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RESEARCH ARTICLE

OPTIMAL PURCHASE DECISION: WHICH DOMINATES WHAT

***Gaurdas Sarkar**

Associate Professor, Gobardanga Hindu College, West Bengal, India

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ABSTRACT

Conventional theory of demand postulates that demand is derived from utility maximizing behaviour of an individual consumer. It is so postulated as the theory presumes that the consumer is motivated to maximize his utility. Thus the utility maximizing exercise has occupied an important place in the theory of demand. But utility is a subjective concept and it is neither measurable nor observable. It is not a pragmatic hypothesis to postulate that demand is derived through utility maximizing exercise as utility is derived after consumption. Purchase decision is taken prior to consumption. Actually purchase decision is guided by interplay of Ability and Preference. While dealing with equilibrium purchase decision of an individual consumer, the theory of consumer's behaviour must incorporate the specific characteristic feature of the product as well as the complex interplay of Ability and Preference. In the opinion of present author consumer's equilibrium purchase decision is the outcome of the complex interplay of Ability and Preference incorporating the specific characteristic feature of the product. Therefore equilibrium purchase behaviour of an individual consumer is claimed to be better explained in terms of concentration of maximum Preference per unit of Ability. This present paper seeks to analyze a purchase decision in the light of such interplay. Section-I deals with introductory background. Section-II is devoted to analyze equilibrium of the consumer. Section-III deals with comparative static properties and section-IV concentrates on conclusion.

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INTRODUCTION

Conventional theory of demand postulates that demand is derived from utility maximizing behaviour of an individual consumer. It is so postulated as the theory presumes that the consumer is motivated to maximize his utility. Thus the utility maximizing exercise has occupied an important place in the theory of demand. But utility is a subjective concept and it is neither measurable nor observable. The subjectivity of utility function and preference ordering has stimulated the development of Paul A Samuelson's Revealed Preference Hypothesis, a theory based solely on observable and measurable phenomena. The Revealed Preference hypothesis assumes consistent and transitive consumer's behaviour with given price vector and a fixed money income. According to the Revealed Preference Hypothesis a consumer's observed behaviour is assumed to reveal consumer's preference in favour of a commodity bundle over other affordable bundles and interestingly the conclusions

derived in the Revealed Preference Hypothesis are equivalent to those derived in utility maximizing hypothesis. Such equivalence bears the implication that Revealed Preference Hypothesis has its obvious merit of observability and measurability. Both the utility maximizing hypothesis as well as Revealed Preference Hypothesis assume fixed income and given price vector to describe equilibrium position of an individual consumer. But this constancy of budget constraint does not suit our practical experience in our day to day life as a consumer does not purchase all the goods at a time. The constancy of income level or income constraint can be thought of to be the constant amount of money that an individual consumer is able to spend for the purchase of a select good. Regarding this ability there arises some degree of flexibility. In real life situation we find that actual expenditure differs from and is around the intended expenditure. This intended expenditure actually forms the domain of preference. Standard theory of consumer behavior does not incorporate ability as a determinant of domain of preference. If ability is not considered to be a determinant of preference, such preference will surely yield notional demand but not effective demand. The divergence of actual expenditure from intended expenditure is essentially the outcome of interplay of Ability and Preference as each one of

***Corresponding author: Gaurdas Sarkar,**
Associate Professor, Gobardanga Hindu College, West Bengal, India.

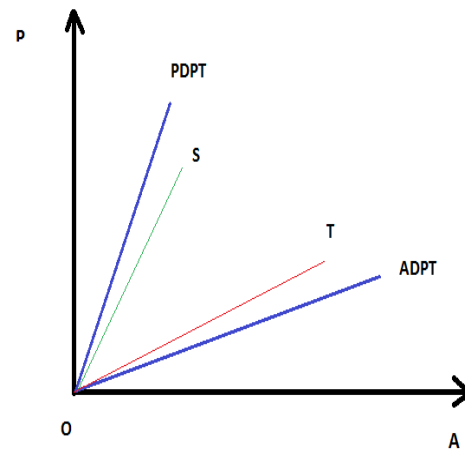
them influences the other. Such interplay forms the basis of a purchase decision. It is not a pragmatic hypothesis to postulate that demand is derived through utility maximizing exercise as utility is derived after consumption. It would be much more rational to postulate that demand is derived through the interplay of Ability and Preference. With this postulate in mind let us analyze equilibrium purchase decision of an individual consumer.

