3-2 Observing the Law of Supply and Demand

GOALS

- Explain microeconomics and the concept of consumer demand.
- Identify factors that affect supply and its relationship to demand.

KEY TERMS

macroeconomics, *p. 66*
microeconomics, *p. 66*
demand curve, *p. 68*
law of demand, *p. 68*
economic market, *p. 68*
economic resources, *p. 69*
supply curve, *p. 69*
law of supply, *p. 70*
market price, *p. 71*

marketing matters

Microeconomics analyzes the interaction of consumer demand with producer supply to predict how changes in one affect the other. Much depends on consumers' needs and wants and on the availability of alternatives. When the independent decisions of consumers and producers are combined, they can be illustrated as curved lines on a two-dimensional graph that intersect at the market price.

Make a list of the last article of clothing you purchased, the last restaurant menu item you bought, and your last transportation-related expense, along with the prices you paid for each. If each had cost 20% more, would you still have bought them? What if they were 50% more? Twice as much as you paid? What determines the point at which you decide not to buy something or to find an alternative?

Microeconomics and Consumer Demand

Economics attempts to understand and explain how consumers and producers make decisions concerning the allocation of their resources. That understanding helps consumers and producers use their resources more effectively. It also helps government decision makers determine if and when they should become involved in the economy as they work to maintain an even balance between producers and consumers and to maintain a strong economy that improves the standard of living for citizens.

Economics operates on two levels. The first level, **macroeconomics**, studies the economic behavior and relationships of an entire society. Macroeconomics looks at the big picture. It helps to determine if society's resources are being used as effectively and efficiently as possible. Macroeconomics studies the decisions of all consumers and producers and the effects of those decisions on the economy.

The second level, **microeconomics**, examines relationships between individual consumers and producers. Microeconomics looks at small parts of the total economy. Microeconomics studies how individuals make decisions about what to produce and what to consume.

While a broad understanding of economics is important to marketers, they are

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How do the concepts of supply and demand apply to a farmers market?

most concerned about microeconomics. Information about how consumers make purchasing decisions and how much they are willing to pay can be very important in selecting target markets and developing effective marketing mixes. Marketers must also understand how a business's competitors make decisions about what they will produce and the prices they are likely to charge. Microeconomics looks at supply, demand, and the level of individual product prices. The relationship between supply and consumer demand is an important tool for marketers.

Factors Affecting Demand

A number of factors influence consumers' decisions regarding what to purchase and how much to pay. If a need or want is particularly important or strong, a consumer might be willing to spend more money to satisfy it. For example, if you are at a baseball game and your favorite player hits three home runs, obtaining a t-shirt with the player's name on it may seem very important to you. You may be willing to pay much more to buy a t-shirt right away at the ballpark rather than waiting to make the purchase later at a sporting goods store.

Another factor that affects consumers' decisions is the available supply of products and services to satisfy their needs. If there is a very large supply of a product, consumers will usually place a lower value on it. Imagine walking through a farmers' market where a large number of producers are selling fresh fruits and vegetables. As a consumer, you see there are many choices of sellers and a large quantity of each product available. Therefore, you will probably be careful not to overpay for the fruits or vegetables you want. On the other hand, if a large number of customers are at the market and only a few farmers are there to sell their products, the customers may pay much higher prices to be sure they get the items they need.

A third factor is the availability of alternative products that consumers believe will satisfy their needs. If consumers believe there is only one product or brand that meets their needs, they are willing to pay a higher price. If several options seem to be equally satisfying, consumers are more careful about how much they pay.

An example of this factor is your choice of entertainment for an evening. If there are very few things from which you and your friends can choose, you will likely be willing to pay quite a bit for a specific activity. However, if you identify several options (a movie, bowling, an amusement park, renting a video game) and each seems enjoyable, you may consider the cost more carefully. You might select one that is inexpensive but which you and your friends will still enjoy.

Analyzing Demand Curves

Economists try to determine how much consumers are willing and able to pay for various quantities of products or services. The relationship between price and the quantity demanded is often illustrated in a graph known as a **demand curve**. Figure 3-1 shows a sample demand curve for movies. As the price of movies increases, fewer people buy tickets. As the price decreases, more tickets are sold. This relationship is known as the **law of demand**: When the price of a product is increased, less will be demanded. When the price is decreased, more will be demanded.

