Calicut University

COURSE
BBA

SEMESTER
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SUBJECT
BUSINESS ECONOMICS

MODULE
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Background to Demand and Supply

7 Demand and the Consumer: Characteristics and Approaches to Analysing Consumer Demand

Demand and the Consumer

Consumer demand refers to the quantity of goods or services a consumer is willing and able to purchase at different prices during a given period.

Demand is influenced not only by price, but also by income, preferences, lifestyle, expectations, and the prices of related goods.

Characteristics of Consumer Demand

Demand is based on willingness as well as purchasing power. A person may want a product, but without the ability to pay, it does not become effective demand.

Demand changes according to market conditions and consumer behavior.

Consumer demand is generally inversely related to price. When price rises, demand usually falls.

Demand also differs from consumer to consumer depending on tastes and income levels.

Approaches to Analysing Consumer Demand

Economists use different approaches to understand how consumers make choices.

Cardinal Utility Approach

This approach assumes that utility, or satisfaction, can be measured numerically.

Consumers are expected to choose goods that provide maximum satisfaction.

The law of diminishing marginal utility is an important part of this approach.

Ordinal Utility Approach

This approach assumes that satisfaction cannot be measured exactly but can be ranked.

Consumers compare combinations of goods and choose the one they prefer most.

This approach forms the basis of indifference curve analysis.

Indifference Curve Analysis

An indifference curve shows combinations of two goods that provide equal satisfaction to a consumer.

Consumers aim to reach the highest possible indifference curve within their budget.

8 Marginal Utility Theory, Demand Under Risk and Uncertainty

Marginal Utility Theory

Marginal utility refers to the additional satisfaction gained from consuming one more unit of a product.

According to the law of diminishing marginal utility, the satisfaction obtained from each additional unit gradually decreases.

Example:

The first glass of water gives high satisfaction, but each additional glass gives less satisfaction than the previous one.

Consumers allocate income in a way that maximizes total satisfaction.

Demand Under Risk and Uncertainty

Consumers and firms often make decisions without complete certainty about future outcomes.

Risk

Risk exists when possible outcomes are known and probabilities can be estimated.

Example:

An insurance company can estimate accident probability using past data.

Uncertainty

Uncertainty exists when future outcomes cannot be predicted accurately.

Example:

Sudden economic crises or unexpected market changes.

Consumer Behavior Under Risk

Consumers generally try to avoid high risk situations.

Many consumers prefer stable and predictable outcomes rather than uncertain gains.

Insurance and savings are common methods used to reduce risk.

9 Demand and the Firm: Estimating Demand Functions, Forecasting Demand

Demand and the Firm

Firms study demand to decide how much to produce, what price to charge, and how to plan future operations.
Accurate demand analysis reduces business risk and improves profitability.
Estimating Demand Functions

A demand function shows the relationship between demand and factors affecting it.
Demand depends on variables such as price, consumer income, population, advertising, and prices of related products.

A simple demand function may be expressed as:
$Qd=f(P,Y,A,Pr)Q_d = f(P, Y, A, P_r)Qd=f(P,Y,A,Pr)$
Where:
Qd represents quantity demanded
P represents price
Y represents income
A represents advertising
Pr represents prices of related goods

Forecasting Demand

Demand forecasting means estimating future demand for a product.
Businesses use forecasting to plan production, inventory, staffing, and investment.

Methods of Demand Forecasting

Survey Method

Consumers are directly asked about future purchasing plans.

Trend Analysis

Past sales data is studied to identify future patterns.

Statistical Methods

Mathematical and statistical tools are used to estimate future demand.

Expert Opinion

Experienced professionals provide predictions about market conditions.

10 Cost and Production: Nature, Meaning and Types of costs

Cost and Production

Production refers to the process of converting inputs into goods and services.

Cost refers to the expenditure incurred in the production process.

Firms aim to produce efficiently while controlling costs.

Nature of Cost

Costs arise because firms use resources such as labor, machinery, land, and raw materials.

Costs are important in pricing, production planning, and profit determination.

Types of Costs

Fixed Cost

Fixed costs do not change with the level of output in the short run.

Examples include rent, salaries, and insurance.

Variable Cost

Variable costs change according to output.

Examples include raw materials and wages linked to production.

Total Cost

Total cost is the sum of fixed cost and variable cost.

TC=FC+VCTC = FC + VCTC=FC+VC

Average Cost

Average cost is the cost per unit of output.

AC=TC/Q

Marginal Cost

Marginal cost is the additional cost of producing one more unit.

MC=ΔTC/ΔQ

11 Production in the Short run and Long run, Cost in the Short run and Long run

Production in the Short run

In the short run, at least one factor of production remains fixed.

Firms can increase output only to a limited extent by changing variable inputs.

Law of Variable Proportions

This law explains how output changes when one input is varied while others remain fixed.

Initially, output increases at an increasing rate.

Later, output increases at a decreasing rate.

Eventually, additional input may reduce total output.

Production in the Long run

In the long run, all factors of production are variable.

Firms can expand capacity, adopt new technology, and change plant size.

Economies of Scale

Large scale production may reduce average cost due to efficiency advantages.

These benefits are called economies of scale.

Diseconomies of Scale

Very large firms may face coordination and management problems that increase cost.

Cost in the Short run

Short run costs include both fixed and variable costs.

Fixed costs continue even if production stops temporarily.

Cost in the Long run

In the long run, all costs become variable because firms can adjust every input.

Long run decisions focus on plant size, expansion, and efficiency.

12 Revenue: Meaning, Nature, Types and its Curves, Calculation of Types of Revenue

Meaning of Revenue

Revenue is the income earned by a firm from selling goods or services.
It is a major factor in determining profit and business performance.

Nature of Revenue

Revenue changes according to sales volume and pricing decisions.
Higher sales usually increase total revenue, but market conditions also influence revenue growth.

Types of Revenue

Total Revenue

Total revenue is the total income earned from sales.

$$TR = P \times Q$$

Average Revenue

Average revenue is revenue earned per unit sold.

$$AR = TR / Q$$

In most cases, average revenue is equal to price.

Marginal Revenue

Marginal revenue is the additional revenue earned by selling one more unit.

$$MR = \Delta TR \Delta Q$$

Revenue Curves

Total Revenue Curve

Shows the relationship between output sold and total revenue.

Average Revenue Curve

Shows revenue earned per unit of output.

Marginal Revenue Curve

Shows the change in revenue from selling additional units.

13 Relationship of Price and Revenue. Profit maximization

Relationship of Price and Revenue

Price directly affects revenue.

When price changes, total revenue may increase or decrease depending on demand conditions.

In competitive markets, firms usually accept the market price.

In imperfect markets, firms may influence price through output decisions.

Profit Maximization

Profit is the difference between total revenue and total cost.

$$Profit = TR - TC$$

A firm aims to maximize profit by choosing the output level where marginal revenue equals marginal cost.

$$MR = MC$$

If marginal revenue is greater than marginal cost, increasing production may increase profit.

If marginal cost becomes greater than marginal revenue, additional production may reduce profit.