EQUILIBRIUM ANALYSIS: A consumer is confronted with various types of purchases. Categorically various purchase situations can be classified as Indivisible Branded Purchase (IBP), Divisible Branded Purchase (DBP), Indivisible Non-Branded Purchase (INBP), Divisible Non-Branded Purchase (DNBP) and such classification is exhaustive in nature as they cover any type of purchase. In any purchase situation consumer is supposed to form an idea about his intended expenditure. Regarding this intended expenditure we can distinguish between two cases.

One is a situation where market price of the product is anticipated to be so low as compared to income of the consumer that he does not feel any necessity of determining intended expenditure and the other is a situation where market price is anticipated to be significant enough and the consumer determines his intended expenditure on the basis of his income and information collected from market. In both the cases a consumer's purchase decision is found to be the outcome of the interplay of Ability and Preference. This interplay gives birth to the existence of actual expenditure around the consumer's intended expenditure. While the consumer is taking a purchase decision he can not put equal emphasis on Ability and Preference. Sometimes Preference dictates his decision by influencing Ability. Sometimes Ability dictates his decision by influencing Preference.

Here we can think of two purchase technologies. While Preference dictates consumer's purchase decision by influencing Ability we can term it to be 'Preference Deepening Purchase Technology' (PDPT). While Ability dictates his purchase decision by influencing Preference we can term it to be 'Ability Deepening Purchase Technology' (ADPT). In case of 'Preference Deepening Purchase Technology' incremental Preference Ability ratio is higher as compared to that in 'Ability Deepening Purchase Technology'.

If we measure Ability (A) along the horizontal axis and Preference (P) along the vertical axis a ray passing through the origin and relatively closer to the Ability axis represents 'Ability Deepening Purchase Technology' as along this ray relatively higher amount of Ability is associated with relatively lower amount of Preference. On the contrary a ray passing through the origin and relatively closer to the Preference axis represents 'Preference Deepening Purchase Technology' as along this ray relatively higher amount of Preference is associated with relatively lower amount of Ability. In Ability-Preference plane we can identify two rays to represent those two purchase technologies. At the same time we can locate two distinct points, S & T, one of which will represent intended expenditure and the other will represent actual expenditure. This can be done very conveniently as each of them separately yields a particular combination of Ability and Preference. Graphically this can be shown as follows:



Now if we join origin and the point representing actual expenditure we can easily identify whether the purchase technology is Preference Deepening or Ability Deepening. If the joining line is relatively closer to the Preference axis as compared to the Ability axis purchase technology is identified to be Preference Deepening and vice versa. So far as the concept of equilibrium is concerned we know that equilibrium is a state where the participating agent or agents do not find any incentive to alter the existing situation. Here consumer's purchase decision is guided by the interplay of Ability and Preference. Therefore the consumer is said to be in equilibrium if maximum Preference per unit of Ability is concentrated. Maximization of Preference per unit of Ability on the part of the consumer is possible if he is not able to raise Preference per unit of Ability by purchasing any substitute. After taking purchase decision no individual consumer goes for the purchase of any substitute and therefore we can take it for granted that the consumer has been able to get maximum Preference concentrated per unit of Ability by taking this particular purchase decision. In other words the consumer will be in equilibrium by purchasing commodity (X) if and only if he is not able to raise Preference per unit of Ability by purchasing any substitute good I. This is possible only when

$$P_X / A = P_I / A$$

Where P_X / A represents Preference per unit of Ability from commodity X and P_I / A represents Preference per unit of Ability from commodity I. In the opinion of present author consumer's equilibrium purchase decision is the outcome of the complex interplay of Ability and Preference and therefore equilibrium purchase behaviour of an individual consumer is claimed to be better explained in terms of concentration of maximum Preference per unit of Ability.

