP ??



*INCREASE
IN COSTS*

YOUR MARKET IS : CD's

THE CD IS INVENTED

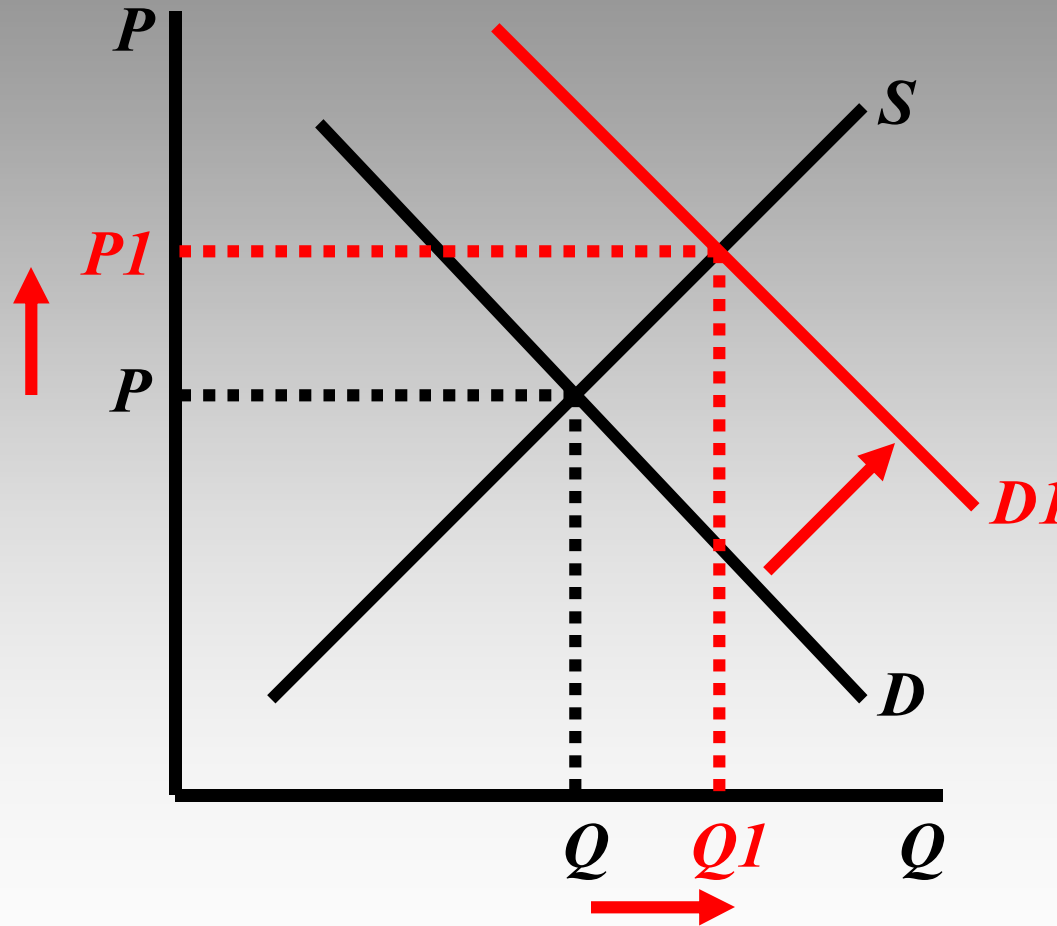


DECREASE IN PREFERENCES

YOUR MARKET IS : CASSETTE TAPES



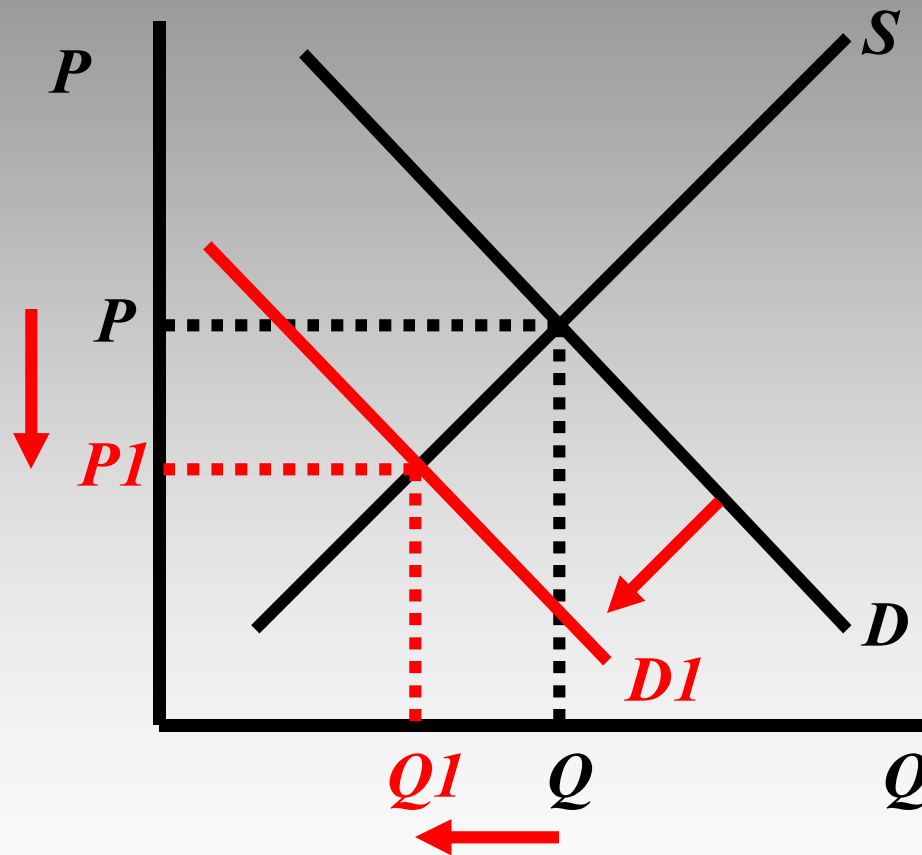
THE U.S. GOES THROUGH A BOOM ECONOMY, WHAT HAPPENS TO THE MARKET FOR STEAK ??



