Chapter 01

The Goals and Activities of Financial Management

**True / False Questions**

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| 1. | As finance emerged as a new field, much emphasis was placed on mergers and acquisitions.  True    False |

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| 2. | Inflation is assumed to be a temporary problem that does not affect financial decisions.  True    False |

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| 3. | Financial capital is composed of long-term plant and equipment, as well as other tangible investments.  True    False |

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| 4. | Real capital is composed of long-term plant and equipment.  True    False |

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| 5. | During the 1930s, financial practice revolved around such topics as the preservation of capital, maintenance of liquidity, the reorganization of financially troubled corporations, and bankruptcy.  True    False |

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| 6. | In the mid 1950s, finance began to change to a more analytical, decision-oriented approach.  True    False |

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| 7. | Recently, the emphasis of financial management has been on the relationship between risk and return.  True    False |

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| 8. | The first Nobel Prizes given to finance professors were for their contributions to capital structure theory and portfolio theories of risk and return.  True    False |

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| 9. | "Credit default swaps" are one of several tools that Congress and the President of the United States have jointly developed to ease the financial crisis that began in 2008.  True    False |

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| 10. | The Internet impacts e-commerce by creating a mechanism for improved communications between a business, its customers, and its suppliers.  True    False |

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| 11. | The Internet has accounted for an acceleration of productivity for "old economy" firms.  True    False |

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| 12. | The Internet is responsible for many new business models.  True    False |

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| 13. | Businesses will increasingly rely on B2B Internet applications to speed up the cash flows through their firms.  True    False |

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| 14. | The Dodd-Frank Act contains the Volcker Rule, which encourages financial institutions to allow for more speculative investments for average investors.  True    False |

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| 15. | The Dodd-Frank Act's oversight allowing regulation of banking fees and available products has been considered as not being in the best interests of a free market.  True    False |

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| 16. | Sole proprietorship means single-person ownership and offers the advantages of simplicity of decision making and low organizational and operating costs.  True    False |

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| 17. | Profits of sole proprietorships are taxed at corporate tax rates.  True    False |

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| 18. | There is unlimited liability in a general partnership.  True    False |

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| 19. | The most common partnership arrangement carries limited liability to the partners.  True    False |

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| 20. | A limited partnership limits the profits partners may receive.  True    False |

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| 21. | In terms of revenues and profits, the corporation is by far the most important form of business organization in the United States.  True    False |

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| 22. | As noted in *Finance in Action*, initial public offerings have now increased because long-term results are favored by shareholders and institutional investors.  True    False |

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| 23. | Dividends paid to corporate stockholders have already been taxed once as corporate income.  True    False |

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| 24. | One advantage of the corporate form of organization is that income received by stockholders is not taxable since the corporation already paid taxes on the income distributed.  True    False |

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| 25. | A corporation must have more than 75 stockholders to qualify for Subchapter S designation.  True    False |

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| 26. | Profits of a Subchapter S corporation are taxed at corporate tax rates.  True    False |

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| 27. | The formation of a Subchapter S corporation is a way to circumvent the double taxation of a small corporation.  True    False |

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| 28. | Corporate governance issues have become less important to the financial community during the first decade of the new millennium.  True    False |

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| 29. | The issues of corporate governance are really agency problems.  True    False |

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| 30. | Agency theory examines the relationship between companies and their customers.  True    False |

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| 31. | Institutional investors have had increasing influence over corporations with their ability to vote with large blocks of stock and replace poorly performing boards of directors.  True    False |

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| 32. | Agency theory assumes that corporate managers act to increase the wealth of corporate shareholders.  True    False |

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| 33. | The Sarbanes-Oxley Act reduced agency conflicts by giving corporate managers greater flexibility to select their preferred candidates to the board of directors.  True    False |

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| 34. | A major focus of the Sarbanes-Oxley Act is to make sure that publicly traded companies accurately present their assets, liabilities, and income in their financial statements.  True    False |

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| 35. | The Sarbanes-Oxley Act is primarily intended to increase public scrutiny of private companies that had previously been exempt from many public disclosure requirements.  True    False |

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| 36. | Timing is not a particularly important consideration in financial decisions.  True    False |

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| 37. | The higher the profit of a firm, the higher the value the firm is assured of receiving in the market.  True    False |

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| 38. | There are some serious problems with the financial goal of maximizing the earnings of the firm.  True    False |

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| 39. | Maximizing the earnings of the firm is the goal of financial management.  True    False |

