

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

- 1) Arnold discusses four vital financial issues facing management. The first is "What type of finance should we raise?". What are the other three? 1) _____

A) In what projects are we going to invest our shareholders' money?
B) How do we manage risk?
C) How can we maximise profit?
D) How do we create and measure shareholder value?

Answer: A, B, D

- 2) In which two ways do financial institutions and markets encourage growth and progress? 2) _____

A) By encouraging investment
B) By controlling interest rates
C) By mobilising savings
D) By discouraging small savers

Answer: A, C

- 3) Which of the following are essential aspects of a financial managers knowledge? 3) _____

A) Cash and risk management
B) Financial markets
C) Investment appraisal methods
D) All of the above

Answer: D

- 4) Which of the following options best describes how financial managers primarily contribute to their firms' success? 4) _____

A) Through investment and finance decisions based on a search for company growth and stability.
B) Through investment and finance decisions based on a search for profit maximisation over the next five years.
C) Through finance decisions that aim to reduce costs of production.
D) Through investment in sound advice from independent advisers.

Answer: A

- 5) What name is given to the theory which views the firm as a network of contracts which specify the roles played by various participants and their returns, with shareholders entitled to any surplus after other participants have received their contractual return? 5) _____

A) Participant-role theory
B) Stakeholder theory
C) Contractual theory
D) Network theory

Answer: C

- 6) Which of the following best describes the overall objective of the firm, according to contractual theory? 6) _____

A) Long-term maximisation of profit
B) A maximisation of returns to all stakeholders
C) Maximisation of shareholder wealth over the long-term
D) Short-term maximisation of profit

Answer: C

- 7) What are the two most important possible uses for cash created by a firm's operations ? 7) _____
 A) Cash return to investors B) Selling assets to investors
 C) Reinvestment D) Purchase of new shares
 Answer: A, C
- 8) Financial institutions encourage the flow of savings into investment by acting in two key roles? 8) _____
 What are those roles?
 A) Auditors B) Brokers
 C) Savers D) Asset transformers
 Answer: B, D
- 9) Which three of the following institutions are classified as being part of the banking sector? 9) _____
 A) Finance houses B) Insurance funds
 C) Building societies D) Retail banks
 Answer: A, C, D
- 10) Which three of the following generally describe the preferences and situation of a primary investor? 10) _____
 A) A wish for high agreement costs B) A preference for low risk
 C) A preference for high liquidity D) Having small amounts to invest
 Answer: B, C, D
- 11) Which type of organisation most commonly works to alleviate the conflict of preferences between primary investors and ultimate borrowers? 11) _____
 A) Firms B) Financial institutions
 C) Transformed asset holders D) Government
 Answer: B
- 12) In which two ways do households most directly provide investment funds for business? 12) _____
 A) Through taxes
 B) By direct purchase of shares
 C) Through returns on bonds and shares
 D) By making deposits with financial institutions
 Answer: B, D
- 13) Which statement best describes the role of financial intermediaries? 13) _____
 A) They maximise the cost benefits from the flow of funds from ultimate borrowers to primary investors.
 B) They facilitate the flow of funds to primary investors from ultimate borrowers at low cost.
 C) They facilitate the flow of funds from primary investors to ultimate borrowers at low cost.
 D) They minimise the costs of the flow of funds from ultimate borrowers to primary investors.
 Answer: C
- 14) Which of the following best describes the situation in an economy without financial intermediaries? 14) _____
 A) Risk to investors is high.. B) Search costs are low.
 C) Monitoring costs are low. D) Agreement costs are high.
 Answer: D

