

FYBCOM HOLIDAYS – 1

BUSINESS ECONOMICS

UNIT – 4: COST AND REVENUE ANALYSIS

COST ANALYSIS – Cost analysis

Introduction (Introduction)

Cost analysis (Cost Analysis) It is the cost incurred by a firm to produce goods or provide services. **Systematic testing and evaluation.** It identifies different types of expenses., Classification, Measurements and analysis are performed., Such as **Fixed costs, Variable costs, Direct costs, Indirect costs, Marginal cost and opportunity cost.**

Cost analysis A An important tool of managerial economics There is, Because it is management. **Cost, Product, Understanding the relationship between price and profit** Helps and assists in making better business decisions.

Importance of cost analysis

(Importance of Cost Analysis)

1. Helps in cost control

(Helps in Cost Control)

Cost analysis firm Identify unnecessary and excessive expenses Helps. By comparing actual costs with standard or expected costs, management can take appropriate corrective actions to reduce waste and control costs.

2. Helps determine the selling price

(Helps in Fixing the Selling Price)

Of any product **Cost is an important basis for determining the selling price.** Cost analysis helps the firm to estimate the total cost per unit and accordingly, a suitable price can be determined that covers the costs and also gives a reasonable profit.

3. Helps in profit planning

(Helps in Profit Planning)

Profit **Relationship between income and expenditure** By analyzing the costs incurred at different levels of production, management can estimate expected profits and carry out effective profit planning.

4. Helps in product decisions

(Helps in Production Decisions)

Cost analysis management **How much to produce?** It helps to determine the average cost., By studying marginal cost and total cost, a firm can determine the maximum cost of production. **Economic level** Can decide.

5. Helps in making or buying decisions

(Helps in Make-or-Buy Decisions)

A firm often has to decide whether to use a component **Make it yourself or buy it from an outside supplier.** Cost analysis provides the relevant cost information needed for such a decision.

6. Helps prepare budgets

(Helps in Budget Preparation)

Cost related information **Product, Sale, Purchasing and operating budgets** It is an important basis for preparation. Proper cost analysis contributes to effective financial planning.

7. Helps in allocating resources

(Helps in Resource Allocation)

Labor, Capital, Raw materials and machinery Resources such as are limited. Cost analysis helps management to allocate these resources to their **Among the most productive and profitable uses** Helps in allocating.

8. Helps identify spending behavior

(Helps in Identifying Cost Behaviour)

Cost analysis helps to classify costs based on their behavior., Such as:

- **Fixed costs (Fixed Cost)**
- **Variable costs (Variable Cost)**
- **Semi-variable costs (Semi-Variable Cost)**

Understanding cost behavior helps management avoid production fluctuations. **How much will the total cost change?** It helps to estimate it.

9. Helps in break-point analysis

(Helps in Break-Even Analysis)

Cost analysis provides necessary information about fixed costs and variable costs., Which **Dotted line (Break-Even Point)** It is necessary to decide.

It helps management to know the level of production where:

Total income = Total expenditure

At this point the firm **There is no profit or loss..**

10. Helps in decision making.

(Helps in Decision-Making)

Management often has to make various types of decisions., Such as:

- Product expansion
- Product selection
- Pricing
- Outsourcing
- Decision to discontinue production
- Whether to accept special orders or not
- Use of resources

Cost analysis provides the information needed for such decisions and **Helps in rational decision making.**

11. Helps measure efficiency

(Helps in Measuring Efficiency)

Various departments, Products, Management by comparing costs across periods or production methods **Can identify areas of efficiency and inefficiency.**

This way the firm can improve inefficient operations and make better use of resources.

12. Helps in product selection

(Helps in Product Selection)

When a firm produces more than one product, cost analysis determines which products **More economical and profitable** It can be determined.

Hence management focuses on more profitable products. **More focused** Can.

13. Helps in quantity management

(Helps in Inventory Management)

Through cost analysis **Raw materials, Goods in process (Work-in-Progress) and finished goods** Helps determine the price of.

It helps in effective quantity control and quantity related **Reduces unnecessary expenses.**

14. Helps in long-term planning

(Helps in Long-Term Planning)

Cost Analysis Production Capacity, Technology, Provides information on the costs of production equipment and the potential impacts of changes in production volume.

