



overhead A

Opportunity costs and the time value of money

01.01.03

Opportunity costs

Refer to what a person gives up when a decision is made. This cost, also called a trade-off, may involve one or more of your resources (time, money, and effort).

Personal opportunity costs

These may involve time, health, or energy. For example, time spent on studying usually means lost time for leisure or working. However, this trade-off may be appropriate since your learning and grades will likely improve.

Financial opportunity costs

Involve monetary values of decisions made. For example, the purchase of an item with money from your savings means you will no longer obtain interest on those funds.

Time value of money

Can be used to measure financial opportunity costs using interest calculations.

Calculation

$\$1,000 \times .04$ (4 percent) \times 1 year = \$40

Over 10 years, that \$40 a year (saved at 4 percent) would have a value of over \$480 due to compound interest.

Example

Spending \$1,000 from a savings account paying 4 percent a year means an opportunity cost of \$40 in lost interest.



activity A

Activity A

Measuring financial opportunity costs

01.01.03

name: _____

date: _____

Calculating financial opportunity costs will assist in decision making. For each scenario, calculate the financial opportunity costs.

Scenario 1

You decide to spend \$2,000 from your savings account, which pays 3.75% per year.

Scenario 2

You need a new cell phone plan. Should it be pay-as-you-go or flat rate? Research a familiar provider. Calculate financial opportunity costs.

Scenario 3

- a. Calculate the cost of going to the University of your Choice for four years (www.canadianbusiness.com) vs. working for four years at \$28,000 per year.
- b. Determine the opportunity costs.

Scenario 4

Brainstorm a list of all of the things you could do with \$20,000