Microeconomics/ Business Economics- BBA 1 and BCP 1

Microeconomics is the branch of economics that studies the behaviour of individual economic units such as consumers, firms, and industries. It focuses on resource allocation, price determination, and output decisions under different market conditions.

Importance of Microeconomics:-

Helps firms decide price, output, and profit maximization

Useful in understanding market efficiency

Assists government in policy formulation

Business economics helps in:

-Pricing decisions

-Cost and output decisions

-Profit planning

-Capital budgeting

-Risk and uncertainty management

-Policy formulation and strategy development

Demand Analysis

Meaning of Demand

Demand is the desire backed by willingness and ability to pay for a commodity at a given price and time.

Types of Demand

Individual and Market Demand

Derived Demand (For eg demand for a house gives rise to demand for labours, brick etc)

Joint Demand (for eg. Car and petrol)

Composite Demand (goods that have multiple uses – e.g. steel)

Utility Analysis

Utility refers to the want satisfying power of a commodity . There are two ways to analysis utility :--

1. Cardinal Utility Analysis (Utility can be measured numerically)
2. Ordinal Utility Analysis (Utility cannot be measured but ranked/in order etc)

Cardinal Utility is based on Law of Diminishing Marginal Utility

Assumptions:

Utility is measurable

Rational consumer

Constant marginal utility of money

Ordinal Utility Analysis

Utility is measured in rankings

Uses Indifference Curve Analysis

More realistic than cardinal utility

Elasticity of Demand

Elasticity measures responsiveness of demand to changes in any of its determinants.

1. Price Elasticity of Demand

Measures responsiveness of quantity demanded to price change.

Formula:

Ep = (% change in quantity demanded) / (% change in price)

Types:

Perfectly elastic

Perfectly inelastic

Unit elastic

Relatively elastic

Relatively inelastic

2. Income Elasticity of Demand

Measures responsiveness of demand to income change.

Types:

Positive (Normal goods)

Negative (Inferior goods)

Zero (Inexpensive Necessities)

3. Cross Elasticity of Demand

Measures responsiveness of demand of one good to price change of another.

Positive → Substitute Goods (Eg tea & Coffee)

Negative → Complementary Goods (Eg Car & Petrol)

Zero → Unrelated goods

4. Advertising Elasticity of Demand

Measures responsiveness of demand to advertising expenditure.

Application: Marketing and promotional budgeting.

Demand Forecasting

Demand forecasting means estimating future demand for a product or service.

It helps in :-

Production planning

Inventory control

Pricing policy

Expansion decisions

Financial planning

Techniques of Demand Forecasting

Qualitative Techniques:

Consumer surveys

Expert opinion

Delphi method

Market research

Quantitative Techniques:

Trend projection

Regression analysis

Time series analysis

Econometric models

SUPPLY – Total amount of a commodity that producers are willing and able to offer at a particular price during a particular period of time.

SUPPLY HAS DIRECT RELATIONSHIP WITH PRICE WHEREAS DEMAND HAS INVERSE RELATIONSHIP WITH PRICE.

Indifference Curve Analysis

Indifference Curve (IC)

An indifference curve shows various combinations of two goods that give equal level of satisfaction to the consumer.

Properties of Indifference Curves -

Downward sloping

Convex to the origin

Two Indifference curve never intersect each other

Higher IC represents higher level of satisfaction

Cost Analysis and Profit Analysis

Concept of Cost

Cost is the expenditure incurred in producing a commodity.