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| 40. | Because socially desirable goals can impede profitability in many instances, managers should not try to operate under the assumption of wealth maximization.  True    False |

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| 41. | Insider trading involves the use of information not available to the general public to make profits from trading in a company's stock.  True    False |

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| 42. | Social responsibility and profit maximization are synonymous.  True    False |

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| 43. | Financial markets exist as a vast global network of individuals and financial institutions that may be lenders, borrowers, or owners of public companies worldwide.  True    False |

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| 44. | Money markets refer to those markets dealing with short-term securities having a life of one year or less.  True    False |

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| 45. | Money markets refer to markets where excess corporate cash is exchanged for foreign currencies that can earn a higher return than domestic money.  True    False |

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| 46. | Capital markets refer to those markets dealing with short-term securities that have a life of one year or less.  True    False |

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| 47. | The primary market includes the sale of securities by way of initial public offerings.  True    False |

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| 48. | High-quality initial public offerings are usually sold in a primary market, such as the New York Stock Exchange. However, low-quality stocks must usually be sold in secondary markets, such as NASDAQ.  True    False |

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| 49. | Although NASDAQ is a secondary market, some of the firms traded there, such as Microsoft, are large enough to move to the primary market if they so desire.  True    False |

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| 50. | The secondary market characteristically has had stable prices over the past 20 years.  True    False |

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| 51. | In the United States, stocks sold on either the New York Stock Exchange or NASDAQ are considered sold in the primary market.  True    False |

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| 52. | New issues are sold in the secondary market.  True    False |

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| 53. | Existing securities are traded in the secondary market.  True    False |

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| 54. | Many companies have cross-listed their stock on multiple international stock exchanges and more than several hundred foreign companies have listed their shares on the New York Stock Exchange.  True    False |

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| 55. | Higher return always induces stockholders to invest in a company.  True    False |

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| 56. | Social responsibility is an expense and thus should be avoided by financial managers because it will lead to loss of income.  True    False |

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| 57. | Financial management requires both short-term activities as well as long-term planning such as raising funds.  True    False |

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| 58. | One of the primary disadvantages of maximizing shareholder value is that it only provides a short-term perspective.  True    False |

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| 59. | If a company has a written code of ethics, they will generally avoid ethical problems.  True    False |

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| 60. | Risk management will be an important factor over the next decade.  True    False |

**Multiple Choice Questions**

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| 61. | Which of the following did not contribute to the financial crisis?

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| A.  | The use of market-to-market accounting standards |

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| B.  | Solid credit ratings from the ratings agencies |

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| C.  | The extension of credit to high-risk borrowers |

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| D.  | The merger of JPMorgan Chase and Bear Stearns |

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| E.  | All of the options contributed to the financial crisis. |

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| 62. | Credit swaps are

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| A.  | an insurance product designed to protect financial institutions from customers who default on their loans. |

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| B.  | securities with a maturity of less than one year. |

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| C.  | the result of a leveling off or slowing down of price increases. |

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| D.  | market trades in previously issued securities. |

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| 63. | What is the primary goal of financial management?

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| A.  | Increased earnings |

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| B.  | Maximizing cash flow |

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| C.  | Maximizing shareholder wealth |

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| D.  | Minimizing risk of the firm |

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| 64. | In the past, the study of finance has included

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| A.  | mergers and acquisitions. |

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| B.  | raising capital. |

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| C.  | bankruptcy. |

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| D.  | All of the options |

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| 65. | Professor Merton Miller received the Nobel Prize in Economics for his work on

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| A.  | dividend policy. |

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| B.  | investment theory. |

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| C.  | working capital management. |

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| D.  | capital structure theory. |

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| 66. | Professors Harry Markowitz and William Sharpe received their Nobel Prize in Economics for their contributions to the

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| A.  | options pricing model. |

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| B.  | theories of working capital management. |

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| C.  | theories of risk-return and portfolio management. |

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| D.  | theories of international capital budgeting. |

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| 67. | Which of the following is NOT addressed by the Dodd-Frank Act?

