Student name:\_\_\_\_\_\_\_\_\_\_

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.

1. 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.

1. 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.

1. 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

1. 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.

1. 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 statements are false.

1. 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.

both "larger the higher is the risk premium used to compute the firm’s value" and "the price for which the firm can be sold minus the present value of the expected future profits".

1. Suppose Marv, the owner-manager of Marv's Hot Dogs, earned $122,000 in revenue last year. Marv's explicit costs of operation totalled $36,000. Marv has a Bachelor of Science degree in mechanical engineering and could be earning $80,000 annually as mechanical engineer. Based on this information, what must be true?

Marv's implicit cost of using owner-supplied resources is $36,000.

Marv's economic profit is $36,000.

Marv's implicit cost of using owner-supplied resources is $30,000.

Marv's economic profit is $6,000.

1. A risk premium is

a measure calculated to reflect the riskiness of future profits.

subtracted from the discount rate when calculating the present value of a future stream of profits.

lower the riskier the future stream of profits.

an additional compensation paid to the workers of a business enterprise.

1. Owners of a firm want the managers to make business decisions which will

maximize the value of the firm.

maximize expected profit in each period of operation.

maximize the market share of the firm.

both "maximize the value of the firm" and "maximize expected profit in each period of operation" are correct when revenue and cost conditions in one time period are independent of revenues and costs in future time periods.

1. The principal-agent problem arises when

the principal and the agent have different objectives.

the principal cannot enforce the contract with the agent or finds it too costly to monitor the agent.

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.

both "the principal and the agent have different objectives" and "the principal cannot enforce the contract with the agent or finds it too costly to monitor the agent".

1. Moral hazard

occurs when managers pursue profit maximization without regard to the interests of society in general.

exists when either party to a contract has an incentive to cancel the contract.

occurs only rarely in modern corporations.

is the cause of principal-agent problems.

1. A price-taking firm can exert no control over price because

the firm's demand curve is downward sloping.

of a lack of substitutes for the product.

the firm's individual production is insignificant relative to total production in the industry.

no other firms make a product that is nearly identical to its product.

1. Which of the following statements is true?

Shareholders as a group have little or no ability to force managers to pursue maximization of the firm's value.

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.

Reducing the amount of debt financing can reduce divergence between the shareholders' interests and the manager's interests.

Equity ownership by managers is thought to be one of the most effective corporate control mechanisms.

All of the statements are true.

1. When a firm is a price-taking firm,

the price of the product it sells is determined by the intersection of the market demand and supply curves for the product.

raising the price of the product above the market-determined price will cause sales to fall nearly to zero.

many other firms produce a product that is identical to the output produced by the rest of the firms in the industry.

All of the choices are correct.

1. A price-setting firm

can lower the price of its product and sell more units.

can raise the price of its product and sell the same number of units.

possesses little market power.

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.

1. A market

raises the transaction costs of doing business.

is any arrangement that brings buyers and sellers together to exchange goods or services.

is an institution used rarely by capitalist nations.

is characterized by rigid prices.

1. Which of the following is NOT one of features characterizing market structures?

the number and size of firms

the likelihood of new firm's entering a market

the level of capital investment in research and development

the degree of product differentiation

1. In a perfectly competitive market,

all firms produce and sell a standardized or undifferentiated product.

the output sold by a particular firm may be quite different from the output sold by the other firms in the market.

firms are price-setters.

it is difficult for new firms to enter the market due to barriers to entry.

1. Which of the following is NOT a characteristic of monopoly market structures?

A single firm produces the entire market output.

The easier consumers can find imperfect substitutes for the firm's product the lower will be the firm's market power.

There are no barriers to entry.

No close substitutes for the product are available.

1. In markets characterized by monopolistic competition,

a small number of relatively small firms sell a differentiated product.

a small number of relatively large firms sell a standardized product.

entry into the market is relatively easy so that profit in the long run is zero.

entry into the market is restricted so that profit may be positive in the long run.

1. In markets characterized by oligopoly,

a large number of relatively large firms sell a differentiated product.

a small number of relatively small firms sell a standardized product.

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.

entry into the market is restricted so that profit may be positive in the long run.