So that generation **Effective long-term planning** Helps to do.

15. Helps maximize profits

(Helps in Maximising Profit)

General purpose of the business **To make a decent profit** Cost analysis to reduce unnecessary costs, To improve efficiency, Helps determine the right price and select profitable options.

Cost analysis in this way **Makes an important contribution to profit maximization.**

Conclusion

(Conclusion)

Cost Analysis of Modern Business Management **Essential tool** It is. It is expensive. **Form, Behavior and level** Provides systematic information about and helps management control costs, To determine the price, To plan production, To prepare a budget, Helps to allocate resources and increase profits.

So, Effective cost analysis firm **Efficiency, Makes a significant contribution to increasing competitiveness and profitability.**

Cost concepts (COST CONCEPTS) – Full note

Introduction

Cost (Cost) It means the economic sacrifice made by a firm in the production of goods and services or the use of resources. **Managerial Economics (Managerial Economics)** Decisions about production in, Pricing, Various concepts of cost are used to analyze

profitability and efficient allocation of resources. Cost is understood from different perspectives., Such as **Past or present, Actual cost or opportunity foregone and direct or indirect relationship to a specific product.**

The following important concepts of cost are discussed here:

1. Historical costs (Historical Cost)
 2. Restoration costs (Replacement Cost)
 3. Accounting expenses (Accounting Cost)
 4. Economic costs (Economic Cost)
 5. Direct costs (Direct Cost)
 6. Indirect costs (Indirect Cost)
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1. Historical costs (HISTORICAL COST)

Meaning

Historical costs That is, no means in the past by generation, Property, The amount actually paid to purchase raw materials or resources. **Original amount.**

In simple words:

Historical cost = original purchase price

It represents the price paid when the property or equipment was purchased.

Example

Suppose a company has a year 2020 A machine in ₹5,00,000 Bought in.

So:

Historical cost = ₹5,00,000

If the price of the same machine today ₹7,00,000 Have, Even so, its historical cost ₹5,00,000 Will remain the same., Because at the time of purchase the company ₹5,00,000 Paid.

Another example

A textile company produced cotton last year. ₹200 Per kg Bought at a price of.

Historical cost = ₹200 Per kg

Cotton price today ₹260 Historical cost even if it is per kg ₹200 It will remain the same.

Importance

- It is based on actual transactions.
- It is easy to verify.
- It is recorded in the accounting records.
- Useful in analyzing past expenses.
- Provides an objective basis for measuring costs.

Limit

The historical cost of an asset when there has been a significant change in price **The present economic value or the current cost of replacing it** Does not show.

2. Restoration costs (REPLACEMENT COST)

Meaning

Restoration costs That is, the current property, New property equivalent to equipment or raw materials, The firm must replace the equipment or raw materials **Amount currently due.**

In simple words:

Replacement cost = current cost to replace existing property

Example

A company has a year 2020 A machine in ₹5,00,000 Bought in.

The same type of machine today ₹7,50,000 Found in.

So:

- Historical cost = ₹5,00,000
- Restoration cost = ₹7,50,000

The replacement cost shows that if the company **Today, the same type of machine has to be replaced.**, So how much will he have to spend?

Another example

A firm purchased raw materials last year. **₹200 Per kg** Bought at a price of.

Current price = **₹260 Per kg**

So:

- Historical cost = ₹200
- Restoration cost = ₹260

Importance

Restoration costs are useful in the following tasks:

- In the analysis of current costs
 - In pricing decisions
 - In production decisions
 - In property change decisions
 - Understanding the current economic situation
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Difference between historical cost and restoration cost

Support	Historical costs	Restoration costs
Meaning	Original price paid in the past	Current replacement cost
Time	Past	Current
Price basis	Original purchase price	Current market price
Example	Machine ₹5 Lakhs Bought for The same machine today ₹7.5 Lakhs It is worth lakhs.	
Main purpose	Measurement of past costs	Current cost analysis

Remember easily

Historical costs→How much did you pay then??

Restoration costs→How much would it cost to replace it today??

3. Accounting expenses (ACCOUNTING COST)

Meaning

Accounting expenses It means the expenditure made by a firm to produce goods and services. **Actual financial costs**, Which is recorded in the accounting books of the firm.