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| A.  | Liquidation of non-bank financial companies such as insurance companies. |

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| B.  | Limits upon speculative investing by federally insured banks. |

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| C.  | Written certifications of financial statements by the CEO and CFO. |

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| D.  | Registration of hedge funds with the SEC. |

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| 68. | Proper risk-return management means that

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| A.  | the firm should take as few risks as possible. |

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| B.  | the firm must determine an appropriate trade-off between risk and return. |

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| C.  | the firm should earn the highest return possible. |

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| D.  | the firm should value future profits more highly than current profits. |

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| 69. | One of the major disadvantages of a sole proprietorship is

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| A.  | that there is unlimited liability to the owner. |

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| B.  | the simplicity of decision making. |

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| C.  | low organizational costs. |

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| D.  | low operating costs. |

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| 70. | One of the major advantages of a sole proprietorship is

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| A.  | that the owner has limited liability. |

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| B.  | that stock in the proprietorship can be easily transferred. |

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| C.  | that it is exempt from many tax rules that would otherwise apply when employees are hired by the firm. |

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| D.  | low operating costs. |

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| 71. | The partnership form of an organization

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| A.  | avoids the double taxation of earnings and dividends found in the corporate form of organization. |

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| B.  | usually provides limited liability to the partners. |

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| C.  | has unlimited life. |

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| D.  | simplifies decision making. |

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| 72. | A corporation is

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| A.  | owned by stockholders who enjoy the privilege of limited liability. |

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| B.  | easily divisible between owners. |

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| C.  | a separate legal entity with perpetual life. |

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| D.  | All of the options |

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| 73. | With an S corporation

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| A.  | income is taxed as direct income to stockholders. |

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| B.  | stockholders have the same liability as members of a partnership. |

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| C.  | the number of stockholders is unlimited. |

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| D.  | the life of the corporation is limited. |

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| 74. | An S corporation

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| A.  | is similar to a partnership in that it carries unlimited liability. |

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| B.  | is a separate legal entity that is treated like a normal corporation. |

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| C.  | has all the organizational benefits of a corporation and its income is only taxed once. |

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| D.  | All of the options |

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| 75. | Corporate governance is the

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| A.  | relationship and exercise of oversight by the board of directors of the company. |

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| B.  | relationship between the chief financial officer (CFO) and institutional investors. |

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| C.  | operation of a company by the chief executive officer (CEO) and other senior executives on the management team. |

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| D.  | governance of the company by the board of directors with a focus on social responsibility. |

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| 76. | Many companies such as Tyco, Enron, and WorldCom that suffered financial distress in the late 1990s and early 2000s

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| A.  | committed fraud. |

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| B.  | had failed corporate governance oversight. |

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| C.  | went bankrupt. |

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| D.  | All of the options are true. |

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| 77. | Agency theory examines the relationship between the

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| A.  | shareholders of the firm and the firm's investment banker. |

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| B.  | owners of the firm and the managers of the firm. |

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| C.  | board of directors and large institutional investors. |

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| D.  | shareholders and the firm's transfer agent. |

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| 78. | Agency theory would imply that conflicts are more likely to occur between management and shareholders when

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| A.  | the company is owned and operated by the same person. |

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| B.  | management acts in the best interests of maximizing shareholder wealth. |

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| C.  | the chairman of the board is also the chief executive officer (CEO). |

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| D.  | the board of directors exerts strong and involved oversight of management. |

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| 79. | Agency theory deals with the issue of

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| A.  | when to hire an agent to represent the firm in negotiations. |

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| B.  | the legal liabilities of a firm if an employee, acting as the firm's agent, injures someone. |

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| C.  | the limitations placed on an employee acting as the firm's agent to obligate or bind the firm. |

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| D.  | the conflicts that can arise between the viewpoints and motivations of a firm's owners and managers. |

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| 80. | Agency problems are least likely to arise in which organizational form?

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| A.  | Sole proprietorship |

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| B.  | Limited partnership |

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| C.  | Corporation |

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| D.  | Subchapter S corporation |

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| 81. | Institutional investors are important in today's business world because

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| A.  | as large investors, they have more say in how businesses are managed. |

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| B.  | they have a fiduciary responsibility to the workers and investors that they represent to see that the firms they own are managed in an ethical way. |

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| C.  | as a group they can vote large blocks of stock for the election of board members. |

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| D.  | All of the options |

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| 82. | The increasing percentage ownership of public corporations by institutional investors has

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| A.  | had no effect on corporate management. |

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| B.  | created higher returns for the stock market in general. |

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| C.  | created more pressure on public companies to manage their firms more efficiently. |

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| D.  | taken away the voice of the individual investor. |

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| 83. | The Sarbanes-Oxley Act was passed in an effort to

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| A.  | protect small business from large corporations dominating the market. |

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| B.  | ensure that partnerships divide profits among partners in a fair manner. |

