





AQA Economics A-level **Microeconomics**

Topic 2: Individual Economic Decision Making




2.1 Consumer behaviour

Notes







Utility theory: total and marginal utility, diminishing marginal utility

-  When making economic decisions, consumers aim to maximise their utility and firms aim to maximise profits.
-  A consumer's utility is the total satisfaction received from consuming a good or service.
-  Marginal utility is the extra satisfaction derived from consuming one extra unit of the good.
-  The demand curve is downward sloping because of **diminishing marginal utility**. The law of diminishing marginal utility suggests that consumer surplus generally declines with extra units consumed. This is because the extra unit generates less utility than the one already consumed. Therefore, consumers are willing to pay less for extra units.

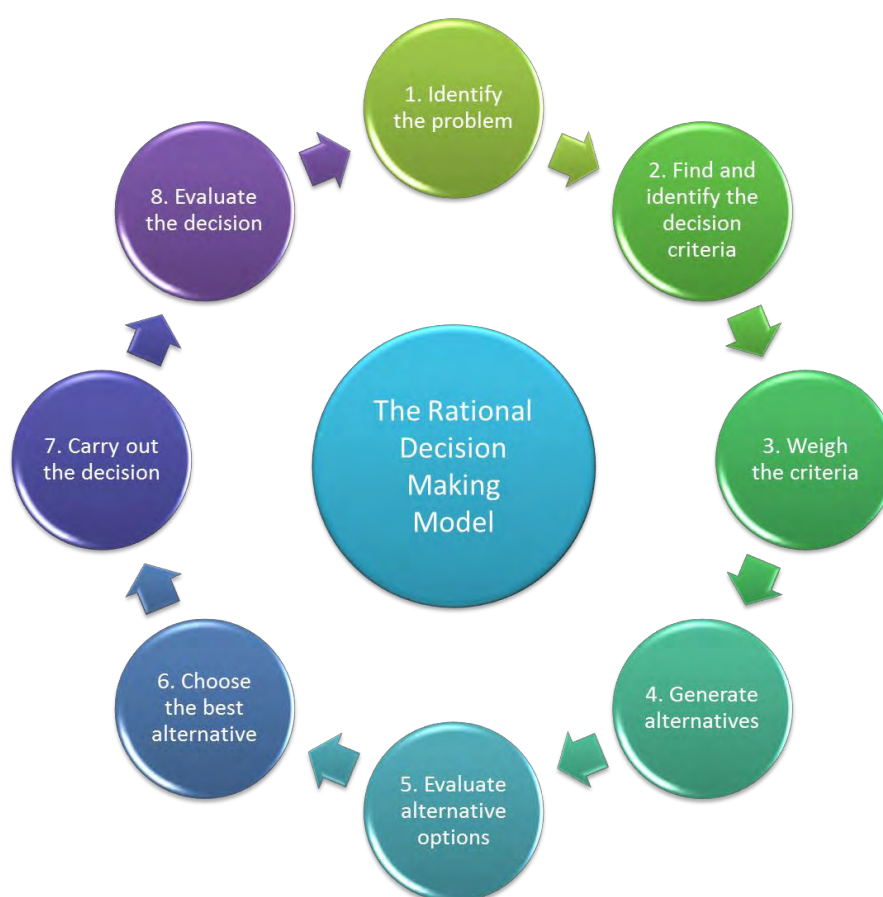
Utility maximisation

-  **Maximisation** for consumers is when consumers aim to generate the greatest utility possible from an economic decision. Firms aim to generate the highest profits possible.
-  It is assumed that economic agents only act in their own interests.
-  Some firms might have philanthropic owners who seek to maximise the utility of others.

Rational economic decision making and economic incentives

-  Economic agents respond to incentives, which can allocate scarce resources to provide the highest utility to each agent.
-  For the entrepreneur in a firm, the incentive for taking risks is profit.
-  Rewards are positive incentives which will make consumers better off, whilst penalties make them worse off.
-  Where incentives are not given properly, resources will be misallocated.
-  Prices in market economies provide signals to buyers and sellers, which is an incentive to purchase or sell the good. This changes their behaviour.
-  For example, a high demand and high price for a good will give an incentive to firms to allocate more resources to producing that good.


- 📄 An entrepreneur wants to avoid loss and gain profit, which makes them want to innovate, so they can reduce their production costs, and improve the quality of their products.
- 📄 Firms need an incentive to engage in risk taking, so they innovate. Without innovation, production will cost more and there will be a misallocation of resources.
- 📄 A firm or an individual can make decisions using intuition or rationally. Intuition uses the feelings or instincts of the consumer and does not use facts. Businesses use this when they do not have access to facts or when making the decision is difficult. A rational decision is made using several steps, and it involves analysis and facts.







- 1) **Identify the problem:** For a firm, this might be falling profits.
- 2) **Find and identify the decision criteria:** The firm might have to find information or criteria that will increase their profits. The firm’s criteria might include, for example, keep a certain number of employees or to not change the price of their goods. The criteria might include how the decision will affect stakeholders (the customer and the staff, for instance), and how the quality might be affected.
- 3) **Weigh the criteria:** The firm will have to rank the criteria based on their relative importance. They might think keeping all of their employees is the most important, for example.

- 4) **Generate alternatives:** The firm might consider some alternative options. For instance, they might think that moving their premises somewhere else will reduce costs and hence increase profits. Perhaps they will consider a loyalty scheme or a promotion for the consumer. Alternatively, they might decide to reduce the size of their workforce.
- 5) **Evaluate alternative options:** The firm might now consider which of the alternatives meet their criteria the best, and help them increase their profits the most.
- 6) **Choose the best alternative:** Now the firm will choose the alternative they think meets their criteria.
- 7) **Carry out the decision:** The firm can now see what the consequences of the decision are.
- 8) **Evaluate the decision:** After seeing what effect the decision has on the firm, they can consider whether this was the best option or not.

Limitations:

-  This is not always the best or most realistic way for firms to make decisions. Although it might be fairer than making an intuitive decision, it takes significantly longer to decide, which is not practical in a firm with strict time constraints.

The importance of the margin when making choices

-  Thinking at the margin means thinking about the effect of an additional action.
-  An action could involve a marginal increase in product or a marginal cost. For example, working for one extra hour could produce 6 more units of output. However, each extra unit of output costs 10 minutes.
-  Thinking at the margin is important, because it allows consumers to keep thinking ahead. It prevents consumers thinking about things they have already done, and allows them to consider how to maximise their utility now or in the future.
-  When making choices, margins can also increase productivity, since the most important tasks which maximise utility the most, are the ones which are prioritised.