

Chapter 1: MANAGERS, PROFITS, AND MARKETS

Multiple Choice

- I-1 Economic theory is a valuable tool for business decision making because it
- identifies for managers the essential information for making a decision.
 - assumes away the problem.
 - creates a realistic, complex model of the business firm.
 - provides an easy solution to complex business problems.

Answer: a

Difficulty: 01 Easy

Topic: The Economic Way of Thinking about Business Practices and Strategy

AACSB: Reflective Thinking

Blooms: Remember

Learning Objective: 01-01

- I-2 Economic profit
- is a theoretical measure of a firm's performance and has little value in real world decision making.
 - can be calculated by subtracting implicit costs of using owner-supplied resources from the firm's total revenue.
 - is negative when total costs exceed total revenues.
 - is generally larger than accounting profit.

Answer: c

Difficulty: 01 Easy

Topic: The Economic Way of Thinking about Business Practices and Strategy

AACSB: Reflective Thinking

Blooms: Remember

Learning Objective: 01-02

- I-3 Economic profit is the difference between
- total revenue and the opportunity cost of all of the resources used in production.
 - total revenue and the implicit costs of using owner-supplied resources.
 - accounting profit and the opportunity cost of the market-supplied resources used by the firm.
 - accounting profit and explicit costs.

Answer: a

Difficulty: 01 Easy

Topic: The Economic Way of Thinking about Business Practices and Strategy

AACSB: Reflective Thinking

Blooms: Remember

Learning Objective: 01-02

- I-4 When economic profit is positive,
- total revenue exceeds total economic cost.
 - the firm's owners have successfully solved the principle-agent problem.
 - the firm's owners experience a decrease in their wealth.
 - foreign companies experience loss of market share

Answer: a

Difficulty: 01 Easy

Topic: The Economic Way of Thinking about Business Practices and Strategy
AACSB: Reflective Thinking
Blooms: Remember
Learning Objective: 01-02

- 1-5 Consider a firm that employs some resources that are owned by the firm. When accounting profit is zero, economic profit
- must also equal zero.
 - is sure to be positive.
 - must be negative and shareholder wealth is reduced.
 - cannot be computed accurately, but the firm is breaking even nonetheless.

Answer: c

Difficulty: 02 Medium

Topic: The Economic Way of Thinking about Business Practices and Strategy
AACSB: Analytical Thinking
Blooms: Apply
Learning Objective: 01-02

- 1-6 Which of the following statements is false?
- Explicit costs of using market-supplied resources entail an opportunity cost equal to the dollar cost of obtaining the resources in the market.
 - When economic profit is zero, the firm's owners could *not* have done better putting their resources in some other industry of comparable risk.
 - If economic profit is positive, accounting profit must also be positive.
 - If economic profit is negative, accounting profit must also be negative.
 - None of the above statements is false.

Answer: d

Difficulty: 02 Medium

Topic: The Economic Way of Thinking about Business Practices and Strategy
AACSB: Analytical Thinking
Blooms: Apply
Learning Objective: 01-02

- 1-7 The value of a firm is
- smaller the higher is the risk premium used to compute the firm's value.
 - larger the higher is the risk premium used to compute the firm's value.
 - the price for which the firm can be sold minus the present value of the expected future profits.

d. both *b* and *c*

Answer: a

Difficulty: 02 Medium

Topic: The Economic Way of Thinking about Business Practices and Strategy
AACSB: Analytical Thinking
Blooms: Apply
Learning Objective: 01-02

- 1-8 Suppose Marv, the owner-manager of Marv's Hot Dogs, earned \$82,000 in revenue last year. Marv's explicit costs of operation totaled \$36,000. Marv has a Bachelor of Science degree in mechanical engineering and could be earning \$40,000 annually as mechanical engineer.
- Marv's implicit cost of using owner-supplied resources is \$36,000.
 - Marv's economic profit is \$36,000.

- c. Marv's implicit cost of using owner-supplied resources is \$30,000.
- d. Marv's economic profit is \$6,000.

Answer: d

Difficulty: 01 Easy

Topic: The Economic Way of Thinking about Business Practices and Strategy

AACSB: Analytical Thinking

Blooms: Apply

Learning Objective: 01-02

- 1-9 A risk premium is
- a. a measure calculated to reflect the riskiness of future profits.
 - b. subtracted from the discount rate when calculating the present value of a future stream of profits.
 - c. lower the riskier the future stream of profits.
 - d. an additional compensation paid to the workers of a business enterprise.