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| C.  | guarantee that outside auditors can control corporate accounting practices. |

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| D.  | control corrupt corporate behavior. |

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| 84. | The Sarbanes-Oxley Act set up the Public Company Accounting Oversight Board with the responsibility for all of the following except

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| A.  | auditing standards within companies. |

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| B.  | controlling the quality of audits. |

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| C.  | certifying the competence of financial executives. |

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| D.  | setting rules and standards for the independence of auditors. |

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| 85. | A financial manager's goal of maximizing current or short-term earnings may not be appropriate because

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| A.  | it fails to consider the timing of the benefits. |

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| B.  | increased earnings may be accompanied by unacceptably higher levels of risk. |

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| C.  | earnings are subjective; they can be defined in various ways such as accounting or economic earnings. |

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| D.  | All of the options |

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| 86. | Maximization of shareholder wealth is a concept in which

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| A.  | increased earnings is of primary importance. |

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| B.  | profits are maximized on a quarterly basis. |

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| C.  | virtually all earnings are paid as dividends to common stockholders. |

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| D.  | optimally increasing the long-term value of the firm is emphasized. |

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| 87. | Which of the following is not a true statement about the goal of maximizing shareholder wealth?

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| A.  | It takes into account the timing of cash-flows. |

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| B.  | It is a short-run point of view that takes risk into account. |

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| C.  | It considers risk as a factor. |

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| D.  | None of the options is a false statement. |

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| 88. | As mergers, acquisitions, and restructuring have increased in importance, agency theory has become more important in assessing whether

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| A.  | a stock repurchase should be undertaken. |

|  |  |
| --- | --- |
| B.  | shareholder goals are truly being achieved by managers in the long run. |

|  |  |
| --- | --- |
| C.  | managers are actually agents or only employees of the firm. |

|  |  |
| --- | --- |
| D.  | managers and owners are actually the same people with the same interests. |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 89. | Insider trading occurs when

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| --- | --- |
| A.  | someone has information not available to the public which they use to profit from trading in stocks. |

|  |  |
| --- | --- |
| B.  | corporate officers buy stock in their company. |

|  |  |
| --- | --- |
| C.  | lawyers, investment bankers, and others buy common stock in companies represented by their firms. |

|  |  |
| --- | --- |
| D.  | any stock transactions occur in violation of the Federal Trade Commissions restrictions on monopolies. |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 90. | The major difficulty in most insider-trading cases has been

|  |  |
| --- | --- |
| A.  | that lenient judges have simply released the guilty individuals. |

|  |  |
| --- | --- |
| B.  | that insider trading, even though illegal, actually serves a beneficial economic and financial purpose. |

|  |  |
| --- | --- |
| C.  | that inside trades have not been legally well-defined. |

|  |  |
| --- | --- |
| D.  | inside trades actually have a beneficial effect on the wealth of all stockholders. |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 91. | Money markets include which of the following securities?

|  |  |
| --- | --- |
| A.  | Common stock and corporate bonds. |

|  |  |
| --- | --- |
| B.  | Treasury bills and commercial paper. |

|  |  |
| --- | --- |
| C.  | Certificates of deposit and preferred stock. |

|  |  |
| --- | --- |
| D.  | All of the options |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 92. | Capital markets do not include which of the following securities?

|  |  |
| --- | --- |
| A.  | Common stock |

|  |  |
| --- | --- |
| B.  | Commercial paper |

|  |  |
| --- | --- |
| C.  | Government bonds |

|  |  |
| --- | --- |
| D.  | Preferred stock |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 93. | When a corporation uses the financial markets to raise new funds, the sale of securities is made in the

|  |  |
| --- | --- |
| A.  | primary market. |

|  |  |
| --- | --- |
| B.  | secondary market. |

|  |  |
| --- | --- |
| C.  | online market. |

|  |  |
| --- | --- |
| D.  | third market. |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 94. | Companies that have higher risk than a competitor in the same industry will generally have

|  |  |
| --- | --- |
| A.  | to pay a higher interest rate than its competitors. |

|  |  |
| --- | --- |
| B.  | a lower relative stock price than its competitors. |

|  |  |
| --- | --- |
| C.  | a higher cost of funds than its competitors. |

|  |  |
| --- | --- |
| D.  | All of the options |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 95. | The financial markets allocate capital to corporations by