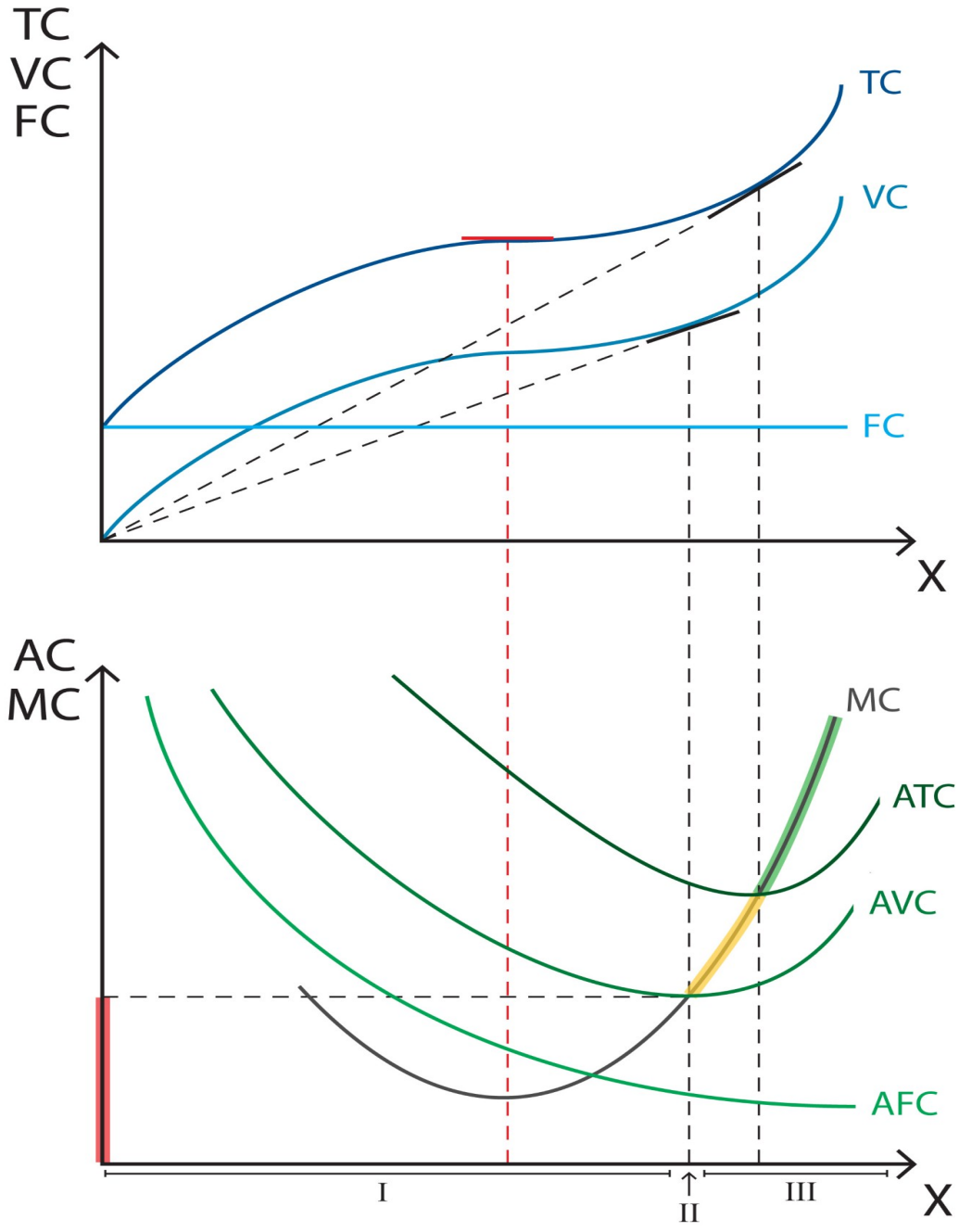
Cost Classification

Fixed and Variable Costs (Money spent on fixed factors and variable factors of production)

Total, Average and Marginal Cost (Short run and Long run costs)

Explicit and Implicit Costs

Sunk and Opportunity Costs



TC = TVC + TFC

MC = TCn – TC n-1

Cost–Output Relationship

Short Run

Fixed and variable costs exist

U-shaped cost curves

Long Run

All costs are variable

LAC curve is envelope of SAC curves

Economies of Scale

Cost advantages due to large-scale production.

Internal Economies:

Technical

Managerial

Financial

Marketing

External Economies:

Industry-based advantages

Law of Variable Proportions

It holds good in short run where one factor varies and others remain constant.

The law states that as we add more and more variable factor to a given quantity of fixed factors, the total product may increase at an increasing rate initially but eventually it will increase at a diminishing rate.

