UNIT V

- COST and REVENUE – cost concepts – relationship between AC and MC- short run and long run cost curves –revenue concepts- revenue curves under perfect and imperfect competition

Cost Concept:

- **Cost is the total expenditure incurred in producing a commodity**

Cost….

COST CONCEPTS

The cost concepts that are relevant to business operation and decisions can be grouped on the basis of their nature and propose under to overlapping categories:-

1. Cost concept used for accounting propose

2. Analytical cost concepts and used in economic analysis of business activities

Cost concepts…

ACCOUNTING COST CONCEPTS

- Opportunity Cost And Actual Cost
- Business Cost And Full Costs
- Explicit Cost And Implicit Cost
- Out- Of- Pocket And Book Cost

Cost…

ANALYTICAL COST CONCEPTS(Con.)

- Fixed And Variable Cost
- Total, Average And Marginal Costs
- Sort-run And Long-run Cost
- Incremental Costs And Sunk Costs
- Historical And Replacement Cost
- Private And Social Costs

Cost…

Fixed Costs(FC)

Fixed Cost denotes the costs which do not vary with the level of production. FC is independent of output.

Eg: Depreciation, Interest Rate, Rent, Taxes

- **Total fixed cost (TFC):**
  All costs associated with the fixed input.
- **Average fixed cost** per unit of output:
  AFC = TFC /Output

Cost….

Variable Costs(VC)

Variable Costs is the rest of total cost, the part that varies as you produce more or less. It depends on Output.

Eg: Increase of output with labour.

- **Total variable cost (TVC):**
  All costs associated with the variable input.
- **Average variable cost**- cost per unit of output:
  AVC = TVC/ Output

Cost….

Total costs(TC)

The sum of total fixed costs and total variable costs:

$$TC = TFC + TVC$$

Average Total Cost

Average total cost per unit of output:

