Test Bank for Corporate Finance, 6th Canadian Edition by Jonathan Berk, Peter DeMarzo - Complete Chapters Included (Chap 1 to 31)

***Corporate Finance, 6Ce* (Berk)**

**Chapter 1 The Corporation and Financial Markets**

# The Three Types of Firms

1. A sole proprietorship is owned by:
   1. one person.
   2. two or more people.
   3. shareholders.
   4. bankers. Answer: A

Diﬀ: 1 Type: MC

Topic : 1.1 The Three Types of Firms

1. Which of the following organization forms is the most common in the economy?
   1. Limited Liability Partnership
   2. Limited Partnership
   3. Sole Proprietorship
   4. Publicly Traded Corporation Answer: C

Diﬀ: 1 Type: MC

Topic : 1.1 The Three Types of Firms

1. Which of the following organization forms earns the most revenue?
   1. Privately Owned Corporation
   2. Limited Partnership
   3. Publicly Owned Corporation
   4. Limited Liability Company Answer: C

Diﬀ: 1 Type: MC

Topic : 1.1 The Three Types of Firms

1. Which of the following is NOT an advantage of a sole proprietorship?
   1. Single taxation
   2. Ease of setup
   3. Limited liability
   4. No separation of ownership and control Answer: C

Diﬀ: 2 Type: MC

Topic : 1.1 The Three Types of Firms

1. Which of the following statements regarding limited partnerships is true?
   1. There is no limit on a limited partner's liability.
   2. A limited partner's liability is limited by the amount of his investment.
   3. A limited partner is not liable until all of the assets of the general partners have been exhausted.
   4. A general partner's liability is limited by the amount of his investment. Answer: B

Diﬀ: 2 Type: MC

Topic : 1.1 The Three Types of Firms

1. Which of the following are advantages of incorporation?
   1. Access to capital markets
   2. Limited liability
   3. Unlimited life
   4. All of the above Answer: D

Diﬀ: 2 Type: MC

Topic : 1.1 The Three Types of Firms

1. In Canada, a limited liability partnership, LLP, is essentially:
   1. a limited partnership without limited partners.
   2. a limited partnership without a general partner.
   3. just another name for a limited partnership.
   4. just another name for a corporation. Answer: B

Diﬀ: 1 Type: MC

Topic : 1.1 The Three Types of Firms

1. In Canada, which of the following business organization forms cannot avoid double taxation?
   1. Limited Partnership
   2. Publicly Traded Corporation
   3. Privately Owned Corporation
   4. Limited Liability Company Answer: B

Diﬀ: 1 Type: MC

Topic : 1.1 The Three Types of Firms

1. In Canada, the dividend tax credit gives some relief by eﬀectively giving:
   1. a lower tax rate on dividend income than on other sources of income.
   2. a higher tax rate on dividend income than on other sources of income.
   3. the same tax rate on dividend income as on other sources of income.
   4. a tax rate of zero on dividend income compared to other sources of income. Answer: A

Diﬀ: 1 Type: MC

Topic : 1.1 The Three Types of Firms

1. Which of the following statements is most correct?
   1. An advantage to incorporation is that it allows for less business regulation.
   2. An advantage of a corporation is that it is subject to double taxation.
   3. Unlike a partnership, a disadvantage of a corporation is that it has limited liability.
   4. Corporations face more regulations when compared to partnerships. Answer: D

Diﬀ: 2 Type: MC

Topic : 1.1 The Three Types of Firms

1. In Canada, the distinguishing feature of a corporation is that:
   1. there is no legal diﬀerence between the corporation and its owners.
   2. it is a legally deﬁned, artiﬁcial being, separate from its owners.
   3. it spreads liability for its corporate obligations to all shareholders.
   4. it provides limited liability only to small shareholders. Answer: B

Diﬀ: 2 Type: MC

Topic : 1.1 The Three Types of Firms

1. Which of the following is subject to double taxation in Canada?
   1. Corporation
   2. Partnership
   3. Sole proprietorship
   4. Both A and B Answer: A