In simple words:

Accounting cost = Actual financial cost

Accounting expenses **Direct financial costs (Explicit Cost)** It is also said, Because real money is paid in it.

Examples

- Wages paid to workers
- Rent paid

- Raw material cost
- Electricity cost
- Transportation costs
- Insurance cost
- Advertising costs

Example

Suppose a firm incurs the following expenses:

Cost	Amount
Raw materials	₹2,00,000
Salary	₹1,20,000
Rent	₹50,000
Electricity	₹30,000
Transportation	₹20,000
Accounting expenses	₹4,20,000

So:

Accounting cost = ₹4,20,000

Accounting profit

Accounting profit = Total revenue – Accounting expenses

Suppose the total income ₹6,00,000 is:

Accounting profit = ₹6,00,000 – ₹4,20,000

Accounting profit = ₹1,80,000

Symptoms

1. It involves real money payments.
2. It is recorded in the accounting books.

3. It mainly includes direct financial costs.
 4. Its measurement is usually easy.
 5. It is used to calculate accounting profit.
-

4. Economic costs (ECONOMIC COST)

Meaning

Economic costs That is, the use of resources **Total cost**, In addition to the actual financial costs, there is also the cost of using the firm's own resources. **Opportunity cost (Opportunity Cost)** Also included.

In simple words:

Economic cost = Accounting cost + Opportunity cost

Therefore, Economic costs incurred for production **Total financial sacrifice** Measures.

Components of economic costs

There are two main components of economic costs:

A. Accounting / Direct Financial Cost

This is the actual financial payment made by the firm.

Examples:

- Salary
- Rent
- Raw materials
- Electricity
- Transportation

B. Opportunity cost / implicit cost

Lost from using the firm's own resources **Value of income from the second best alternative** It's called opportunity cost.

Examples:

- Rent lost from using one's own house for business purposes
 - Interest lost on investing one's own capital in a business
 - Salary lost from working in one's own business
-

Example of economic cost

Suppose a businessman runs a business in his house.

Actual costs:

- Raw material = ₹2,00,000
- Salary = ₹1,50,000
- Electricity = ₹50,000
- Other expenses = ₹50,000

Accounting cost = ₹4,50,000

If this businessman had rented out his house to another person, he would have **₹1,00,000** The rent would have been paid.

If he had invested his capital elsewhere, he would have **₹50,000** Interest would have been earned.

So:

Opportunity cost = ₹1,00,000 + ₹50,000

Opportunity cost = ₹1,50,000

Now:

Economic cost = Accounting cost + Opportunity cost

= ₹4,50,000 + ₹1,50,000

Economic cost = ₹6,00,000

This ₹1,50,000 Why is it included??

The generation ₹1,50,000 Actually **Not paid**.

But since the trader has used his own resources in the business, he loses the opportunity to earn the following income:

- From the building ₹1,00,000 Rent
- From capital ₹50,000 Interest

So this lost revenue **Economic costs** Becomes part of.

Economic profit

Use of economic costs **Economic profit** It is considered.

Formula:

Economic profit = Total revenue – Economic cost

Importance

Economic costs:

- Measures the actual economic sacrifice.
 - Includes opportunity costs.
 - Helps in managerial decision making.
 - Helps determine economic profit.
 - Helps to compare alternative uses of resources.
-

Difference between accounting cost and economic cost

Support	Accounting expenses	Economic costs
Meaning	Actual cost	Total financial sacrifice
Inclusion	Direct costs	Direct + implicit costs
Opportunity cost	Not involved	usually Gets involved
Note in the ledger	Happens	Implicit costs are usually not recorded.
Main purpose	Accounting profit	Economic profit
Scope	Less	More

Remember easily

Accounting expenses→What the firm actually paid?

Economic costs→What the firm paid + what it lost?

5. Direct costs (DIRECT COST)

Meaning

Direct costs That is, an expense that is incurred on a specific item., Service, Work, With a project or unit of production **Directly and easily connected or identifiable.**

In simple words:

Direct costs = costs directly related to a specific product

Main types of direct costs

A. Direct raw material cost

Raw materials used directly in making a product.

Examples:

- Cotton used for making clothes
 - Wood for making furniture
 - Machine-building steel
 - Bread flour
-

B. Direct labor cost

Wages paid to workers directly involved in the production process.