$$ATC = AFC + AVC$$

$$ATC = TC/\ Output$$

Cost…

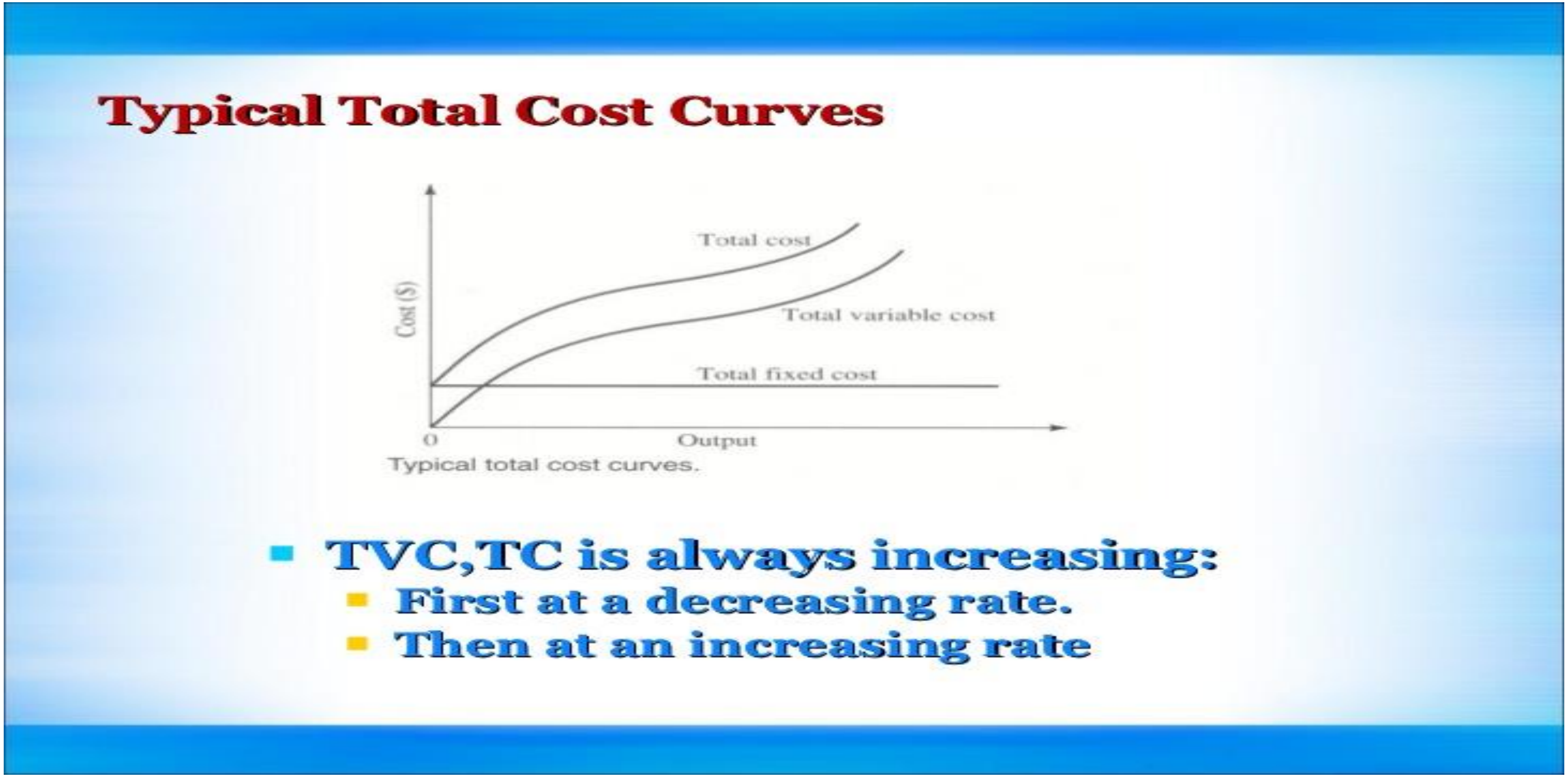
Marginal Costs

- The additional cost incurred from producing an additional unit of output:

