A
Presentation
on
UTILITY ANALYSIS

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UTILITY

- **Definition:**

  In objective terms, utility may be defined as the “amount of satisfaction derived from a commodity or service at a particular time”.

Meaning of utility

Utility may not be confused with usefulness as it is purely subjective satisfaction derived from the consumption of a commodity.

Example:

- water has the ability to slake thirst, pen has ability to write.

What is utility ?

- Utility is the want satisfying power of commodity.
- It is a subjective entity and varies from person to person.
- It should be noted that utility is a not the some thing as usefulness.

UTILITY APPROACH

- **Two Types of Approach**
  - **Cardinal Approach**
    - The cardinal utility theory says that utility is **measurable** and by placing a number of alternatives so that the utility can be added.
    - The index used to measure utility is called **utils.**
  - **Ordinal Approach**
    - The ordinal utility theory says that utility is **not measurable** but it can be compared.
    - Ordinal approach uses the **ranking of alternatives** as first, second, third and so on.

Cardinal Utility Analysis and Ordinal Utility Analysis

Utility Analysis

Cardinal Utility analysis

- **Alfred Marshal**
- can be measured
- 'Utils'
- **Law of Diminishing Marginal Utility**
- **Law of Equi-marginal Utility**

Ordinal Utility Analysis

- **J. R. Hicks & R.G.D. Allen**
- Cannot be measured but compared as rank
- **Indifference Curve** analysis

Characteristics of utility

- Dependent upon human wants.
- Immeasurable.
- Utility depend upon use.
- Utility is subjective.
- Utility depends upon shape.
- Utility depends upon on knowledge.
- Utility depends upon ownership.

Concepts of Utility

- **Initial Utility-** Satisfaction Derived from very first unit consumed of any object.

- **Total Utility** – Total Satisfaction derived from the product.

- **Marginal Utility**- The word Marginal means "Border" or "Edge".

  It is the addition made to the total utility by consuming one more unit of a commodity.

Utility is of two types:

- Total Utility
- Marginal Utility

TOTAL UTILITY(TU)

- The sum total of satisfaction which a consumer receives by consuming the various unity of the commodity.

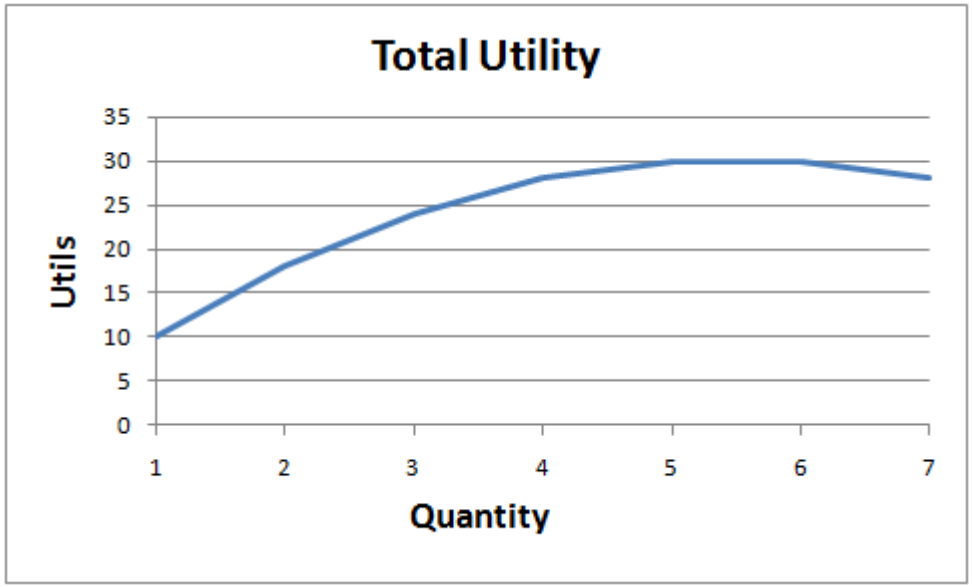
- (The more unit of a commodity he consumes, the greater will be his total utility)

Total Utility

- The total satisfaction of wants & needs obtained from the consumption of goods & services
- Based on the presumption that the amount of utility generated from the consumption of a good can be explicitly measures
- Hypothetical measure is util

Curve of Total Utility

Quantity	Total Utility
1	10
2	18
3	24
4	28
5	30
6	30
7	28



MARGINAL

- **The term marginal refers to the effects of a small change in consumption.**

  'Marginal considerations are considerations which concern a slight increase or reduction of the stock of anything which we possess**.'**

Marginal

- Marginal utility can be defined as a measure of relative satisfaction gained or lost from an increase or decrease in the consumption of that good or service.

