

Financial Management: Principles and Applications, 11e (Titman)
Chapter 2 Firms and the Financial Market

2.1 The Basic Structure of the U.S. Financial Markets

1) Most businesses are considered to be savers.

Answer: FALSE

Diff: 1

Topic: 2.1 The Basic Structure of the U.S. Financial Markets

Keywords: financial intermediaries

Principles: Principle 2: There Is a Risk-Return Tradeoff

2) Financial intermediaries help bring savers and borrowers together.

Answer: TRUE

Diff: 1

Topic: 2.1 The Basic Structure of the U.S. Financial Markets

Keywords: financial intermediaries

Principles: Principle 2: There Is a Risk-Return Tradeoff

3) Individuals are often savers because they wish to save for things such as a down payment on a home or graduate school.

Answer: TRUE

Diff: 1

Topic: 2.1 The Basic Structure of the U.S. Financial Markets

Keywords: risk

Principles: Principle 2: There Is a Risk-Return Tradeoff

4) Financial markets are where money and credit are exchanged.

Answer: TRUE

Diff: 1

Topic: 2.1 The Basic Structure of the U.S. Financial Markets

Keywords: financial markets

Principles: Principle 2: There Is a Risk-Return Tradeoff

2.2 The Financial Marketplace: Financial Institutions

1) All of the following operate as financial intermediaries EXCEPT:

A) commercial banks.

B) mutual funds.

C) insurance companies.

D) public universities.

Answer: D

Diff: 1

Topic: 2.2 The Financial Marketplace: Financial Institutions

Keywords: financial intermediaries

2) All of the following are true about insurance companies EXCEPT:

- A) They invest their reserves.
- B) They may guarantee to reimburse lenders should lenders' loans go into default.
- C) They participate in equipment leasing.
- D) They may only invest their reserves in interest paying bank accounts under Federal law.

Answer: D

Diff: 1

Topic: 2.2 The Financial Marketplace: Financial Institutions

Keywords: financial institutions

Principles: Principle 1: Money Has a Time Value

3) Which of the following is true regarding Investment Banks?

- A) As a result of the financial crisis of 2008, all stand alone Investment banks either failed, were merged into commercial banks, or became commercial banks.
- B) Under the Glass-Steagal act, commercial banks were allowed to operate as Investment banks.
- C) When Glass-Steagal was repealed in 1999, commercial banks and Investment banks had to be separate entities.
- D) As of 2010, stand alone Investment banks are numerous.

Answer: A

Diff: 1

Topic: 2.2 The Financial Marketplace: Financial Institutions

Keywords: financial institutions

4) Each of the following is true of Mutual Funds EXCEPT:

- A) Funds can be classified as load or no-load funds.
- B) Mutual Fund shares must be bought from or sold to the Fund by investors.
- C) An index fund is the fund with the highest expenses payable by investors.
- D) The NAV is the total value of stock held by the fund divided by the number of outstanding shares in the mutual fund.

Answer: C

Diff: 1

Topic: 2.2 The Financial Marketplace: Financial Institutions

Keywords: mutual funds

Principles: Principle 3: Cash Flows Are the Source of Value

5) In financial markets, borrowers pay savers by giving them a return on investment.

Answer: TRUE

Diff: 1

Topic: 2.2 The Financial Marketplace: Financial Institutions

Keywords: financial intermediaries

Principles: Principle 3: Cash Flows Are the Source of Value

6) All financial intermediaries are banks.

Answer: FALSE

Diff: 1

Topic: 2.2 The Financial Marketplace: Financial Institutions

Keywords: financial intermediaries

7) Mutual Funds and ETFs provide the investor a chance to diversify without having to buy shares in numerous corporations.

Answer: TRUE

Diff: 2

Topic: 2.2 The Financial Marketplace: Financial Institutions

Keywords: mutual funds

Principles: Principle 2: There Is a Risk-Return Tradeoff

8) Private equity firms are financial intermediaries that are not traded on public capital markets.