1. When economic profit is zero,

there is just enough revenue left after paying all explicit costs to cover the cost of using the firm’s owner-supplied resources.

accounting profit is positive.

accounting profit is exactly equal to the implicit cost of using the firm’s owner-supplied resources.

All of the choices are correct.

1. Economic profit is a better measure of a firm’s performance than accounting profit because

accounting profit is unreliable because generally accepted accounting practices (GAAP) overstates the firm’s true costs of using resources.

economic profit fully accounts for all sources of revenue.

as a general rule, only explicit costs can be subtracted from revenue for the purposes of computing taxable profit.

the opportunity cost of using ALL resources is subtracted from total revenue.

both "as a general rule, only explicit costs can be subtracted from revenue for the purposes of computing taxable profit" and "the opportunity cost of using ALL resources is subtracted from total revenue".

1. A manager who does not see his or her goal as the maximization of profit

may nevertheless maximize the value of the firm.

may create a principle-agent problem.

will follow objectives that conflict with those of the owners of the firm.

both "may create a principle-agent problem" and "will follow objectives that conflict with those of the owners of the firm".

1. Over the past 25 years, which of the following developments encouraged globalization of markets?

Eleven European countries began using the "euro" as a common currency.

The ability to buy and sell goods on the Internet was increased.

Numerous bilateral and multilateral trade agreements were reached.

Both "Eleven European countries began using the “euro” as a common currency" and "numerous bilateral and multilateral trade agreements were reached".

All of the choices are correct.

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

the value of time worked by the owner

any wages and salaries paid to employed

forgone rent on property owned by firm

both "the value of time worked by the owner" and "forgone rent on property owned by firm"

All of the choices are correct.

1. 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

nothing because it was a gift.

how much the hospital pays for upkeep—taxes, insurance, utilities, maintenance, etc.

how much the hospital would receive if it rented or sold the mansion.

the legal expenses to transfer ownership to St. Charles Hospital.

both "how much the hospital pays for upkeep—taxes, insurance, utilities, maintenance, etc." and "how much the hospital would receive if it rented or sold the mansion".

1. Until recently you worked as a sales associate 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 \_\_\_\_\_\_\_\_\_.

$190,000; −$10,000

$90,000; $90,000

$130,000; $50,000

$150,000; $30,000

1. At the beginning of 2024, 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.
2. An annual income statement for Quest Realty, Inc. is shown below:
3. An annual income statement for Quest Realty, Inc. is shown below:
4. An annual income statement for Quest Realty, Inc. is shown below:
5. An annual income statement for Quest Realty, Inc. is shown below:
6. An annual income statement for Quest Realty, Inc. is shown below:
7. 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 everyday.

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.

1. 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 choices are correct.

both "studies the behavior of individual economic units or segments of the economy" and "contributes to the understanding of ordinary business practices or tactics".

1. 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 choices are correct.

1. 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

treating implicit opportunity costs as part of the total costs of using resources

increasing the rate of production in order to reduce unit costs of production

All of the choices are correct.

1. Which of the following economic forces promotes profitability in the long run?

existence of strong barriers to entry

a large number of complementary products

a large number of close substitute products

both "Existence of strong barriers to entry" and "A large number of complementary products"

All of the choices are correct.

1. Which of the following is NOT one of the economic forces that promotes long-run profitability of business firms?

low market power of input suppliers

low market power of consumers

strong barriers to entry of rival firms

fierce rivalry among the firms competing in the industry

abundance of complementary products

1. The economic cost to the owners of a firm for using productive resources

is measured fully by the explicit or out-of-pocket expenses incurred when the firm uses resources it purchases in the market.

does not include implicit costs associated with resources the firm already owns.

is the total opportunity cost of all resources used by the firm.

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

both "is the total opportunity cost of all resources used by the firm" and "is measured by the sum of the explicit costs of market-supplied resources plus the implicit costs of owner-supplied resources."

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

Managers and owners have different objectives for the firm.

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

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

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.

Both "Managers and owners have different objectives for the firm" and "It is very costly to oversee every managerial decision to make sure all decisions increase the value of the firm".

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

Managers’ and owners’ objectives are nonaligned.

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

Managers can take hidden actions.

Both "Managers’ and owners’ objectives are nonaligned" and "Managers can take hidden actions".