COMPARATIVE STATIC PROPERTIES: Consumer's purchase decision, as we have seen, is the outcome of interplay of Ability and Preference. If we assume that the purchase decision will come into effect we will be in a position to ensure that the demand function exists for all plausible combinations of Ability and Preference. At the same time if we assume that the consumer is not suffering from indecision under any circumstance we can ensure that the demand relationships are functions rather than correspondence and thus we can ensure uniqueness property

of the demand function. Coming to the comparative static properties we are to answer the following questions:

- What does happen to the equilibrium purchase decision in the event of a change in price of the concerned commodity?
- What does happen to the equilibrium purchase decision in the event of a change in income of the concerned consumer?

Let us first analyze the effect of change in price of the concerned commodity on equilibrium purchase decision. Here we should keep in mind that each purchase is characterized by its own distinguishing character and this character bears an important implication in the matter of analyzing changes in equilibrium purchase decision. In this connection we can distinguish among purchases of Durable Indivisible Product, Durable Divisible Product, Non-Durable Indivisible Product, and Non-Durable Divisible Product. Let us take up the cases one by one.

Purchase of Durable Indivisible Product: If the concerned commodity is a Durable Indivisible Product, there is no possibility of purchase of any additional unit of the product in near future with a fall in price of the product. Similarly a rise in price of the product has no effect on individual demand as it is a durable product. In both the cases conclusion of conventional demand theory does not hold good. So far as market demand is concerned a rise in price of the product will lead to have a fall in market demand due to a fall in number of potential consumers. On the contrary a fall in price of the product is supposed to attract new consumers leading to a rise in market demand. But our real life situation is not so simple that price fall will unambiguously attract new consumers. This is due to the fact that a price fall will surely be accompanied by a price competition leading to a simultaneous fall in prices of its substitutes. In that case preference may be shifted to the product of other brand or to other variety of the same brand. On both the occasions price fall will not boost up market demand. Present day business community is well aware of this fact and therefore they simply go for product differentiation to attract new potential consumers.

Purchase of Non-Durable Indivisible Product: If the commodity in question is a Non-Durable Indivisible product, a fall in price of the product will lead to have purchase of same or higher quantity provided that the consumer's preference remains unaltered. Here consumer's preference plays an important role. With a fall in the price of the product as well as its substitutes, which is very common in real life situation, consumer's preference may be shifted to the product of other brand or to other variety of the same brand either for changing taste or for experiment. As the product is not divisible a fall in quantity demanded may not be operationally viable in case of a rise in price of the product. In both the cases conclusion of conventional demand theory does not hold good.

Purchase of Durable Divisible Product: If the concerned commodity is a Durable Divisible Product, this purchase variety is very rare, if not non-existent. A fall in price of the product will have no immediate effect on individual demand as it is a durable good. Similarly a rise in price of the product has no immediate effect on individual demand.

In both the cases conclusion of conventional demand theory does not hold good. A rise in price of the product is expected to have a fall in market demand due to a fall in number of potential consumers. On the contrary a fall in price of the product is supposed to attract new consumers leading to a rise in market demand. But our real life situation is not so simple that price fall will unambiguously attract new consumers. This is due to the fact that a price fall will surely be accompanied by a price competition leading to a simultaneous fall in prices of its substitutes. In that case preference may be shifted to the product of other brand or to other variety of the same brand. On both the occasions price fall will not boost up market demand. Present day business community is well aware of this fact and therefore they simply go for product differentiation to attract new potential consumers.