Answer: TRUE

Diff: 1

Topic: 2.2 The Financial Marketplace: Financial Institutions

Keywords: financial intermediaries

Principles: Principle 2: There Is a Risk-Return Tradeoff

9) Capital markets are markets for short term debt instruments maturing in less than one year, and money markets are markets for long term debt instruments maturing in more than one year.

Answer: FALSE

Diff: 2

Topic: 2.2 The Financial Marketplace: Financial Institutions

Keywords: capital markets

Principles: Principle 1: Money Has a Time Value

10) Banks that are financial intermediaries generate earnings when they facilitate the transfer of money from savers to borrowers by paying savers a smaller return than they demand from borrowers.

Answer: TRUE

Diff: 2

Topic: 2.2 The Financial Marketplace: Financial Institutions

Keywords: financial intermediaries

Principles: Principle 3: Cash Flows Are the Source of Value

11) In Financial markets, borrowers and lenders must both be located in the same country.

Answer: FALSE

Diff: 1

Topic: 2.2 The Financial Marketplace: Financial Institutions

Keywords: capital markets

12) The difference between mutual funds and ETFs is that ETFs are traded on exchanges and mutual funds are not.

Answer: TRUE

Diff: 1

Topic: 2.2 The Financial Marketplace: Financial Institutions

Keywords: financial intermediaries

Principles: Principle 3: Cash Flows Are the Source of Value

13) Describe the costs and benefits to investors of owning Mutual Funds.

Answer: Owners of mutual fund shares get professional management of their portfolio, and get a diversified portfolio, as each mutual share is a share in the whole portfolio purchased by the mutual fund. In order to get these benefits, the investor must pay commissions upon purchase, and/or pay yearly management fees. The fees can significantly diminish the value of the shares of the mutual fund to the investor. An alternative for the investor is to buy an index fund, that is a fund that tracks an index such as the Dow Jones Industrial Average or the S & P 500. An index fund tracking the DJIA, for example, will automatically purchase stocks in the same percentage that they are used to determine the Dow Jones Industrial Average. Owning an index fund reduces costs, because there is no need to have professionals running the portfolio.

Diff: 2

Topic: 2.2 The Financial Marketplace: Financial Institutions

Keywords: mutual funds

Principles: Principle 3: Cash Flows Are the Source of Value

2.3 The Financial Marketplace: Securities Markets

1) Which of the following is true about bonds?

- A) They are obligations from the investor to the corporation.
- B) Their interest rate always varies with the Consumer Price Index
- C) They have a fixed maturity, and they pay an amount equal to the maturity value times the coupon rate each year.
- D) At maturity of the bond, the investor receives the market price of the bond.

Answer: C

Diff: 1

Topic: 2.3 The Financial Marketplace: Securities Markets

Keywords: bonds

Principles: Principle 3: Cash Flows Are the Source of Value

2) Which of the following is true about Preferred Stock?

- A) Preferred shareholders always have voting rights.
- B) If at a time a dividend is due on preferred stock, if the company does not have the funds to pay the dividend, the right of the preferred shareholders to collect that dividend lapses.
- C) Preferred dividends are not tax deductible to the corporation.
- D) Like bonds, preferred stock always has a maturity date at which time the issue price must be repaid to shareholders.

Answer: C

Diff: 1

Topic: 2.3 The Financial Marketplace: Securities Markets

Keywords: preferred stock

Principles: Principle 2: There Is a Risk-Return Tradeoff

3) A security is a written instrument that represents a financial claim.

Answer: TRUE

Diff: 1

Topic: 2.3 The Financial Marketplace: Securities Markets

Keywords: securities

Principles: Principle 1: Money Has a Time Value

4) Primary markets are always larger than secondary markets.

Answer: FALSE

Diff: 1

Topic: 2.3 The Financial Marketplace: Securities Markets

Keywords: primary and secondary markets

Principles: Principle 2: There Is a Risk-Return Tradeoff

5) ABC Corporation issued and sold 10 shares of stock to Irene Investor, a private individual. This represents a secondary market transaction.

