Introduction to opportunity cost commerce essay

It is a very powerful concept when someone has to make a decision to select a particular product or making a choice. In simple words, opportunity cost means choosing or making a best decision from different option. When one has to make a decision in between various actions to select only one particular work at a time is called opportunity cost.

Example: From a economist point of view when a kid has to make a decision to choose between ice cream and chocolate at a time. When the kid has got a limited pocket money of $10 only and ice cream cost is $8 whereas chocolate cost is $15. So, the kid will have to select ice cream only as the kid has only limited cash in hand. It is also an example of scarcity too. In this example, there is scarcity of money.

“ NEEDS” AND “ WANTS”

According to Macpherson (1977, p. 27) defines needs and wants as “ The problem of needs and wants is both an ontological and a historical problem”.

NEEDS

The basic requirement to satisfy human beings desire is included in needs. Needs are a basic necessity which are used in daily life like food, water, clothing, medicine, shelter etc. A man’s survival is dependent on these needs only on the primary stage.

In a modern society the basic needs keeps on changing according to the society standards. In case of modern society the basic needs of a man may differ from clothing to electricity, food to running water, shelter to furniture, medicine to electronic items etc.

After talking about primary needs, secondary needs is the another topic which are needed to be explained. In case of secondary needs the necessity can be regarded as luxury. Like an automobile is a necessity in The United States. As the country grows to progress and development, the luxury too gets into necessity item for the people.

At earlier stage cars could be only affordable by rich people. But at present, many of the middle level income people are also willing to afford it. Growth in a countries economy helps one to go beyond his or her limits.

WANTS

Wants include needs but it goes beyond that. Before we get deep into " wants", we should understand the gap between " needs" and " wants". According to Heibroner (1962, p. 135) makes the statement that " Consumer demand is no longer driven to essentials but hesitates before a whole range of possible luxuries and semi-luxuries."

It means that now a days, consumer demand are unlimited and it's no longer situated in a stage where consumer use to select between luxury and semi-luxury products. Due to the growth in economy, now most of the middle class people are also willing to afford luxury products. In a few years back was just a dream for them to afford the price for a luxury product.

SCARCITY

It is a stage when the wants are not satisfied up to the satisfaction of people. When the production is not enough or sufficient, to satisfy the demand for a particular commodity, the problem of scarcity arises.

The scarcity keeps on changing from one society to various countries. As the society keeps on developing, the standard of living also gets higher. The demand also keeps on increasing according to the economy of a country and the satisfactory level of the society. So, the resources get scarcer to produce goods and services for the satisfaction of wants.

OPPORTUNITY COST

According to (Pearce, 1983, p. 322) opportunity cost can be defined as " opportunity cost can only arise in a world where the resources available to meet wants are limited so that all wants cannot be satisfied".

In simple words, we could say that the wants and needs of human being are unlimited. But the resources available in the market are limited. And so, it is not possible to satisfy each and every wants and desires of human being. And thus, the topic opportunity cost arises in a world.

Choosing the best alternative when there is scarcity for a particular product, it can be measured in opportunity cost for the satisfaction of the needs and wants.

The value of the next best alternative which is available in the market is termed in as opportunity cost.

ADVANTAGES OF OPPORTUNITY COST

Opportunity cost provides a benefit of choosing one option over another. It may be personal or business related, opportunity cost arises when we select one option over another taking into consideration that the selected option has better advantage comparing with the another option. It helps one to study each and every facilities and satisfactory level of various products similar in nature, when the resources are limited.

Opportunity cost provides us awareness towards choosing the best alternative product, which helps one to make fully informed and to make appropriate planning and decision making, which helps to maximize ones resources.

Price of a product plays an important role in considering opportunity cost, as it allows us to consider and compare prices between each alternative product and to select the most effective and satisfactory product from the option.

DISADVANTAGES OF OPPORTUNITY COST

Opportunity cost consumes a lot of time to calculate the features, price, budget, success ratio, satisfactory level etc of a product and many times we do not have time to evaluate the benefits of every product to choose the best alternatives.

The biggest disadvantage of opportunity cost from a economist point of view is that the opportunity cost is not considered in accounting process of any company accounts. And so, the cost of opportunity involved in a selection of a particular product and the alternative product which was not selected, cannot be taken into accounts for future studies at all from a financial point of view.

