

Opportunity costs

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Opportunity Costs Affiliation: Critical decisions must be made in allocation of resources, since human needs and wants surpass resource availability.

Scarcity of resources directs resource allocation among the best uses, making it critical to choose among alternatives that depend on the same resources available. In this pursuit, the concept of opportunity cannot be avoided. Scarcity of resources holds it that one alternative choice will outperform the others, not because the other alternatives are not important but because choices have to be made among the alternatives (Gerber, 2010). Resources are never enough to satisfy human needs and wants, and the concept of opportunity cost, therefore, informs choices among alternative use of resources.

Individuals, firms and governments face opportunity cost from time to time in their efforts to allocate resources for the most suitable purpose (Keat & Young, 2006). At an individual level, one may want to pay for mortgage and buy a car given a certain level of resource available. While both the car and mortgage are equally important to the individual, the individual may forego the car and make the mortgage payment. The individual pays for the mortgage at the expense of the car. The car is the next-best alternative given up when the individual pays for the mortgage.

In a firm's context, the firm may want to maximize shareholders' wealth and at the same time retain significant profits for firm operations. If the firm chooses to maximize shareholders' wealth at the expense of retaining more profits for the firm, more profits becomes the foregone item (Douma & Schreuder, 2008). In the choice made in this case, the next-best alternative is shareholder wealth maximization. Governments also face opportunity cost.

A government may want to finance a healthcare project while it also needs to acquire more military equipment using the same resources. Choosing to finance the healthcare project over acquiring military equipment makes military equipment acquisition the foregone item. The choice to finance healthcare makes military equipment acquisition the next-best alternative.

References

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Keat, G. & Young, P. (2006). *Managerial economics: economic tools for today's decision makers*. New York: Pearson Prentice Hall.