Diﬀ: 1 Type: MC

Topic : 1.1 The Three Types of Firms

1. The Canada Revenue Agency, CRA, allows an exemption from double taxation for certain ﬂow- through entities where all income produced by the business ﬂows to the investors and virtually no earnings are retained within the business. These entities are called:
   1. Canadian Federal Crown Corporations.
   2. Canadian Controlled Corporations.
   3. Income Trust Corporations.
   4. Foreign Controlled Corporations. Answer: C

Diﬀ: 1 Type: MC

Topic : 1.1 The Three Types of Firms

1. In 2006, the Canadian government eﬀectively neutralized the tax advantages that had existed for most income trusts, relative to ﬁrms set up as corporations. The advantages that existed for income trusts before these changes were that:
   1. income trusts avoided double taxation in that the Canada Revenue Agency did not collect corporate taxes but rather collected only personal taxes from income trust unit holders.
   2. income trusts eﬀectively aﬀorded unlimited liability to unitholders while corporate shareholders could face unlimited liability.
   3. while double taxation existed for both income trusts and corporations, the net tax paid by income trust unit holders was in most cases less than that paid by corporate shareholders.
   4. the changes introduced in 2006 eliminated double taxation for corporations, thereby making the taxation of income trusts and corporations substantially equivalent.

Answer: A

Explanation: The 2006 changes imposed new taxes on most income trusts to mirror the total tax revenue received from corporations. As a result, with no material tax advantage, these ﬁrms reverted from income trusts back to a corporate structure. The exception was Real Estate Investment Trusts (REIT), which are exempted from the changes imposed on all other trusts.

Diﬀ: 2 Type: MC

Topic : 1.1 The Three Types of Firms

1. One of the major characteristics of a limited liability partnership, LLP, in Canada is:
   1. the limitation on a partner's liability is only in cases related to actions of negligence by other partners or those supervised by other partners.
   2. any partner will not be liable for their own negligence at any time.
   3. any partners will be only liable for other partners' negligence.
   4. none of the above. Answer: A

Diﬀ: 2 Type: MC

Topic : 1.1 The Three Types of Firms

1. You own 100 shares of a publicly traded Canadian Corporation. The corporation earns $5.00 per share before taxes. Once the corporation has paid any corporate taxes that are due, it will distribute the rest of its earnings to its shareholders in the form of a dividend. If the corporate tax rate is 40% and your personal tax rate on (both dividend and non-dividend) income is 30%, then how much money is left for you after all taxes have been paid?

A) $210

B) $300

C) $350

D) $500

Answer: A

Explanation: EPS × number of shares × (1 - Corporate Tax Rate) × (1 - Individual Tax Rate)

$5.00 per share × 100 shares × (1 - .40) × (1 - .30) = $210

Diﬀ: 3 Type: MC

Topic : 1.1 The Three Types of Firms

1. You own 100 shares of a Canadian Income Trust Corporation. The corporation earns $5.00 per share before taxes. Once the corporation has paid any corporate taxes that are due, it will distribute the rest of its earnings to its shareholders in the form of a dividend. If the corporate tax rate is 40% and your personal tax rate on (both dividend and non-dividend) income is 30%, then how much money is left for you after all taxes have been paid?

A) $210

B) $300

C) $350

D) $500

Answer: C

Explanation: EPS × number of shares × (1 - Individual Tax Rate)

$5.00 per share × 100 shares × (1 - .30) = $350

Diﬀ: 3 Type: MC

Topic : 1.1 The Three Types of Firms

1. You are a shareholder in a publicly owned corporation. This corporation earns $4 per share before taxes. After it has paid taxes, it will distribute the remainder of its earnings to you as a dividend. The dividend is income to you, so you will then pay taxes on these earnings. The corporate tax rate is 35%, and your tax rate on dividend income is 15%. The eﬀective tax rate on your share of the corporation's earnings is closest to:

A) 15%.

