LESSON 6 – SUPPLY

How Firms Make Production Decisions

Slide 1 – Introduction

Good morning everyone.

In the previous lesson, we focused on demand — how consumers make decisions.

Today, we will shift perspective. We now look at producers, or firms.

We ask:

How do firms decide how much to produce and sell?

This brings us to the concept of supply.

Slide 2 – What is Supply?

Supply is about both willingness and ability. It refers to how much of a good or service firms are willing and able to produce at different prices. Just like demand, supply depends on incentives and constraints. But instead of consumers' maximizing satisfaction, firms are typically trying to maximize profit.

Slide 3 – Why Supply Slopes Upward

The supply curve slopes upward for several key reasons.

1. Profit Incentives

Higher prices increase potential profit.

When firms can sell their goods at higher prices, production becomes more attractive. So they increase output.

2. Opportunity Cost

As firms produce more of a good, they must divert resources from other uses.

This increases opportunity cost. So higher prices are needed to justify producing more.

3. Entry of Firms

Higher prices attract new firms to the market. More firms mean greater total supply.

Together, these factors explain why supply curves slope upward.

Slide 4 – The Law of Supply

This leads us to the law of supply. The law of supply states that: As price increases, quantity supplied increases — all else equal.

This is the opposite relationship to demand. Firms respond positively to price because of profit incentives.

Slide 5 – The Supply Curve

Let's now look at the supply curve. Each point on the curve shows how much firms are willing to supply at a given price.

There are two key features:

- It slopes upward
- It assumes ceteris paribus — all other factors are held constant

This assumption is crucial. Because if other factors change, the curve will shift.

Slide 6 – Movement vs Shift

We must clearly distinguish between:

Movement along the supply curve

This occurs when the price changes. For example, if price increases, firms move up the curve and supply more.

Shift of the supply curve

This occurs when non-price factors change. For example, changes in costs, technology, or regulations.

This distinction is essential for accurate analysis.

Slide 7 – Short Run vs Long Run

Supply behaves differently in the short run and the long run.

In the short run

Capacity is fixed.

Firms cannot easily expand production.

They may be limited by:

- Machinery
- Buildings
- Labour contracts

So the supply is relatively inelastic.

In the long run

Firms can be adjusted fully.

They can:

- Invest in new capital
- Expand production
- Enter or exit markets

So the supply becomes more elastic.

Slide 8 – Application: Private Schools

Let’s apply this to a real-world example — private schools.

Private schools face several constraints:

- High fixed costs
- Limited physical capacity

- Regulation
- Staffing constraints

Because of these factors, supply is relatively inelastic in the short run. If a tax increases costs, schools cannot quickly expand or adjust. They may struggle to absorb the cost. This means price changes may be passed to consumers — for example, higher school fees.

Slide 9 – Why Precision Matters

Understanding supply is not just theoretical. It has real-world implications. It helps us predict:

1. Whether prices rise or fall

If supply is limited, prices are more likely to increase.

2. How firms respond to taxes

Do firms absorb the cost, or pass it on to consumers?

3. Long-term investment decisions

Will firms expand capacity or exit the market?

Supply behavior plays a key role in shaping economic outcomes.

Slide 10 – Summary

Let’s summarize.

Supply shows producer behavior. The law of supply states that price and quantity supplied are positively related. Price changes cause movements along the curve. Non-price factors cause shifts in the curve. And importantly, supply differs between the short run and the long run.

Slide 11 – Conclusion

The key takeaway is this:

Firms respond to incentives.

Higher prices encourage production.
Higher costs discourage it.

Understanding supply allows us to predict how producers react to changes in the market.

In the next lesson, we will combine demand and supply to understand market equilibrium — how prices are actually determined.

Thank you.