

**Chapter 1: An Introduction to Finance****Multiple Choice Questions****Section 1.1 – Real versus Financial Assets**

1. Which of the following items is not a real asset?

- A. Land
- B. Television
- C. Bond
- D. Gold mine

Answer: C    Type: Definition    Level of Difficulty: Easy    LO: 1.2

2. Of the following list, which item is a financial asset?

- A. Land
- B. Bond
- C. Building
- D. Inventory

Answer: B    Type: Definition    Level of Difficulty: Easy    LO: 1.2

3. What is the main difference between real assets and financial assets?

- A. Real assets are tangible and financial assets are intangible.
- B. Real assets have known values, while the values of financial assets are not known.
- C. Real assets are intangible and financial assets are tangible.
- D. Real assets have unknown values, while the values of financial assets are known.

Answer: A    Type: Definition    Level of Difficulty: Easy    LO: 1.2

4. If Canadian households, in aggregate, own real assets with a market value of \$3.194 trillion, and also own net financial assets with a market value of \$2.344 trillion, the total net assets of Canadian households have a market value of:

- A. 3.194 trillion
- B. 5.538 trillion
- C. -0.850 trillion
- D. 0.850 trillion

Answer: B    Type: Calculation    Level of Difficulty: Easy    LO: 1.2

How the answer was determined:

$$5.538 \text{ trillion} = \$3.194 + \$2.344$$

5. Given the following hypothetical information regarding the real and financial assets in Canada for 2008 (numbers in \$ billions):

	Real Assets	Net Financial Assets
Government	677	-658
Business	2,202	-1,635
Households	3,194	2,344

What is the total value of the net real assets in Canada for 2008?

- A. \$5,842 billion
- B. \$6,086 billion
- C. \$6,124 billion
- D. \$6,105 billion

Answer: C Type: Calculation Level of Difficulty: Medium LO: 1.2

How the answer was determined:

$$\$6,124 \text{ billion} = 677 + 2202 + 3194 - 658 - 1635 + 2344$$

6. You are provided with the following hypothetical information regarding the real and financial assets in Canada for 2008 (numbers in \$ billions):

	Real Assets	Net Financial Assets
Government	677	-658
Business	2,202	-1,635
Households	3,194	2,344

What is the value of the net financial assets owned by *non-residents* for 2008?

- A. \$901 billion
- B. \$709 billion
- C. \$2293 billion
- D. There is not enough information to answer the question.

Answer: A Type: Calculation Level of Difficulty: Difficult LO: 1.2

How the answer was determined:

$\$901 \text{ billion} = 3194 - 658 - 1635$ . The value of net financial assets held by non-residents is equal to the negative of the sum of the net financial assets of government, businesses, and households.

7. Which of the following sectors is the primary source of savings in the economy?

- A. Business sector
- B. Household sector
- C. Government sector
- D. Banking sector

Answer: B Type: Concept Level of Difficulty: Easy LO: 1.2

### **Section 1.2 – The Financial System**

8. Entities that invest funds on behalf of others and change the nature of the transactions are called:

- A. Brokers
- B. Financial intermediaries
- C. Dealers
- D. Market intermediaries

Answer: B Type: Definition Level of Difficulty: Easy LO: 1.3

9. Joe has just borrowed \$5,000 from his aunt in order to make a down payment on a car. This borrowing transaction is an example of:

- A. Indirect intermediation

- B. Direct intermediation
- C. External intermediation
- D. Market transaction

Answer: B      Type: Definition      Level of Difficulty: Easy      LO: 1.3

10. An example of direct intermediation would be:

- A. An individual borrowing money from a bank
- B. An individual borrowing money from her mother
- C. An individual using a real estate broker to finance her home purchase
- D. A stockbroker selling securities to an individual

Answer: B      Type: Concept      Level of Difficulty: Easy      LO: 1.3

11. The three intermediation channels which transfer money from lenders to borrowers are:

- A. Direct, indirect, and financial intermediation
- B. Direct, indirect, and monetary intermediation
- C. Direct, financial, and monetary intermediation
- D. Indirect, financial, and monetary intermediation

Answer: A      Type: Definition      Level of Difficulty: Easy      LO: 1.3

12. Although Canadian banks are involved in almost all areas of the financial system, which of the following is their core activity?

