

Opportunity Costs

Business Economics

Opportunity Cost

- Definition: the best alternative that is forgone because a particular course of action is taken; the cost of passing up the next best choice when making a decision
 - Watching TV instead of doing homework – you lose the benefits of homework
 - You have \$10 to spend; all the alternatives are forfeited; the next best choice (second alternative) is used when calculating opportunity costs

Need to Identify Opportunity Costs

- To choose something is to not choose something else
- Limited resources = forgone alternatives
- Value of the next highest valued alternative



Influences Decision Making

- Three factors that influence the inclusion of opportunity costs in business decision making:
 - Experience – do you know all of the alternatives that exist?
 - Vagueness of information – is it possible to calculate the value of the next best alternative
 - Thoughtfulness – has the situation been explored thoroughly enough to see the decision in light of the alternatives

Opportunity Costs Identified

- Difficult to place a value on some costs such as time, experience gained, etc.
 - Example – not going to college is forgoing knowledge about the world, developing lifelong friendships, exploring career options, and learning about one's self

Opportunity Costs vs. Trade-Offs

- Trade-off – the exchange for one thing in return for another
 - Watching TV instead of doing homework
- Opportunity Cost – the value of the next highest valued alternative
 - Received enjoyment from watching TV, but sacrificed the points you would have received on your homework, the knowledge, and the feeling of accomplishment

Why/When to Include in Decision

“Because of its usefulness as an analytic tool. In a market economy, people seek to make a profit. To do that, they must utilize their resources as efficiently as they can, in order to bring back the greatest benefit to themselves. Many, many factors must be weighed. In making all those decisions, it is a great help to know the value of the next-best thing that one could have chosen.”

Source: Land and Freedom Economic Lessons. (n.d.). *Opportunity costs*. Retrieved October 27, 2009

Ask Yourself Three Questions

- What alternative opportunities are there?
- Which is the best of these alternative opportunities?
- What would I gain if I selected the best alternative instead of the choice I'm considering?



Activity