Answer: a

Difficulty: 01 Easy

Topic: The Economic Way of Thinking about Business Practices and Strategy

AACSB: Reflective Thinking

Blooms: Remember

Learning Objective: 01-02

- 1-10 Owners of a firm want the managers to make business decisions which will
- a. maximize the value of the firm.
 - b. maximize expected profit in each period of operation.
 - c. maximize the market share of the firm.
 - d. both *a* and *b* are correct when revenue and cost conditions in one time period are independent of revenues and costs in future time periods.

Answer: d

Difficulty: 02 Medium

Topic: The Economic Way of Thinking about Business Practices and Strategy

AACSB: Analytical Thinking

Blooms: Apply

Learning Objective: 01-02

- 1-11 The principal-agent problem arises when
- a. the principal and the agent have different objectives.
 - b. the principal cannot enforce the contract with the agent or finds it too costly to monitor the agent.
 - c. the principal cannot decide whether the firm should seek to maximize the expected future profits of the firm or maximize the price for which the firm can be sold.
 - d. both *a* and *b*

Answer: d

Difficulty: 01 Easy

Topic: Separation of Ownership and Control of the Firm

AACSB: Reflective Thinking

Blooms: Remember

Learning Objective: 01-03

- 1-12 Moral hazard

- a. occurs when managers pursue profit maximization without regard to the interests of society in general.
- b. exists when either party to a contract has an incentive to cancel the contract.
- c. occurs only rarely in modern corporations.
- d. is the cause of principal-agent problems.

Answer: d

Difficulty: 02 Medium

Topic: Separation of Ownership and Control of the Firm

AACSB: Reflective Thinking

Blooms: Understand

Learning Objective: 01-03

- 1-13 A price-taking firm can exert no control over price because
- a. the firm's demand curve is downward sloping.
 - b. of a lack of substitutes for the product.
 - c. the firm's individual production is insignificant relative to total production in the industry.
 - d. no other firms make a product that is nearly identical to its product.

Answer: c

Difficulty: 02 Medium

Topic: Market Structure and Managerial Decision Making

AACSB: Analytical Thinking

Blooms: Apply

Learning Objective: 01-04

- 1-14 Which of the following statements is true?
- a. Shareholders as a group have little or no ability to force managers to pursue maximization of the firm's value.
 - b. The effectiveness of a board of directors in monitoring managers is enhanced by appointing members from the firm who are well-informed about the management problems facing the firm.
 - c. Reducing the amount of debt financing can reduce divergence between the shareholders' interests and the manager's interests.
 - d. Equity ownership by managers is thought to be one of the most effective corporate control mechanisms.
 - e. All of the above are true.

Answer: d

Difficulty: 02 Medium

Topic: Separation of Ownership and Control of the Firm

AACSB: Analytical Thinking

Blooms: Apply

Learning Objective: 01-03

- 1-15 When a firm is a price-taking firm,
- a. the price of the product it sells is determined by the intersection of the market demand and supply curves for the product.
 - b. raising the price of the product above the market-determined price will cause sales to fall nearly to zero.
 - c. many other firms produce a product that is identical to the output produced by the rest of the firms in the industry.
 - d. all of the above

Answer: d

Difficulty: 01 Easy
Topic: Market Structure and Managerial Decision Making
AACSB: Reflective Thinking
Blooms: Remember
Learning Objective: 01-04

- 1-16 A price-setting firm
- a. can lower the price of its product and sell more units.
 - b. can raise the price of its product and sell the same number of units.
 - c. possesses little market power.
 - d. sells a product that is not differentiated from the product sold by its rivals or sells in a limited geographic market area with only one or a few sellers.