- A. Stock market investment activity
- B. Retirement planning
- C. Wealth management
- D. Taking deposits and lending funds

Answer: D      Type: Definition      Level of Difficulty: Easy      LO: 1.3

13. Which of the following is *not* a financial intermediary?

- A. Chartered banks
- B. Insurance companies
- C. Pension funds
- D. Mutual funds

Answer: D      Type: Definition      Level of Difficulty: Easy      LO: 1.3

14. Which of the following is *not* one of the main functions performed by mutual funds?

- A. Pooling sums of money to make investments
- B. Paying out premiums to their clients
- C. Providing professional management expertise
- D. Acting as a “pass-through” for individuals to invest in the equity and debt markets

Answer: B      Type: Concept      Level of Difficulty: Medium      LO: 1.3

15. What is the major proportion of Canadians' wealth?

- A. Stocks and bonds
- B. Real Assets
- C. Durable goods
- D. Claims on retirement and insurance funds

Answer: D    Type: Concept    Level of Difficulty: Easy    LO: 1.3

16. In 2008, the Canadian government owes 28.6 percent of its GDP in debt to whom?

- A. Crown corporations
- B. Multinational firms
- C. Canadian households and Corporations
- D. World Bank

Answer: C    Type: Concept    Level of Difficulty: Easy    LO: 1.3

17. In Figure 1-1, how do you explain the negative difference between the value of real assets and the financial assets of Canadian corporations and crown corporations?

- A. Real assets are always less than financial assets
- B. Canadian debt financed the difference
- C. Claims to retirement funds
- D. The 2008–09 financial market crash

Answer: D    Type: Concept    Level of Difficulty: Medium    LO: 1.3

### ***Section 1.3 – Financial Instruments and Markets***

18. Financial markets are usually classified by the type and maturity of the financial assets traded. The two main classifications are as follows:

- A. Bond market and money market
- B. Money market and capital market
- C. Bond market and foreign-exchange market
- D. Commodity market and capital market

Answer: B    Type: Definition    Level of Difficulty: Easy    LO: 1.4

19. Of the following list, who are the dominant players in the money market?

- I. Individuals
- II. Corporations
- III. Governments
- A. I and II
- B. I and III
- C. II and III
- D. I, II and III

Answer: C    Type: Definition    Level of Difficulty: Easy    LO: 1.4

20. All common shares are comprised of which two components?

- A. Ownership and voting rights
- B. Ownership and dividend rights
- C. Voting and dividend rights
- D. Dividend and yield rights

Answer: A    Type: Concept    Level of Difficulty: Easy    LO: 1.4

21. Though they are classified as equity, why are preferred shares also similar to debt?

- A. Both carry the same interest rate.
- B. Dividends on preferred shares must be paid out before any common share dividends.

C. The voting structures for preferred shares and debt are equivalent.

D. Preferred shares have similar maturity structures to debt.

Answer: B    Type: Concept    Level of Difficulty: Difficult    LO: 1.4

22. Which of the following is not a component of debt securities?

A. Maturity

B. Repayment

C. Dividends

D. Interest payments

Answer: C    Type: Definition    Level of Difficulty: Easy    LO: 1.4

23. An example of a non-marketable financial asset is a:

A. Demand deposit

B. T-Bill

C. Commercial paper

D. Common share

Answer: A    Type: Definition    Level of Difficulty: Easy    LO: 1.4

24. How do governments obtain the majority of their short- and long-term financing?

A. T-Bills and Canada Savings Bonds

B. T-Bills, traditional bonds, and Canada Savings Bonds

C. T-Bills, equity, and traditional bonds

D. Traditional bonds and Canada Savings Bonds

Answer: B    Type: Concept    Level of Difficulty: Easy    LO: 1.4

25. Which of the following is *not* an example of a capital market security?

A. Bond

B. Debenture

C. Common equity

D. T-Bill

Answer: D    Type: Definition    Level of Difficulty: Easy    LO: 1.4

26. Which of the following is an existing stock exchange in Canada?

A. Toronto Stock Exchange (TSX)

B. Montreal Exchange (ME)

C. Vancouver Stock Exchange (VSE)

D. Winnipeg Stock Exchange (WSE)

Answer: A    Type: Definition    Level of Difficulty: Easy    LO: 1.4

27. Which of the following was *not* one of the major objectives in the restructuring of the Canadian stock exchanges in 1999 and 2000?