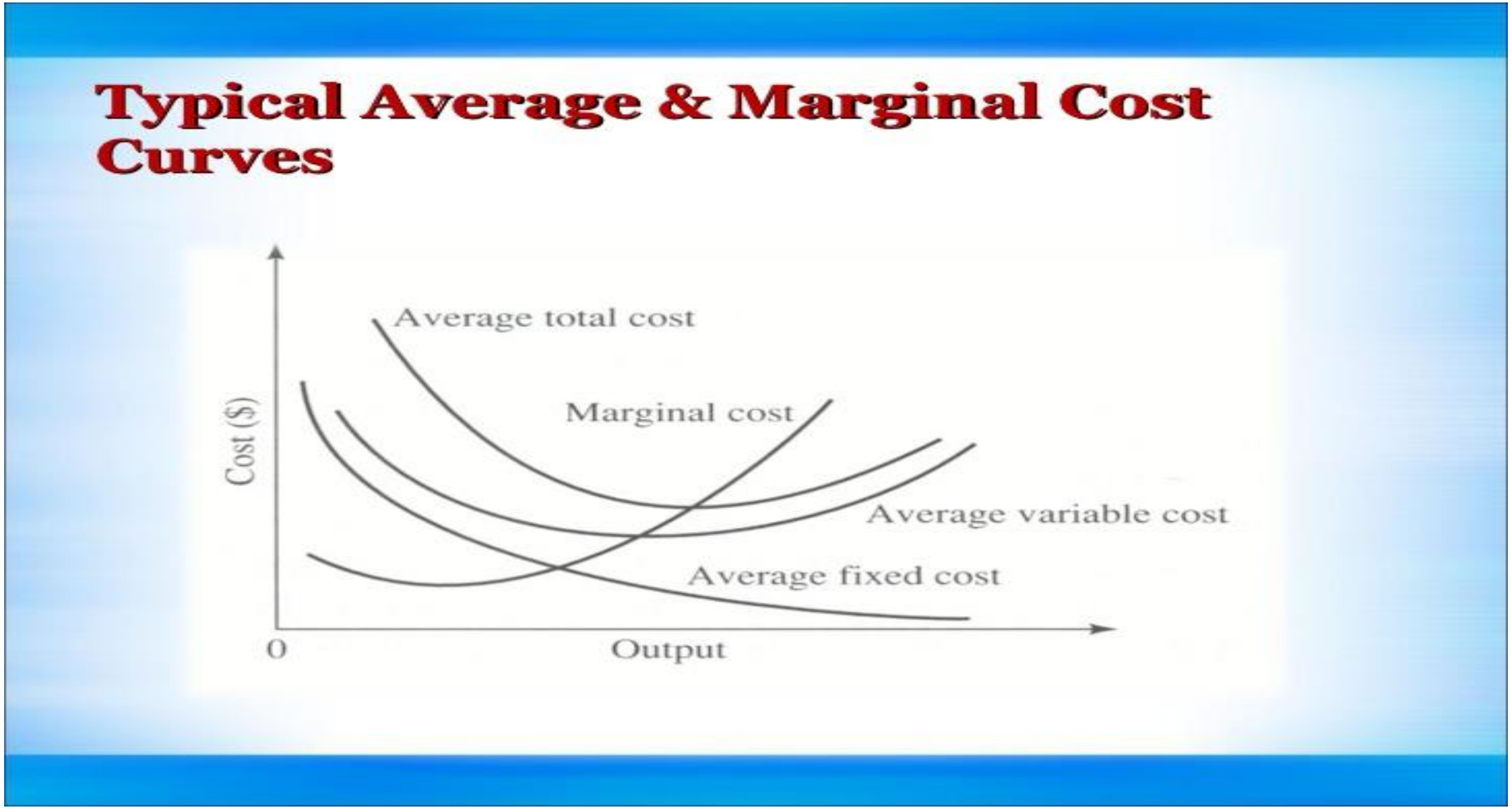
$$MC = \frac{\Delta TC}{\Delta Output}$$