Answer: FALSE

Diff: 2

Topic: 2.3 The Financial Marketplace: Securities Markets

Keywords: primary and secondary markets

Principles: Principle 3: Cash Flows Are the Source of Value

6) Colin, a private individual, sold one thousand shares of stock in DEF Corporation to Colleen, also a private individual. This represents a secondary market transaction.

Answer: TRUE

Diff: 2

Topic: 2.3 The Financial Marketplace: Securities Markets

Keywords: primary and secondary markets

Principles: Principle 3: Cash Flows Are the Source of Value

7) Investors in securities markets do not use a financial intermediary.

Answer: TRUE

Diff: 1

Topic: 2.3 The Financial Marketplace: Securities Markets

Keywords: securities

Principles: Principle 3: Cash Flows Are the Source of Value

8) A bond matures in less than 10 years.

Answer: FALSE

Diff: 1

Topic: 2.3 The Financial Marketplace: Securities Markets

Keywords: bonds

Principles: Principle 2: There Is a Risk-Return Tradeoff

9) Bonds are less risky than are stocks because their return is more predictable.

Answer: TRUE

Diff: 1

Topic: 2.3 The Financial Marketplace: Securities Markets

Keywords: bonds

Principles: Principle 2: There Is a Risk-Return Tradeoff

10) Owners of common stock are the owners of the firm.

Answer: TRUE

Diff: 1

Topic: 2.3 The Financial Marketplace: Securities Markets

Keywords: stocks

11) Each year, shareholders receive a dividend equal to the firm's net earnings divided by the number of shares of common stock.

Answer: FALSE

Diff: 1

Topic: 2.3 The Financial Marketplace: Securities Markets

Keywords: stocks

Principles: Principle 3: Cash Flows Are the Source of Value

12) A stock's market value is dependent on investors' expectations of future cash flows to the firm.

Answer: TRUE

Diff: 1

Topic: 2.3 The Financial Marketplace: Securities Markets

Keywords: stocks

Principles: Principle 3: Cash Flows Are the Source of Value

13) Preferred stock prices are solely dependent on investors' expectations of future cash flows to the corporation.

Answer: FALSE

Diff: 1

Topic: 2.3 The Financial Marketplace: Securities Markets

Keywords: preferred stock

Principles: Principle 3: Cash Flows Are the Source of Value

14) A company has the option to pay bond interest or not.

Answer: FALSE

Diff: 1

Topic: 2.3 The Financial Marketplace: Securities Markets

Keywords: bonds

Principles: Principle 3: Cash Flows Are the Source of Value

15) There are more companies listed on NASDAQ than are listed on the New York Stock Exchange.

Answer: TRUE

Diff: 1

Topic: 2.3 The Financial Marketplace: Securities Markets

Keywords: stock exchanges

16) Organized security exchanges do not physically occupy space.

Answer: FALSE

Diff: 1

Topic: 2.3 The Financial Marketplace: Securities Markets

Keywords: stock exchanges

17) Explain how securities markets provide a link between the corporation and investors.

Answer: First, the corporation sells its securities, which can be common stock, preferred stock, or debt. Since the firm receives money directly from these sales, these are primary market transactions. The firm then invests the money it receives, with the corporate purpose of maximizing the value of its shares of common stock. The corporation must then pay back its investors, and pay taxes. Any other monies can be reinvested into the firm. When these securities are traded on the market, these are secondary market transactions, and by making these trades, investors determine the market value of the securities.

Diff: 2

Topic: 2.3 The Financial Marketplace: Securities Markets

Keywords: securities markets

Principles: Principle 3: Cash Flows Are the Source of Value

18) Describe the tax benefits to a corporation of issuing debt rather than issuing stock.

Answer: The greatest advantage to issuing debt is that the interest payments on debt are tax deductible, and that dividend payments are not tax deductible. In addition, the interest payment is a known amount, and the required return on debt is generally lower than the investor required return on equity because the cash flows to investors are more predictable for debt than they are for equity.

Diff: 2

Topic: 2.3 The Financial Marketplace: Securities Markets

Keywords: tax benefits