A. To create a Canadian market for NASDAQ-listed companies.

B. To combine all futures and options trading on one exchange.

C. To make the TSX the official exchange for the trading of Canadian senior stocks.

D. To create a single national exchange for trading in junior company stocks.

Answer: A    Type: Concept    Level of Difficulty: Medium    LO: 1.4

28. A market where transactions are made directly between large institutions and wealthy individuals that bypass brokers and dealers is an example of:

- A. The primary market
- B. The secondary market
- C. The third market
- D. The fourth market

Answer: D    Type: Definition    Level of Difficulty: Easy    LO: 1.4

29. The main difference between exchanges and dealer/OTC markets is:

- A. Exchanges are a part of the primary market, while dealer and OTC markets are part of the secondary market.
- B. Transactions in dealer markets are conducted entirely by humans, not electronically.
- C. Exchanges have a physical location while dealer and OTC markets do not.
- D. All of the above are differences between exchanges and dealer markets.

Answer: C    Type: Concept    Level of Difficulty: Easy    LO: 1.4

30. The exchange that acts as the Canadian national derivatives market and conducts all options and futures trading is called the:

- A. Bourse de Montreal
- B. Winnipeg Commodity Exchange
- C. Toronto Stock Exchange
- D. Canadian Trading and Quotation System Inc.

Answer: A    Type: Definition    Level of Difficulty: Easy    LO: 1.4

31. Which is the only province where trades in unlisted securities need to be reported?

- A. British Columbia
- B. Quebec
- C. Alberta
- D. Ontario

Answer: D    Type: Definition    Level of Difficulty: Easy    LO: 1.4

32. Which one of the following is not a function of brokers?

- A. Manage money for clients
- B. Make the market work
- C. Charge a fee for their services
- D. Assist with the transaction process

Answer: A    Type: Concept    Level of Difficulty: Easy    LO: 1.4

33. What was **not** a reason for the credit crunch of 2008-09?

- A. Mistrust between financial intermediaries
- B. Illiquidity of debt markets
- C. The arrest of Bernard Madoff
- D. Bankruptcy of one of the leading financial institutions

Answer: C    Type: Concept    Level of Difficulty: Easy    LO: 1.4

34. Who are the biggest borrower and lender in Canada respectively?

- A. Government and households
- B. Government and banks
- C. Banks and mutual funds
- Crown corporations and banks

Answer: A    Type: Concept    Level of Difficulty: Easy    LO: 1.4

35. Why can't the Canadian government issue equity?

- A. Because assets belong to all Canadians
- B. It is not listed in the financial markets
- C. It has too much debt
- D. Because expenditures exceed revenues

Answer: A    Type: Concept    Level of Difficulty: Medium    LO: 1.4

36. If the stock of a listed firm decreases by 50 percent what does it mean to the stock holders?

- A. Their ownership of the firm will decrease by 50 percent
- B. Total value of their holdings decreases by 50 percent
- C. The debt of the firm decreases by 50 percent
- D. Nothing

Answer: B    Type: Concept    Level of Difficulty: Medium    LO: 1.4

#### ***Section 1.4 – The Global Financial Community***

37. Which of the following is *not* a benefit of global financial markets?

- A. They represent important sources of funds for borrowers.
- B. They provide diversification benefits to Canadian investors.
- C. Canadian companies can list their shares in different markets.
- D. The value of Canadian shares becomes more stable.