INCREASE IN INCOMES AFFECTS NORMAL GOODS

YOUR MARKET IS : BEEF / STEAK

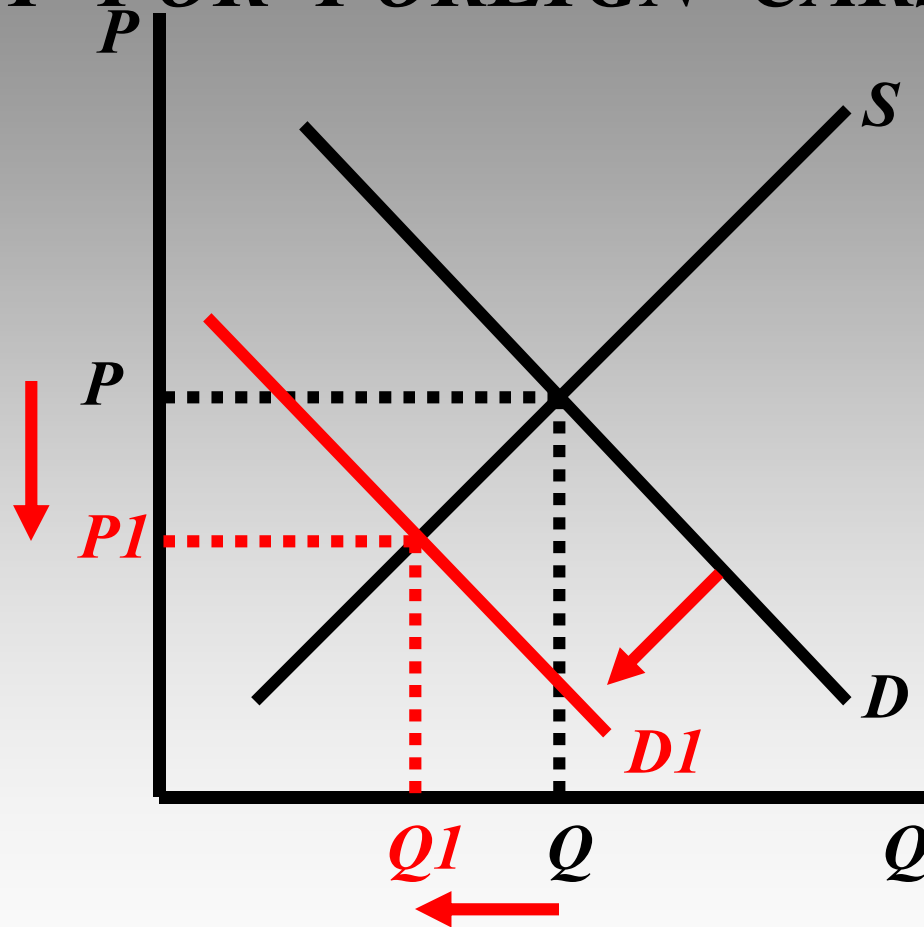
***THE PRICE OF GASOLINE DOUBLES ;
WHAT HAPPENS TO THE MARKET FOR
SPORT UTILITY VEHICLES AND TRUCKS ?***



