

## **Chapter 1—The Scope of Corporate Finance**

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### **MULTIPLE CHOICE**

1. One of the tasks for financial managers when identifying projects that increase firm value is to identify those projects where
- benefits are at least equal to the project's costs.
  - taking the project will increase the book value of the firm's common stock.
  - taking the project will decrease the book value of the firm's debt outstanding.
  - d.** none of the above

ANS: A

PTS: 1

DIF: E

REF: 1.1 The Role of Corporate Finance in Modern Business NAT: Reflective thinking

LOC: create a finance application in a computer spreadsheet and as an analyst using public information

2. Which finance career classification involves analyzing a firm's business processes and strategies as well as recommending a change in practice in order to make a firm more competitive?
- corporate finance
  - commercial banking
  - investment banking
  - d.** consulting

ANS: D

PTS: 1

DIF: M

REF: 1.1 Career Opportunities in Finance

NAT: Reflective thinking

LOC: understand the role of the finance function in the enterprise

3. If you would like to work in finance by trading debt and equity securities for customers, then which finance career classification should you target?
- corporate finance
  - commercial banking
  - investment banking
  - d.** money management

ANS: C

PTS: 1

DIF: M

REF: 1.1 Investment Banking

NAT: Reflective thinking

LOC: understand the role of the finance function in the enterprise

4. Which form of invested capital is subject to most of the firm's business and financial risk?
- debt capital
  - equity capital
  - borrowed capital
  - d.** intellectual capital

ANS: B

PTS: 1

DIF: E

REF: 1.2 Debt and Equity

NAT: Reflective thinking

LOC: understand stocks and bonds

5. Which of the following is not a true capital-raising event for the firm?
- primary market transaction
  - secondary market transaction
  - initial public offering
  - d.** a corporate loan from a bank

ANS: B

PTS: 1

DIF: E

REF: 1.2 The Growing Importance of Financial Markets NAT: Reflective thinking  
LOC: acquire knowledge of financial markets and interest rates

6. Which of the following is not one of the five basic corporate finance functions?
- external financing function
  - capital budgeting function
  - risk management
  - auditing

ANS: D PTS: 1 DIF: M  
REF: 1.2 The Five Basic Corporate Finance Functions NAT: Reflective thinking  
LOC: understand the role of the finance function in the enterprise

7. William and Theodore have decided to start a travel business called Excellent Adventures. Since their business primarily involves time-travel their clients may be harmed during a small but significant portion of the travels. Consequently, William and Theodore would like a business form that will shield their personal wealth from any legal claims that the firm might be subject to after one of the travel mishaps. If William and Theodore are the only investors in this U.S. domiciled firm, which legal form of organization would be best for Excellent Adventures to protect both William and Theodore?
- sole proprietorship
  - partnership
  - limited partnership
  - corporation

ANS: D  
sole proprietorship - not possible with 2 owners  
partnership - has joint and several liability that will not help the owners  
limited partnership - one partner must be the general partner and consequently could not protect both owners  
corporation - has limited liability

PTS: 1 DIF: H REF: 1.3 Legal Forms of Business Organizations  
NAT: Reflective thinking  
LOC: understand the role of the finance function in the enterprise

8. Within a limited partnership context, what are the conditions on a limited partner?
- There is a limit to the amount of capital that a limited partner can contribute, as mandated by law.
  - There is a limit to the number of limited partners that the firm may take on as investors.
  - The limited partner must remain a low level employee and cannot ever serve in a managerial role in the firm.
  - A limited partner may not take any active role in the operation of the business.

ANS: D PTS: 1 DIF: H  
REF: 1.3 Legal Forms of Business Organizations | 1.3 Partnerships  
NAT: Reflective thinking  
LOC: understand the role of the finance function in the enterprise

9. The rules dictating voting procedures and other aspects of corporate governance for a corporation are
- the minutes of the board of directors meeting.
  - the corporate charter.
  - the Institute for Corporate Governance corporate governance procedures.
  - the Securities and Exchange Commission rules for corporate governance.

ANS: B PTS: 1 DIF: M

REF: 1.3 Legal Forms of Business Organizations | 1.3 Corporations

NAT: Reflective thinking

LOC: understand stocks and bonds

10. The ultimate owner(s) of an ongoing corporation are
- the federal government.
  - the debt holders.
  - the equity holders.
  - the executive staff of the corporation.

ANS: C

PTS: 1

DIF: E

REF: 1.3 Legal Forms of Business Organizations | 1.3 Corporations

NAT: Reflective thinking

LOC: understand stocks and bonds

11. Agency costs refer to
- the costs associated with managing the demands of federal agencies.
  - the costs involved when converting an entity from a proprietorship to a corporation.
  - the costs that arise due to conflicts of interest between shareholders and managers.
  - d.** none of the above.