- 15) Which three statements correctly relate, according to the finance theory view, to the maximisation of shareholder wealth? 15) _____
- A) In an efficient market it is equivalent to maximising the share price.
 - B) It is equivalent to maximising the discounted cash flow to shareholders over a long time horizon.
 - C) It is equivalent to maximising the purchasing power available from a shareholding in a firm.
 - D) It can be ensured by maximising profit-based bonuses for senior management.
- Answer: A, B, C
- 16) Which two of the following properties best describe the savings characteristics of primary investors (households)? 16) _____
- A) Small amounts.
 - B) Low risk.
 - C) Low liquidity.
 - D) High search costs.
- Answer: A, B
- 17) What name is given to the process of creating intermediate securities for the primary investor while transferring funds to the ultimate borrower. 17) _____
- A) Asset transformation.
 - B) Financial intermediacy.
 - C) Fund transfer.
 - D) Security provision.
- Answer: A
- 18) Which three of the following properties best describe the investment characteristics of ultimate borrowers (businesses)? 18) _____
- A) Large amounts.
 - B) High risk.
 - C) Low liquidity.
 - D) High search costs.
- Answer: A, B, C
- 19) What is the key reason why financial institutions can transform assets and encourage transfer of funds? 19) _____
- A) They can invest the dividends.
 - B) They can work individually with savers' funds.
 - C) They can use their own funds for investment.
 - D) They have economies of scale.
- Answer: D
- 20) Which three of the following are types of asset transformation? 20) _____
- A) Volume transformation.
 - B) Saver transformation.
 - C) Maturity transformation.
 - D) Risk transformation.
- Answer: A, C, D
- 21) Which three out of the following are reduced by financial markets? 21) _____
- A) Liquidity.
 - B) Risk.
 - C) Monitoring costs.
 - D) Search costs.
- Answer: B, C, D
- 22) In the banking sector, which organisations generally carry out hire purchase, factoring and leasing? 22) _____
- A) Investment banks.
 - B) Financial advisers.
 - C) Finance houses.
 - D) Building societies.
- Answer: C

- 23) Which three of the following act as financial intermediaries between primary investors and ultimate borrowers? 23) _____
A) Asset transformers. B) Financial markets.
C) Financial managers. D) Brokers.
Answer: A, C, D
- 24) Which three of the following economies of scale enable intermediaries to transform assets effectively? 24) _____
A) Risk spreading. B) Efficiencies in gathering information.
C) Low customer numbers. D) Lower transaction costs.
Answer: A, B, D
- 25) Which two of the following are classified as long-term savings institutions? 25) _____
A) Insurance funds. B) Pensions funds.
C) Wholesale banks. D) Finance houses.
Answer: A, B
- 26) What is the main activity in the primary market of the stock exchange? 26) _____
A) The firm raises funds from investors.
B) Brokers sell shares for investors.
C) Investors raise funds from firms.
D) Investors buy and sell shares between each other.
Answer: A
- 27) What is the main activity in the secondary market of the stock exchange? 27) _____
A) Investors buy and sell shares between each other.
B) Investors raise funds from firms.
C) The firm raises funds from investors.
D) Brokers sell shares for investors.
Answer: A
- 28) What term is used to describe a situation in which investors can sell quickly at low cost? 28) _____
A) Market liquidity. B) Investment opportunity.
C) Market minimisation. D) Free markets.
Answer: A
- 29) OEICs are a hybrid between which two types of investment? 29) _____
A) Investment trusts. B) Cash investments.
C) Unit trusts. D) Annuities.
Answer: A, C
- 30) Which of the following is not a main area of activity for a wholesale bank? 30) _____
A) Raising external finance for companies. B) Broking and dealing.
C) Eurocurrency transfers. D) Fund management.
Answer: C
- 31) Which three of the following are classified as 'risk-spreaders'? 31) _____
A) Money markets. B) Unit trusts.
C) Investments trusts. D) OEICs.
Answer: B, C, D

- 32) What particular benefit do brokers offer when matching a provider of finance with a user of funds? 32) _____
 A) Search costs are reduced. B) Risk is reduced.
 C) Monitoring costs are reduced. D) Agreement costs are increased.
 Answer: A
- 33) Which three of the following are economies of scale available to intermediaries but not small investors? 33) _____
 A) Reduced transaction costs. B) Efficiency in gathering information.
 C) Ability to benefit from low liquidity. D) Ability to spread risk.
 Answer: A, B, D
- 34) The 'conflict of preferences' occurs because: 34) _____
 A) Primary investors want low-cost liquidity and certainty, and the ultimate borrowers want long-term risk-bearing capital.
 B) Primary investors want a completely risk-free investment with high returns and borrowing firms offer only high risk/low returns as their securities.
 C) Customers of firms have different needs to those assumed by suppliers.
 D) Preference shares do not carry a sufficiently high dividend, given their risk.
 Answer: A
- 35) In which type of market is one currency most commonly exchanged for another? 35) _____
 A) Foreign exchange. B) Bond markets.
 C) Derivatives. D) Money market.
 Answer: A
- 36) Which one of the following statements correctly applies to the type of market described? 36) _____
 A) Wholesale banks deal primarily with low-volume, high-value transactions.
 B) Euronext.liffe is a market set up to permit the purchase and sale of life assurance policies.
 C) Investment trusts are not limited companies.
 D) Bond markets are primarily concerned with financing imports and exports.
 Answer: A
- 37) Which one of the following is the most important benefit of defining a firm's overall objectives. 37) _____
 A) To enable effective information flow. B) To enable progress to be assessed.
 C) To provide information to savers. D) To provide a focus for decision making.
 Answer: D
- 38) Which three of the following statements are correct? 38) _____
 A) The foreign exchange markets are those markets in which one currency is exchanged for another.
 B) Pension funds typically invest between 40 and 80 per cent of their funds in shares.
 C) The money markets are markets in lending and borrowing money for more than two years.
 D) Unit trusts are open-ended collective investment funds.
 Answer: A, B, D