Examples:

- A motor vehicle or A haircut

MARGINAL UTILITY (MU)

The additional to total utility as a result of consuming one more units of the same good or services.

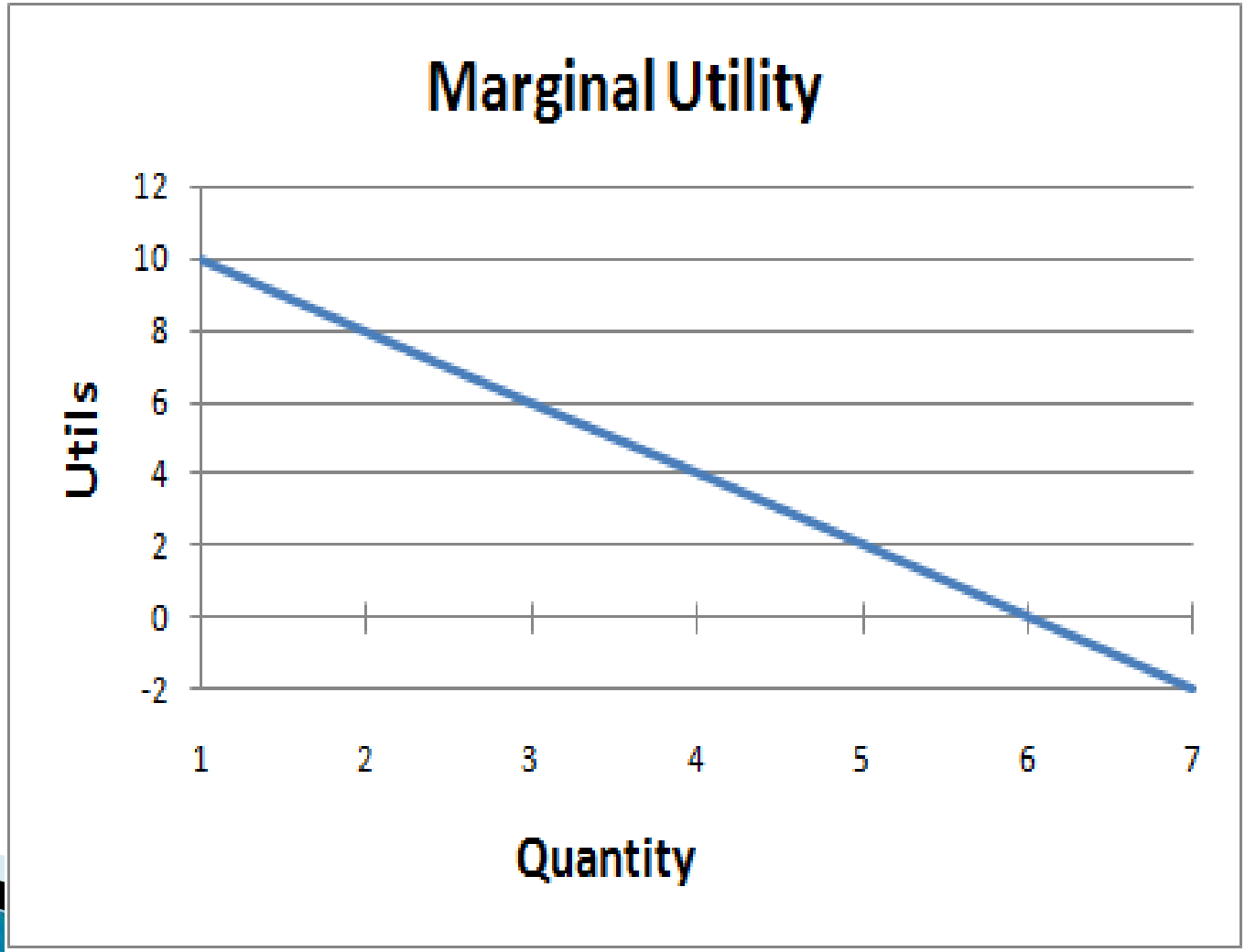
Marginal Utility (MU) = Change in Total Utility