B) 35%.

C) 45%.

D) 50%.

Answer: C

Explanation: First, the corporation pays taxes. It earned $4 per share, but it must pay $4 × .35 = $1.40 to the government in corporate taxes. That leaves $4.00 - $1.40 = $2.60 to distribute to the shareholders.

However, the shareholder must pay $2.60 × .15 = $0.39 in income taxes on this amount, leaving only $2.21 to the shareholder after all taxes are paid. The total amount paid in taxes is $1.40 + 0.39 = $1.79. The eﬀective tax rate is then $1.79 ÷ $4 = .4475 or 44.75% which is closest to 45%.

Diﬀ: 3 Type: MC

Topic : 1.1 The Three Types of Firms

1. Explain the beneﬁts of incorporation. Answer:
2. Limited liability
3. Unlimited life
4. Access to capital markets / availability of outside funding
5. Required transparency in ﬁnancial information disclosure

Diﬀ: 2 Type: ES

Topic : 1.1 The Three Types of Firms

1. What is the legal requirement for forming a Corporation in Canada?

Answer: Articles of incorporation must be ﬁled with the relevant registrar of corporations. The articles of incorporation are like a corporate constitution that sets out the terms of the corporation's ownership and existence.

Diﬀ: 2 Type: SA

Topic : 1.1 The Three Types of Firms

# Ownership versus Control of Corporations

1. The person charged with running the corporation by instituting the rules and policies set by the board of directors is called:
   1. the Chief Operating Oﬃcer.
   2. the Company President.
   3. the Chief Executive Oﬃcer.
   4. the Chief Financial Oﬃcer. Answer: C

Diﬀ: 1 Type: MC

Topic : 1.2 Ownership Versus Control of Corporations

1. The Principal-Agent Problem arises:
   1. because managers have little incentive to work in the interest of shareholders when this goal means working against their own self-interest.
   2. because of the separation of ownership and control in a corporation.
   3. Both A and B
   4. None of the above Answer: C

Diﬀ: 1 Type: MC

Topic : 1.2 Ownership Versus Control of Corporations

1. In a corporation, the ultimate decisions regarding business matters are made by:
   1. the Board of Directors.
   2. debt holders.
   3. shareholders.
   4. investors. Answer: A

Diﬀ: 1 Type: MC

Topic : 1.2 Ownership Versus Control of Corporations

1. One of the major reasons that corporations have a principal-agent problem is that:
   1. management is less transparent.
   2. they have an ineﬃcient and incompetent management team.
   3. direct control and ownership are often separate.
   4. there is a lack of communication between the owners and the management team. Answer: C

Diﬀ: 2 Type: MC

Topic : 1.2 Ownership Versus Control of Corporations

1. The ultimate goal of ﬁnancial management in corporations is to maximize:
   1. annual proﬁt.
   2. the beneﬁt of the employees.
   3. the interest of the communities.
   4. shareholder wealth. Answer: D

Diﬀ: 2 Type: MC

Topic : 1.2 Ownership Versus Control of Corporations

1. Corporate social responsibility can be described as all of the following EXCEPT:
   1. solely focusing on proﬁt maximization without considering the impact of the ﬁrm's operations on society and environment.
   2. corporate initiative to assess and take responsibility for the company's eﬀects on the environment and impact on social welfare.
   3. corporate social responsibility may also be referred to as 'corporate citizenship' and can involve incurring short-term costs that do not provide an immediate ﬁnancial beneﬁt to the company, but instead promote positive social and environmental change.
   4. the term generally applies to company eﬀorts that go beyond what may be required by regulators or environmental protection groups.