PRACTICE OF OPPORTUNITY COST IN REALITY

Opportunity cost is calculated everyday by a human being who has the desire to purchase any product available in the market. Whether it may be implicit or explicit cost, it is considered into opportunity cost itself.

An example of opportunity cost in case of financial sector is as given below:-

A decision maker must study the impact of opportunity costs deeply before making the decision. If we consider a situation of an investor, whether to make investment in stock market or mutual fund investment. If a person makes an investment of $20, 000 in Mutual Fund Investment of any company for one year, then he thinks what if he had put the same $20, 000 in stock market rather than mutual fund investment. Perhaps he may expect a return of 20% on stock, and then the investor has an opportunity cost of $4000. Mutual fund may only provide a return of 10% ($2000).

Then the investor has to consider the risk taking capacity, if he goes directly with stock market. As stock market value keeps on changing from time to time and there is always a risk of losing the money.

In case of mutual fund investment, investor finds it more safe and secure for his money. There is very less chance of losing the money as compared with stock market.

Hence, the investor may take the decision on the best alternative to invest in after considering the opportunity cost.

PRACTICES ADOPTED BY ORGANIZATION IN RELATION TO OPPORTUNITY COST

Opportunity cost is very important concept in financial sector. Especially in business progress related strategies. Opportunity cost helps one to examine the details and to make a profitable deal in a business purchase and selling process. The opportunity cost is the value mentioned to the next best choice. When an organization makes a decision to purchase an asset over another, there the organization is transferring the opportunity cost offered by another asset which was not selected.

From my personal investigation on use of opportunity cost in business world, opportunity cost helps the organization to manage time with fully efficiency.

Opportunity cost helps the organization to manage time with full efficiency. Even the business organization has to analysis which productive material should be purchased or not. Evento study the profitability level of various materials before purchasing it. It helps in a better decision making.

Examples of opportunity cost in Business organization:

A company has $2 million to spend on a project. The company can decide to invest the money for advertisement purpose of the particular product at the time of launch in the market. If they decide to invest the money in production and to buy machinery and all then the opportunity cost gets lost for advertisement purpose. And if they decide to spend the money on advertisement purpose, then the opportunity cost will be the organizations ability to produce commodity with more efficiently.

Another example for business organization is that an organization owns a building in which it operates its function and so, it does not have to pay any rent for the office room space and all. But from economist point of view the business owner might have kept the office space for current use itself or the office space might have given for rent for money. So, that the owner could have earned from the rent but if the owner will not consider or provide the office space for rent then there is a loss in business expenses according to economist view point. But in real life accountant of a business organization cannot provide any loss expenses due to opportunity cost in any accounts.

Even though opportunity cost is not considered by the accountants in case of financial accounts and all. But it is very much important for a manager of the business organization to consider opportunity cost in relation to business strategies. A business manager must consider opportunity cost in calculating the opportunity expenses in the organization for analyzing the profitable deals available in the market. It also helps in utilizing limited resources efficiently.

CONCLUSION

The value of the next best alternative which is available in the market is termed in as opportunity cost. It means choosing or making a decision from different options. From a economist point of view when a kid has to make a decision to choose between ice cream and chocolate at a time. When the kid has got a limited pocket money of $10 only and ice cream cost is $8 and chocolate cost is $15. So, the kid will have to select ice cream only as the kid has limited cash in hand. It is also a better example for scarcity too.

When we talk about “ opportunity cost”, we must take scarcity, needs and wants also into consideration. As, the basic needs to satisfy human beings desire is included in “ needs”. Needs are a basic requirements which are used in daily life like food, water, clothing, medicine, shelter etc. A man’s survival is dependent on theseneeds only on the primary level.

Saying about “ wants” it includes needs but it goes beyond that. Now a day’s consumer demands are unlimited but the resources are limited. It makes the demand margin to get higher, comparing with supply or resources.

“ Scarcity” is a stage when the wants are not satisfied up to the mark. When the production is insufficient to satisfy the demand for a particular commodity the problem of scarcity arises.

Opportunity cost provides a benefit of choosing the best option available in the market after concluding the advantages and disadvantages. It also provides awareness towards choosing a product. From a business concern opportunity cost helps to maintain time management to make business decisions.

Even opportunity cost involves limitations like consumption of a lot of time and opportunity cost is not considered by accountants.