All of the choices are correct.

1. Corporate control mechanisms

can make it easier to detect hidden actions by managers.

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

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

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

both "can make it easier to detect hidden actions by managers" and "will exacerbate moral hazard problems when complete contracts are effectively solving the principal–agent problem".

1. An annual income statement for Bonus Realty, Inc. is shown below:
2. An annual income statement for Bonus Realty, Inc. is shown below:
3. An annual income statement for Bonus Realty, Inc. is shown below:
4. An annual income statement for Bonus Realty, Inc. is shown below:
5. An annual income statement for Bonus Realty, Inc. is shown below:
6. During 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.Knight’s explicit costs for the year are $\_\_\_\_\_\_\_\_\_, its implicit costs are $\_\_\_\_\_\_\_\_\_, and thus Knight’s total economic cost is $\_\_\_\_\_\_\_\_\_.

$3,500,000; $1,000,000; $4,500,000

$3,500,000; $120,000; $3,620,000

$4,500,000; $1,000,000; $5,500,000

$5,000,000; $1,000,000; $6,000,000

1. During 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.
Knight’s Electric earns accounting profit of $\_\_\_\_\_\_\_\_\_ and its economic profit is $\_\_\_\_\_\_\_\_\_.

$1,500,000; $1,000,000

$3,500,000; $120,000

$4,500,000; $1,000,000

$1,500,000; $1,380,000

None of the choices is correct.

1. Economic theory is a valuable tool for business decision-making because it

acts like a road map to abstract away from nonessential matters to allow managers to concentrate on the relevant items for making a decision.

creates a realistic, complex model of the business decision.

allows managers to apply the economic way of thinking to make valid explanations and predictions about real-world business problems.

both "acts like a road map to abstract away from nonessential matters to allow managers to concentrate on the relevant items for making a decision" and "allows managers to apply the economic way of thinking to make valid explanations and predictions about real-world business problems".

"acts like a road map to abstract away from nonessential matters to allow managers to concentrate on the relevant items for making a decision", "creates a realistic, complex model of the business decision," and "allows managers to apply the economic way of thinking to make valid explanations and predictions about real-world business problems".

1. 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 statements is false.

1. What is the most important characteristic of oligopoly?

firms have market power

product differentiation

barriers to entry

interdependence of profits

1. Suppose that you work as a sales associate after graduation, earning $50,000 annually. Assume that you inherit a small piece of commercial real estate (that’s brining in rental income of $44,000 annually) and $82,000 in a savings account (earning an annual interest rate of 5%).
Suppose that you decide to leave your job and operate a small video game rental business in the commercial real estate you inherited. You do all the work yourself and you do not hire any worker.
Suppose further that at the end of the first year, the total income generated from renting video games is $162,000. The total amount spend on inventory, utilities, taxes, and supplies equals $60,000. For simplicity, let’s assume that all these expenses are paid upfront in the beginning of the year. To cover these expenses, you withdrew money from your savings account.
What is the amount of total revenue from opening the video game rental store?

$50,000.

$65,000.

$97,000

$162,000

1. Suppose that you work as a sales associate after graduation, earning $50,000 annually. Assume that you inherit a small piece of commercial real estate (that’s brining in rental income of $44,000 annually) and $82,000 in a savings account (earning an annual interest rate of 5%).
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What is the amount of explicit cost from opening the video game rental store?

$60,000.

$65,000.

$97,000

$162,000

1. Suppose that you work as a sales associate after graduation, earning $50,000 annually. Assume that you inherit a small piece of commercial real estate (that’s brining in rental income of $44,000 annually) and $82,000 in a savings account (earning an annual interest rate of 5%).
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What is the amount of implicit cost from opening the video game rental store?

$50,000.

$94,000.

$97,000

$162,000

1. Suppose that you work as a sales associate after graduation, earning $50,000 annually. Assume that you inherit a small piece of commercial real estate (that’s brining in rental income of $44,000 annually) and $82,000 in a savings account (earning an annual interest rate of 5%).
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Suppose further that at the end of the first year, the total income generated from renting video games is $162,000. The total amount spend on inventory, utilities, taxes, and supplies equals $60,000. For simplicity, let’s assume that all these expenses are paid upfront in the beginning of the year. To cover these expenses, you withdrew money from your savings account.
What is the amount of accounting profit from opening the video game rental store?

