

Chapter 2 – Consumer Behavior - I

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Utility

- Utility is defined as the 'Want-satisfying capacity of a product or a service'
- In simpler terms, it can be considered as a satisfaction derived from consuming a product
- Utility is qualitative aspect but the laws of economics assume that the Utility can be quantified

Law of Diminishing Marginal Utility (DMU)

The law of diminishing marginal utility states that **other things remaining same**,

'as consumption increases, the marginal utility derived from each additional unit declines.'

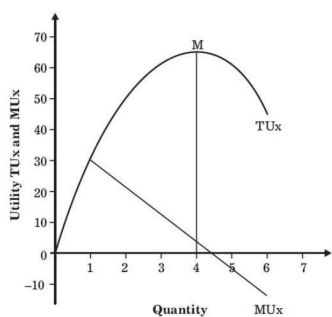
Assumptions to the law of DMU

- Cardinal Measurement
- Continuous Consumption
- No change in Quality/Homogeneous products
- Rational Consumer
- Fixed Price or Income of the consumer

Measures of Utility

- TU = Total Utility
- TU = Total Utility generated by consuming multiple units
- MU = Marginal Utility
- MU = Additional Utility generated from the consumption of additional unit

Law of Diminishing Marginal Utility (DMU)



Exception to the law of DMU

- MU of Money
- Addiction or Hobby

Equi-Marginal Utility

Law of Equi-marginal utility states that:

“Available resources (inputs) should be so allocated between the alternative options, so that the marginal utility from the various alternatives are equalized”

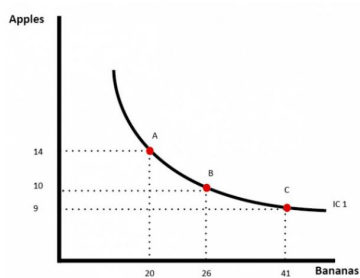
In other words,

“To maximize utility, consumers will allocate their limited incomes among goods and services in such a way that the marginal utilities per dollar (rupee) of expenditure on the last unit of each good purchased will be equal”

Indifference Curve

- An ‘Indifference Curve’ connects points on a graph representing different quantities of two goods, between which a consumer is indifferent.
- One can also refer to each point on the indifference curve as rendering the same level of utility (satisfaction) for the consumer.
- There can be multiple indifference curve possible for a particular individual or a firm

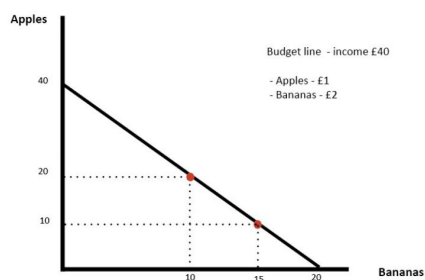
Indifference Curve



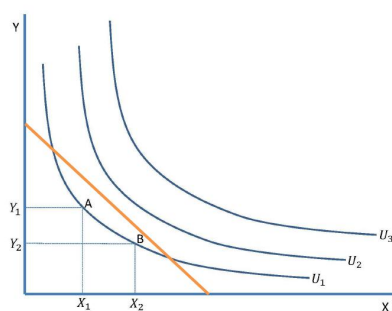
Budget Line

- A budget line shows the combination of goods that can be afforded with your current income.
- It's a graph, typically a straight line which connects the combination of two goods that an individual can afford at a particular level

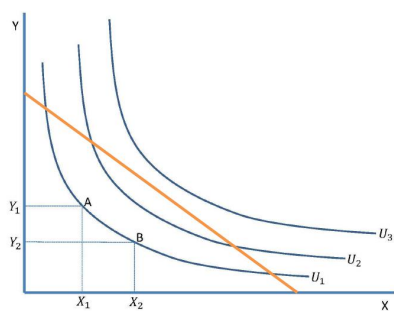
Budget Line



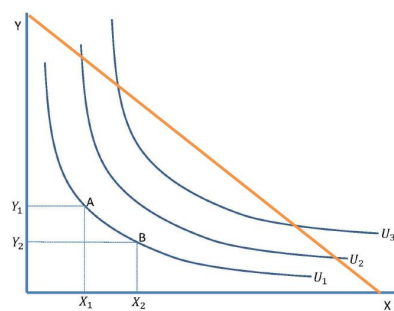
Optimal Solution for a Consumer



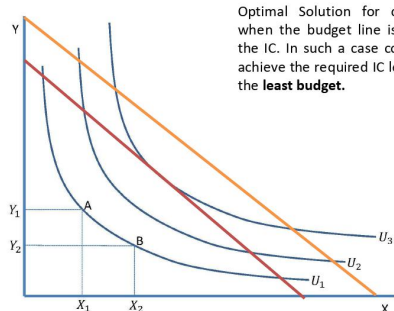
Optimal Solution for a Consumer



Optimal Solution for a Consumer



Optimal Solution for a Consumer



Optimal Solution for consumer is when the budget line is **Tangent** to the IC. In such a case consumer can achieve the required IC level utility at the **least budget**.