Answer: a

Difficulty: 01 Easy
Topic: Market Structure and Managerial Decision Making
AACSB: Reflective Thinking
Blooms: Understand
Learning Objective: 01-04

- 1-17 A market
- a. raises the transaction costs of doing business.
 - b. is any arrangement that brings buyers and sellers together to exchange goods or services.
 - c. is an institution used rarely by capitalist nations.
 - d. is characterized by rigid prices

Answer: b

Difficulty: 01 Easy
Topic: Market Structure and Managerial Decision Making
AACSB: Reflective Thinking
Blooms: Remember
Learning Objective: 01-04

- 1-18 Which of the following is NOT one of features characterizing market structures?
- a. the number and size of firms
 - b. the likelihood of new firm's entering a market
 - c. the level of capital investment in research and development
 - d. the degree of product differentiation

Answer: c

Difficulty: 01 Easy
Topic: Market Structure and Managerial Decision Making
AACSB: Reflective Thinking
Blooms: Remember
Learning Objective: 01-04

- 1-19 In a perfectly competitive market,
- a. all firms produce and sell a standardized or undifferentiated product.
 - b. the output sold by a particular firm may be quite different from the output sold by the other firms in the market.
 - c. firms are price-setters.
 - d. it is difficult for new firms to enter the market due to barriers to entry.

Answer: a

Difficulty: 01 Easy

Topic: Market Structure and Managerial Decision Making
AACSB: Reflective Thinking
Blooms: Remember
Learning Objective: 01-04

- 1-20 Which of the following is NOT a characteristic of monopoly market structures?
- a. A single firm produces the entire market output.
 - b. The easier consumers can find imperfect substitutes for the firm's product the lower will be the firm's market power.
 - c. There are no barriers to entry.
 - d. No close substitutes for the product are available.

Answer: c

Difficulty: 02 Medium

Topic: Market Structure and Managerial Decision Making
AACSB: Reflective Thinking
Blooms: Understand
Learning Objective: 01-04

- 1-21 In markets characterized by monopolistic competition,
- a. a small number of relatively small firms sell a differentiated product.
 - b. a small number of relatively large firms sell a standardized product.
 - c. entry into the market is relatively easy so that profit in the long run is zero.
 - d. entry into the market is restricted so that profit may be positive in the long run.

Answer: c

Difficulty: 01 Easy

Topic: Market Structure and Managerial Decision Making
AACSB: Reflective Thinking
Blooms: Remember
Learning Objective: 01-04

- 1-22 In markets characterized by oligopoly,
- a. a large number of relatively large firms sell a differentiated product.
 - b. a small number of relatively small firms sell a standardized product.
 - c. mutual interdependence of firms means that actions of any one firm in the market will have no effect on the sales of all other firms in the market.
 - d. entry into the market is restricted so that profit may be positive in the long run.

Answer: d

Difficulty: 01 Easy

Topic: Market Structure and Managerial Decision Making
AACSB: Reflective Thinking
Blooms: Remember
Learning Objective: 01-04

- 1-23 When economic profit is zero,
- a. there is just enough revenue left after paying all explicit costs to cover the cost of using the firm's owner-supplied resources.
 - b. accounting profit is positive.
 - c. accounting profit is exactly equal to the implicit cost of using the firm's owner-supplied resources.

- d. all of the above
- e. none of the above

Answer: d
Difficulty: 02 Medium
Topic: The Economic Way of Thinking about Business Practices and Strategy
AACSB: Reflective Thinking
Blooms: Understand
Learning Objective: 01-02

- 1-24 Economic profit is a better measure of a firm's performance than accounting profit because
- a. accounting profit is unreliable because generally accepted accounting practices (GAAP) overstates the firm's true costs of using resources.
 - b. economic profit fully accounts for all sources of revenue.
 - c. as a general rule, only explicit costs can be subtracted from revenue for the purposes of computing taxable profit.
 - d. the opportunity cost of using ALL resources is subtracted from total revenue.
 - e. both c and d

Answer: d
Difficulty: 02 Medium
Topic: The Economic Way of Thinking about Business Practices and Strategy
AACSB: Reflective Thinking
Blooms: Understand
Learning Objective: 01-02

- 1-25 A manager who does not see his or her goal as the maximization of profit
- a. may nevertheless maximize the value of the firm.
 - b. may create a principle-agent problem.
 - c. will follow objectives that conflict with those of the owners of the firm.
 - d. both b and c

Answer: d
Difficulty: 01 Easy
Topic: Separation of Ownership and Control of the Firm
AACSB: Reflective Thinking
Blooms: Understand
Learning Objective: 01-03

- 1-26 Over the past 25 years, which of the following developments encouraged globalization of markets?
- a. Eleven European countries began using the "euro" as a common currency.
 - b. The ability to buy and sell goods on the Internet was increased.
 - c. Numerous bilateral and multilateral trade agreements were reached.
 - d. both a and c
 - e. all of the above

Answer: e
Difficulty: 01 Easy
Topic: Market Structure and Managerial Decision Making
Reflective Thinking
Blooms: Understand
Learning Objective: 01-04

1-27 Which of the following is an example of an implicit cost for a firm?