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| --- | --- |
| A.  | reflecting expectations of the market participants in the price of the corporation's stock. |

|  |  |
| --- | --- |
| B.  | requiring higher returns from companies with lower risk than their competitors. |

|  |  |
| --- | --- |
| C.  | rewarding companies with expected high returns with lower relative stock prices. |

|  |  |
| --- | --- |
| D.  | relying on the opinion of investment bankers. |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 96. | Corporate restructuring has been one result of more institutional ownership. Restructuring can cause

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| --- | --- |
| A.  | changes in the assets and liabilities of the firm. |

|  |  |
| --- | --- |
| B.  | the sale of low-profit margin divisions. |

|  |  |
| --- | --- |
| C.  | the removal of current management and/or large reductions in the workforce. |

|  |  |
| --- | --- |
| D.  | All of the options |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 97. | A corporate restructuring can result in

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| --- | --- |
| A.  | changes in the capital structure. |

|  |  |
| --- | --- |
| B.  | selling of low-profit margin divisions. |

|  |  |
| --- | --- |
| C.  | reductions in the workforce. |

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| --- | --- |
| D.  | All of the options |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 98. | Which of the following is not an example of restructuring as discussed in the text?

|  |  |
| --- | --- |
| A.  | Repurchase of common stock |

|  |  |
| --- | --- |
| B.  | Creating a new organizational chart |

|  |  |
| --- | --- |
| C.  | Merging with companies in related industries |

|  |  |
| --- | --- |
| D.  | Divesting of an unprofitable division |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 99. | Future financial managers will need to understand

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| --- | --- |
| A.  | international cash flows. |

|  |  |
| --- | --- |
| B.  | computerized funds transfers. |

|  |  |
| --- | --- |
| C.  | international currency hedging strategies. |

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| --- | --- |
| D.  | All of the options |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 100. | The increase in the internationalization of financial markets has led to

|  |  |
| --- | --- |
| A.  | companies searching the global financial markets for low-cost funds. |

|  |  |
| --- | --- |
| B.  | an increase in American Depository Receipts (ADRs) on the New York Stock Exchange. |

|  |  |
| --- | --- |
| C.  | an increase in debt obligations denominated in foreign currency on U.S. corporate balance sheets. |

|  |  |
| --- | --- |
| D.  | All of the options |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 101. | The internationalization of the financial markets has

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| --- | --- |
| A.  | allowed firms such as McDonald's to raise capital around the world. |

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| --- | --- |
| B.  | raised the cost of capital. |

|  |  |
| --- | --- |
| C.  | forced companies to price everything in U.S. dollars. |

|  |  |
| --- | --- |
| D.  | All of the options |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 102. | The Internet has affected the financial markets by

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| --- | --- |
| A.  | creating more competition between markets. |

|  |  |
| --- | --- |
| B.  | pushing the cost of trading down. |

|  |  |
| --- | --- |
| C.  | forcing brokerage companies to consolidate. |

|  |  |
| --- | --- |
| D.  | All of the options |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 103. | Increased productivity due to technology has

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| --- | --- |
| A.  | increased corporations' reliance on debt for capital expansion needs. |

|  |  |
| --- | --- |
| B.  | created larger asset values on the firm's historical balance sheet. |

|  |  |
| --- | --- |
| C.  | made it cheaper (in terms of interest costs) for firms to borrow money. |

|  |  |
| --- | --- |
| D.  | helped to keep corporate costs in check. |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 104. | Companies that perform well

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| --- | --- |
| A.  | can sell their stock for a lower price. |

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| --- | --- |
| B.  | can minimize dilution when issuing new shares. |

|  |  |
| --- | --- |
| C.  | can issue debt at a lower interest rate. |

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| --- | --- |
| D.  | can minimize dilution when issuing new shares and can issue debt at a lower interest rate. |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 105. | The entity that is responsible for establishing the allocation and cost of capital is/are

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| --- | --- |
| A.  | the corporation. |

|  |  |
| --- | --- |
| B.  | the economy. |

|  |  |
| --- | --- |
| C.  | investors. |

|  |  |
| --- | --- |
| D.  | customers. |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 106. | The benefits of social responsibility often include

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| --- | --- |
| A.  | a better reputation. |

|  |  |
| --- | --- |
| B.  | higher short-term earnings. |

|  |  |
| --- | --- |
| C.  | lower expenses. |

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| --- | --- |
| D.  | None of the options |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 107. | Regarding risk levels, financial managers should

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| --- | --- |
| A.  | pursue higher-risk projects because they increase value. |

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| --- | --- |
| B.  | avoid higher-risk projects because they destroy value. |

