

1. This book is mainly about

**A.** financial decisions made by corporations.

B. financial decisions made by households.

C. financial decisions made by governments.

D. financial decisions made by employees.

*Accessibility: Keyboard Navigation*

*Difficulty: Basic*

2. Shareholders of a corporation may be, among others,

A. individuals.

B. individuals and pension funds.

C. pension funds.

**D.** individuals, pension funds, and insurance companies.

*Accessibility: Keyboard Navigation*

*Difficulty: Intermediate*

3. Generally, a corporation is owned by its

A. managers.

B. board of directors and shareholders.

**C.** shareholders.

D. managers, board of directors, and shareholders.

*Accessibility: Keyboard Navigation*

*Difficulty: Basic*

4. A corporation, potentially, has infinite life because it

**A.** is a legal entity.

B. has the same ownership and management.

C. has limited liability.

D. is closely regulated.

*Accessibility: Keyboard Navigation*

*Difficulty: Intermediate*

5. Limited liability is an important feature of

A. sole proprietorships.

B. partnerships.

**C.** corporations.

D. both partnerships and corporations.

*Accessibility: Keyboard Navigation*

*Difficulty: Basic*

6. As a legal entity, a corporation can perform the following functions *except*

A. borrow money and lend money.

B. borrow money, lend money, and sue and be sued.

**C.** vote.

D. borrow money, lend money, sue and be sued, and vote.

*Accessibility: Keyboard Navigation*

*Difficulty: Intermediate*

7. Which of the following assets is tangible?

**A.** ExxonMobil's corporate headquarters building

B. Apple Inc.'s trademark

C. Hewlett-Packard's most recent printer patent

D. Microsoft's technical expertise

*Accessibility: Keyboard Navigation*

*Difficulty: Intermediate*

8. Which of the following types of assets are intangible?

A. Production machinery

B. Factories

**C.** Trademarks

D. Office equipment

*Accessibility: Keyboard Navigation*

*Difficulty: Intermediate*

9. A firm's investment decision is also called its

A. financing decision.

B. liquidity decision.

**C.** capital budgeting decision.

D. leasing decision.

*Accessibility: Keyboard Navigation*

*Difficulty: Intermediate*

10. Which of the following is not a financial asset?

A. Common stock

B. Bank loans

C. Preferred stock

**D.** Buildings

*Accessibility: Keyboard Navigation*

*Difficulty: Intermediate*

11. Which of the following is an important function of financial markets?

A. Providing financing

B. Providing financing and liquidity

**C.** Providing financing, providing liquidity, reducing risk, and providing information

D. Providing information

*Accessibility: Keyboard Navigation*

*Difficulty: Intermediate*

12. Disadvantages of the corporate form include

A. agency costs.

B. double taxation.

C. cost of managing the corporation.

**D.** all of the options.

*Accessibility: Keyboard Navigation*

*Difficulty: Intermediate*

13. In the principal–agent framework,

A. shareholders are the principals.

B. managers are the principals.

C. managers are the agents.

**D.** shareholders are the principals and managers are the agents.

*Accessibility: Keyboard Navigation*

*Difficulty: Intermediate*

14. Costs associated with the conflicts of interest between the bondholders and the shareholders of a corporation are called