ANS: C

PTS: 1

DIF: E

REF: 1.3 Corporations | 1.4 Agency Cost Definition

NAT: Reflective thinking

LOC: understand stocks and bonds

12. Since the Tax Relief Act of 2003, if a corporation has pre-tax earnings of \$110,000 while the corporation is subject to a 35% income tax rate and an investor is subject to a 35% personal tax rate and a 15% capital gains tax rate, then what is the after-tax income that the investor could capture if all of the firm's earnings are paid out in dividends?
- \$93,500
  - \$71,500
  - \$60,775
  - \$46,475

ANS: C

$\$110,000 * .65 * .85 = \$60,775$

PTS: 1

DIF: M

REF: 1.3 Corporations

NAT: Analytic skills

LOC: acquire knowledge of financial markets and interest rates

13. Since the Tax Relief Act of 2003, if a corporation or partnership has pre-tax earnings of \$110,000 while the corporation is subject to a 35% income tax rate and an investor is subject to a 35% personal tax rate and a 15% capital gains tax rate, then what is the advantage to being a partnership (compared to a corporation) if all of the proceeds are paid out to investors in either legal form?
- (\$22,500)
  - \$0
  - \$10,725
  - \$24,725

ANS: C

Partnership:  $\$110,000 * .65 = \$71,500$

Corporation:  $\$110,000 * .65 * .85 = \$60,775$

Partnership - Corporation =  $\$71,500 - \$60,775 = \$10,725$

PTS: 1                      DIF: H                      REF: 1.3 Legal Forms of Business Organizations  
NAT: Analytic skills  
LOC: acquire knowledge of financial markets and interest rates

14. Which of the following characteristics would disqualify a firm from being an S Corporation?
- a. a firm with 51 different individual shareholders
  - b. the controlling majority shareholder is a Fortune 500 corporation
  - c. one of the shareholders of the proposed S Corporation is an elected official
  - d. none of the above would disqualify a firm from qualifying as an S Corporation**

ANS: B                      PTS: 1                      DIF: M                      REF: 1.3 Corporations  
NAT: Reflective thinking                      LOC: understand stocks and bonds

15. Which of the following is a valid criticism concerning the goal of firms to maximize profits?
- a. profit maximization ignores expenses
  - b. profit maximization is completely unrelated to shareholder wealth
  - c. profit maximization may ignore the timing of those profits
  - d. there are no valid criticisms of profit maximizing firms

ANS: C                      PTS: 1                      DIF: M  
REF: 1.4 What Should a Financial Manager Try to Maximize?   NAT: Reflective thinking  
LOC: understand the role of the finance function in the enterprise

16. Managers of firms should only take actions that
- a. increase the value of the firm's future cash flows.
  - b. they expect will increase the firm's share price.
  - c. have benefits which are at least as great as the cost of those actions.
  - d. all of the above**

ANS: D                      PTS: 1                      DIF: M  
REF: 1.4 What Should a Financial Manager Try to Maximize? | 1.4 Maximize Shareholder Wealth  
NAT: Reflective thinking  
LOC: understand the role of the finance function in the enterprise

17. Which of the following parties have the proper incentives to make risky, value increasing investments for the firm?
- a. suppliers
  - b. creditors
  - c. shareholders
  - d. managers who are only compensated with a salary

ANS: C                      PTS: 1                      DIF: M  
REF: 1.4 What Should a Financial Manager Try to Maximize? | 1.4 Maximize Shareholder Wealth  
NAT: Reflective thinking                      LOC: understand stocks and bonds

18. An agent of a firm could be any of the following:
- a. 100% owner of the firm
  - b. the IRS agent in charge of auditing the firm's tax return
  - c. an employee who does not own any proportion of the firm
  - d. a supplier of the firm

ANS: C                      PTS: 1                      DIF: H  
REF: 1.4 How Can Agency Costs Be Controlled in Corporate Finance?  
NAT: Reflective thinking                      LOC: understand stocks and bonds

19. Shareholders can attempt to overcome agency problems by all BUT ONE of the following:
- a. incurring costs to monitor managers
  - b. paying managers a good salary
  - c. relying on market forces to exert managerial discipline
  - d. paying the manager a proportion of the profits that the firm generates

ANS: B

PTS: 1

DIF: H

REF: 1.4 What Should a Financial Manager Try to Maximize? | 1.4 Types of Agency Costs

NAT: Reflective thinking

LOC: understand stocks and bonds

20. The Sarbanes-Oxley Act of 2002
- a. established the Securities and Exchange Commission.
  - b. requires CEO and CFOs of all large companies to personally certify their firms' financial statements.
  - c. defined ethical behavior.
  - d. established that a CFO must be a member of the firm's audit committee of the board of directors.

ANS: B

PTS: 1

DIF: M

REF: 1.4 How the Sarbanes-Oxley Act Is Changing How Corporate America Conducts Business

NAT: Reflective thinking

LOC: acquire knowledge of financial markets and interest rates

21. Which of the following is the best bonding expenditure to help limit agency costs?
- a. auditing the managers work on a monthly basis
  - b. a contract whereby the manager will forfeit a portion of his deferred compensation in the event of poor performance
  - c. granting the manager a large number of options that will become valuable if the firm performs well
  - d. paying the manager a bonus if the firm performs well

ANS: B

PTS: 1

DIF: H

REF: 1.4 How Can Agency Costs Be Controlled in Corporate Finance?

NAT: Reflective thinking

LOC: acquire knowledge of financial markets and interest rates

22. A root cause of firm agency costs is
- a. managerial carelessness.
  - b. a manager owning too much of his firm's stock.
  - c. a managers concern for his personal well-being.
  - d. federal agency filing requirements.

ANS: C

PTS: 1

DIF: H

REF: 1.4 How Can Agency Costs Be Controlled in Corporate Finance?