$$MC = \frac{\Delta TVC}{\Delta Output}$$

Cost…

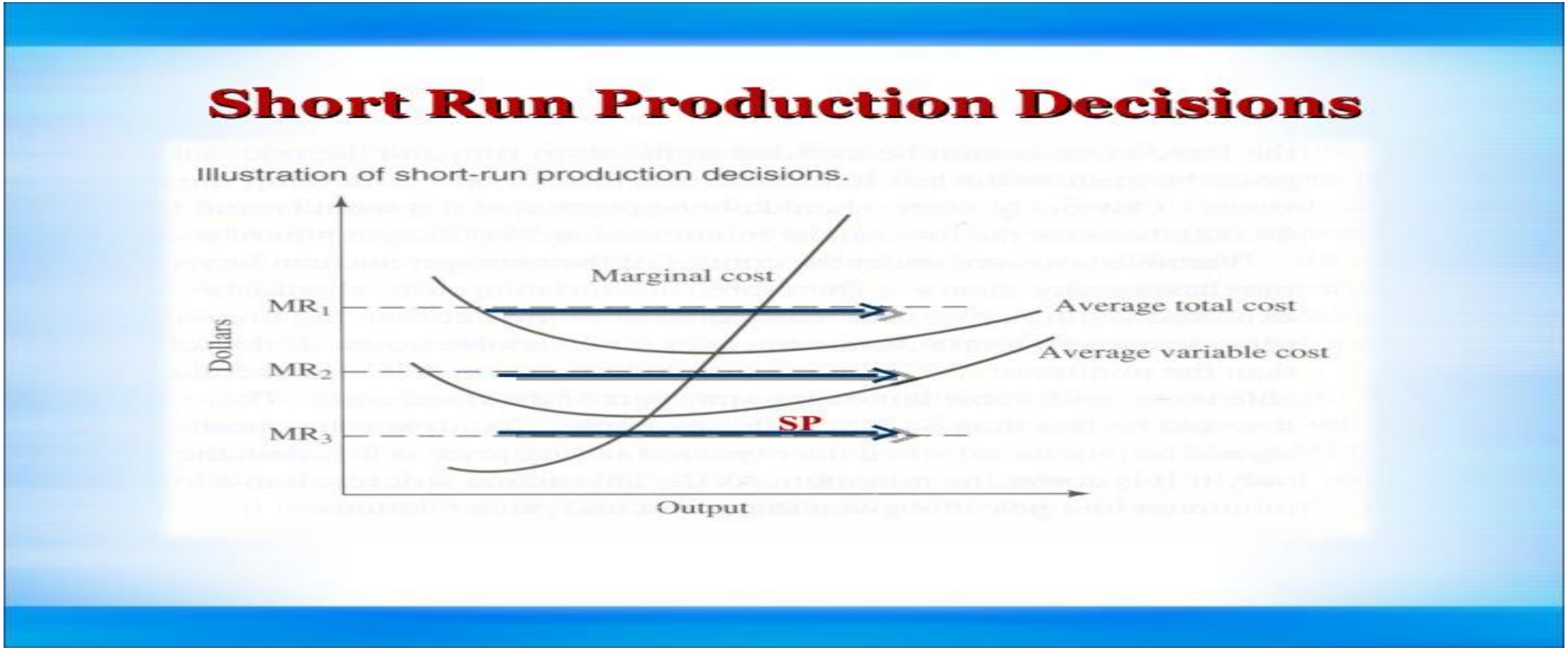

Typical Total Cost Curves
Total cost
Total variable cost
Total fixed cost
Cost ($)
0
Output
Typical total cost curves.
TVC,TC is always increasing:
First at a decreasing rate.
Then at an increasing rate

Cost….