- a. the value of time worked by the owner.
- b. any wages and salaries paid to employed.
- c. forgone rent on property owned by firm.
- d. both *a* and *c*
- e. all of the above

Answer: d

Difficulty: 01 Easy

Topic: The Economic Way of Thinking about Business Practices and Strategy

AACSB: Reflective Thinking

Blooms: Understand

Learning Objective: 01-02

1-28 St. Charles Hospital, located in an upper-income neighborhood of a large city, recently received a restored mansion as a gift from an appreciative patient. The board of directors decided to remodel the mansion and use it as recuperative quarters for patients willing to pay for luxurious accommodations. The cost to the hospital of using the mansion includes

- a. nothing because it was a gift.
- b. how much the hospital pays for upkeep--taxes, insurance, utilities, maintenance, etc.
- c. how much the hospital would receive if it rented or sold the mansion.
- d. the legal expenses to transfer ownership to St. Charles Hospital.
- e. both *b* and *c*

Answer: e

Difficulty: 01 Easy

Topic: The Economic Way of Thinking about Business Practices and Strategy

AACSB: Reflective Thinking

Blooms: Understand

Learning Objective: 01-02

1-29 Until recently you worked as an accountant earning \$60,000 annually. Then you inherited a piece of commercial real estate bringing in \$40,000 rent annually. You decided to leave your job and open a tattoo parlor in the office space you inherited.

At the end of the first year, your books showed total revenues of \$180,000 and total explicit costs of \$90,000 for labor, ink, utilities, taxes, and miscellaneous supplies. Your total cost of doing business during the first year is _____ and you earned economic profit of _____.

- a. \$190,000; -\$10,000
- b. \$90,000; \$90,000
- c. \$130,000; \$50,000
- d. \$150,000; \$30,000

Answer: a

Difficulty: 02 Medium

Topic: The Economic Way of Thinking about Business Practices and Strategy

AACSB: Reflective Thinking

Blooms: Understand

Learning Objective: 01-02

1-30 At the beginning of 2020, market analysts expect Atlantis Company, holder of a valuable patent, to earn the following stream of economic profits over the next five years. At the end of five years, Atlantis will lose its patent protection, and analysts expect economic profit to be zero after five years.

<i>Year</i>	<i>Expected Economic Profit</i>
2020	\$ 225,000
2021	\$ 325,000
2022	\$ 425,000
2023	\$ 200,000
2024	\$ 100,000

If investors apply an annual risk-adjusted discount rate of 15%, the value of Atlantis Company in 2020 is \$ _____, which is also the maximum price investors would be willing to pay for Atlantis Company.

- a. \$726,916
- b. \$884,912
- c. \$1,275,000
- d. \$2,215,000
- e. \$3,824,318

Answer: b

Difficulty: 03 Hard

Topic: The Economic Way of Thinking about Business Practices and Strategy

AACSB: Analytical Thinking

Blooms: Analyze

Learning Objective: 01-02

Answer the next five questions using the following annual income statement for Quest Realty, Inc.:

Revenues	
Revenue from sales of goods and services.....	\$80,000,000
Operating costs and expenses:	
Cost of products and services sold.....	\$30,000,000
Selling expenses.....	\$3,000,000
Administrative expense.....	\$4,000,000
Total operating costs and expenses.....	\$37,000,000
Income from operations.....	\$43,000,000
Interest expense (corporate bonds & loans).....	\$300,000
Non-recurring expense (Legal expenses/fines in settling a federal antitrust suit).....	\$200,000
Income taxes.....	\$700,000
Net income.....	\$41,800,000

During this year of operation, Quest Realty owned and occupied an office building in downtown Indianapolis. For this year, the building could have been leased to other businesses for \$2,000,000 in lease income. Quest Realty also owned undeveloped land valued at \$15,000,000. Owners of Quest Realty can earn a 14% rate of return annually on funds invested elsewhere.