NAT: Reflective thinking

LOC: acquire knowledge of financial markets and interest rates

23. Which of the following is a weakness of a sole proprietorship?
- a. Unlimited life
  - b. Easy to form
  - c. Limited liability
  - d. Limited access to capital

ANS: D

PTS: 1

DIF: E

REF: 1.3 Legal Forms of Business Organizations

NAT: Reflective thinking

LOC: acquire knowledge of financial markets and interest rates

24. Which of the following is a strength of a sole proprietorship?

- a. Unlimited life
- b. Easy to form
- c. Limited liability
- d. Limited access to capital

ANS: B PTS: 1 DIF: E

REF: 1.3 Legal Forms of Business Organizations

NAT: Reflective thinking

LOC: acquire knowledge of financial markets and interest rates

25. Which of the following is a strength of the corporate form of business?

- a. Limited life of the business
- b. Unlimited access to capital
- c. Unlimited liability
- d. Double taxation of income

ANS: B PTS: 1 DIF: M

REF: 1.3 Legal Forms of Business Organizations

NAT: Reflective thinking

LOC: acquire knowledge of financial markets and interest rates

26. Which of the following is NOT a strength of the corporate form of business?

- a. Unlimited life of the business
- b. Unlimited access to capital
- c. Unlimited liability
- d. Individual contracting

ANS: C PTS: 1 DIF: M

REF: 1.3 Legal Forms of Business Organizations

NAT: Reflective thinking

LOC: acquire knowledge of financial markets and interest rates

27. What type of corporation allows shareholders to be taxed as partners while retaining their limited liability status?

- a. J Corporation
- b. LLP Corporation
- c. S Corporation
- d. Series 6 Corporation

ANS: C PTS: 1 DIF: M

REF: 1.3 Legal Forms of Business Organizations

NAT: Reflective thinking

LOC: acquire knowledge of financial markets and interest rates

28. Shareholders are said to have a residual claim on the firm's assets. What does this mean?

- a. Shareholders have limited liability in their investment.
- b. Shareholders do not receive any payoff from the firm until all creditors are paid.
- c. Shareholders are allowed to recover their investment first if the firm experiences financial distress.
- d. Shareholders have priority in electing the board of directors for the firm.

ANS: B PTS: 1 DIF: M

REF: 1.2 Corporate Finance Essentials NAT: Reflective thinking

LOC: acquire knowledge of financial markets and interest rates

29. What market is where transactions that generate new cash flow for the firm occur?

- a. Primary market transactions
- b. Secondary market transactions
- c. Commodities market transactions
- d. Initial public offering transactions

ANS: A                      PTS: 1                      DIF: M  
REF: 1.2 Corporate Finance Essentials      NAT: Reflective thinking  
LOC: acquire knowledge of financial markets and interest rates

30. Which type of finance position focuses on preparing firm financial plans and the evaluation of the firm's financial ratios?
- a. Financial analyst
  - b. Capital budgeting analyst
  - c. Cash manager
  - d. Portfolio manager

ANS: A                      PTS: 1                      DIF: M  
REF: 1.1 The Role of Corporate Finance in Modern Business      NAT: Reflective thinking  
LOC: understand the role of the finance function in the enterprise

31. What of the following is FALSE regarding debt capital?
- a. Debt holders receive interest payments at fixed intervals.
  - b. Debt holders receive the amount of their loan (called principal) at the debt's maturity date.
  - c. Debt holders can force the firm into bankruptcy if interest payments are not made.
  - d. Debt holders have voting rights for the firm's board of directors.

ANS: D                      PTS: 1                      DIF: M  
REF: 1.2 Corporate Finance Essentials      NAT: Reflective thinking  
LOC: understand stocks and bonds

32. Which of the following is FALSE regarding equity capital?
- a. Common stock holders bear most of the firm's business and financial risk.
  - b. Preferred stock holders receive a fixed annual payment on their invested capital.
  - c. Common stock holders have ownership in the firm by voting for the firm's management.
  - d. Preferred stockholders can force the firm into bankruptcy if dividend payments are not paid.

ANS: D                      PTS: 1                      DIF: M  
REF: 1.2 Corporate Finance Essentials      NAT: Reflective thinking  
LOC: understand stocks and bonds

33. What was the key impact to the Jobs and Growth Tax Reconciliation Act of 2003?
- a. It greatly reduced the risk and liability of owning a small business.
  - b. It provided tax credits and incentives for corporations to maintain their operations in the United States.
  - c. It reduced the effect of double taxation on corporate earnings by lowering the tax rate on corporate dividends.
  - d. It reduced taxes in an effort to keep Social Security solvent through 2040.

ANS: C                      PTS: 1                      DIF: M  
REF: 1.3 Legal Forms of Business Organizations      NAT: Reflective thinking  
LOC: acquire knowledge of financial markets and interest rates

34. What is a fiduciary?
- a. Someone who performs ratio analysis for a corporation.

- b. Someone who invest and manages money on someone else's behalf.
- c. Someone who manages the release of a initial public offering.
- d. Someone who evaluates the performance of individual bonds.