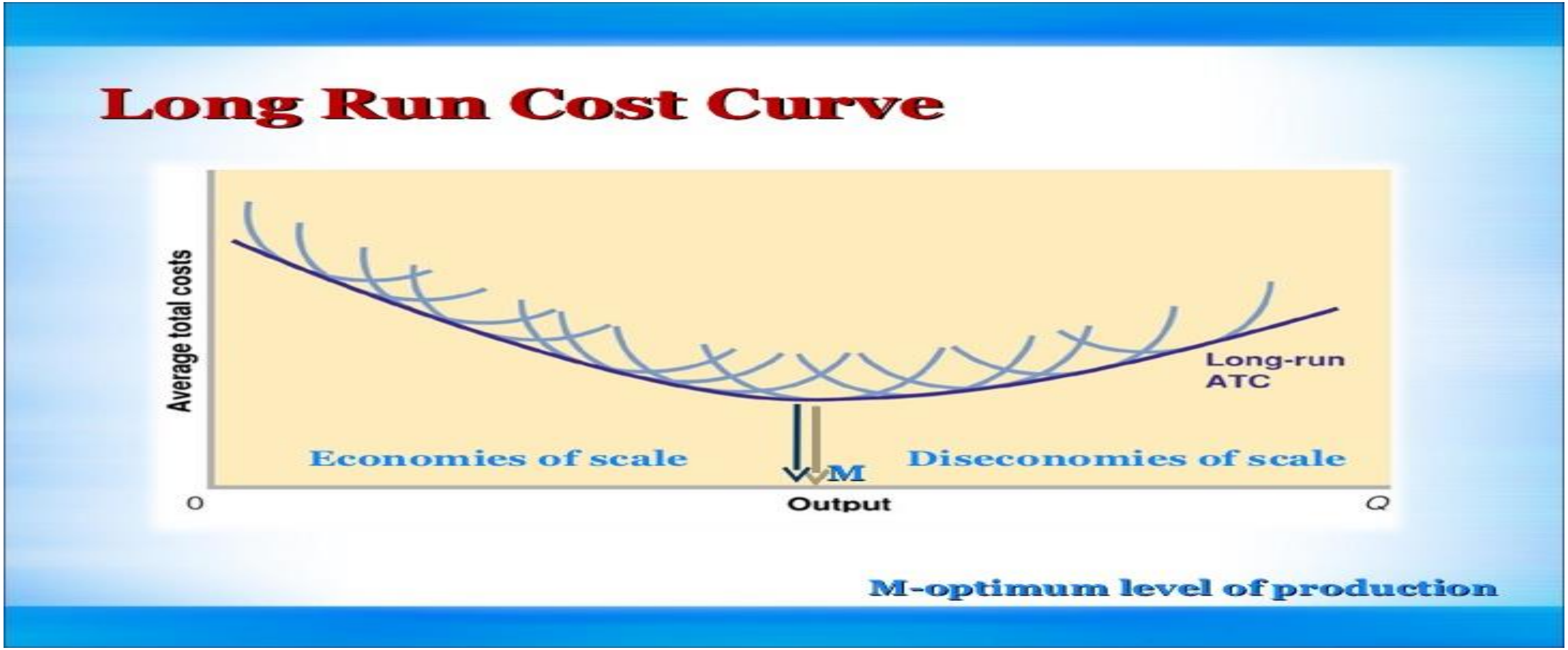


Typical Average & Marginal Cost Curves
Average total cost
Marginal cost
Cost ($)
Average variable cost
Average fixed cost
0
Output

Cost…


Short Run Production Decisions
Illustration of short-run production decisions.
Marginal cost
MR1
MR2
MR3
Average total cost
Average variable cost
SP
Dollars
Output

Cost…


Long Run Cost Curve
Average total costs
Long-run
ATC
Economies of scale
M
Diseconomies of scale
O
Output
Q
M-optimum level of production

Revenue

Revenue

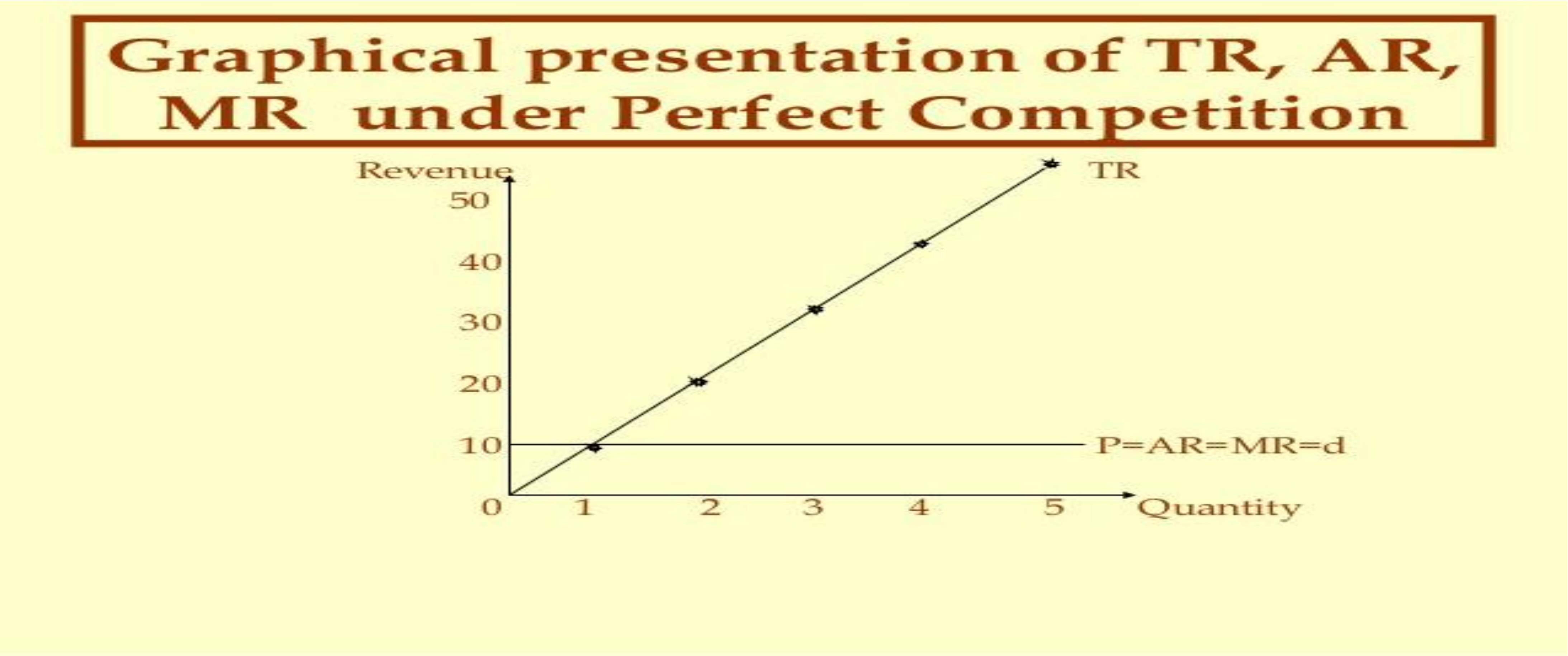
Revenue is the money payment received from the sale of a commodity.

