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CORE CONCEPT OF

BUSINESS ECONOMICS & ENVIRONMENT

1. What is Concept of utility analysis?
2. Point out the cardinal utility.
3. Briefly explain the Cardinal Vs. Ordinal Utility.
4. Illustrate the Total Utility?
5. What is Ordinal Utility?

What is the difference between Cardinal and Ordinal Utility?

Cardinal and ordinal utility are theories that are used to explain the levels of satisfaction that a consumer derives from the consumption of goods and services. There are a number of differences between the methods in which either measure consumption satisfaction. While cardinal utility is a quantitative measure, ordinal utility is a qualitative measure. Using Cardinal utility a customer can assign a number to a product that when consumed was able to satisfy their needs. Using ordinal utility a customer can rank the products according to the level of satisfaction that was derived. Further to this in cardinal utility it is assumed that consumers derive satisfaction through consumption of one good at a time. However, in ordinal utility it is assumed that a consumer may derive satisfaction from the consumption of a combination of goods and services, which will then be ranked according to preference.

Cardinal vs Ordinal Utility

- Utility refers to the satisfaction that a consumer obtains from the purchase and use of commodities and services. According to economics there are two theories that are able to measure the satisfaction of individuals. These are the cardinal utility theory and the ordinal utility theory.
- Cardinal utility states that the satisfaction that the consumer derives by consuming goods and services can be measured with numbers.



- Ordinal utility states that the satisfaction that the consumer derives from the consumption of goods and services cannot be measured in numbers. Rather, ordinal utility uses a ranking system in which a ranking is provided to the satisfaction that is derived from consumption.
- While cardinal utility is a quantitative measure, ordinal utility is a qualitative measure.
- In cardinal utility, it is assumed that consumers derive satisfaction through consumption of one good at a time. However, in ordinal utility it is assumed that a consumer may derive satisfaction from the consumption of a combination of goods and services, which will then be ranked according to preference.

Utility Analysis:

A subset of consumer demand theory that **analysis** consumer behavior and market demand using total **utility** and marginal **utility**. The key principle of **utility analysis** is the law of diminishing marginal **utility**, which offers an explanation for the law of demand and the negative slope of the demand curve.

Total Utility: Total utility is the aggregate utility that a person derives from consuming a particular product. Total utility is the one which goes on increasing with increase in intake or through more consumption. But does this go on forever? Does the total utility keep on increasing and increasing? The answer is it doesn't. The total utility increases in the beginning but once certain number of units are consumed than the total utility becomes constant and beyond this it starts decreasing. So how do we comprehend this nature of total utility? It means that initially the consumer gets more and more satisfaction from consumption of a particular product but beyond a certain level this satisfaction reaches at the point where it does not rise but remains constant and thereafter starts falling. To put in other words that total utility that a consumer derives from consumption of a particular product increases with a diminishing rate.

For instance say you are very hungry. You eat one sandwich. You feel better. You eat another one. You feel satisfied. Now you have a third one. Your stomach is already full. The further intake of additional sandwiches will make you bored of eating sandwiches. This behaviour simply shows that how initially the satisfaction increases and the consumer tries to derive maximum satisfaction through consumption of the particular product but beyond this level the utility becomes constant after a particular point it starts diminishing.