***PRICE OF A
RELATED
PRODUCT
COMPLEMENT***

YOUR MARKET IS : SUVs AND TRUCKS

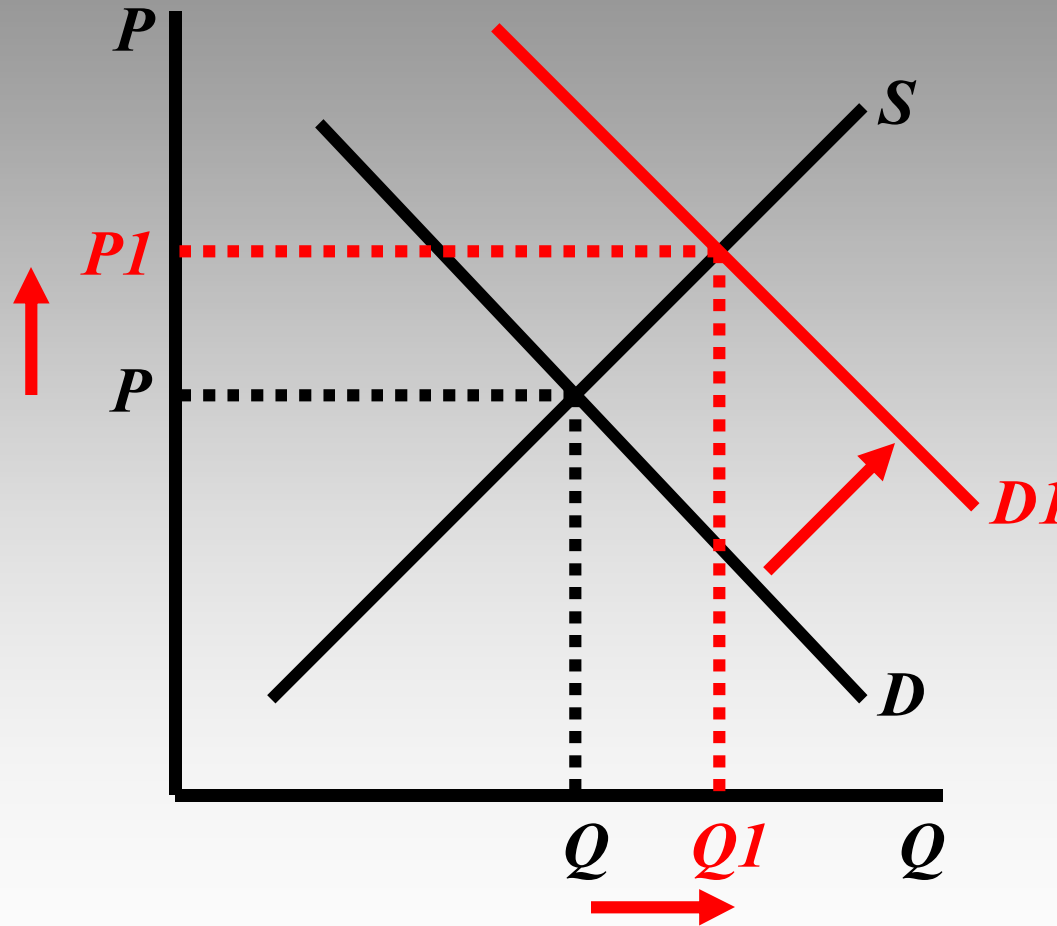
U.S. AUTOMAKERS INVENT HYBRID TECHNOLOGY ; WHAT HAPPENS TO THE MARKET FOR FOREIGN CARS ??