- I-31 Total explicit costs of using market-supplied resources for Quest Realty for this year are
- a. \$23,000,000
 - b. \$37,000,000
 - c. \$38,200,000
 - d. \$41,100,000
 - e. none of the above

Answer: c

Difficulty: 03 Hard

Topic: The Economic Way of Thinking about Business Practices and Strategy

AACSB: Analytical Thinking

Blooms: Analyze

Learning Objective: 01-02

- I-32 Total implicit costs of using owner-supplied resources for Quest Realty for this year are
- a. \$4,100,000
 - b. \$19,000,000
 - c. \$38,200,000
 - d. \$41,000,000
 - e. none of the above

Answer: a

Difficulty: 02 Medium

Topic: The Economic Way of Thinking about Business Practices and Strategy

AACSB: Analytical Thinking

Blooms: Apply

Learning Objective: 01-02

- I-33 Quest's total economic cost is
- a. \$17,000,000
 - b. \$38,200,000
 - c. \$41,000,000
 - d. \$42,300,000

Answer: d

Difficulty: 02 Medium

Topic: The Economic Way of Thinking about Business Practices and Strategy

AACSB: Analytical Thinking

Blooms: Apply

Learning Objective: 01-02

- I-34 Quest's accounting profit is
- a. -\$4,100,000
 - b. \$9,360,000
 - c. \$38,200,000
 - d. \$42,300,000
 - e. none of the above

Answer: e

Difficulty: 02 Medium

Topic: The Economic Way of Thinking about Business Practices and Strategy

AACSB: Analytical Thinking

Blooms: Apply

Learning Objective: 01-02

- 1-35 Quest's economic profit is
- \$19,000,000
 - \$21,800,000
 - \$38,200,000
 - \$41,000,000
 - none of the above
- Answer: e
Difficulty: 02 Medium
Topic: The Economic Way of Thinking about Business Practices and Strategy
AACSB: Analytical Thinking
Blooms: Apply
Learning Objective: 01-02
- 1-36 Firms with market power may try to limit entry of rival firms in the long run by setting the price of their product below the level that maximizes profit. This kind of pricing behavior
- is OK in theory but would not be commonly practiced in the real world because no manager will ever price either above or below the profit-maximizing level.
 - is a business practice or tactic because pricing decisions are routine decisions made by managers every day.
 - should always be implemented in order maximize the firm's market share in both the short run and long run periods.
 - is a strategic pricing decision because the manager is making the pricing decision with the goal of altering the behavior of rival firms to protect its profit in the long run.
- Answer: d
Difficulty: 02 Medium
Topic: Market Structure and Managerial Decision Making
AACSB: Analytical Thinking
Blooms: Apply
Learning Objective: 01-04
- 1-37 Microeconomics
- is generally too complex and abstract to be of much use in making real-world business decisions.
 - studies the behavior of individual economic units or segments of the economy.
 - contributes to the understanding of ordinary business practices or tactics.
 - all of the above.
 - both *b* and *c*.
- Answer: e
Difficulty: 01 Easy
Topic: The Economic Way of Thinking about Business Practices and Strategy
AACSB: Reflective Thinking
Blooms: Remember
Learning Objective: 01-01
- 1-38 Which of the following is a common mistake that managers make?
- Using marginal analysis to make output decisions.
 - Maximizing the value of the firm instead of maximizing the firm's profits.
 - Reducing price to increase the firm's share of total market sales.
 - Treating implicit opportunity costs as part of the total costs of using resources.
 - all of the above.
- Answer: c
Difficulty: 02 Medium

Topic: The Economic Way of Thinking about Business Practices and Strategy
AACSB: Analytical Thinking
Blooms: Apply
Learning Objective: 01-02

- 1-39 Which of the following is a common mistake that managers make?
- a. Using marginal analysis to make output decisions.
 - b. Maximizing the value of the firm instead of maximizing the firm's profits.
 - c. Treating implicit opportunity costs as part of the total costs of using resources.
 - d. Increasing the rate of production in order to reduce unit costs of production.
 - e. all of the above.

