

SUPPLY, DEMAND, AND HOLIDAY SHOPPING

Lars Perner, Ph.D.

Assistant Professor of Clinical Marketing

Department of Marketing, Marshall School of Business

University of Southern California

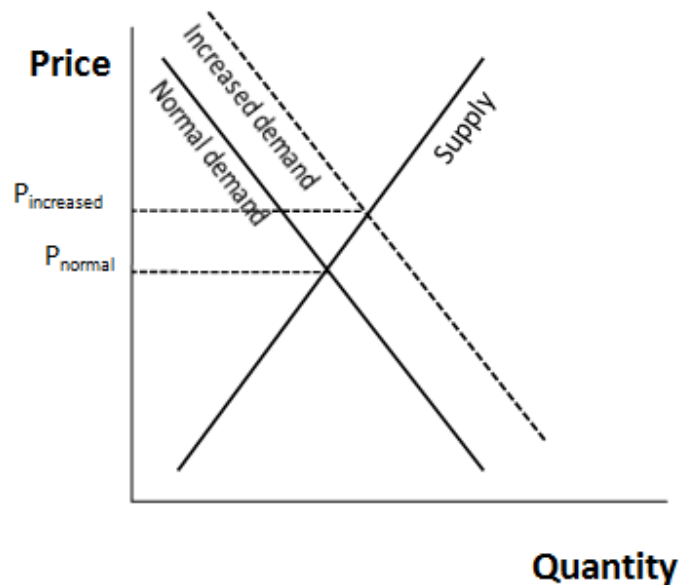
Los Angeles, CA 90089-0443

Phone: (213) 740-7127 Cell: (760) 412-0154

perner@marshall.usc.edu

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Economic theory suggests that as demand increases, sellers will be able to increase prices of scarce products. With an increase in demand, the new demand curve would intersect the supply curve at a higher equilibrium price. Why, then, do we actually see steep price discounts during the holiday shopping season when consumers are seeking to buy a large amount of goods?



There are several reasons:

- **Demand requires a *willingness to pay* in addition to an interest buying in the item.** Therefore, it cannot be definitively concluded that an increase in demand has actually occurred.
- **There is high substitutability among many gift items.** Although some shoppers are intent on buying a specific gift for an individual—such as a particular toy requested by a child—most consumers have considerably more leeway in choosing between numerous suitable gifts for an individual. A book, a DVD, or a T-shirt may all be suitable for an individual. Within each of these categories, there are a lot of choices—both among brands and retailers. The ready availability of substitutes decreases demand, resulting in a lower equilibrium price.
- **Increased elasticity among consumers during the holiday season will encourage retailers to discount.** Retailers which offer low prices are likely to both attract more shoppers and sell more merchandise to each. This is especially the case in densely populated areas where traffic—and finding a parking space at the mall—may be difficult, thus making “one stop” shopping convenient. Consumers may choose to other, higher-margin merchandise while in the store when they come to find the “loss leader” items. For children who may receive multiple gifts, sales may especially encourage greater quantity purchases.
- **Retailers compete intensely among themselves.** Each retailer competes not just with others selling the same brand and category, but with all who offer substitutes. Antitrust laws in the U.S. prevent retailers from getting together to “fix” prices. With the proliferation of discounters, everyone competes against the lowest price. Large discounters such as Wal-Mart and Target have considerable bargaining power due to the volume they purchase, so these can negotiate very low prices and, because of the high price elasticity among consumers, will find it optimal to pass much of the savings on to customers. Over the last two decades, a large number of “category killer” retail chains have emerged. Chains such as Circuit City, Best Buy, Staples, and Office Depot specialize in a limited assortment of goods. Within these categories, the “category killers” move large volumes, resulting in considerable bargaining power. In addition, many of these chains will make very large volume orders on items in targeted categories well in advance in return for exceptionally low prices. All these retailers must in turn compete against warehouse clubs such as Costco and Sam’s Club.
- **Since much of the merchandise ordered for the holiday season will lose considerable value after the holidays, it is important to “move” this merchandise before Christmas.** Extreme examples of this involve ornaments and wrapping paper, but even categories such as jewelry are heavily affected since there will be few major gift occasions during the subsequent months.
- **Because of a tradition of heavy pre-Christmas discounting, retailers must try to “one-up” each other to stay competitive.** Historically, there were few major before-Christmas sales. Back in the days when the retail environment was less competitive, the plan was to discount little before and then hold “after Christmas” sales as needed. However, in years with a sluggish economy, retailers often got nervous over the large amount of inventory remaining and, fearing that they would be

stuck with merchandise, they concluded that sales would be the lesser of two evils. In subsequent years, then, stores had to second guess each other, trying to discount before they did. Gradually, then, these sales became institutionalized, with consumers being reluctant to buy before discounts, spurring on the vicious cycle.

With the current state of the U.S. economy, this year's holiday shoppers are likely to be especially price sensitive. Many will probably shop around more than they would have done in better economic times. There may also be an increased tendency—especially within families—to give “practical” gifts such as everyday clothing rather than going for more “luxurious” and “frivolous” gifts.

On the one hand, retailers this year will have advance notice that consumers are likely to buy this year. This has encouraged retailers to order smaller quantities—and perhaps a smaller assortment of goods. Recent media reports indicate that a large number of factory workers in China losing their jobs due to reduced export expectations. With smaller quantities, there may be less of a need to discount. On the other hand, each retailer will try to optimize its own sales knowing that it has no control over others. Therefore, retailers which do not discount will likely have great difficulty attracting customers. On “Black Friday,” the Friday after Thanksgiving, retailers have to compete heavily to get customers into their doors. Many retailers, on this day when a lot of Christmas shopping is done, will rely heavily on “loss leaders”—products that are priced to get customers in the door. On these items, retailers will often make little or no profit. Instead, they hope that customers will make additional purchases of higher margin items once they are in the store given the difficulty of “hitting” a lot of other stores that day. To be “in the running,” then, many retailers will need to offer—and advertise—a great deal of “loss leaders” to persuade customers to come.

Another factor that may influence holiday prices is the growth of “category killer” chains such as Best Buy, Office Depot, and Staples. These chains often place very large orders far in advance of the holiday season in order to get significant discounts. These stores, then, are committed to taking a great deal of merchandise that must be “moved” at the price necessary to make this happen. Aside from the cost of storage and financing items kept in inventory, electronic products, in particular, are likely to lose value rapidly as new models come along.

Lars Perner is an Assistant Professor of Clinical Marketing at the Marshall School of Business of the University of Southern California. He holds a Ph.D. in marketing from the Marshall School of Business and a B.A. in political science and psychology and an M.B.A. from California Polytechnic State University, San Luis Obispo. His research interests center on consumer behavior, branding, corporate philanthropy, and non-profit marketing.