ANS: B

PTS: 1

DIF: E

REF: 1.1 The Role of Corporate Finance in Modern Business NAT: Reflective thinking

LOC: understand the role of the finance function in the enterprise

35. Calculate the tax disadvantage to organizing a U.S. business today, after passage of the Jobs and Growth Tax Reconciliation Act of 2003, as a corporation versus a partnership, given the following assumptions. All earnings will be paid out as dividends, and operating income before taxes will be \$200,000. The effective corporate tax rate is 35%, and the tax rate on corporate dividends is 15%. The average personal tax rate for partners in the business is 35%.
- a. \$17,500
  - b. \$19,500
  - c. \$20,000
  - d. \$22,250

ANS: B

$$200k \cdot .65 \cdot .85 = 110.5k$$

$$200k \cdot .65 = 130.0k$$

$$130k - 110.5k = 19.5k$$

PTS: 1

DIF: M

REF: 1.3 Legal Forms of Business Organizations

NAT: Analytic skills

LOC: acquire knowledge of financial markets and interest rates

36. Calculate the tax disadvantage to organizing a U.S. business today, after passage of the Jobs and Growth Tax Reconciliation Act of 2003, as a corporation versus a partnership, given the following assumptions. All earnings will be paid out as dividends, and operating income before taxes will be \$750,000. The effective corporate tax rate is 35%, and the tax rate on corporate dividends is 15%. The average personal tax rate for partners in the business is 35%.
- a. \$63,125
  - b. \$64,250
  - c. \$66,000
  - d. \$73,125

ANS: D

$$750k \cdot .65 \cdot .85 = 414.375k$$

$$750k \cdot .65 = 487.500k$$

$$487.5k - 414.375k = 73.125k$$

PTS: 1

DIF: M

REF: 1.3 Legal Forms of Business Organizations

NAT: Analytic skills

LOC: acquire knowledge of financial markets and interest rates

37. Calculate the tax disadvantage to organizing a U.S. business today, after passage of the Jobs and Growth Tax Reconciliation Act of 2003, as a corporation versus a partnership, given the following assumptions. All earnings will be paid out as dividends, and operating income before taxes will be \$1,500,000. The effective corporate tax rate is 35%, and the tax rate on corporate dividends is 15%. The average personal tax rate for partners in the business is 35%.
- a. \$146,250
  - b. \$152,250
  - c. \$166,850



d. \$170,375

ANS: A

$$1,500k \cdot .65 \cdot .85 = 828.75k$$

$$1,500k \cdot .65 = 975.00k$$

$$975k - 828.75k = 146.25k$$

PTS: 1

DIF: M

REF: 1.3 Legal Forms of Business Organizations

NAT: Analytic skills

LOC: acquire knowledge of financial markets and interest rates

38. Before passage of the Jobs and Growth Tax Reconciliation Act of 2003, some argued to completely eliminate the tax rate on dividends. Calculate the tax disadvantage to organizing a U.S. business today if the Jobs and Growth Tax Reconciliation Act of 2003 passed with this provision. Consider the following firm: All earnings will be paid out as dividends, and operating income before taxes will be \$1,500,000. The effective corporate tax rate is 35%, and the tax rate on corporate dividends is 0%. The average personal tax rate for partners in the business is 35%. What is the tax disadvantage?
- a. \$0
  - b. \$75,000
  - c. \$100,000
  - d. \$125,000

ANS: A

$$1,500k \cdot .65 = 975k$$

$$1,500k \cdot .65 = 975k$$

$$975k - 975k = 0$$

PTS: 1

DIF: M

REF: 1.3 Legal Forms of Business Organizations

NAT: Analytic skills

LOC: acquire knowledge of financial markets and interest rates

39. What is meant by the term “double taxation” as applied to the corporate form of business organization?
- a. Corporate income as taxed at twice the rate of partnership income.
  - b. Corporate income is taxed, and then corporate dividends are taxed as well.
  - c. Corporations pay both Federal income tax and state income tax on their earnings.
  - d. Corporations pay both income tax and sales taxes on their goods.

ANS: B

PTS: 1

DIF: E

REF: 1.2 Corporate Finance Essentials

NAT: Reflective thinking

LOC: acquire knowledge of financial markets and interest rates

40. What is the proper goal for management of a firm?
- a. Maximize shareholder wealth
  - b. Maximize net income or earnings
  - c. Maximize sales revenue
  - d. Minimize expenses

ANS: A

PTS: 1

DIF: E

REF: 1.4 The Corporate Financial Manager's Goals

NAT: Reflective thinking

LOC: understand the role of the finance function in the enterprise

41. What is a basic guide for financial decision making?
- a. Make decisions where the benefits exceed the costs.
  - b. Make decisions where the total benefits exceed the total costs.

- c. Make decisions where the average benefits exceed the fixed costs.
- d. Make decisions where the average benefits exceed the average costs.

ANS: A                      PTS: 1                      DIF: E

REF: 1.1 The Role of Corporate Finance in Modern Business      NAT: Reflective thinking

LOC: understand the role of the finance function in the enterprise

42. What recent act has attempted to reduce the possibility of more accounting scandals in our economy?
- a. Tax Relief Act of 2003
  - b. Internal Accounting Standards Act of 2002
  - c. McCain-Feingold Act of 2003
  - d. Sarbanes-Oxley Act of 2002

ANS: D                      PTS: 1                      DIF: E

REF: 1.4 The Corporate Financial Manager's Goals

NAT: Ethical understanding & reasoning

LOC: acquire knowledge of financial markets and interest rates

43. What is a key provision regarding CEOs in the Sarbanes-Oxley Act of 2002?
- a. CEOs cannot hold options in the firms they direct.
  - b. CEOs total compensation cannot exceed a limit set by the SEC.
  - c. CEOs are personally liable for any mistakes on company financial filings.
  - d. CEOs are prohibited from commenting on company filings to the SEC.

