

**Dr.SNS RAJALAKSHMI COLLEGE OF ARTS AND SCIENCE
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University) Coimbatore- 49



**DEPARTMENT OF COMMERCE WITH
INFORMATION TECHNOLOGY**

**MANAGERIAL ECONOMICS
Cost Concept**

**Dr. R.Arthi, M.Com (IB).,M.Phil., MBA.,M.Com.,Ph.D.,
Assistant Professor,
Department of Commerce with Information Technology**

Cost Concept

The concept of cost is a key concept in Economics. It refers to the amount of payment made to acquire any goods and services. In a simpler way, the concept of cost is a financial valuation of resources, materials, risks, time and utilities consumed to purchase goods and services. From an economist's point of view, the cost of manufacturing any goods and services is often said to be the concept of opportunity cost.

Explicit vs. Implicit Costs

Explicit Costs (Accounting): Direct, out-of-pocket payments. Examples include rent, wages, and raw materials. These are the "visible" costs above the water.

Implicit Costs (Economic): The value of foregone opportunities. Examples include the owner's time or the potential interest on invested capital. These are the "hidden" costs below the surface.

Profit Distinction: Economic profit is always lower than accounting profit because it subtracts both explicit and implicit costs.

Opportunity Cost

The Road Not Taken

Opportunity cost is the value of the **next best alternative** that is foregone when a decision is made.

It applies to all resources: time, money, and land.

Example: If a company invests \$1M in new equipment, the opportunity cost is the interest they could have earned by keeping that money in the bank, or the value of R&D they didn't fund.



Fixed Costs

The Unavoidable Expenses

Fixed costs do not change with the level of output.

They are incurred even if production is zero.

Examples: Factory rent, insurance premiums, salaries of top management, and depreciation on machinery.

In the short run, these costs are "sunk" and cannot be altered. They provide the infrastructure capacity for production.



Variable Costs



Raw Materials

The most direct variable cost. As you produce more units, you consume more wood, steel, or plastic.



Direct Labor

Wages paid to hourly workers directly involved in manufacturing. More production requires more hours.



Distribution

Shipping and packaging costs. These are incurred only when a product is sold and shipped to a customer.

Total Cost

Total cost: Total cost is the total expenditure incurred by the producer to produce his goods. Total cost is also the summation of total fixed costs and total variable costs. Total cost is evaluated as follows:- 1. Total Cost = Cost per unit x Quantity Produced 2. Total Cost = Total Fixed Cost (TFC) + Total Variable Cost (TVC) Total cost is defined as follows: “Total cost is the cost which is incurred by the producer to produce a particular quantity of the commodity.”

Average Cost

Average cost (AC) is the cost per unit of output. It is obtained by dividing the total cost by the total quantity produced. According to Dooley, “The average cost of production is the total cost per unit of output”.

$$AC = \frac{TC}{Q}$$

Average total cost or average cost is the sum of average fixed cost, and the average variable costs. The per unit fixed costs are known as the average fixed cost.

$$AFC = \frac{TFC}{Q}$$

Average variable cost refers to the variable cost per unit of output.

$$AVC = \frac{TVC}{Q}$$

Sunk Costs

The Sunk Cost Fallacy

A sunk cost is a cost that has already been incurred and cannot be recovered.

Example: R&D for a product that failed safety tests. That money is gone; the decision to proceed should only weigh future costs vs. future benefits.