PRICE OF A RELATED PRODUCT SUBSTITUTE

YOUR MARKET IS : FOREIGN CARS

*THE PRICE OF AIRLINE TICKETS
DOUBLES, WHAT HAPPENS TO THE
MARKET FOR BUS TICKETS ??*



*INCREASE IN
THE PRICE
OF A
RELATED
PRODUCT
SUBSTITUTE*

*YOUR MARKET IS : **BUS TICKETS***

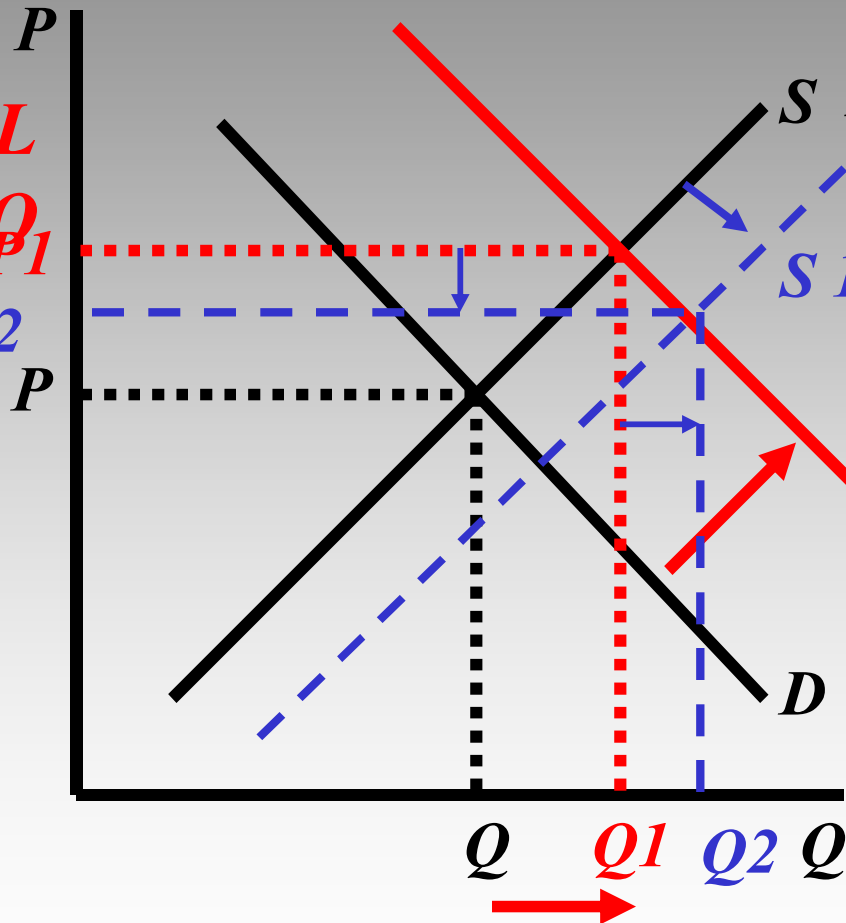
***SO, NOW YOU THINK YOU
UNDERSTAND THIS DEMAND AND
SUPPLY STUFF ??***

***ALL WE HAVE DONE IS LOOK
AT THE “ SHORT TERM ”***

***LETS COMPLETE THE PICTURE
BY ALSO LOOKING AT
THE “ LONG TERM ”***

**WHAT HAPPENS TO THE MARKET FOR CD's
WHEN THE PRICE OF CD PLAYERS GOES
DOWN ??**

**WHAT WILL
HAPPEN TO
DEMAND
AND
SUPPLY
OVER THE
LONG
TERM ?**

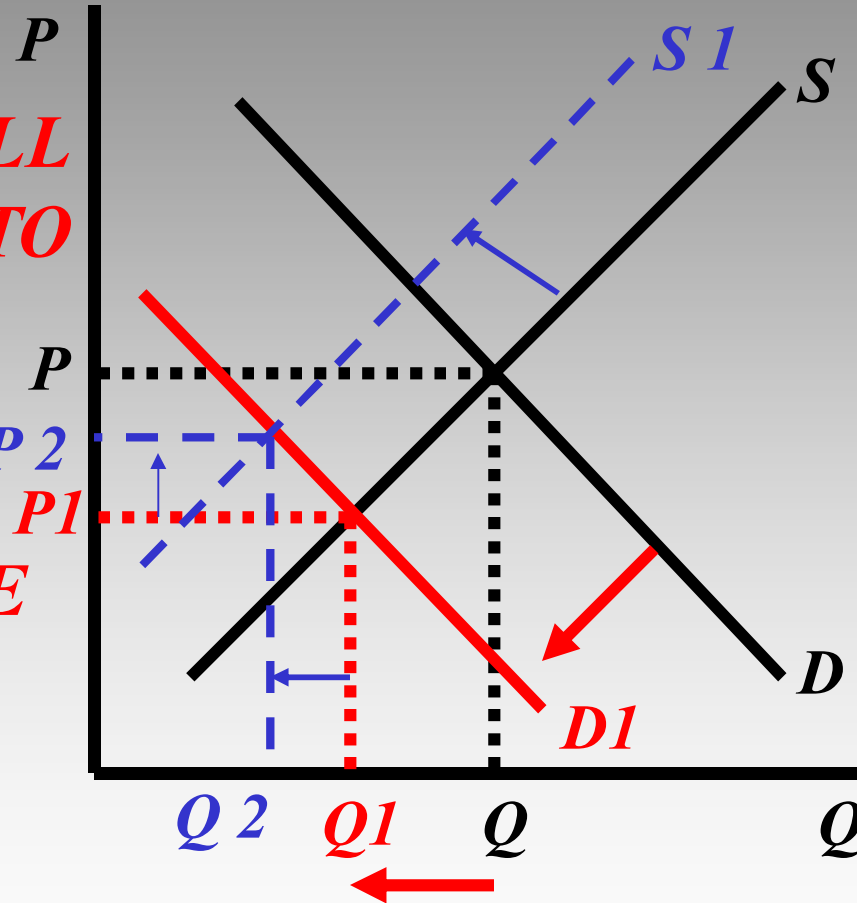


**MORE SUPPLIERS
WILL BE
ATTRACTED BY
THE HIGHER
DEMAND AND
PRICES > THIS
DRIVES PRICES
DOWN !!**

YOUR MARKET IS : CD's

WHAT HAS HAPPENED TO THE MARKET FOR CD PLAYERS WITH THE INVENTION OF THE MP 3 PLAYER ??

WHAT WILL HAPPEN TO DEMAND AND SUPPLY OVER THE LONG TERM ?



SOME SUPPLIERS WILL LEAVE THE MARKET, BUT THE DECREASE IN PREFERENCES SURVIVE UNTIL THE PRICE OF THE MP 3 PLAYER COMES DOWN

YOUR MARKET IS : CD PLAYERS



WHAT CAN WE LEARN FROM THE PETROLEUM MARKET ??