Just as in marketing, economists use the concept of markets. All of the consumers who will purchase a particular product or service comprise an **economic market**. Economists believe that the consumers in an economic market view the relationship of products and prices in the same way.

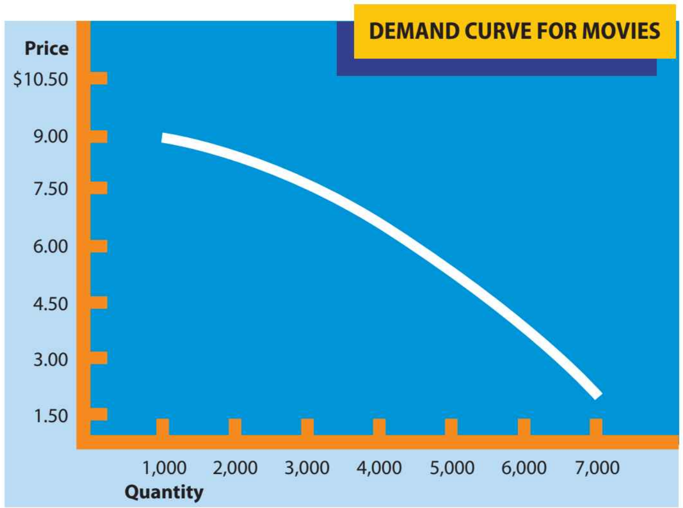

FIGURE 3-1
As the price of movies increases, the number of consumers willing and able to pay that price decreases.

Checkpoint

How does microeconomics differ from macroeconomics?

Supplying the Product

There are several factors that influence what and how many products or services a business will produce. Factors include the possibility of profit, the amount of competition, and the capability of developing and marketing the products or services.

One of the most important reasons for businesses to operate in a private enterprise economy is to make a profit. Businesses will try to offer products and services that have a good chance of making a large profit, rather than products and services likely to yield either a small profit or the likelihood of a loss. Business managers carefully consider both the costs of producing and marketing products and the prices they will be able to charge for those products. That analysis helps in determining the most profitable choices to produce.

Handling the Competition

When looking for opportunities, businesses consider the amount and type of competition. When competition is intense—with many businesses offering the same types of products or services—there are fewer opportunities for success than when there is little competition. When possible, suppliers may choose to offer products and services that have few competitors. Another option when there is a lot of competition is to change the product to make it different from those offered by other businesses. For example, an owner of an apartment complex in a community where there are many vacant apartments may provide free cable TV for residents. The owner may extend short-term leases or may offer furnished apartments if those types of services are not available in other apartment complexes.

Finally, businesses use the resources available to develop products and services. **Economic resources** are classified as natural resources, capital, equipment, and labor. The specific types of resources a business has available will determine the types of products and services it can develop and sell. Some resources are very flexible, enabling a business to change and offer new products quickly. For example, if the owners of an electronics store found that equipment such as fax machines and scanners was not profitable, they could quickly change the products sold in that part of the store to some that are more profitable. Other businesses have more difficulty changing products. Companies that own oil wells or coal mines, for instance, have few options because the natural resources they own are their products. They must sell the oil and coal even if those products are not very profitable.

Analyzing a Supply Curve

Some economists predict how the quantity of products and services changes at various prices. The graph of the relationship between price and quantity supplied is known as a **supply curve**. An example supply curve for cell phones is shown in Figure 3-2. The graph shows that as the price increases, producers will manufacture more cell phones. As the price goes down, fewer will be manufactured. This relationship