- 39) What is meant by a balanced stakeholder approach? 39) _____
- A) Aiming to satisfy the needs of creditors, customers, employees, shareholders and society in general.
 - B) Ensuring that a company has a wide spread of investors.
 - C) Aiming to involve creditors, customers, employees, shareholders and society in general in decision making.
 - D) Ensuring that investors spread their risk in a balanced way.
- Answer: A
- 40) In firms that are attractive to shareholders the actions of senior management align with the interests of shareholders. What term is used to describe such a situation? 40) _____
- A) Goal congruence
 - B) Competitive maximisation
 - C) Profit maximisation
 - D) A Company congruence
- Answer: A
- 41) Select the two alternative factors that can be said to demonstrate that shareholder wealth has been maximised. 41) _____
- A) The sum of discounted cash flows has been maximised.
 - B) Discounted cash flow has been minimised.
 - C) Management and production costs have been minimised.
 - D) Purchasing power has been maximised.
- Answer: A, D
- 42) What is the key aim when maximising shareholder wealth? 42) _____
- A) To maximise the size of dividends over a short time period.
 - B) To maximise the flow of discounted cash flow over a long time period.
 - C) To maximise the flow of discounted cash flow over a short time period.
 - D) To minimise the flow of cash in the forms of dividends over a long time period.
- Answer: B
- 43) Which one of the following options best describes the principal-agent problem? 43) _____
- A) When the shareholders have to incur the expense of ensuring that managers act in the interest of the shareholders.
 - B) When there is a breakdown of communication between shareholders and brokers.
 - C) When stockbrokers fail to collect principal payments on a financial security on behalf of the owner.
 - D) When brokers ask for additional payments to carry out a transaction.
- Answer: A
- 44) Which three of the following are most likely to be solutions to the principal-agent problem? 44) _____
- A) Increasing management pay levels.
 - B) Selling shares and the takeover threat.
 - C) Link managerial rewards to shareholder wealth improvement.
 - D) Corporate governance regulation.
- Answer: B, C, D

- 45) Which three of the following statements are correct? 45) _____
- A) Unit trusts are open-ended collective investment funds.
 - B) Pension funds typically invest between 40 and 80 per cent of their funds in shares.
 - C) The main function and source of profits of wholesale banks is to take deposits and lend money.
 - D) Foreign banking in the UK is UK banks conducting transactions in sterling with non-UK residents.
- Answer: A, B, D
- 46) Which three of the following statements concerning financial intermediaries are correct? 46) _____
- A) They only act as agents between savers and borrowers.
 - B) They are able to reduce the transaction costs of transferring funds from savers to borrowers in society compared with the primary lenders.
 - C) They generally display efficiencies in gathering information as compared with primary investors.
 - D) They are often more able to spread risk than primary investors.
- Answer: B, C, D
- 47) Which of the following best identifies the main risk of having clear separation between ownership and control? 47) _____
- A) Agent-principle problems, where the agent may take uncontrolled, unprincipled actions.
 - B) Managerialism, where managers take decisions in their own interests rather than those of the shareholders.
 - C) Stakeholder control, where non-investors have excessive influence on management.
 - D) Profit maximisation, where managers adopt long-term views that conflict with the overall needs of the organisation.
- Answer: B
- 48) What does it mean when stakeholders have been 'satisficed'? 48) _____
- A) They are the only stakeholders who feel satisfied.
 - B) They have been given more than their contribution justified.
 - C) They have been given just enough to make their contribution worthwhile.
 - D) They have been given returns based on partial, biased information.
- Answer: C
- 49) Which three of the following are reasons why a firm should use external finance to maximise shareholder wealth? 49) _____
- A) It counters the tendency for management to pursue goals for their own benefit.
 - B) The shareholders own the firm.
 - C) This approach encourages high levels of motivation in managers.
 - D) To survive in a competitive world.
- Answer: A, B, D
- 50) Profit maximisation is not the same as shareholder wealth maximisation. Select the two things that a profit comparison does not take into account? 50) _____
- A) Risk.
 - B) Future prospects.
 - C) Communication.
 - D) Management expertise.
- Answer: A, B