GLOBAL PETROLEUM FACTS :

***É DEMAND IS EXPECTED TO RISE AT
LEAST 60 % BY 2030***

***É SUPPLY IS EXPECTED TO BE STABLE
AT CURRENT LEVELS > NO NEW OIL
FIELDS WILL BE FOUND***

***É ONLY ONE NEW REFINERY IS
PLANNED AND IT IS STILL AT***

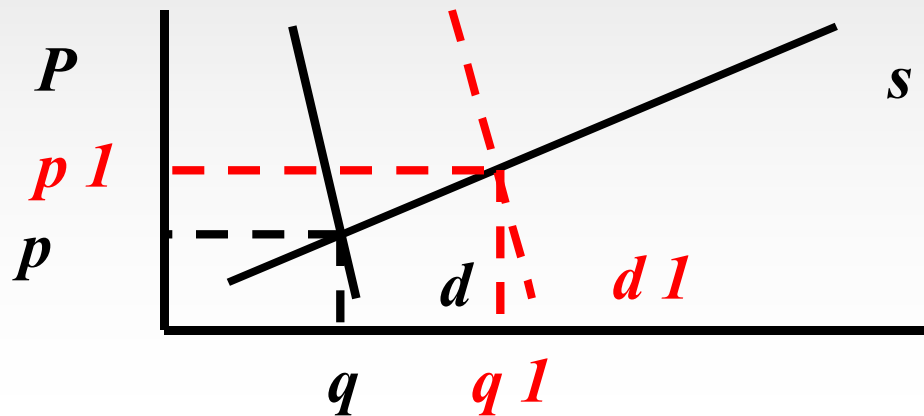


WHAT CAN WE LEARN FROM THE PETROLEUM MARKET ??

GLOBAL PETROLEUM FACTS :

É ... *LEAST FIVE YEARS FROM BEING PUT INTO OPERATION*

RAPIDLY RISING DEMAND + NO INCREASE IN SUPPLY + BOTTLENECKS LIMITING DISTRIBUTION = ↑↑ PRICES ↑↑

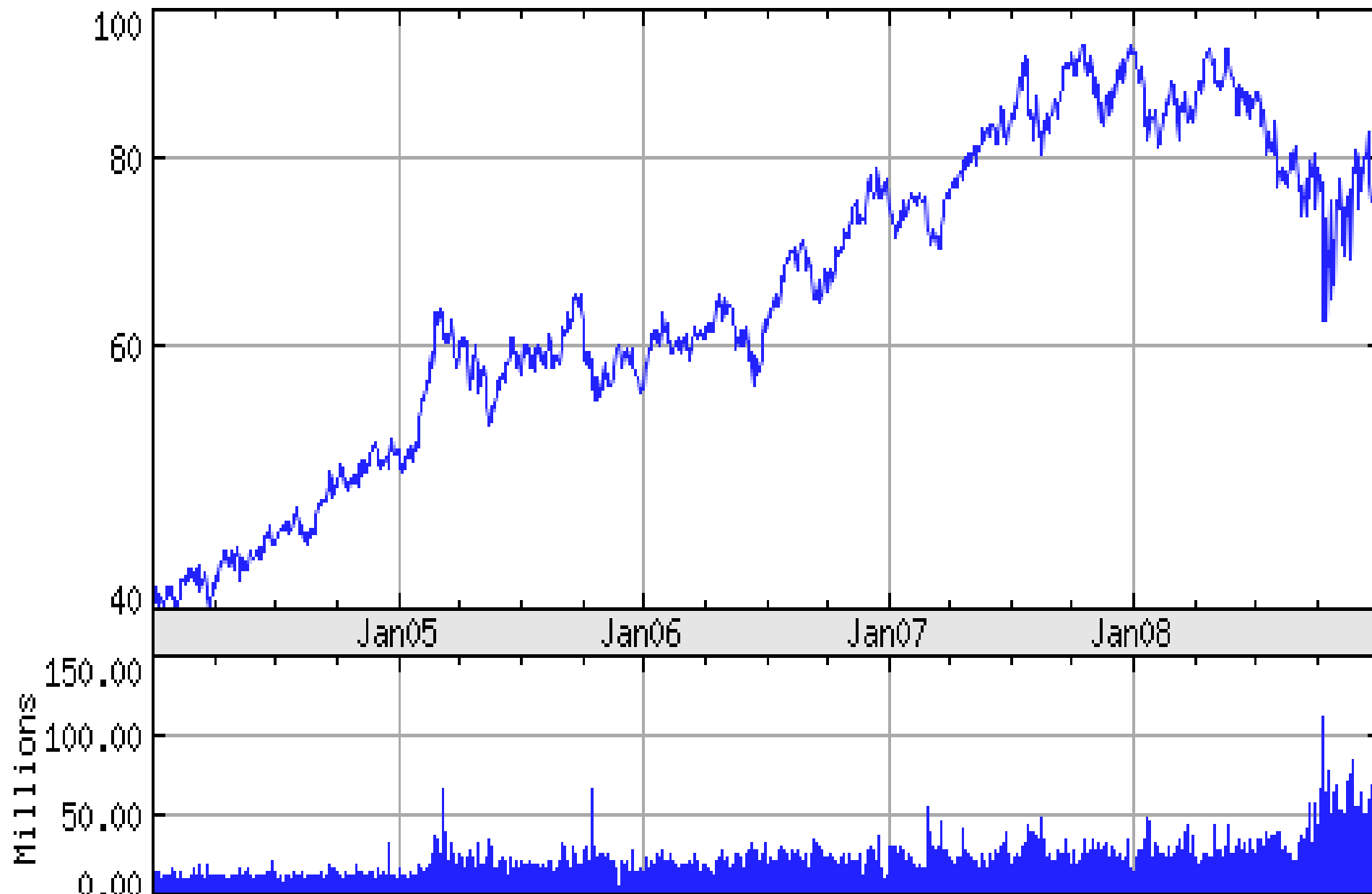


INVESTMENT OPPORTUNITY ?