Types…

Types of Revenue

1. Total Revenue
2. Average Revenue
3. Marginal Revenue

TR ,AR & MR


Graphical presentation of TR, AR, MR under Perfect Competition
Revenue
50
40
30
20
10
0
1
2
3
4
5
Quantity
TR
P=AR=MR=d

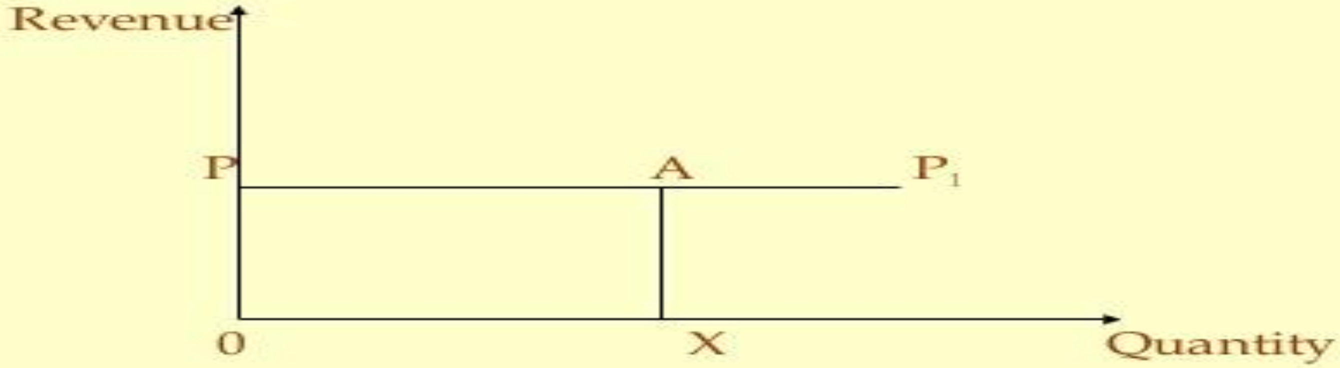
TR,AR…..

Relationship between TR, AR, MR under Perfect Competition

- TR is a straight positively sloping line from the origin.
- TR increases in the same proportion as increase in output sold.
- AR is horizontal line parallel to x-axis. It coincides with the price line or the demand curve i.e. AR = P = d
- MR is also a horizontal line parallel to x-axis. Since AR is constant MR is also constant. MR curve coincides with the AR curve such that P= d = AR = MR