$5,000.

$8,000.

$102,000

$162,000

1. Suppose that you work as a sales associate after graduation, earning $50,000 annually. Assume that you inherit a small piece of commercial real estate (that’s brining in rental income of $44,000 annually) and $82,000 in a savings account (earning an annual interest rate of 5%).
Suppose that you decide to leave your job and operate a small video game rental business in the commercial real estate you inherited. You do all the work yourself and you do not hire any worker.
Suppose further that at the end of the first year, the total income generated from renting video games is $162,000. The total amount spend on inventory, utilities, taxes, and supplies equals $60,000. For simplicity, let’s assume that all these expenses are paid upfront in the beginning of the year. To cover these expenses, you withdrew money from your savings account.
What is the amount of economic profit from opening the video game rental store?

$5,000.

$8,000.

$102,000

$162,000

1. Suppose that you work as a sales associate after graduation, earning $50,000 annually. Assume that you inherit a small piece of commercial real estate (that’s brining in rental income of $44,000 annually) and $82,000 in a savings account (earning an annual interest rate of 5%).
Suppose that you decide to leave your job and operate a small video game rental business in the commercial real estate you inherited. You do all the work yourself and you do not hire any worker.
Suppose further that at the end of the first year, the total income generated from renting video games is $162,000. The total amount spend on inventory, utilities, taxes, and supplies equals $60,000. For simplicity, let’s assume that all these expenses are paid upfront in the beginning of the year. To cover these expenses, you withdrew money from your savings account.
What is the amount of implicit cost of using the money from the savings account as needed for the upfront $60,000 expenses?

$3,000.

$60,000.

$0 as the money was inherited

$63,000

1. Suppose that a firm’s accounting profit is positive. What is true about the firm’s economic profit?

It must also be positive.

It may be positive, negative, or equal to zero.

It must be less than the firm’s accounting profit.

Both B and C are correct

None of the above are true.

1. Suppose that the firm’s economic profit is negative. What must be true?

The firm’s accounting profit must be negative as well.

The firm’s accounting profit must be greater than its implicit cost.

The firm’s accounting profit must be less than its implicit cost.

The firm’s explicit cost must be greater than its implicit costs.

None of the statements are true.

1. The value of a firm is Moonlight Madness is a nightclub in Tampa. This year, the nightclub is forecasted to earn an accounting profit of $1 million dollars. Last year the accounting profit was also $1 million dollars. The owner of the nightclub is calling a meeting with all of its staff and employees. During the meeting she announces:
"*We are sorry, but we will have to close the club and exit the nightclub market. It's too costly to stay open.*"
What could have motivated the owner to reach this decision?

The firm’s implicit cost must have been less than $1 million.

The firm’s implicit cost must have been greater than $1 million.

The firm’s explicit cost must have been less than $1 million.

The firm’s explicit cost must have been greater than $1 million.

1. Agricultural producers often complain that they are being ‘squeezed from both directions’ in that the markets in which they sell their output generate low market prices that they can’t influence while at the same time their inputs are purchased in markets with only a few sellers, who often charge high prices for the inputs the farmers need. What does that tell us about the output and input markets faced by agricultural producers?

The output markets are perfectly competitive while the input markets are monopolies.

The output markets are oligopolies while the input markets are perfectly competitive.

The output markets are perfectly competitive while the input markets are oligopolistic.

Both their output markets and input markets are monopolistically competitive.

1. Suppose that the corporate leadership of the Pepsi-Cola Corporation is discussion business strategies for the upcoming decade. The discussion is focused on wanting to maximize Pepsi’s economic profit. Suppose that the CEO of Pepsi sets as a goal to *increase Pepsi’s market-share*. The President of Pepsi does not agree. The President claims, instead, that Pepsi should focus on *increasing their profit margin*.
 What can be assessed of their respective strategies?

The CEO’s strategy is more likely to maximize profit under most circumstances.

The President’s strategy is more likely to maximize profit under most circumstances.

Both strategies are likely to maximize profit under most circumstances.

Neither strategy is likely to maximize profit under most circumstances.

**Answer Key**Test name: Thomas14eCh01

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