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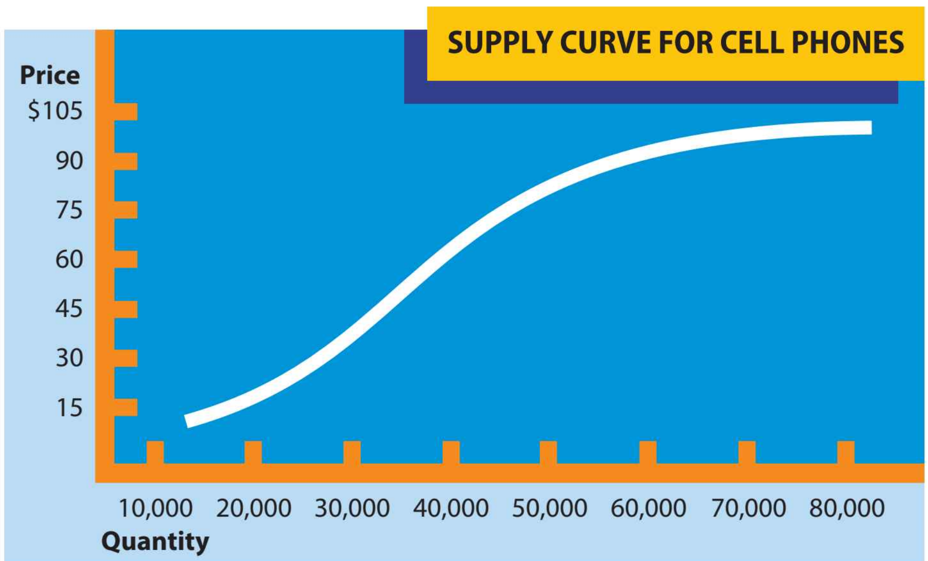

FIGURE 3-2
As the price for cell phones decreases, so does the quantity of phones that manufacturers will be willing to supply.

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is known as the **law of supply**: When the price of a product is increased, more will be produced. When the price is decreased, less will be produced.

Whenever possible, producers use their resources to provide products and services that receive the highest prices. Just as with demand, economists believe that all producers in a market respond in similar ways when determining what to produce. Like consumers, producers see a relationship between products and prices.

Intersecting Supply and Demand

We learned that suppliers and consumers make independent decisions. When the decisions of many consumers of the same product are combined, they form a demand curve illustrating the quantity of a product or service that will be demanded at various prices. And when the decisions of all the suppliers of the same product or service are combined, they form a supply curve. That curve illustrates the quantity of the product that will be supplied at various prices.

Figure 3-3 shows a demand curve and a supply curve for a particular type of notebook computer. The demand curve shows that fewer computers will be purchased as the price increases. As expected, computer manufacturers are willing to supply a larger number of computers if prices are high, fewer if prices are low.

To determine the number of computers that will actually be produced and sold, the two curves must be combined. The combined curves are shown in Figure 3-4 on the next page. Notice that the two lines cross or intersect at a price of $1,300 and a quantity of 450,000 computers. The point where supply and demand for a product are equal is

Fast FACTS

The supply and demand for many consumer products is seasonal. For example, Christmas holiday items don't sell well in April, and bathing suits have a limited sales appeal in January.

