Practice Midterm 2 (100+ minutes).

Question 1.

Consider the following scenario. After your graduation, you have received job offers from two start-ups, A and B. You like the two jobs the same and they require the same amount of effort, however, they differ in the payment structure.

Contract A has the following payment structure over the next three years:

$200,000 dollars today, and $310,000 dollars in 3 years

Contract B has the following payment structure over the next three years:

$200,000 dollars today, $100,000 dollars in two years and $200,000 dollars in three years.

The interest rate is R = 0.1

a) Please calculate the PDV of the two contracts. Make sure to show your work.

b) Which contract should you choose? Provide a 1-sentence explanation for your answer.

c) Suppose that, being a newly graduated student, you are severely borrowing-constrained, and