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| --- | --- |
| C.  | focus primarily on market fluctuations. |

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| --- | --- |
| D.  | evaluate investors' desire for risk. |

 |

**Matching Questions**

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 108. | Match the following with the questions below:

|  |  |  |
| --- | --- | --- |
| 1. corporation  |      The ability to make profits on financial securities because of having knowledge not available to the public.  |   \_\_\_\_  |
| 2. subchapter S corporation  |      An agreement of partners specifying the ownership interest of a company.  |   \_\_\_\_  |
| 3. partnership  |      A form of organization that represents single-person ownership and offers the advantages of simplicity of decision making and low organizational and operating costs.  |   \_\_\_\_  |
| 4. articles of partnership  |      Separate legal entity owned by shareholders who only have limited liability.  |   \_\_\_\_  |
| 5. sole proprietorship  |      The study of the relative importance of debt and equity.  |   \_\_\_\_  |
| 6. agency theory  |      Examines the relationship between the owners of the firm and the managers of the firm.  |   \_\_\_\_  |
| 7. capital structure theory  |      A form of ownership in which profit is taxed as direct income to the stockholders and thus is only taxed once.  |   \_\_\_\_  |
| 8. insider trading  |      A form of ownership that carries unlimited liability to the owners and where the profits are taxed at the individual tax rates of the owners.  |   \_\_\_\_  |

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| 109. | Match the following with the questions below:

|  |  |  |
| --- | --- | --- |
| 1. inflation  |      This form of capital is found on the balance sheet under long-term liabilities and equity.  |   \_\_\_\_  |
| 2. secondary market  |      When the purchasing power of the dollar is shrinking over time.  |   \_\_\_\_  |
| 3. real capital  |      A market where the securities being traded are new public offerings.  |   \_\_\_\_  |
| 4. capital market  |      Securities with a maturity of less than one year.  |   \_\_\_\_  |
| 5. financial capital  |      Redeploying the asset and liability structure of the firm.  |   \_\_\_\_  |
| 6. restructuring  |      A leveling off or slowing down of price increases.  |   \_\_\_\_  |
| 7. primary market  |      Market composed of common stock, preferred stock, commercial and government bonds, and other long-term securities.  |   \_\_\_\_  |
| 8. money market  |      This market trades previously issued securities.  |   \_\_\_\_  |
| 9. disinflation  |      The high inflation rates of the 1980s caused this form of capital to hold its value better than other forms of capital during this time period.  |   \_\_\_\_  |

 |

Chapter 01 The Goals and Activities of Financial Management Answer Key

**True / False Questions**

|  |  |
| --- | --- |
| 1. | As finance emerged as a new field, much emphasis was placed on mergers and acquisitions.  **TRUE** |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: BasicLearning Objective: 01-01 The field of finance integrates concepts from economics; accounting; and a number of other areas.* |

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| 2. | Inflation is assumed to be a temporary problem that does not affect financial decisions.  **FALSE** |

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| *AACSB: AnalyticBlooms: UnderstandDifficulty: BasicLearning Objective: 01-01 The field of finance integrates concepts from economics; accounting; and a number of other areas.* |

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| --- | --- |
| 3. | Financial capital is composed of long-term plant and equipment, as well as other tangible investments.  **FALSE** |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: BasicLearning Objective: 01-01 The field of finance integrates concepts from economics; accounting; and a number of other areas.* |

|  |  |
| --- | --- |
| 4. | Real capital is composed of long-term plant and equipment.  **TRUE** |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: BasicLearning Objective: 01-01 The field of finance integrates concepts from economics; accounting; and a number of other areas.* |

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| 5. | During the 1930s, financial practice revolved around such topics as the preservation of capital, maintenance of liquidity, the reorganization of financially troubled corporations, and bankruptcy.  **TRUE** |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: BasicLearning Objective: 01-01 The field of finance integrates concepts from economics; accounting; and a number of other areas.* |

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| 6. | In the mid 1950s, finance began to change to a more analytical, decision-oriented approach.  **TRUE** |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: BasicLearning Objective: 01-01 The field of finance integrates concepts from economics; accounting; and a number of other areas.* |

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| 7. | Recently, the emphasis of financial management has been on the relationship between risk and return.  **TRUE** |