Examples:

- Tailor's salary
 - Carpenter's salary
 - Machine operator salary
-

C. Direct Cost / Direct Other Cost

A cost directly related to a particular product or work.

Examples:

- Cost for special design
 - The cost of special equipment rented for a specific project
 - Royalty paid per unit of production
-

Example

A clothing company manufactures shirts.

Cost	Amount
Cloth	₹1,00,000
Button and zip	₹20,000
Tailors' wages	₹60,000

Cost	Amount
Factory rent	₹50,000
Manager's salary	₹40,000

Direct costs:

Fabric + Button and Zip + Tailor's Wages

= ₹1,00,000 + ₹20,000 + ₹60,000

Direct cost = ₹1,80,000

Factory rent and manager's salary usually **Indirect costs** It counts.

Symptoms

- Has a direct relationship.
 - Can be easily linked to a specific product.
 - Its measurement is relatively easy.
 - Directly related to production.
 - It is important in determining the cost of production.
-

6. Indirect costs (INDIRECT COST)

Meaning

Indirect costs That is, the cost that a particular product, Service, With a unit of work or production **Cannot be connected directly and easily**.

In simple words:

Indirect costs = common costs that support multiple products or the entire business.

Indirect costs are usually **Overhead (Overhead Cost)** It is also said.

Types of indirect costs

A. Indirect raw material cost

Materials used in production that cannot be easily associated with any one specific product.

Examples:

- Lubricating oil for the machine
- Cleaning materials
- Small tools
- Maintenance materials

B. Indirect labor costs

The cost of workers who assist in production but are not directly involved in the production of a particular product.

Examples:

- Supervisor's salary
- Security guard salary
- Storekeeper's salary
- Maintenance workers' wages

C. Indirect Costs / Indirect Other Costs

General expenses that support the overall operation of a product or business.

Examples:

- Factory rent
- Factory electricity

- Wear and tear
 - Insurance
 - Repair and maintenance
-

Example

A factory produces shirts and pants.

Its costs are as follows:

Cost	Amount	Type
Shirt fabric	₹1,00,000	Direct
Tailors' wages	₹60,000	Direct
Factory rent	₹50,000	Indirect
Supervisor's salary	₹40,000	Indirect
Factory electricity	₹30,000	Indirect

So:

Indirect cost = ₹50,000 + ₹40,000 + ₹30,000

Indirect cost = ₹1,20,000

This cost helps more than one product., Therefore, it is usually divided between different products. **To allocate or distribute** It falls.

Difference between direct costs and indirect costs

Support	Direct costs	Indirect costs
Meaning	Direct relationship with the product	No direct relationship

Support	Direct costs	Indirect costs
Relationship	With a specific product	Common with many products
Identification	Can be done easily	Difficult
Allocation	Not usually necessary	Usually required
Example	Raw materials, Direct labor	Rent, Supervisor's salary
Other names	—	Overhead

COST CONCEPTS – Full summary

Concept of cost	Meaning	Simple example
Historical costs	Original price paid in the past	Machine ₹5 Lakhs Bought for
Restoration costs	Current cost to replace property	The same machine today ₹7.5 Lakhs. It is worth
Accounting expenses	Actual financial costs	Salary, Rent, Raw materials
Economic costs	Accounting cost + opportunity cost	₹4.5 Lakh Payments + ₹1.5 Millions of missed opportunities
Direct costs	Direct relationship to a specific product	Shirt fabric
Indirect costs	General expenses not directly related to a specific product	Factory rent

A way to easily remember all six cost concepts

1. Historical costs

Past expenses

→ *How much did you pay then??*

2. Restoration costs

Current expenses

→ *How much would it cost to replace it today??*

3. Accounting expenses

Actual payments

→ *How much did the firm actually spend??*

4. Economic costs

Actual Payout + Foregone Opportunity

→ *How much did the firm pay and what did it lose??*

5. Direct costs

Direct relationship to a specific product

→ *Can this cost be directly linked to this product??*

6. Indirect costs

General expenses

→ *Does this cost help multiple products or the entire business??*

Conclusion

Cost concepts help us understand the costs and economic sacrifices incurred in the production process from different perspectives. **Historical costs and restoration costs** Explains the difference between past and present costs.; **Accounting costs and**

economic costs Shows the difference between actual financial costs and total economic sacrifice; When **Direct costs and indirect costs** Classifies costs based on their relationship to a particular product. A clear understanding of these cost concepts **Cost control, Pricing, Production planning, Profit measurement, Efficient allocation of resources and managerial decision making** Very important.