Answer: D    Type: Concept    Level of Difficulty: Easy    LO: 1.5

38. Which is the world's largest and most famous stock market?

- A. New York Stock Exchange (NYSE)
- B. Toronto Stock Exchange (TSX)
- C. Tokyo Stock Exchange (TSE)
- D. London Stock Exchange (LSE)

Answer: A    Type: Definition    Level of Difficulty: Easy    LO: 1.5

39. The spread of the financial crisis in the autumn of 2008 was **not** augmented by:

- A. Linkages between global financial markets
- B. The cross listing of firms in different markets
- C. The consolidation of the global financial system
- D. Excessive debt of the government

Answer: D    Type: Concept    Level of Difficulty: Medium    LO: 1.5

40. What is a 'Ninja' loan?

- A. Mortgage to individuals with poor credit
- B. Mortgage with unknown rates

C. Mortgages to individuals with good credit

D. Mortgages backed by unspecified assets

Answer: A      Type: Definition      Level of Difficulty: Easy      LO: 1.5

### Practice Problems

41. How do financial intermediaries help those with “too much money today” and those with “not enough money today”?

Type: Concept      Level of Difficulty: Medium      LO: 1.4

Suggested answer:

Financial markets provide these surplus- and deficit-spending units with a way to improve their respective situations. Deficit-spending units do not have to postpone profitable investments today, and surplus-spending units can hold financial securities that generate a return. More importantly, financial markets provide a framework that facilitates the “meeting” of these two parties. Financial markets accelerate, simplify, and reduce the cost of contact between borrowers and lenders.

42. What are the differences between the primary markets and the secondary markets?

Type: Concept      Level of Difficulty: Easy      LO: 1.4

Suggested answer:

The primary market is where a borrower issues new securities and exchanges these securities for cash from investors. The proceeds of the sale of securities in the primary market go to the issuing corporation or government.

In secondary markets, investors trade already issued securities with other investors. Securities may trade repeatedly in the secondary markets, but the original issuers will be unaffected in the sense that they will not receive any additional cash from these transactions.

43. Why is the secondary market important?

Type: Definition      Level of Difficulty: Medium      LO: 1.4

Suggested answer:

The secondary market is where investors trade already issued securities. It is important because it provides liquidity to investors. If an efficient secondary market did not exist, investors would be very reluctant to hold securities with longer maturities. If they are not willing to buy these securities, then securities in the primary market will become more difficult to sell. Hence, the secondary market is necessary for the proper functioning of the primary market.

44. What is an over-the-counter market? Do all bonds in Canada trade over-the-counter?

Type: Concept      Level of Difficulty: Easy      LO: 1.4

Suggested answer:

“Over-the-counter” means a large network of dealers make markets in various securities, both debt and equity. The market doesn’t have a physical location but instead consists of a network of dealers who trade with each other over phone or computer networks. Investors can buy and sell with their brokers who then trade with other dealers.



The majority of bonds in Canada trade over-the-counter, although some bonds trade on stock exchanges such as the Toronto Stock Exchange (convertible bonds only) and the Canadian Venture Exchange.

45. Explain what an auction market is and how it works.

Type: Definition      Level of Difficulty: Easy      LO: 1.4

Suggested answer:

Stock exchanges are auction markets. Brokers act on behalf of their clients and arrange to match buyers and sellers through an auction system. Trading takes place either on the floor of an exchange or by computer link. For their services, brokers charge a commission that is a percentage of the value of the transaction.

46. Define and describe the difference between the third and fourth markets.

Type: Definition      Level of Difficulty: Easy      LO: 1.4

Suggested answer:

The third market is an OTC market for the trading of securities that are listed on organized exchanges. The fourth market refers to transactions made directly between large institutions and/or wealthy individuals, thereby bypassing brokers and dealers.

The difference between the third and fourth market:

The third market involves extremely large transactions and is used primarily to avoid exchange commission fees. The fourth market involves relatively smaller trades and is used to avoid information leaks regarding who is trading which stock(s).

47. Explain the gravity of the situation of pension holders in Quebec after the loss of 25 percent of the caisse de depot's portfolio (pension fund manager of Quebec) in 2008.

Type: Concept      Level of Difficulty: Difficult      LO: 1.5

La caisse de depot is the manager of pensions in Quebec. The loss of 25 percent of its portfolio represents the loss of funds available to pay pensions. In order to keep the same level of payment of pensions promised to pensioners, the contributions have to be increased or the province has to contribute from its own money to increase the level of funds.

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