Answer: A

Diﬀ: 2 Type: MC

Topic : 1.2 Ownership Versus Control of Corporations

1. If shareholders are unhappy with a CEO's performance, they are most likely to:
   1. buy more shares to gain control of the ﬁrm.
   2. ﬁle a shareholder resolution.
   3. replace the CEO through a grassroots shareholder uprising.
   4. sell their shares. Answer: D

Diﬀ: 2 Type: MC

Topic : 1.2 Ownership Versus Control of Corporations

1. A is when a rich individual or organization purchases a large fraction of the stock of a poorly performing ﬁrm and in doing so gets enough votes to replace the board of directors and the CEO.
   1. shareholder proposal
   2. leveraged buyout
   3. shareholder action
   4. hostile takeover Answer: D

Diﬀ: 3 Type: MC

Topic : 1.2 Ownership Versus Control of Corporations

1. Which of the following statements is false?
   1. In bankruptcy, management is allowed to reorganize the ﬁrm and renegotiate with debt holders.
   2. Because a corporation is a separate legal entity, when it fails to repay its debts, the people who lent to the ﬁrm (the debt holders) are entitled to seize the assets of the corporation in compensation for the default.
   3. As long as the corporation can satisfy the claims of the debt holders, ownership remains in the hands of the equity holders.
   4. If the corporation fails to satisfy debt holders' claims, equity holders may take control of the ﬁrm. Answer: D

Explanation: If the corporation fails to satisfy debt holders' claims, debt holders may take control of the ﬁrm.

Diﬀ: 3 Type: MC

Topic : 1.2 Ownership Versus Control of Corporations

1. What strategies are available to shareholders to help ensure that managers are motivated to act in the interest of the shareholders rather than their own interest?

Answer:

1. The threat of a hostile takeover
2. Shareholder initiatives
3. Performance-based compensation

Diﬀ: 3 Type: ES

Topic : 1.2 Ownership Versus Control of Corporations

1. Why are appropriate public policies and regulations required to strike a balance between corporate interests and social interests?

Answer: At times, decisions to increase shareholders' wealth may be costly for society as a whole. For example, think of a corporation that, in the course of doing business, pollutes the environment and does not pay for the costs of cleaning up the pollution. In such cases, appropriate public policies and regulations are required to ensure that corporate interest and public interest are aligned. Public policies may be designed and regulations put in place to make such corporations ﬁnancially responsible for environmental pollution and to incentivize positive action to curb pollution. Sound public policy should allow ﬁrms to continue to pursue the maximization of shareholder value in a way that beneﬁts society overall.

Diﬀ: 3 Type: ES

Topic : 1.2 Ownership Versus Control of Corporations

1. Why do ﬁrms need to care about non-ﬁnancial goals?

Answer: While the goal of a ﬁnancial manager is to increase the value of the ﬁrm to its stakeholders, this responsibility does not imply any impact of the ﬁrm's decisions on other stakeholders. Proﬁtable ﬁrms are those that create value for their customers, and that value can include producing in a way that aligns with customer preferences on environmental and social issues. Similarly, if the ﬁrm makes decisions that beneﬁt employees (for example, increasing their job security or providing better health beneﬁts), it will be able to attract better employees and beneﬁt from increased productivity. On the other hand, if customers or employees anticipate that the ﬁrm is likely to exploit them, they will pay less for its products and demand higher wages. Thus, to maximize shareholder value, the ﬁnancial manager must consider the impacts of decisions on all stakeholders of the ﬁrm.

Diﬀ: 3 Type: SA

Topic : 1.2 Ownership Versus Control of Corporations

# The Stock Market

1. Which of the following statements is correct?
   1. The TSX is an electronic exchange, and investors can post orders onto the TSX trading system from anywhere in the world.
   2. The TSX is an electronic exchange, and investors can post orders onto the TSX trading system from anywhere in North America.
   3. The TSX is an electronic exchange, and investors can post orders onto the TSX trading system from anywhere in Canada.
   4. The TSX is an electronic exchange, and investors can post orders onto the TSX trading system from anywhere in Toronto.