ANS: C                      PTS: 1                      DIF: M

REF: 1.4 The Corporate Financial Manager's Goals

NAT: Ethical understanding & reasoning

LOC: acquire knowledge of financial markets and interest rates

44. Which of the following describes the “collective action problem”?
- a. When a CEO fails to represent the interest of shareholders in daily decisions of the firm.
  - b. When the shareholders of a firm fail to act in their own best interests.
  - c. When the managers of a firm lack incentive to maximize shareholder wealth.
  - d. When an individual stockholder spends time and resources monitoring managers, bearing the cost, while the benefits go to all the shareholders in the firm.

ANS: D                      PTS: 1                      DIF: M

REF: 1.2 Corporate Finance Essentials      NAT: Reflective thinking

LOC: acquire knowledge of financial markets and interest rates

45. To maximize the value of a business, a firm needs access to capital and to minimize risk for investors. Given these guidelines, which business form should maximize value for a firm?
- a. Sole proprietorship
  - b. Limited partnership
  - c. General partnership
  - d. Corporation

ANS: D                      PTS: 1                      DIF: H

REF: 1.3 Legal Forms of Business Organizations

NAT: Reflective thinking

LOC: understand stocks and bonds

46. What is the term applied to a firm that offers shares to the general public for the first time?
- a. Initial Public Offering
  - b. Initial Placed Offering
  - c. Investment Plan Offer

d. Investment of Public Offers

ANS: A                      PTS: 1                      DIF: M  
REF: 1.2 Corporate Finance Essentials      NAT: Reflective thinking  
LOC: acquire knowledge of financial markets and interest rates

47. Which statement best describes the capital structure decision process for a firm?
- The firm finds the least expensive debt to finance its projects.
  - The firm finds the mix of debt and equity to maximize firm value.
  - The firm purchases the mix of debt and equity to match the guidelines of the company charter.
  - The firm makes the necessary filings for an initial public offering.

ANS: B                      PTS: 1                      DIF: M  
REF: 1.2 Corporate Finance Essentials      NAT: Reflective thinking  
LOC: acquire knowledge of capital budgeting and the cost of capital

48. Which is not a duty of a financial manager?
- Budgeting
  - Financial forecasting
  - Product research
  - Investment analysis

ANS: C                      PTS: 1                      DIF: E  
REF: 1.2 Corporate Finance Essentials      NAT: Reflective thinking  
LOC: understand the role of the finance function in the enterprise

49. A business with a single owner is called a
- partnership.
  - sole proprietorship.
  - corporation.
  - limited liability company.

ANS: B                      PTS: 1                      DIF: E  
REF: 1.3 Legal Forms of Business Organizations      NAT: Reflective thinking  
LOC: acquire knowledge of financial markets and interest rates

50. Which form of business organization allows shareholders to be taxed as partners while still retaining their limited liability status?
- Corporation
  - Partnership
  - S Corporation
  - Sole Proprietorship

ANS: C                      PTS: 1                      DIF: E  
REF: 1.3 Legal Forms of Business Organizations      NAT: Reflective thinking  
LOC: acquire knowledge of financial markets and interest rates

51. A corporation is a separate legal entity. What consequences does that have for the corporation?
- It can sue and be sued.
  - They can own property.
  - a only
  - a and b

ANS: D                      PTS: 1                      DIF: E  
REF: 1.3 Legal Forms of Business Organizations      NAT: Reflective thinking

LOC: acquire knowledge of financial markets and interest rates

52. In order to be eligible for S status, a firm must
- have 100 or fewer shareholders.
  - be a financial intermediary.
  - have been incorporated for more than 5 years.
  - not have more than one line of business.

ANS: A                      PTS: 1                      DIF: E

REF: 1.3 Legal Forms of Business Organizations

NAT: Reflective thinking

LOC: acquire knowledge of financial markets and interest rates

53. Which of the following represents career opportunities in finance?
- Corporate finance
  - Investment banking
  - Consulting
  - d.** All of the above

ANS: D                      PTS: 1                      DIF: E

REF: 1.1 The Role of Corporate Finance in Modern Business

NAT: Reflective thinking

LOC: understand the role of the finance function in the enterprise

54. Which of the following is NOT a career opportunity in corporate finance?
- Financial analyst
  - Mortgage banker
  - Cash manager
  - Controller

ANS: B                      PTS: 1                      DIF: E

REF: 1.1 The Role of Corporate Finance in Modern Business

NAT: Reflective thinking

LOC: understand the role of the finance function in the enterprise

55. Which of the following DOES NOT represent a career opportunity in money management?
- Portfolio manager
  - Securities analyst
  - Financial planner
  - Capital budgeting analyst

ANS: D                      PTS: 1                      DIF: E

REF: 1.1 The Role of Corporate Finance in Modern Business

NAT: Reflective thinking

LOC: understand the role of the finance function in the enterprise

56. What are the broad types of capital?
- Equity
  - Debt
  - c.** Assets
  - d.** both (a) and (b)

ANS: D                      PTS: 1                      DIF: E

REF: 1.2 Corporate Finance Essentials

NAT: Reflective thinking

LOC: understand stocks and bonds

57. What is considered a primary market transaction?
- Corporations sell securities to investors in exchange for cash.
  - Investor A buys stock from investor B.