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Cost	Amount
Accounting expenses	₹4,20,000

So:

Accounting cost = ₹4,20,000

Accounting profit

Accounting profit = Total revenue – Accounting expenses

Suppose the total income ₹6,00,000 is:

Accounting profit = ₹6,00,000 – ₹4,20,000

Accounting profit = ₹1,80,000

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Opportunity cost = ₹1,50,000

Now:

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= ₹4,50,000 + ₹1,50,000

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So this lost revenue **Economic costs** Becomes part of.

Economic profit

Use of economic costs **Economic profit** It is considered.

Formula:

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- Measures the actual economic sacrifice.
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Direct costs:

Fabric + Button and Zip + Tailor's Wages

= ₹1,00,000 + ₹20,000 + ₹60,000

Direct cost = ₹1,80,000

Factory rent and manager's salary usually **Indirect costs** It counts.

Symptoms

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Types of indirect costs

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Examples:

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Examples:

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C. Indirect Costs / Indirect Other Costs

General expenses that support the overall operation of a product or business.

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Tailors' wages	₹60,000	Direct
Factory rent	₹50,000	Indirect
Supervisor's salary	₹40,000	Indirect

Cost	Amount	Type
Factory electricity	₹30,000	Indirect

So:

Indirect cost = ₹50,000 + ₹40,000 + ₹30,000

Indirect cost = ₹1,20,000

This cost helps more than one product., Therefore, it is usually divided between different products. **To allocate or distribute** It falls.

Difference between direct costs and indirect costs

Support	Direct costs	Indirect costs
Meaning	Direct relationship with the product	No direct relationship
Relationship	With a specific product	Common with many products
Identification	Can be done easily	Difficult
Allocation	Not usually necessary	Usually required
Example	Raw materials, Direct labor	Rent, Supervisor's salary
Other names	—	Overhead

COST CONCEPTS – Full summary

Concept of cost	Meaning	Simple example
Historical costs	Original price paid in the past	Machine ₹5 lakhs Bought for

Concept of cost	Meaning	Simple example
Restoration costs	Current cost to replace property	The same machine today ₹7.5 Lakh. It is worth lakhs.
Accounting expenses	Actual financial costs	Salary, Rent, Raw materials
Economic costs	Accounting cost + opportunity cost	₹4.5 Lakh Payments + ₹1.5 Millions of missed opportunities
Direct costs	Direct relationship to a specific product	Shirt fabric
Indirect costs	General expenses not directly related to a specific product	Factory rent

A way to easily remember all six cost concepts

1. Historical costs

Past expenses

→ *How much did you pay then??*

2. Restoration costs

Current expenses

→ *How much would it cost to replace it today??*

3. Accounting expenses

Actual payments

→ *How much did the firm actually spend??*

4. Economic costs

Actual Payout + Foregone Opportunity

→ *How much did the firm pay and what did it lose??*

5. Direct costs

Direct relationship to a specific product

→ *Can this cost be directly linked to this product??*

6. Indirect costs

General expenses

→ *Does this cost help multiple products or the entire business??*

Conclusion

Cost concepts help us understand the costs and economic sacrifices incurred in the production process from different perspectives. **Historical costs and restoration costs** Explains the difference between past and present costs.; **Accounting costs and economic costs** Shows the difference between actual financial costs and total economic sacrifice; When **Direct costs and indirect costs** Classifies costs based on their relationship to a particular product. A clear understanding of these cost concepts **Cost control, Pricing, Production planning, Profit measurement, Efficient allocation of resources and managerial decision making** Very important.

Average Cost, Marginal Cost and Total Cost

Average cost, Marginal cost and total cost

These three **Cost Analysis** There are very important concepts.

1. Total cost (Total Cost – TC)

Meaning

Total cost That is, to produce a certain amount of output, the firm has to **Total cost**.