EXXON MOBIL CORP
as of 30-Dec-2008

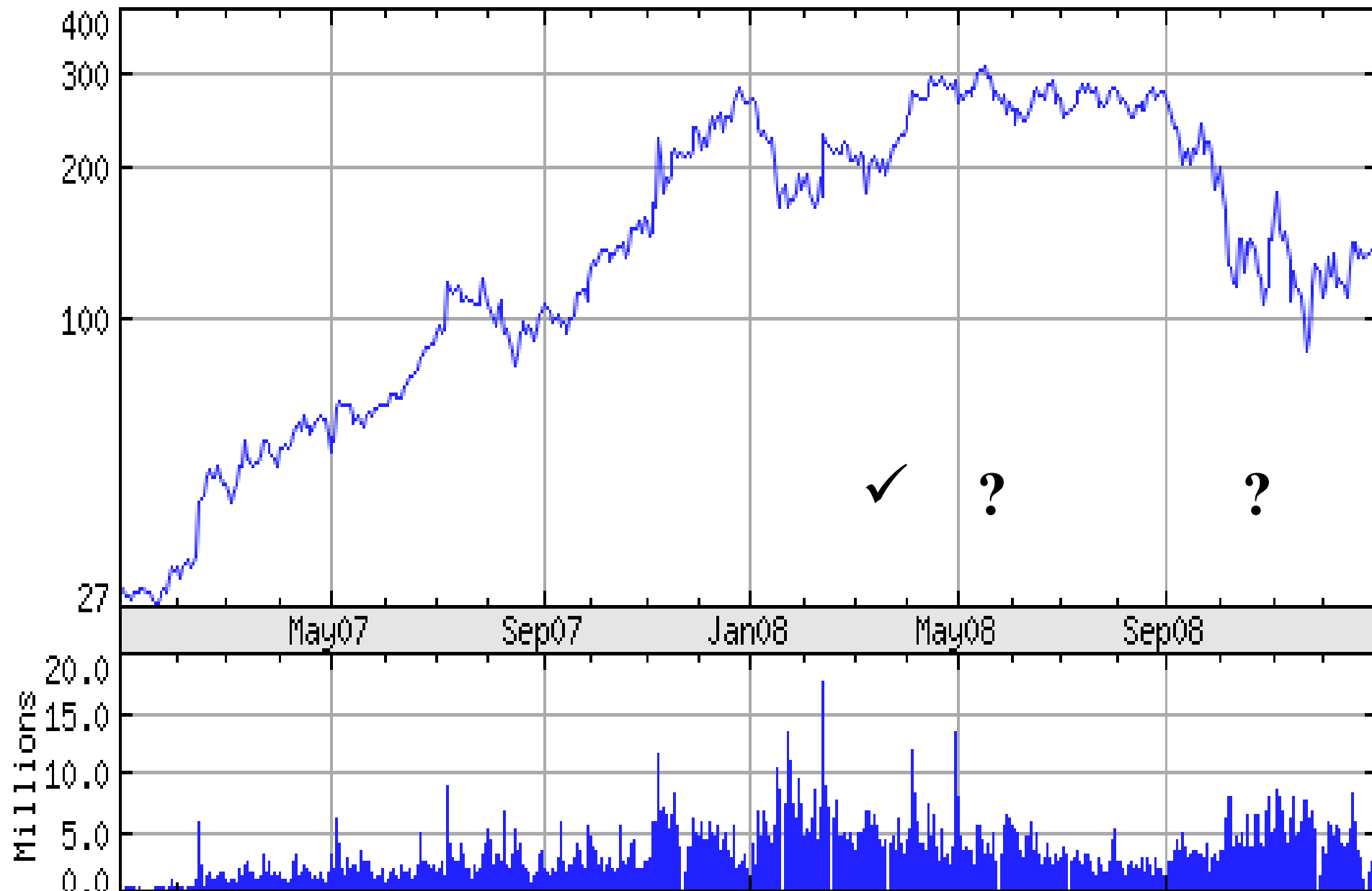
EXXON MOBIL > JAN 2005 TO JAN 2008 >
↑ 100 %