- c. A company declares a dividend.
- d. A company makes a bank deposit.

ANS: A                      PTS: 1                      DIF: E  
REF: 1.2 Corporate Finance Essentials      NAT: Reflective thinking  
LOC: acquire knowledge of financial markets and interest rates

58. Capital budgeting is the single most important activity of the firm's financial manager. Which of the following is not a part of the capital budgeting process?
- a. Identifying potential investments.
  - b. Identifying investments that create shareholder value.
  - c. Developing new products.
  - d. Implementing and monitoring the selected investments.

ANS: C                      PTS: 1                      DIF: E  
REF: 1.2 Corporate Finance Essentials      NAT: Reflective thinking  
LOC: acquire knowledge of capital budgeting and the cost of capital

59. Of the five basic corporate finance functions, which deals with developing company-wide structures that force managers to act ethically and to make decisions that further the interests of the firm's stockholders?
- a. Financing
  - b. Corporate governance
  - c. Financial management
  - d. Risk management

ANS: B                      PTS: 1                      DIF: E  
REF: 1.2 Corporate Finance Essentials      NAT: Reflective thinking  
LOC: understand the role of the finance function in the enterprise

60. Which of the following is NOT considered a weakness of the sole proprietorship?
- a. Limited life
  - b. Unlimited personal liability
  - c. Simplicity
  - d. Limited access to capital

ANS: C                      PTS: 1                      DIF: E  
REF: 1.3 Legal Forms of Business Organizations      NAT: Reflective thinking  
LOC: acquire knowledge of financial markets and interest rates

61. Which of the following does NOT apply to a partnership?
- a. Limited life
  - b. Limited access to capital
  - c. A single owner
  - d. Unlimited personal liability

ANS: C                      PTS: 1                      DIF: E  
REF: 1.3 Legal Forms of Business Organizations      NAT: Reflective thinking  
LOC: acquire knowledge of financial markets and interest rates

62. What are the responsibilities of the board of directors in a corporation?
- a. Hire and fire managers.
  - b. Manage day-to-day operations.
  - c. Amend the firm's corporate charter when necessary.
  - d. Hire and fire entry level employees.

ANS: A                      PTS: 1                      DIF: E  
REF: 1.3 Legal Forms of Business Organizations                      NAT: Reflective thinking  
LOC: understand the role of the finance function in the enterprise

63. Which of the following is NOT true about common stockholders and preferred stockholders?
- a. Preferred stockholders receive a fixed dividend each year.
  - b. Common stockholders vote to elect the members of the board of directors.
  - c. Preferred stockholders have a more senior claim on the firm's assets in the event of bankruptcy.
  - d. Preferred stockholders are considered the firm's ultimate owners.

ANS: D                      PTS: 1                      DIF: E  
REF: 1.3 Legal Forms of Business Organizations                      NAT: Reflective thinking  
LOC: understand stocks and bonds

64. What is the goal of financial management?
- a. Maximize corporate profits.
  - b. Maximize shareholder wealth.
  - c. Minimize costs.
  - d. Maximize earnings.

ANS: B                      PTS: 1                      DIF: E  
REF: 1.4 The Corporate Financial Manager's Goals                      NAT: Reflective thinking  
LOC: understand the role of the finance function in the enterprise

65. You were just hired as the CEO of a company. Your primary objective should be
- a. to maximize the company's earnings.
  - b. to maximize profits.
  - c. to maximize the company's price of common stock.
  - d. to eliminate the company's competitors.

ANS: C                      PTS: 1                      DIF: M  
REF: 1.4 The Corporate Financial Manager's Goals                      NAT: Reflective thinking  
LOC: understand the role of the finance function in the enterprise

66. What should be the objective of a focus on stakeholders?
- a. Maximize the stakeholders' interests.
  - b. In situations of conflict pick stakeholders' interests over shareholders' interests.
  - c. Preserve stakeholders' interests.
  - d. Disregard shareholders' interests all together.

ANS: C                      PTS: 1                      DIF: M  
REF: 1.4 The Corporate Financial Manager's Goals                      NAT: Reflective thinking  
LOC: understand the role of the finance function in the enterprise

67. In which form of business organization is a agency problem most likely to occur?
- a. Sole proprietorship
  - b. Corporation
  - c. Partnership
  - d. Limited liability company

ANS: B                      PTS: 1                      DIF: M  
REF: 1.4 The Corporate Financial Manager's Goals                      NAT: Reflective thinking  
LOC: acquire knowledge of financial markets and interest rates

68. Which of the following scenarios could be considered an example of an agency problem.
- a. Management decides to close a plant to lower operating costs.
  - b. Management decides to go ahead with an expansion that is expected to benefit the company's value.
  - c. The board of directors rewards management for the company's last year performance.
  - d. Management decides to purchase a Boeing 747 as a corporate plane.

ANS: D                      PTS: 1                      DIF: M

REF: 1.4 The Corporate Financial Manager's Goals

NAT: Reflective thinking

LOC: acquire knowledge of financial markets and interest rates

69. Which of the following encourages managers to act in the shareholders' interests?
- a. Performance based compensation.
  - b. Audits.
  - c. Threat of hostile takeovers.
  - d.** All of the above.