In simple words:

Total cost = Fixed cost + Variable cost

Formula

$$\begin{aligned} &[\\ &TC = TFC + TVC \\ &] \end{aligned}$$

Here,

- **TC = Total Cost (Total cost)**
- **TFC = Total Fixed Cost (Total fixed costs)**
- **TVC = Total Variable Cost (Total variable costs)**

Example

Suppose that the firm:

- Total fixed cost = ₹10,000
- Total variable cost = ₹15,000

So:

$$\begin{aligned} &[\\ &TC = ₹10,000 + ₹15,000 = ₹25,000 \\ &] \end{aligned}$$

That's it. **Total cost = ₹25,000**.

Symptoms

1. It includes both fixed and variable costs.
2. Total costs generally increase when production increases.
3. Even at zero output, total cost is not zero due to fixed costs.
4. Total costs are different at different levels of production.

2. Average cost (Average Cost – AC)

Meaning

Average cost So every unit produced comes after **Average cost**.

In simple words:

Average cost = cost per unit of production

Formula

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

Here,

- **AND = Average cost**
- **TC = Total cost**
- **Q = Product quantity**

Average cost can also be expressed as:

$$[AC = AFC + AVC]$$

Here,

- **AFC = Average fixed cost**
- **AVC = Average variable cost**

Example

Suppose the firm **1,000 Units** Produces.

Total cost = **₹50,000**

So:

$$[AC = \frac{₹50,000}{1,000}]$$

AND = ₹50 Per unit

That is, the average behind each unit ₹50 It costs.

3. Marginal cost (Marginal Cost – MC)

Meaning

Marginal cost That is, by producing one additional unit of output, **Increase in total expenditure.**

In simple words:

Additional cost of producing one additional unit = Marginal cost

Formula

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

Here,

- **MC = Marginal cost**
- **ΔTC = Change in total cost**
- **ΔQ = Product changes**

If production increases by one unit:

$$MC = TC_n - TC_{n-1}$$

Example

Suppose:

- 100 Total cost of production of units = ₹5,000
- 101 Total cost of production of units = ₹5,040

So:

$$MC = ₹5,040 - ₹5,000$$

$$MC = ₹40$$

That is, 101 Additional cost to produce a unit ₹40 Done.

A combined example of all three

Suppose that the generation **Total fixed costs** ₹100 Is.

Product (Q)	TFC	TVC	TC	AC	MC
0	₹100	₹0	₹100	—	—
1	₹100	₹60	₹160	₹160	₹60
2	₹100	₹100	₹200	₹100	₹40
3	₹100	₹135	₹235	₹78.33	₹35
4	₹100	₹180	₹280	₹70	₹45
5	₹100	₹240	₹340	₹68	₹60

For example 4 On the unit:

Total cost:

$$[$$

$$TC = TFC + TVC$$

$$]$$

$$[$$

$$= ₹100 + ₹180 = ₹280$$

$$]$$

Average cost:

$$[$$

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

$$]$$

$$[$$

$$= \frac{₹280}{4} = ₹70$$

$$]$$

Marginal Cost:

4 Total cost of adding a unit ₹235 From ₹280 Done.

$$[$$

$$MC = ₹280 - ₹235 = ₹45$$

$$]$$

So:

- **TC = ₹280**
- **AND = ₹70**
- **MC = ₹45**

TC, AC And MC The difference between

Support	Total cost (TC)	Average cost (AM)	Marginal cost (MC)
Meaning	Total cost of production	Average cost per unit	Additional cost of one additional unit
Formula	TFC + TVC	$TC \div Q$	$\Delta TC \div \Delta Q$
What does it show??	Total cost	Cost per unit	Additional unit cost
Relationship with the product	Increases as production increases	May decrease initially, It may increase later.	May decrease initially, It may increase later.
Main use	To know the total cost	To know the cost per unit	To decide whether to produce more or not

Remember easily

Total Cost (TC)

→ *What is the total cost of all the units??*

Average Cost (AC)

→ *What is the average cost per unit??*

Marginal Cost (MC)

→ *How much additional cost does it cost to produce one additional unit??*

A very important relationship

$MC < AC \rightarrow AC \text{ Decreases}$

$MC = AC \rightarrow AC \text{ is at a minimum point}$

$MC > AC \rightarrow AC \text{ Increases}$

This relationship **Cost Curves And Profit maximization** Very important to understand.