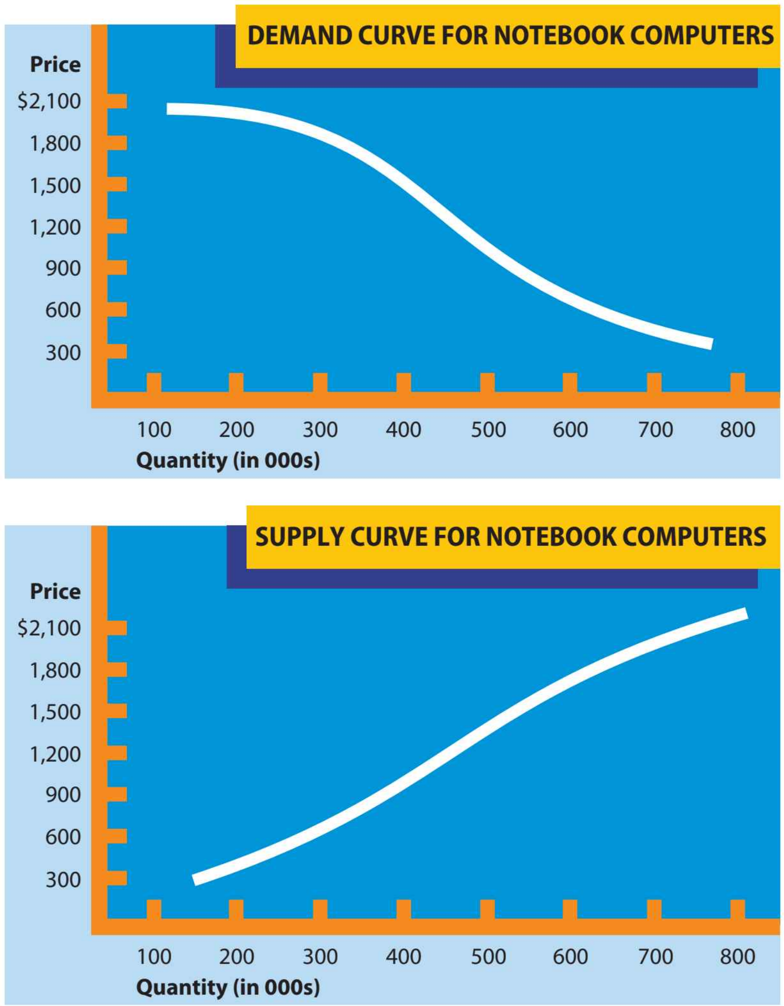

FIGURE 3-3
Consumers and suppliers respond very differently to price changes. The demand curve illustrates consumers' responses, and the supply curve illustrates suppliers' responses.

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known as the **market price**. At that price, 450,000 computers will be manufactured and sold.

Each product in a specific market has its own supply and demand curves. And each market has price and quantity relationships that are unique and result in different curves on the graphs.

Checkpoint

What are the main factors that businesses consider when deciding what and how much to produce?

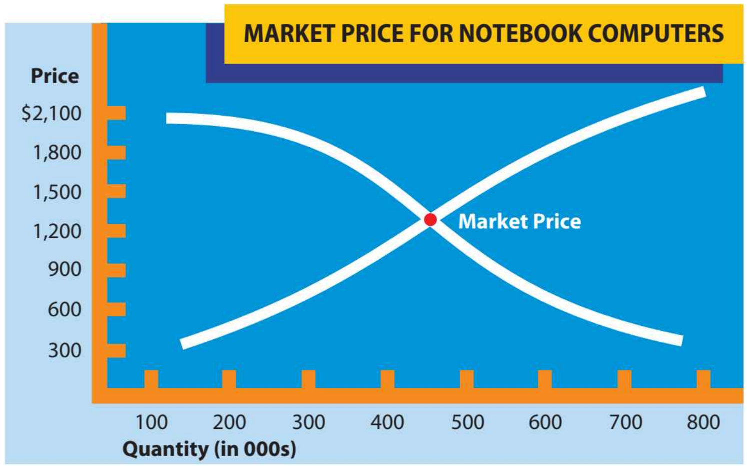

FIGURE 3-4

The point at which the demand curve and the supply curve for notebook computers intersect is the market price.

3-2 Assessment

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Key Concepts

Determine the best answer.

1. What can generally be expected to happen when the price of a product is increased?
   a. demand will increase
   b. demand will decrease
   c. supply will increase
   d. supply will remain constant
2. All of the consumers who will purchase a particular product or service are known as
   a. an economic market
   b. competitors
   c. producers
   d. a demographic
3. The point where supply and demand for a product are equal is known as the
   a. competitive price
   b. discount price
   c. market price
   d. fair value price
4. True or False: Most marketers are primarily concerned about macroeconomics.

Make Academic Connections

5. **Visual Art** Create a picture, poster, or other visual representation of macroeconomics and microeconomics.
6. **Economics** Use the following data to create supply and demand curves for cameras.

Quantity Demanded	Price	Quantity Supplied
100	$70	750
200	60	550
400	50	300
700	40	150

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7. You work for a party planning company that has declining sales and profits. Consider the factors that affect the demand for your services. Based on these factors, develop a plan to improve your business. Write a two-page report for your teacher (judge) describing possible reasons for the decline in business and your recommendations to increase demand for your services.