Splits: ▼



FIRST SOLAR INC
as of 30-Dec-2008

FIRST SOLAR > JAN 2006 TO JAN 2008 > ↑ 500 %

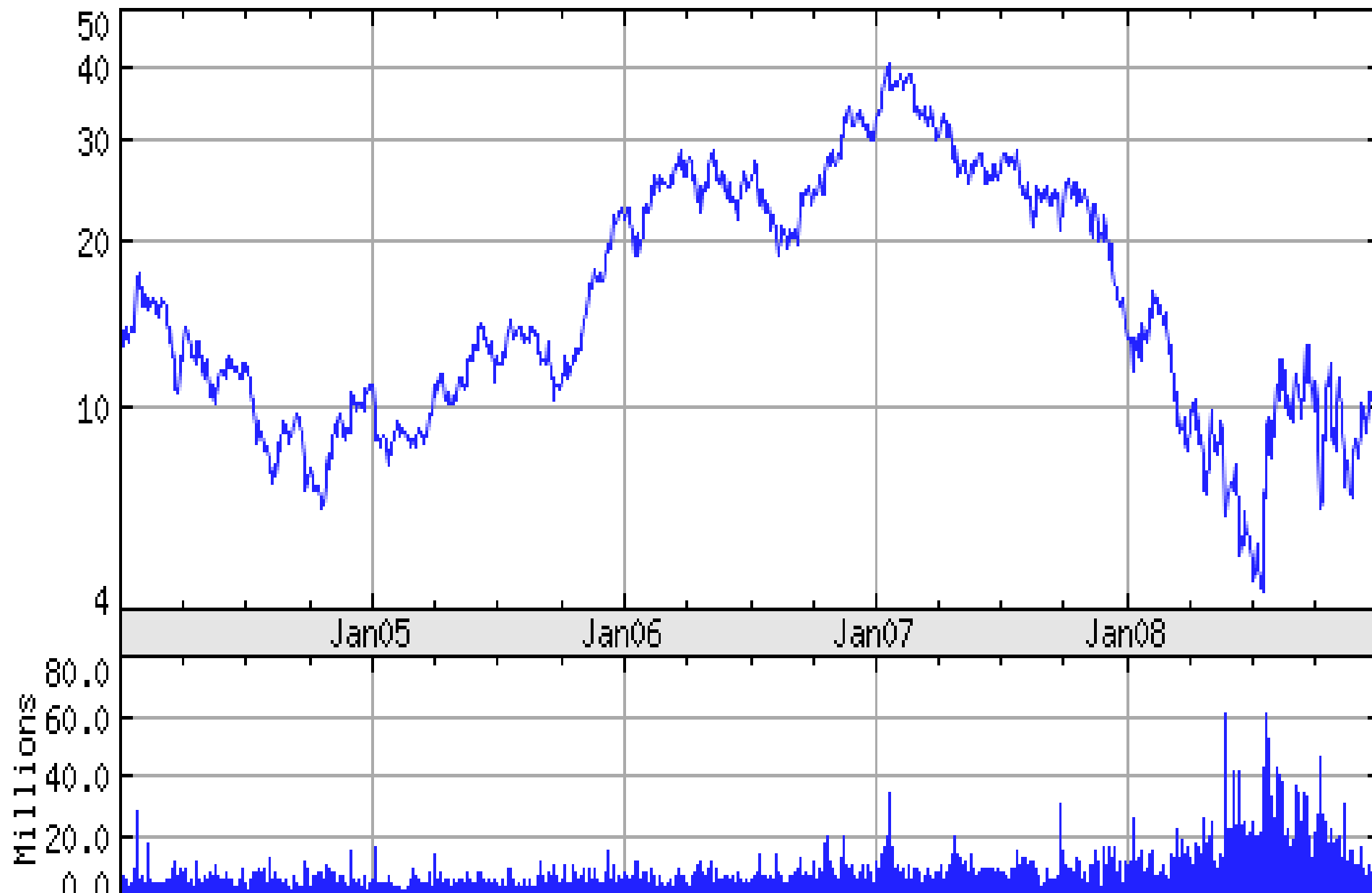


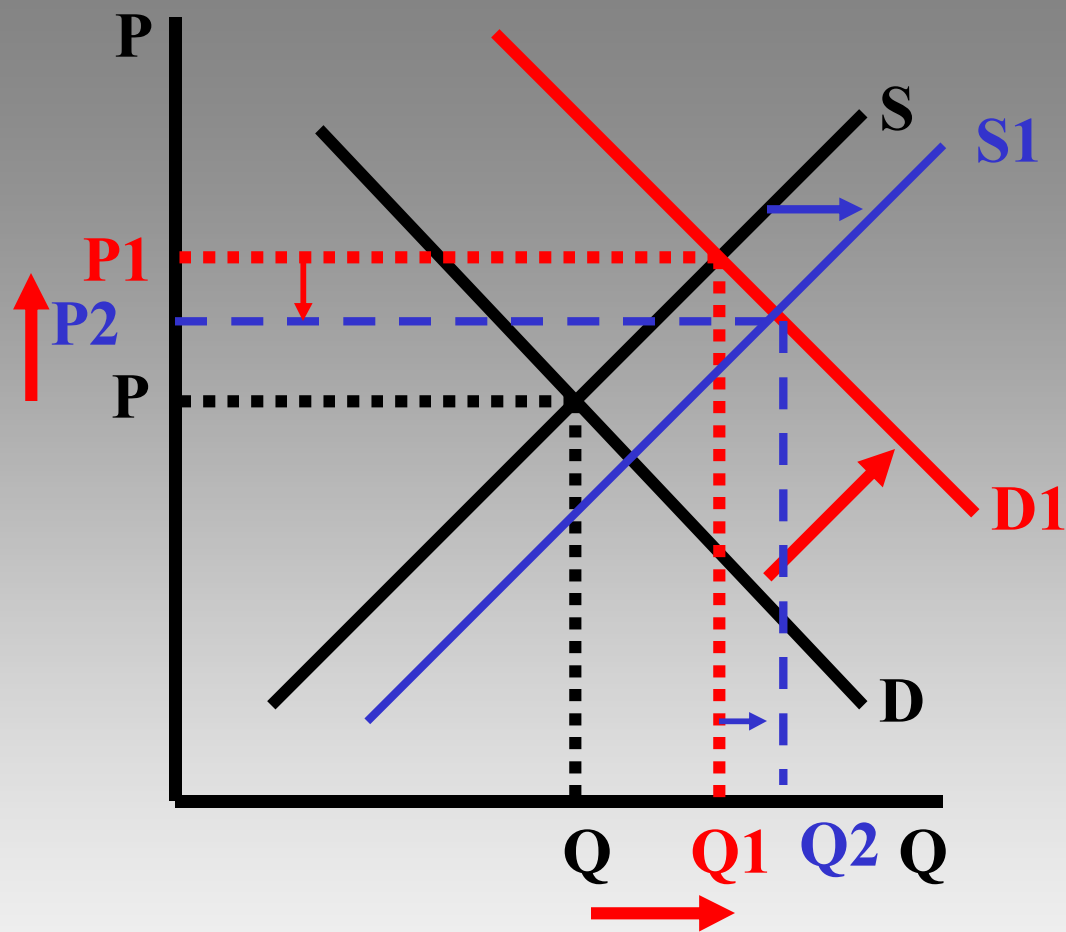
AMR CORP

as of 30-Dec-2008

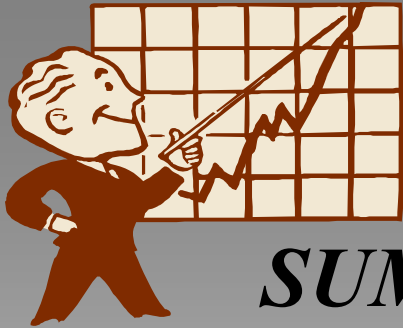
*AMERICAN AIRLINES > JAN 2004 TO
JAN 2009 > ↓ 30 %*

Splits: ▼





A PROPERLY LABELLED DEMAND AND SUPPLY GRAPH



SUPPLY

SUMMARY :

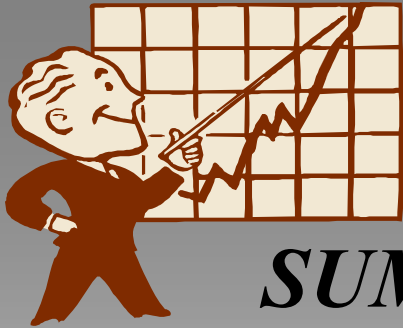
É WHAT IS SUPPLY ?

É WHAT IS THE LAW OF SUPPLY ?

*É WHAT DO WE MEAN WHEN WE SAY
SUPPLY IS ELASTIC ?*

*É WHAT ARE THE CAUSES FOR SUPPLY
BEING ELASTIC ?*

É WHAT CAUSES CHANGES IN SUPPLY ?



SUPPLY