Answer: A

Diﬀ: 1 Type: MC

Topic : 1.3 The Stock Market

1. Stocks trading in a large electronic exchange, such as the TSX, will normally:
   1. experience a narrow bid-ask range.
   2. experience a wide bid-ask range.
   3. be thinly traded.
   4. incur high transaction costs. Answer: A

Diﬀ: 2 Type: MC

Topic : 1.3 The Stock Market

1. As of November 30, 2022, what position was the Toronto Stock Exchange, TSX, ranked based on domestic market capitalization in U.S. dollars?
   1. The 10th position
   2. The 14th position
   3. The 20th position
   4. None of the above Answer: A

Diﬀ: 1 Type: MC

Topic : 1.3 The Stock Market

1. The two common measures used to rank stock markets worldwide are:
   1. the total number of all domestic corporations listed on the exchange and the total value of the volume of shares traded on the exchange at the end of each year.
   2. the total value of all domestic corporations listed on the exchange and the total number of shares traded on the exchange at the end of each year.
   3. the total value of all domestic corporations listed on the exchange and the total value of the volume of shares traded on the exchange at the end of each year.
   4. the total value of all foreign corporations listed on the exchange and the total value of the volume of shares traded on the exchange at the end of each year.

Answer: C

Diﬀ: 3 Type: MC

Topic : 1.3 The Stock Market

1. In 2018, the largest stock market by domestic capitalization in the world was:
   1. the London Stock Exchange.
   2. the NASDAQ.
   3. the American Stock Exchange.
   4. the New York Stock Exchange. Answer: D

Diﬀ: 1 Type: MC

Topic : 1.3 The Stock Market

1. An investment is said to be liquid if the investment:
   1. has large day-to-day ﬂuctuations in price.
   2. has a large bid-ask spread.
   3. can easily be converted into cash.
   4. is traded on a stock exchange. Answer: C

Diﬀ: 2 Type: MC

Topic : 1.3 The Stock Market

1. In 2018, the largest stock market by value of shares traded in the world was:
   1. the London Stock Exchange.
   2. the Shanghai Stock Exchange.
   3. the American Stock Exchange.
   4. the NASDAQ. Answer: B

Diﬀ: 2 Type: MC

Topic : 1.3 The Stock Market

1. What type of company trades on an organized stock exchange?
   1. A limited liability company
   2. A private company
   3. A crown corporation
   4. A public company Answer: D

Diﬀ: 1 Type: MC

Topic : 1.3 The Stock Market

1. Which of the following statements is false?
   1. On the NASDAQ, stocks can and do have multiple market makers who compete with each other. Each market maker must post bid and ask prices in the NASDAQ network where they can be viewed by all participants.
   2. Bid prices exceed ask prices.
   3. Because customers always buy at the ask price and sell at the bid price, the bid-ask spread is a transaction cost investors have to pay to trade.
   4. On the ﬂoor of the NYSE, market makers (known on the NYSE as specialists) match buyers and sellers. Answer: B

Explanation: Ask prices exceed bid prices.

Diﬀ: 2 Type: MC

Topic : 1.3 The Stock Market

*Use the table for the question(s) below.*

Consider the following two quotes for XYZ stock:

## November 11th November 18th

Ask: 25.25 Ask: 26.00

Bid: 25.20 Bid: 25.93

1. How much would you have to pay to purchase 100 shares of XYZ stock on November 18th? A) $2,520

B) $2,525

C) $2,593

D) $2,600

Answer: D

Explanation: 100 shares × $26.00 (ask price) = $2,600

Diﬀ: 1 Type: MC

Topic : 1.3 The Stock Market

1. How much would you receive if you sold 200 shares of XYZ stock on November 11th? A) $5,050

B) $5,040

C) $5,186

D) $5,200

Answer: B

Explanation: 200 shares × $25.20 (bid price) = $5,040

Diﬀ: 2 Type: MC

Topic : 1.3 The Stock Market

1. which of the following statements about dark pools is false?
   1. Dark pools oﬀer investors the opportunity to ﬁll their orders immediately.
   2. Dark pools do not make their limit order books visible.
   3. When dark pools are included, researchers estimate that, in the United States alone, there could be as many as 50 venues in which to trade stocks.
   4. Dark pools oﬀer investors the ability to trade at a better price. Answer: A

Explanation: Dark pools oﬀer investors the opportunity to trade at a better price by saving the bid-ask spread with the tradeoﬀ being that the order might not be ﬁlled if an excess of either buy or sell orders is received.