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| *AACSB: AnalyticBlooms: UnderstandDifficulty: BasicLearning Objective: 01-01 The field of finance integrates concepts from economics; accounting; and a number of other areas.Learning Objective: 01-03 The relationship of risk to return is a central focus of finance.* |

|  |  |
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| 8. | The first Nobel Prizes given to finance professors were for their contributions to capital structure theory and portfolio theories of risk and return.  **TRUE** |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: BasicLearning Objective: 01-01 The field of finance integrates concepts from economics; accounting; and a number of other areas.* |

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| 9. | "Credit default swaps" are one of several tools that Congress and the President of the United States have jointly developed to ease the financial crisis that began in 2008.  **FALSE** |

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| *AACSB: AnalyticBlooms: UnderstandDifficulty: BasicLearning Objective: 01-01 The field of finance integrates concepts from economics; accounting; and a number of other areas.* |

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| --- | --- |
| 10. | The Internet impacts e-commerce by creating a mechanism for improved communications between a business, its customers, and its suppliers.  **TRUE** |

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| *AACSB: AnalyticBlooms: UnderstandDifficulty: BasicLearning Objective: 01-01 The field of finance integrates concepts from economics; accounting; and a number of other areas.* |

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| 11. | The Internet has accounted for an acceleration of productivity for "old economy" firms.  **TRUE** |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: BasicLearning Objective: 01-01 The field of finance integrates concepts from economics; accounting; and a number of other areas.* |

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| --- | --- |
| 12. | The Internet is responsible for many new business models.  **TRUE** |

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| *AACSB: AnalyticBlooms: UnderstandDifficulty: BasicLearning Objective: 01-01 The field of finance integrates concepts from economics; accounting; and a number of other areas.* |

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| 13. | Businesses will increasingly rely on B2B Internet applications to speed up the cash flows through their firms.  **TRUE** |

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| *AACSB: AnalyticBlooms: UnderstandDifficulty: BasicLearning Objective: 01-01 The field of finance integrates concepts from economics; accounting; and a number of other areas.* |

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| --- | --- |
| 14. | The Dodd-Frank Act contains the Volcker Rule, which encourages financial institutions to allow for more speculative investments for average investors.  **FALSE** |

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| *AACSB: AnalyticBlooms: UnderstandDifficulty: IntermediateLearning Objective: 01-01 The field of finance integrates concepts from economics; accounting; and a number of other areas.* |

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| 15. | The Dodd-Frank Act's oversight allowing regulation of banking fees and available products has been considered as not being in the best interests of a free market.  **TRUE** |

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| *AACSB: AnalyticBlooms: UnderstandDifficulty: IntermediateLearning Objective: 01-01 The field of finance integrates concepts from economics; accounting; and a number of other areas.* |

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| 16. | Sole proprietorship means single-person ownership and offers the advantages of simplicity of decision making and low organizational and operating costs.  **TRUE** |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: BasicLearning Objective: 01-02 A firm can have many different forms of organization.* |

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| --- | --- |
| 17. | Profits of sole proprietorships are taxed at corporate tax rates.  **FALSE** |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: BasicLearning Objective: 01-02 A firm can have many different forms of organization.* |

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| --- | --- |
| 18. | There is unlimited liability in a general partnership.  **TRUE** |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: BasicLearning Objective: 01-02 A firm can have many different forms of organization.* |

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| 19. | The most common partnership arrangement carries limited liability to the partners.  **FALSE** |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: IntermediateLearning Objective: 01-02 A firm can have many different forms of organization.* |

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| 20. | A limited partnership limits the profits partners may receive.  **FALSE** |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: BasicLearning Objective: 01-01 The field of finance integrates concepts from economics; accounting; and a number of other areas.* |

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| 21. | In terms of revenues and profits, the corporation is by far the most important form of business organization in the United States.  **TRUE** |

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| *AACSB: AnalyticBlooms: UnderstandDifficulty: BasicLearning Objective: 01-02 A firm can have many different forms of organization.* |

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| 22. | As noted in *Finance in Action*, initial public offerings have now increased because long-term results are favored by shareholders and institutional investors.  **FALSE** |

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| *AACSB: AnalyticBlooms: UnderstandDifficulty: IntermediateLearning Objective: 01-02 A firm can have many different forms of organization.* |

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| 23. | Dividends paid to corporate stockholders have already been taxed once as corporate income.  **TRUE** |

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| *AACSB: AnalyticBlooms: UnderstandDifficulty: BasicLearning Objective: 01-02 A firm can have many different forms of organization.* |

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| 24. | One advantage of the corporate form of organization is that income received by stockholders is not taxable since the corporation already paid taxes on the income distributed.  **FALSE** |