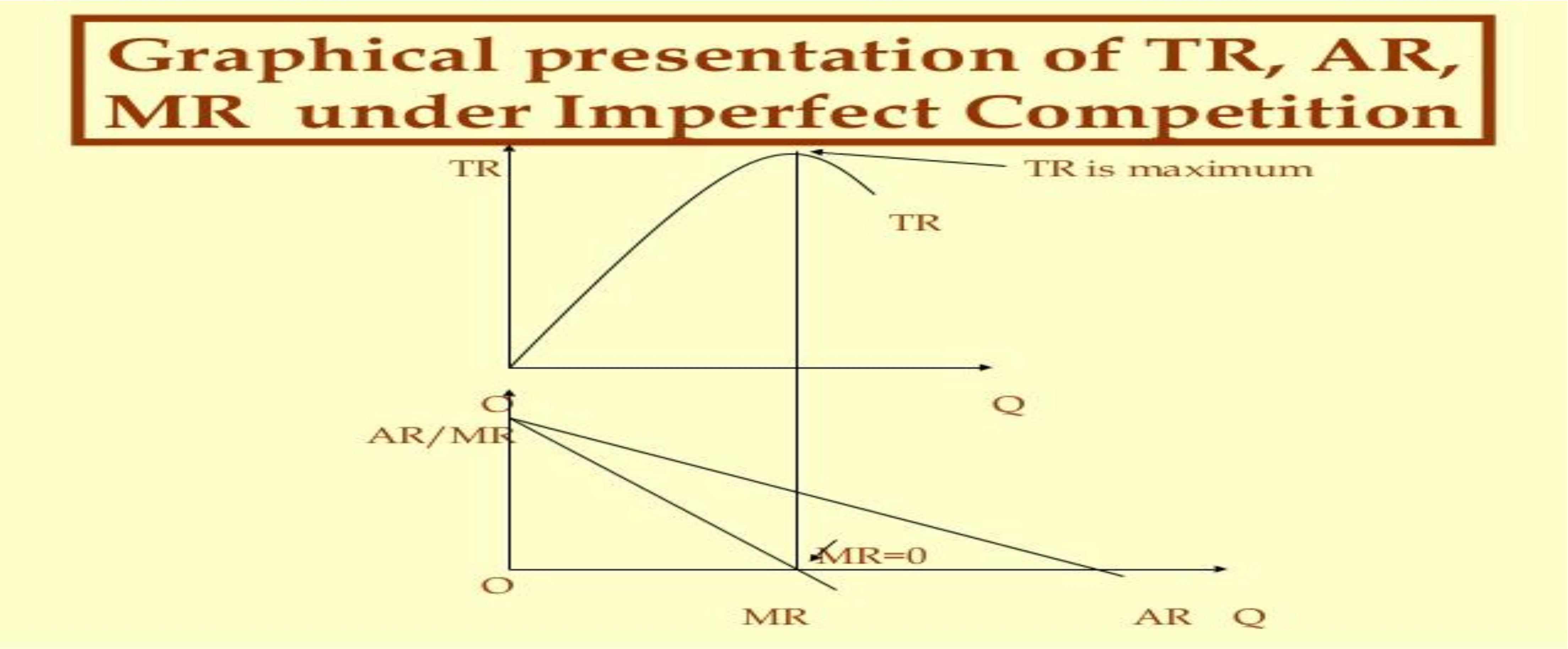
Price line and TR

Price Line and Total Revenue under Perfect Competition



- TR is equal to the area under the price line.
- TR = price x quantity
  = OP x OX
  = OPAX

TR, AR….


Graphical presentation of TR, AR, MR under Imperfect Competition
TR
TR is maximum
TR
O
Q
AR/MR
MR=0
O
MR
AR
Q

Cont..

Relationship between TR, AR, MR under Imperfect Competition

- When TR increases at a decreasing rate, MR is declining but has positive value.
- TR is maximum when MR = 0
- TR starts to decline when MR is negative.
- The rate of fall in MR is twice to that of AR.

Cont..

Profit Maximization for Firms

- A producer is said to be in equilibrium when he produces the level of output at which his profits are maximum.
- It is a situation of profit maximization.

References

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- https://www.slideshare.net/shudola/cost-concept-69542964
- https://www.slideshare.net/mohitsawlani123/revenue-concept
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