Purchase of Non-Durable Divisible Product: If the commodity in question is a Non-Durable Divisible Product, this purchase variety is very common. A change (rise or fall) in price of the product will have immediate effect on individual demand as it is a Non-durable good. In both the cases conclusion of conventional demand theory holds good. Again a rise in price of the product is expected to have a fall in market demand due to a fall in number of potential consumers. On the contrary a fall in price of the product is supposed to attract new consumers leading to a rise in market demand. But our real life situation is not so simple that price fall will unambiguously attract new consumers. This is due to the fact that a price fall will surely be accompanied by a price competition leading to a simultaneous fall in prices of its substitutes. In that case preference may be shifted to the product of other brand or to other variety of the same brand. On both the occasions price fall will not boost up market demand. Present day business community is well aware of this fact and therefore they simply go for product differentiation to attract new potential consumers.

After analyzing various purchases we come to the conclusion that Law of Demand is not applicable in majority of the cases. Though it is applicable in case of Non-Durable goods, it does not hold well in case of Durable goods. Therefore, while dealing with equilibrium purchase decision of an individual consumer, the theory of consumer's behaviour must incorporate the specific characteristic feature of the product as well as the complex interplay of Ability and Preference. In the opinion of present author consumer's equilibrium purchase decision is the outcome of the complex interplay of Ability and Preference incorporating the specific characteristic feature of the product. Therefore equilibrium purchase behaviour of an individual consumer is claimed to be better explained in terms of concentration of maximum Preference per unit of Ability.

Conclusion

The utility maximizing hypothesis as well as Revealed Preference Hypothesis assume fixed income and given price vector to describe equilibrium position of an individual consumer. But this constancy of budget constraint does not suit our practical experience in our day to day life as a consumer does not purchase all the goods at a time. The constancy of income level or income constraint can be thought of to be the constant amount of money that an individual consumer is able to spend for the purchase of

select good. Regarding this ability there arises some degree of flexibility. In real life situation we find that actual expenditure differs from and is around the intended expenditure. This intended expenditure actually forms the domain of preference. Standard theory of consumer behavior does not incorporate ability as a determinant of domain of preference. If ability is not considered to be a determinant of preference, such preference will surely yield notional demand but not effective demand. The divergence of actual expenditure from intended expenditure is essentially the outcome of interplay of Ability and Preference as each one of them influences the other. Such interplay forms the basis of a purchase decision. It is not a pragmatic hypothesis to postulate that demand is derived through utility maximizing exercise as utility is derived after consumption. It would be much more rational to postulate that demand is derived through the interplay of Ability and Preference. In any purchase situation consumer is supposed to form an idea about his intended expenditure. Regarding this intended expenditure we can distinguish between two cases. One is a situation where market price of the product is anticipated to be so low as compared to income of the consumer that he does not feel any necessity of determining intended expenditure and the other is a situation where market price is anticipated to be significant enough and the consumer determines his intended expenditure on the basis of his income and information collected from market. In both the cases a consumer's purchase decision is found to be the outcome of the interplay of Ability and Preference. This interplay gives birth to the existence of actual expenditure around the consumer's intended expenditure.

So far as the concept of equilibrium is concerned we know that equilibrium is a state where the participating agent or agents do not find any incentive to alter the existing situation. Here consumer's purchase decision is guided by the interplay of Ability and Preference. Therefore the consumer is said to be in equilibrium if maximum Preference per unit of Ability is concentrated. After analyzing various purchases we come to the conclusion that Law of Demand is not applicable in majority of the cases. Though it is applicable in case of Non-Durable goods, it does not hold well in case of Durable goods. Therefore, while dealing with equilibrium purchase decision of an individual consumer, the theory of consumer's behaviour must incorporate the specific characteristic feature of the product as well as the complex interplay of Ability and Preference.

In the opinion of present author consumer's equilibrium purchase decision is the outcome of the complex interplay of Ability and Preference incorporating the specific characteristic feature of the product. Therefore equilibrium purchase behaviour of an individual consumer is claimed to be better explained in terms of concentration of maximum Preference per unit of Ability.

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