ANS: D                      PTS: 1                      DIF: E

REF: 1.4 The Corporate Financial Manager's Goals

NAT: Reflective thinking

LOC: acquire knowledge of financial markets and interest rates

70. Which law did Congress pass in 2002 to enforce ethical behavior in corporate finance?
- a. The Jobs and Growth Relief Reconciliation Act
  - b. The Financial Services Modernization Act
  - c. The Patriot Act
  - d. The Sarbanes-Oxley Act

ANS: D                      PTS: 1                      DIF: E

REF: 1.4 The Corporate Financial Manager's Goals

NAT: Ethical understanding & reasoning

LOC: acquire knowledge of financial markets and interest rates

71. Why do shareholders bear most of the risk of running a firm?
- a. They only have a residual claim on the firm's cash flows.
  - b. They receive a salary from the company.
  - c. They are guaranteed a fixed payout each quarter.
  - d. Shares can be taken away at any time without notice.

ANS: A                      PTS: 1                      DIF: E

REF: 1.4 The Corporate Financial Manager's Goals

NAT: Reflective thinking

LOC: understand stocks and bonds

72. What do we call the possible conflict of interests between shareholders and management?
- a. Agency problem.
  - b. Stakeholder problem
  - c. Double taxation
  - d. Shareholders' dilemma

ANS: A                      PTS: 1                      DIF: E

REF: 1.4 The Corporate Financial Manager's Goals

NAT: Reflective thinking

LOC: acquire knowledge of financial markets and interest rates

73. Virtually all finance jobs require:
- a.** Teamwork
  - b.** Good communication skills

- c. Proficiency with computers
- d. All of the above
- e. Both (a) and (c)

ANS: D                      PTS: 1                      DIF: E

REF: 1.1 Career Opportunities in Finance

NAT: Reflective thinking

LOC: understand the role of the finance function in the enterprise

74. Which of the following is true?
- a. If a company files for bankruptcy, preferred stockholders' claims are paid prior to creditors' claims.
  - b. If a company files for bankruptcy, preferred stockholders' claims are paid prior to common stockholders' claims.
  - c. In the event of bankruptcy and subsequent liquidation, preferred stockholders only receive funds after creditors and common stockholders.
  - d. Both (a) and (b)
  - e. None of the above

ANS: B                      PTS: 1

DIF: M

REF: 1.2 Debt and Equity

NAT: Reflective thinking

LOC: understand stocks and bonds

75. Career opportunities in commercial banking do NOT include:
- a. Corporate loan officer
  - b. Credit analyst
  - c. Investment banker
  - d. Mortgage banker
  - e. All of the above are career opportunities in commercial banking

ANS: C                      PTS: 1                      DIF: E

REF: 1.1 Career Opportunities in Finance

NAT: Reflective thinking

LOC: understand the role of the finance function in the enterprise

76. A financial intermediary is an institution that:
- a. Lends money to borrowers and raises that capital by issuing equity
  - b. Lends money to borrowers and raises that capital by issuing liabilities against itself
  - c. Issues stocks and sells shares in itself to generate cash for investing for the stockholders
  - d. None of the above

ANS: B                      PTS: 1

DIF: E

REF: 1.2 Debt and Equity

NAT: Reflective thinking

LOC: acquire knowledge of financial markets and interest rates

77. Banks perform which of the following functions:
- a. Collecting payments on checks sent to their corporate customers
  - b. Making payment on the checks written by their customers to other parties
  - c. Providing information-processing services to small- and medium-sized businesses
  - d. Handling large-volume transactions, such as payroll disbursements
  - e. All of the above

ANS: E                      PTS: 1

DIF: M

REF: 1.2 Debt and Equity

NAT: Reflective thinking

LOC: acquire knowledge of financial markets and interest rates

78. Venture capitalists:
- a. Are banks that provide capital only for low-risk corporations



- b. Will only make investments if there is no risk involved
- c. Are professional investors who provide capital for high risk/high return rapidly-growing entrepreneurial business
- d. None of the above

ANS: C                      PTS: 1                      DIF: E                      REF: 1.2 Debt and Equity  
 NAT: Reflective thinking  
 LOC: acquire knowledge of financial markets and interest rates

79. Capital budgeting:

- a. Is the area in which managers have the greatest scope to create (or destroy) value for shareholders
- b. Involves identifying potential investments, analyzing those investments and identifying which of those will create shareholder value and implement and monitor those investments
- c. Involves identifying potential investments, analyzing those investments and identifying which of those are expected to increase net income and implement and monitor those investments
- d. Both (a) and (b)
- e. None of the above

ANS: D                      PTS: 1                      DIF: H                      REF: 1.2 Debt and Equity  
 NAT: Reflective thinking  
 LOC: acquire knowledge of capital budgeting and the cost of capital

80. Working capital management:

- a. Involves managing the firm's long-term assets, such as plant and equipment
- b. Requires very little in terms of people skills as it mostly involves analyzing numbers
- c. Deals with the firm's seasonal financing, inventory needs, collecting accounts receivable and investing surplus cash
- d. All of the above
- e. None of the above

ANS: C                      PTS: 1                      DIF: M                      REF: 1.2 Debt and Equity  
 NAT: Reflective thinking  
 LOC: acquire knowledge of financial analysis and cash flows