A. legal costs.

B. bankruptcy costs.

C. administrative costs.

**D.** agency costs.

*Accessibility: Keyboard Navigation*

*Difficulty: Challenge*

15. A corporation may incur agency costs because

A. managers may not attempt to maximize the value of the firm to shareholders.

B. shareholders incur monitoring costs.

C. of the separation of ownership and management.

**D.** all of the responses are correct.

*Accessibility: Keyboard Navigation*

*Difficulty: Intermediate*

16. The following groups are some of the claimants to a firm's income stream

A. shareholders and bondholders only.

B. shareholders, bondholders, and employees only.

C. shareholders, bondholders, employees, and management only.

**D.** shareholders, bondholders, employees, management, and government.

*Accessibility: Keyboard Navigation*

*Difficulty: Intermediate*

17. The financial goal of a corporation is to

A. maximize profits.

B. maximize sales.

**C.** maximize the value of the firm for the shareholders.

D. maximize managers' benefits.

*Accessibility: Keyboard Navigation*

*Difficulty: Challenge*

18. The firm's purchase of real assets is also referred to as the

A. capital structure decision.

B. CFO decision.

C. financing decision.

**D.** capital investment decision.

*Accessibility: Keyboard Navigation*

*Difficulty: Basic*

19. The sale of financial assets by a corporation is also referred to as the

A. capital budgeting decision.

B. CFO decision.

**C.** financing decision.

D. investment decision.

*Accessibility: Keyboard Navigation*

*Difficulty: Basic*

20. The choice of the proper mixture of debt and equity, used to finance a corporation, is also referred to as the

A. capital budgeting decision.

**B.** capital structure decision.

C. investment decision.

D. liquidity decision.

*Accessibility: Keyboard Navigation*

*Difficulty: Basic*

21. Which of the following groups are referred to as stakeholders?

A. Employees, customers, and suppliers only

B. Shareholders only

C. Employees and customers only

**D.** Employees, customers, shareholders, and suppliers

*Accessibility: Keyboard Navigation*

*Difficulty: Intermediate*

22. The following are examples of real assets:

**A.** machinery, office buildings, and warehouses only.

B. machinery and office buildings only.

C. common stock only.

D. machinery only.

*Accessibility: Keyboard Navigation*

*Difficulty: Basic*

23. The following are examples of tangible assets *except*

A. machinery only.

B. machinery and office buildings only.

**C.** training courses for employees only.

D. machinery, office buildings, and warehouses only.

*Accessibility: Keyboard Navigation*

*Difficulty: Basic*

24. The ultimate financial goal of a corporation is to

A. minimize stockholder risk.

B. maximize profit.

**C.** maximize the value of the corporation to the stockholders.

D. increase the size of the firm.

*Accessibility: Keyboard Navigation*

*Difficulty: Basic*

25. Mr. Free has $100 income this year and zero income next year. The market interest rate is 10 percent per year.

If Mr. Free consumes $30 this year and invests the rest in the market, what will be his consumption next year?

A. $50

B. $55

**C.** $77

D. $100

*Accessibility: Keyboard Navigation*

*Difficulty: Challenge*

26. Mr. Bird has $100 income this year and zero income next year. The market interest rate is 10 percent per year. Mr. Bird also has an investment opportunity in which he can invest $50 today and receive $80 next year. Suppose Mr. Bird consumes $30 this year and invests in the project. What will be his consumption next year?

A. $80

B. $82

C. $100

**D.** $102

*Accessibility: Keyboard Navigation*

*Difficulty: Challenge*

27. Ms. Venus has $100 income this year and $110 next year. The market interest rate is 10 percent per year. Suppose Ms. Venus consumes $60 this year. What will be her consumption next year?

A. $120

**B.** $154

C. $170

D. 210

*Accessibility: Keyboard Navigation*

*Difficulty: Challenge*

28. Mr. Thomas has $100 income this year and zero income next year. The market interest rate is 10 percent per year. Mr. Thomas also has an investment opportunity in which he can invest $50 this year and receive $80 next year. Suppose Mr. Thomas consumes $50 this year and invests in the project. What will be his consumption next year?

A. $50

B. $55

**C.** $80

D. $110

*Accessibility: Keyboard Navigation*

*Difficulty: Challenge*

29. Mr. Dell has $100 income this year and zero income next year. The expected return from investing in the stock market is 10 percent a year. Mr. Dell also has an investment opportunity—having the same risk as the market in which he can invest $50 this year and receive $80 next year. Suppose Mr. Dell consumes $50 this year and invests in the project. What is the NPV of the investment opportunity?

A. $0

B. $5

**C.** $22.73

D. None of the options

*Accessibility: Keyboard Navigation*

*Difficulty: Challenge*

30. Ms. Anderson has $60,000 income this year and $40,000 next year. The market interest rate is 10 percent per year. Suppose Ms. Anderson consumes $80,000 this year. What will be her consumption next year?

**A.** $18,000

B. $30,000

C. $60,000

D. $70,000

*Accessibility: Keyboard Navigation*

*Difficulty: Challenge*

31. The line that connects the maximum that one can consume this year (now, on the horizontal axis) and the maximum one can consume next year

A. has a slope of (1 + *r*).

**B.** has a slope of - (1 + *r*).

C. has a slope of *r*.

D. has a slope of 1/*r*.

*Accessibility: Keyboard Navigation*

*Difficulty: Challenge*

32. Ms. Newcastle has $60,000 income this year and $40,000 next year. The market interest rate is 10 percent per year. Suppose Ms. Newcastle wishes to consume $62,000 next year. What will be her consumption this year?

A. $19,000

**B.** $40,000

C. $60,000

D. $70,000

*Accessibility: Keyboard Navigation*

*Difficulty: Challenge*

33. Mr. Smith has an income of $40,000 this year and $60,000 next year. He can invest in a project that costs $30,000 this year, which generates an income of $36,000 next year. The market interest rate is 10 percent. What will be his consumption next year if Mr. Smith invests in the project and consumes $50,000 this year?