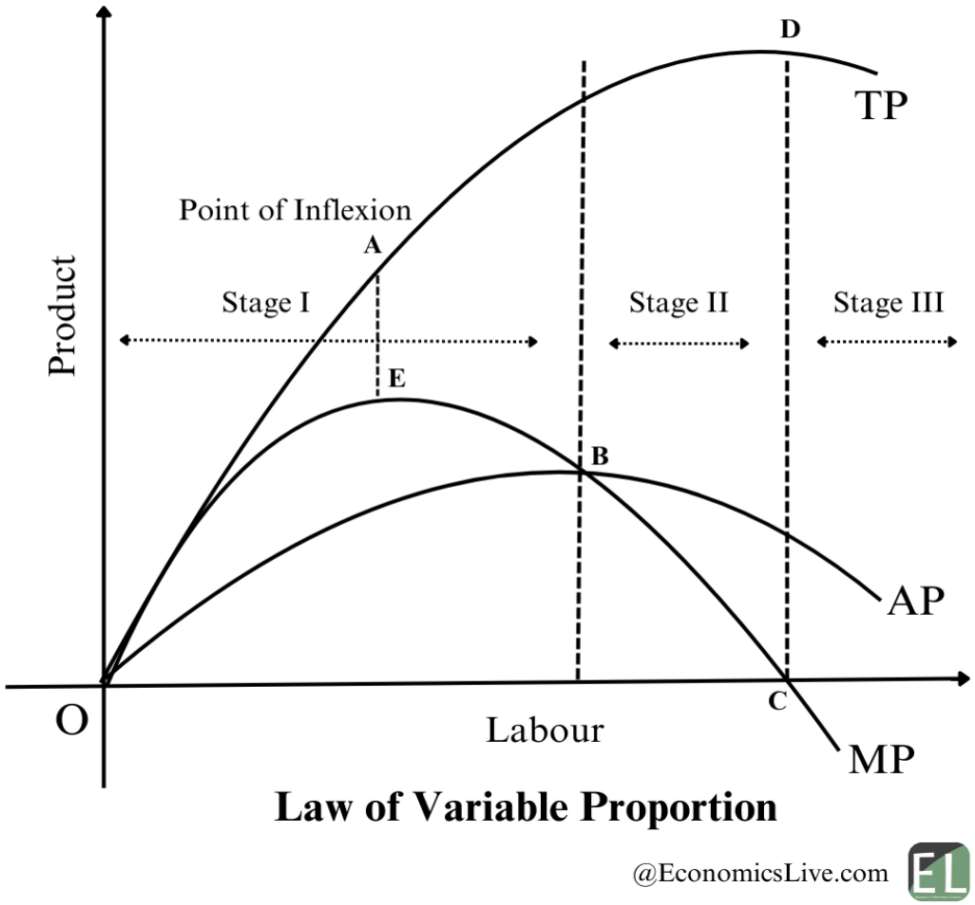
Three stages of production-

Increasing Returns

Diminishing Returns

Negative Returns

Theory of Firm and Market Organization



The theory of the firm explains how firms decide:

What to produce, How much to produce and at what price to sell.

The market organization refers to the structure of the market in which firms operate, affecting pricing and competition.

3. Pricing under Perfect Competition

Meaning

A market structure where:

Large number of buyers and sellers

Homogeneous products

Free entry and exit

Perfect knowledge

Pricing Mechanism

Firms are price takers

Price is determined by industry demand and supply

Firm sells at the market price

Profit Maximization Condition

MR = MC

Average revenue (AR) = Marginal revenue (MR)

In the long run, firms earn normal profits

4. Pricing under Monopoly

Meaning

A monopoly is a market with:

Single seller

No close substitutes

High entry barriers

The monopolist is a price maker.

Pricing Rule

Price is set where MR = MC

Price is determined from the demand curve

Types of Monopoly Pricing

(a) Pure Monopoly Pricing

Single price charged to all consumers

Price > Marginal Cost

Leads to consumer exploitation

(b) Price Discrimination

Charging different prices for the same product to different consumers.

Conditions:

Different elasticities of demand

No resale

Market segmentation

Degrees of Price Discrimination:

First Degree – Maximum price from each consumer

Second Degree – Quantity-based pricing

Third Degree – Different prices in different markets

5. Pricing under Monopolistic Competition

A market structure with:

Many firms

Product differentiation

Free entry and exit

Some control over price

Pricing Behaviour

Firms face downward sloping demand curve

Price is determined where MR = MC

Outcome

Price > MC (some monopoly power)

In the long run, firms earn normal profits

Excess capacity exists

6. Pricing under Oligopoly

Meaning

A market with:

Few large firms

Interdependence among firms

Entry barriers

Examples: Telecom, automobiles, steel industry.

(a) Kinked Demand Curve Theory for oligopoly

Assumptions:

If one firm increases price, rivals do not follow

If one firm decreases price, rivals follow

Features

Demand curve has a kink

Marginal revenue curve is discontinuous

Explains price rigidity

Conclusion

Prices remain stable despite cost changes

(b) Price Leadership

Meaning

One firm (leader) sets the price and others follow.

Types of Price Leadership

-Dominant firm price leadership

-Low-cost firm price leadership

Barometric price leadership

Importance

Reduces price wars

Maintains price stability