Answer: d

Difficulty: 02 Medium

Topic: The Economic Way of Thinking about Business Practices and Strategy
AACSB: Analytical Thinking
Blooms: Apply
Learning Objective: 01-02

- 1-40 Which of the following economic forces promotes profitability in the long run?
- a. Existence of strong barriers to entry.
 - b. A large number of complementary products
 - c. A large number of close substitute products.
 - d. Both a and b
 - e. All of the above

Answer: d

Difficulty: 02 Medium

Topic: The Economic Way of Thinking about Business Practices and Strategy
AACSB: Analytical Thinking
Blooms: Apply
Learning Objective: 01-01

- 1-41 Which of the following is NOT one of the economic forces that promotes long-run profitability of business firms?
- a. Low market power of input suppliers.
 - b. Low market power of consumers.
 - c. Strong barriers to entry of rival firms.
 - d. Fierce rivalry among the firms competing in the industry.
 - e. Abundance of complementary products

Answer: d

Difficulty: 02 Medium

Topic: The Economic Way of Thinking about Business Practices and Strategy
AACSB: Analytical Thinking
Blooms: Apply
Learning Objective: 01-01

- 1-42 The economic cost to the owners of a firm for using productive resources
- a. is measured fully by the explicit or out-of-pocket expenses incurred when the firm uses resources it purchases in the market.
 - b. does not include implicit costs associated with resources the firm already owns.
 - c. is the total opportunity cost of all resources used by the firm.

d. is measured by the sum of the explicit costs of market supplied resources plus the implicit costs of owner-supplied resources.

e. both c and d

Answer: e

Difficulty: 02 Medium

Topic: The Economic Way of Thinking about Business Practices and Strategy

AACSB: Analytical Thinking

Blooms: Apply

Learning Objective: 01-02

1-43 Which of the following conditions must hold in order to have a principal-agent problem?

a. Managers and owners have different objectives for the firm.

b. It is very costly to oversee every managerial decision to make sure all decisions increase the value of the firm.

c. Complete contracts effectively restrain managers from making value-reducing decisions.

d. The objectives of managers and owners are aligned but hidden actions by managers cannot be observed no matter how much is spent on monitoring managers.

e. both a and b

Answer: e

Difficulty: 02 Medium

Topic: Separation of Ownership and Control of the Firm

AACSB: Analytical Thinking

Blooms: Apply

Learning Objective: 01-03

1-44 Moral hazard is a principal-agent problem that arises when

a. Managers' and owners' objectives are nonaligned.

b. Complete contracts effectively restrain managers from making value-reducing decisions.

c. Managers can take hidden actions.

d. both a and c

e. all of the above

Answer: d

Difficulty: 02 Medium

Topic: Separation of Ownership and Control of the Firm

AACSB: Analytical Thinking

Blooms: Apply

Learning Objective: 01-03

1-45 Corporate control mechanisms

a. can make it easier to detect hidden actions by managers.

b. will exacerbate moral hazard problems when complete contracts are effectively solving the principal-agent problem.

c. may not be important when corporate takeovers effectively impose external forces to ensure managerial decisions are value-maximizing.

d. make it impossible for managers to take hidden actions that are harmful to the interests of the firm's owners.

e. both a and b

Answer: c

Difficulty: 02 Medium

Topic: Separation of Ownership and Control of the Firm

AACSB: Analytical Thinking

Blooms: Apply
Learning Objective: 01-03

Answer the next five questions using the following annual income statement for Bonus Realty, Inc.:

Revenues	
Revenue from sales of goods and services.....	\$100,000,000
Operating costs and expenses:	
Cost of products and services sold.....	\$30,000,000
Selling expenses.....	\$3,000,000
Administrative expense.....	\$4,000,000
Total operating costs and expenses.....	\$37,000,000
Income from operations.....	\$63,000,000
Interest expense (corporate bonds & loans).....	\$500,000
Non-recurring expense (Legal expenses/fines in settling a federal antitrust suit.....	\$100,000
Income taxes.....	\$740,000
Net income.....	\$61,660,000

During this year of operation, Bonus Realty owned and occupied an office building in downtown Cleveland. For this year, the building could have been leased to other businesses for \$3,000,000 in lease income. Bonus Realty also owned undeveloped land valued at \$10,000,000. Owners of Bonus Realty can earn a 4% rate of return annually on funds invested elsewhere.