Diﬀ: 3 Type: MC

Topic : 1.3 The Stock Market

*Use the table for the question(s) below.*

Consider the following two quotes for XYZ stock:

## November 11th November 18th

Ask: 25.25 Ask: 26.00

Bid: 25.20 Bid: 25.93

1. What are your net proceeds if you purchased 2,500 shares of XYZ stock on November 11th and then sold them a week later on November 18th?

Answer: Sell at bid price 11/18 = 2,500 × $25.93 = $64,825 Now subtract the price paid for the shares.

Buy at ask price 11/11 = 2,500 × $25.25 = $63,125 So, net proceeds = $64,825 - $63,125 = $1,700 Your net proceeds are $1,700.

Diﬀ: 3 Type: ES

Topic : 1.3 The Stock Market

1. Explain the main diﬀerences between the NYSE and NASDAQ stock markets. Answer: Key points:

NYSE has a physical location—NASDAQ is an electronic market.

NYSE has one specialist in each stock and his role is to match buyers and sellers.

NASDAQ has multiple market makers (dealers) in each stock who stand ready to trade on their own accounts.

Diﬀ: 3 Type: ES

Topic : 1.3 The Stock Market

1. How do high-frequency traders (HFTs) make money?

Answer: HFTs place, update, cancel, and execute trades many times per second in response to new information as well as other orders, making money by both providing liquidity and taking advantage of stale limit orders.

Diﬀ: 2 Type: ES

Topic : 1.3 The Stock Market

# Fintech: Finance and Technology

1. Blockchain technology allows a transaction to be recorded in a publicly veriﬁable way:
   1. without the need for a trusted third party to certify the authenticity of the transaction.
   2. with the help of a government authority that authenticates each transaction.
   3. through a central clearing system used by all registered ﬁnancial institutions.
   4. using a proprietary software developed by Microsoft Corp. Answer: A

Explanation: Blockchain technology allows for digital transfer of assets without the backing of a government or a central clearing house.

Diﬀ: 2 Type: MC

Topic : 1.4 Fintech: Finance and Technology

1. Which of the following statements is false for cryptocurrency?
   1. Cryptocurrencies can be exchanged for U.S. dollars.
   2. Creation and ownership of a cryptocurrency are determined via a public blockchain.
   3. Bitcoin is a cryptocurrency.
   4. Individuals a verify cryptocurrency transactions digitally. Answer: A

Explanation: Cryptocurrencies are created and managed digitally using blockchain technology, which cannot be exchanged for traditional currencies.

Diﬀ: 3 Type: MC

Topic : 1.4 Fintech: Finance and Technology

1. How are robo-advisors disrupting the investment advising service?

Answer: Investment advising service is being disrupted by automation with the recent growth in robo- advisors. Financial institutions have been increasingly using computer programs to replace human advisors to provide detailed and customized investment recommendations to customers.

Diﬀ: 2 Type: ES

Topic : 1.4 Fintech: Finance and Technology

1. Give some examples of the use of machine-learning algorithms in the ﬁnancial industry. Answer: Some examples:

* Sophisticated pattern recognition softwares developed by companies like Renaissance Technology and

D.E. Shaw successfully predicted very short-term stock price movements.

* Lenders are using algorithms to go beyond basic credit scores to make improved lending decisions.
* Insurance providers are using "Big data" to structure the insurance products they oﬀer.

Diﬀ: 1 Type: ES

Topic : 1.4 Fintech: Finance and Technology