Change in Total Quantity

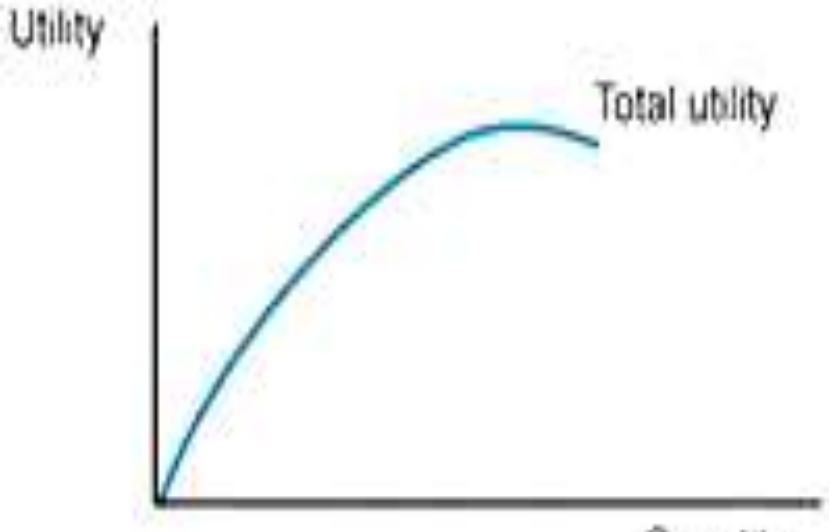
$$MU = \Delta TU / \Delta Q$$

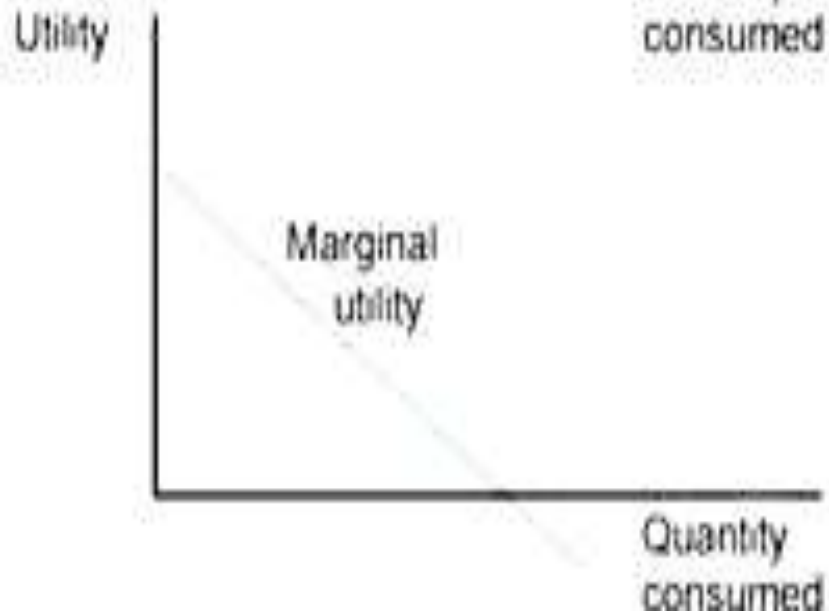
Curve of Marginal Utility

Quantity	Marginal Utility
1	10
2	8
3	6
4	4
5	2
6	0
7	-2



Relation between TU & MU





Quantity	TU	MU	Description
0	0	--	
1	8	8	Initial
2	14	6	
3	18	4	Positive
4	20	2	
5	20	0	Zero
6	18	-2	Negative

Thank you !