A. $40,000

**B.** $52,000

C. $60,000

D. $62,000

*Accessibility: Keyboard Navigation*

*Difficulty: Challenge*

34. The board of directors is ultimately responsible for all large investment decisions.

**TRUE**

*Accessibility: Keyboard Navigation*

*Difficulty: Intermediate*

35. A corporation has a legal existence of its own and is based on "articles of incorporation.

**TRUE**

*Accessibility: Keyboard Navigation*

*Difficulty: Basic*

36. Real assets of a corporation are claims on their financial assets.

**FALSE**

*Accessibility: Keyboard Navigation*

*Difficulty: Intermediate*

37. A firm's total asset value belongs entirely to the shareholders.

**FALSE**

*Accessibility: Keyboard Navigation*

*Difficulty: Intermediate*

38. Managers, shareholders, and the firm's debtholders have identical information about the value of the firm.

**FALSE**

*Accessibility: Keyboard Navigation*

*Difficulty: Intermediate*

39. Explain the term *corporation*.

A corporation is a legal entity and has an existence of its own. Generally, large businesses are organized as corporations.

*Difficulty: Basic*

40. Briefly explain the term *limited liability.*

The shareholders of a corporation cannot be held personally responsible for the debts of the corporation. This is called *limited liability.* Hence, a shareholder's loss is limited to the amount he or she has invested in a corporation. This is an attractive feature for investors.

*Difficulty: Intermediate*

41. Briefly explain the advantages of a corporation as a form of business organization.

 Corporations have infinite life.

 Corporations have very many owners called shareholders and therefore corporations can raise funds more easily than other forms of business.

 There is a separation of ownership and management that is helpful in running the corporation on a day-to-day basis.

It is relatively easy to transfer ownership in a corporation.



 Corporations have limited liability.

*Difficulty: Intermediate*

42. Briefly explain the sequence of cash flows between financial markets and the firm.

 Cash is raised by selling financial assets to investors.

 Cash is invested in the firm's operation and used to purchase real assets.

 Cash is generated by the firm's operations.

 Cash is reinvested or returned to investors.

*Difficulty: Intermediate*

43. Briefly explain the functions of financial markets.

There are five important functions of financial markets. They are

 providing financing for corporations.

 providing liquidity for investors.

 reducing risk for investors.

 providing information.

 monitoring firms' financial performance.

*Difficulty: Intermediate*

44. Briefly discuss the role of financial managers.

Chief financial officer (CFO): Supervises the treasurer and the controller in a large corporation. The CFO is involved in corporate planning and financial policy.

Treasurer: Is responsible for obtaining funds and managing cash, banking relationships, and investor relationships.

Controller: Is responsible for accounting functions, payroll, and taxes.

*Difficulty: Intermediate*

45. Briefly explain the term *agency costs* as related to a corporation

Agency costs arise in a corporation as a result of principal–agent problems. For example, managers may not act in the best interests of shareholders while making decisions. Hence, shareholders incur monitoring costs that are called agency costs. Agency costs also arises as a result of informational asymmetry between managers and other stakeholders of a firm. Agency costs tend to reduce the value of a firm.

*Difficulty: Intermediate*

46. Briefly discuss principal–agent problems as related to a corporation.

Principal–agent problems arise in a corporation as a result of the separation of ownership and management. Managers may not act in the best interests of the shareholders while making decisions. Hence, shareholders incur monitoring and bonding costs, which are a part of agency costs. It also arises as a result of informational asymmetry between managers and other stakeholders of a firm. Agency costs tend to reduce the value of a firm.

*Difficulty: Intermediate*

47. Explain why “maximization of shareholders' wealth” is the appropriate ultimate long-term goal of the firm.

Under perfect market conditions, everyone can borrow or lend at the same interest rate. This implies that differences in consumption patterns can be adjusted in the financial markets. Given this, all investors will agree that they are better off if the firm maximizes their current wealth (i.e., maximizing shareholders' wealth).

*Difficulty: Challenge*

48. Briefly explain some of the institutional arrangements that ensure that managers work toward increasing the value of a firm.

 The board of directors, elected by shareholders, which scrutinizes managers' actions

 Competition among managers

 The threat of takeover that brings a new management team

 Incentive schemes that are closely tied to the value of the firm like stock options

*Difficulty: Intermediate*

49. Briefly explain how individuals can adjust their current and future consumption according to their preferences.

Individuals can adjust their preferences for consumption by borrowing or lending in the financial market. The appropriate balance between present and future consumption that each individual will choose depends on personal preferences. Nevertheless, individuals with different preferences can adjust their preferences using the financial market. Individuals desiring current consumption can borrow from future income. Meanwhile, individuals favoring future consumption can refrain from current consumption and invest in the same financial market.

*Difficulty: Challenge*

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| Difficulty: Basic | 11 |
| Difficulty: Challenge | 13 |
| Difficulty: Intermediate | 25 |