81. Diversifying among different suppliers is an example of:

- a. Capital budgeting
- b. Financial management
- c. External financing
- d. Risk management
- e. Corporate governance

ANS: D                      PTS: 1                      DIF: E                      REF: 1.2 Debt and Equity  
 NAT: Reflective thinking                      LOC: acquire an understanding of risk and return

82. Modern risk management:

- a. Focuses primarily on easily-insured losses such as those from fires or theft
- b. Deals with the use of derivatives to hedge various risks
- c. Has evolved to cover more sophisticated risk reduction, including that which may arise from changes in interest rates and the prices of commodities and currencies
- d. Both (b) and (c)
- e. None of the above

ANS: D                      PTS: 1                      DIF: M                      REF: 1.2 Debt and Equity

NAT: Reflective thinking

LOC: acquire an understanding of risk and return

83. A limited liability company:
- a. Combines the pass-through taxation feature of a partnership with the limited liability feature of an S corporation
  - b. Will probably decline as a form of organization due to its undesirable features
  - c. Are allowed in only a very few states in the U.S.
  - d. Results in personal liability for all partners if one (or more) partner(s) commit malpractice
  - e. Can only be formed if more than one person is a partner (*i.e.*, no one-person LLCs are allowed)

ANS: A

PTS: 1

DIF: M

REF: 1.3 Legal Forms of Business Organizations

NAT: Reflective thinking

LOC: acquire knowledge of financial markets and interest rates

84. Maximizing profit as the manager's goal has several flaws, including:
- a. Earnings figures focus on past performance rather than current or future performance
  - b. The timing of the profits may be ignored
  - c. Focusing on earnings does not mean that the firm will necessarily have enough cash on hand to pay its bills
  - d. Risk is ignored
  - e. All of the above

ANS: E

PTS: 1

DIF: M

REF: 1.4 What Should a Financial Manager Try to Maximize?

NAT: Reflective thinking

LOC: understand the role of the finance function in the enterprise

85. In recent years some firms have
- a. Become more focused on maximizing profits rather than stockholder wealth
  - b. Become more focused on keeping a broader group of stakeholders happy rather than just the stockholders
  - c. Become less interested in managing risks arising from fluctuations in interest rates, commodity prices and currency prices
  - d. Both (b) and (c)
  - e. None of the above

ANS: B

PTS: 1

DIF: M

REF: 1.4 What Should a Financial Manager Try to Maximize?

NAT: Ethical understanding & reasoning

LOC: acquire knowledge of financial markets and interest rates

86. A stock purchased on the New York Stock Exchange is an example of
- a. a primary, money market transaction
  - b. a secondary, money market transaction
  - c. a primary, capital market transaction
  - d. a secondary, capital market transaction

ANS: D

PTS: 1

DIF: E

REF: 1.2 Corporate Finance Essentials

NAT: Reflective thinking

LOC: acquire knowledge of financial markets and interest rates

87. When a corporation offers shares to the public for the first time that is an:
- a. IPO
  - b. PPO
  - c. NPO

d. LBO

ANS: A                      PTS: 1                      DIF: E                      REF: 1.2 Corporate Essentials  
NAT: Reflective thinking  
LOC: understand the role of the finance function in the enterprise

88. Hedging is

- a. Buying derivatives to take advantage of likely changes in the market
- b. Buying stocks firm's own stock
- c. Insuring against risks a firm likely faces
- d. Making sure that the hedges are not too high at the firm's headquarters

ANS: C                      PTS: 1                      DIF: E  
REF: 1.2 Corporate Finance Essentials      NAT: Reflective thinking  
LOC: understand the role of the finance function in the enterprise

89. Which agency oversees fair reporting of financial information to investors of publicly traded stocks?

- a. SEC
- b. IRS
- c. NYSE
- d. NASDAQ

ANS: A                      PTS: 1                      DIF: E  
REF: 1.2 Corporate Finance Essentials      NAT: Reflective thinking  
LOC: understand the role of the finance function in the enterprise

90. Would it be reasonable for a successful manufacturing firm, started as a sole proprietorship or partnership to eventually adopt the corporate organizational form?

- a. No, the tax burden (double taxation) is too costly
- b. No, the reporting burdens are too costly
- c. No, once started as a sole proper ship or partnership, firms are not allowed to change their form
- d. Yes, the competitive disadvantages to sole proprietorship or partnership are too burdensome

ANS: D                      PTS: 1                      DIF: M  
REF: 1.3 Legal Forms of Business Organizations      NAT: Reflective thinking  
LOC: assess the costs and benefits of business forms

91. Which of the following would disqualify a corporation from electing the S Corporate form?

- a. There are 82 shareholders
- b. The corporation only has one class of stock
- c. The corporation is a holding company
- d. The corporation eventually expects to be a C Corporation

ANS: C                      PTS: 1                      DIF: M  
REF: 1.3 Legal Forms of Business Organizations      NAT: Reflective thinking  
LOC: assess the costs and benefits of business forms

92. Which of the following is NOT a stakeholder?

- a. Competitors
- b. Tax collection agencies
- c. Suppliers
- d. Customers

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ANS: A

PTS: 1

DIF: E

REF: 1.4 What Should a Financial Manager Try to Maximize? NAT: Reflective thinking

LOC: understand the role of the finance function in the enterprise