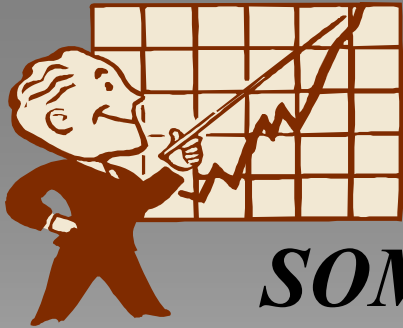
SUMMARY :

É WHEN ARE MARKET SURPLUSES AND SHORTAGES CREATED ?

É WHEN IS A MARKET AT AN EQUILIBRIUM POINT ?

É WHAT MIGHT DISRUPT A MARKET AT EQUILIBRIUM ?





DEMAND & SUPPLY

SOME HISTORY P

É IN ENGLISH PUBS, ALE IS ORDERED BY PINTS AND QUARTS

HOW DID THE TERMS P & Q COME ABOUT ?

Q

É WHEN CUSTOMERS GOT UNRULY, THE BARTENDER WOULD YELL AT THEM TO “MIND” THEIR OWN PINTS AND QUARTS AND SETTLE DOWN > SO THAT’S WHERE WE GOT THE PHRASE “MIND YOUR P s AND Q s” !!



DEMAND & SUPPLY

FOOD FOR THOUGHT

*WHAT WOULD A DEMAND AND SUPPLY
CHART FOR “AIR” LOOK LIKE ??? IS
“AIR” A “FREE” GOOD ???*