- 1-46 Total explicit costs of using market-supplied resources for Bonus Realty for this year are
- \$23,000,000
 - \$37,000,000
 - \$36,200,000
 - \$38,340,000
 - \$41,000,000

Answer: d

Difficulty: 03 Hard

Topic: The Economic Way of Thinking about Business Practices and Strategy

AACSB: Analytical Thinking

Blooms: Analyze

Learning Objective: 01-02

- 1-47 Total implicit costs of using owner-supplied resources for Bonus Realty for this year are
- \$3,400,000
 - \$13,000,000
 - \$14,000,000
 - \$37,000,000
 - none of the above

Answer: a

Difficulty: 03 Hard

Topic: The Economic Way of Thinking about Business Practices and Strategy

AACSB: Analytical Thinking

Blooms: Analyze

Learning Objective: 01-02

- 1-48 Total economic cost is

- a. \$17,000,000
- b. \$38,200,000
- c. \$41,740,000
- d. \$42,300,000

Answer: c

Difficulty: 03 Hard

Topic: The Economic Way of Thinking about Business Practices and Strategy

AACSB: Analytical Thinking

Blooms: Analyze

Learning Objective: 01-02

I-49 Bonus Realty's accounting profit is

- a. -\$4,100,000
- b. \$9,360,000
- c. \$38,200,000
- d. \$41,740,000
- e. none of the above

Answer: e

Difficulty: 03 Hard

Topic: The Economic Way of Thinking about Business Practices and Strategy

AACSB: Analytical Thinking

Blooms: Analyze

Learning Objective: 01-02

I-50 Economic profit for Bonus Realty is

- a. \$19,000,000
- b. \$21,800,000
- c. \$38,200,000
- d. \$41,000,000
- e. none of the above

Answer: e

Difficulty: 03 Hard

Topic: The Economic Way of Thinking about Business Practices and Strategy

AACSB: Analytical Thinking

Blooms: Analyze

Learning Objective: 01-02

1During a year of operation, Knight's Electric, LLC collects \$5,000,000 in revenue and spends \$3,500,000 on labor expense, raw materials, rent, and utilities. Knight's owner has provided \$1,000,000 of her own money to her business instead of investing the money and earning a 12 percent annual rate of return.

I-51 Knight's explicit costs for the year are \$_____, its implicit costs are \$_____, and thus Knight's total economic cost is \$_____.

- a. \$3,500,000; \$1,000,000; \$4,500,000
- b. \$3,500,000; \$120,000; \$3,620,000
- c. \$4,500,000; \$1,000,000; \$5,500,000
- d. \$5,000,000; \$1,000,000; \$6,000,000

Answer: b

Difficulty: 03 Hard

Topic: The Economic Way of Thinking about Business Practices and Strategy

AACSB: Analytical Thinking

Blooms: Analyze

Learning Objective: 01-02

- 1-52 Knight's Electric earns accounting profit of \$_____ and its economic profit is \$_____.
- a. \$1,500,000; \$1,000,000
 - b. \$3,500,000; \$120,000
 - c. \$4,500,000; \$1,000,000
 - d. \$1,500,000; \$1,380,000
 - e. none of the above

Answer: d

Difficulty: 03 Hard

Topic: The Economic Way of Thinking about Business Practices and Strategy

AACSB: Analytical Thinking

Blooms: Analyze

Learning Objective: 01-02

- 1-53 Economic theory is a valuable tool for business decision making because it
- a. acts like a road map to abstract away from nonessential matters to allow managers to concentrate on the relevant items for making a decision.
 - b. creates a realistic, complex model of the business decision.
 - c. allows managers to apply the economic way of thinking to make valid explanations and predictions about real world business problems.
 - d. both *a* and *c*
 - e. *a*, *b* and *c*

Answer: d

Difficulty: 01 Easy

Topic: The Economic Way of Thinking about Business Practices and Strategy

AACSB: Reflective Thinking

Blooms: Remember

Learning Objective: 01-01

- 1-54 Which of the following statements is false?
- a. Explicit costs of using market-supplied resources entail an opportunity cost equal to the dollar cost of obtaining the resources in the market.
 - b. When economic profit is zero, the firm's owners could NOT have done better putting their resources in some other industry of comparable risk.
 - c. If economic profit is positive, accounting profit must also be positive.
 - d. If economic profit is negative, accounting profit must also be negative.
 - e. None of the above statements is false.

Answer: d

Difficulty: 01 Easy

Topic: The Economic Way of Thinking about Business Practices and Strategy

AACSB: Reflective Thinking

Blooms: Remember

Learning Objective: 01-02

- 1-55 What is the most important characteristic of oligopoly?

- a. firms have market power
- b. product differentiation
- c. barriers to entry
- d. interdependence of profits

Answer: d

Difficulty: 01 Easy

Topic: Market Structure and Managerial Decision Making

AACSB: Reflective Thinking

Blooms: Remember

Learning Objective: 01-04