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| *AACSB: AnalyticBlooms: UnderstandDifficulty: BasicLearning Objective: 01-02 A firm can have many different forms of organization.* |

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| 25. | A corporation must have more than 75 stockholders to qualify for Subchapter S designation.  **FALSE** |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: IntermediateLearning Objective: 01-02 A firm can have many different forms of organization.* |

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| 26. | Profits of a Subchapter S corporation are taxed at corporate tax rates.  **FALSE** |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: BasicLearning Objective: 01-02 A firm can have many different forms of organization.* |

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| 27. | The formation of a Subchapter S corporation is a way to circumvent the double taxation of a small corporation.  **TRUE** |

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| *AACSB: AnalyticBlooms: UnderstandDifficulty: IntermediateLearning Objective: 01-02 A firm can have many different forms of organization.* |

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| 28. | Corporate governance issues have become less important to the financial community during the first decade of the new millennium.  **FALSE** |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: BasicLearning Objective: 01-04 The primary goal of financial managers is to maximize the wealth of the shareholders.* |

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| 29. | The issues of corporate governance are really agency problems.  **TRUE** |

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| *AACSB: AnalyticBlooms: UnderstandDifficulty: IntermediateLearning Objective: 01-04 The primary goal of financial managers is to maximize the wealth of the shareholders.* |

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| 30. | Agency theory examines the relationship between companies and their customers.  **FALSE** |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: BasicLearning Objective: 01-04 The primary goal of financial managers is to maximize the wealth of the shareholders.* |

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| 31. | Institutional investors have had increasing influence over corporations with their ability to vote with large blocks of stock and replace poorly performing boards of directors.  **TRUE** |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: BasicLearning Objective: 01-04 The primary goal of financial managers is to maximize the wealth of the shareholders.* |

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| 32. | Agency theory assumes that corporate managers act to increase the wealth of corporate shareholders.  **FALSE** |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: BasicLearning Objective: 01-04 The primary goal of financial managers is to maximize the wealth of the shareholders.* |

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| 33. | The Sarbanes-Oxley Act reduced agency conflicts by giving corporate managers greater flexibility to select their preferred candidates to the board of directors.  **FALSE** |

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| *AACSB: AnalyticBlooms: UnderstandDifficulty: IntermediateLearning Objective: 01-04 The primary goal of financial managers is to maximize the wealth of the shareholders.* |

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| 34. | A major focus of the Sarbanes-Oxley Act is to make sure that publicly traded companies accurately present their assets, liabilities, and income in their financial statements.  **TRUE** |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: IntermediateLearning Objective: 01-04 The primary goal of financial managers is to maximize the wealth of the shareholders.* |

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| 35. | The Sarbanes-Oxley Act is primarily intended to increase public scrutiny of private companies that had previously been exempt from many public disclosure requirements.  **FALSE** |

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| *AACSB: AnalyticBlooms: UnderstandDifficulty: IntermediateLearning Objective: 01-04 The primary goal of financial managers is to maximize the wealth of the shareholders.* |

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| 36. | Timing is not a particularly important consideration in financial decisions.  **FALSE** |

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| *AACSB: AnalyticBlooms: UnderstandDifficulty: BasicLearning Objective: 01-04 The primary goal of financial managers is to maximize the wealth of the shareholders.* |

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| 37. | The higher the profit of a firm, the higher the value the firm is assured of receiving in the market.  **FALSE** |

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| *AACSB: AnalyticBlooms: UnderstandDifficulty: IntermediateLearning Objective: 01-04 The primary goal of financial managers is to maximize the wealth of the shareholders.* |

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| 38. | There are some serious problems with the financial goal of maximizing the earnings of the firm.  **TRUE** |

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| *AACSB: AnalyticBlooms: UnderstandDifficulty: BasicLearning Objective: 01-04 The primary goal of financial managers is to maximize the wealth of the shareholders.* |

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| 39. | Maximizing the earnings of the firm is the goal of financial management.  **FALSE** |

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| *AACSB: AnalyticBlooms: UnderstandDifficulty: BasicLearning Objective: 01-04 The primary goal of financial managers is to maximize the wealth of the shareholders.* |

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| 40. | Because socially desirable goals can impede profitability in many instances, managers should not try to operate under the assumption of wealth maximization.  **FALSE** |

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| *AACSB: EthicsBlooms: ApplyDifficulty: IntermediateLearning Objective: 01-04 The primary goal of financial managers is to maximize the wealth of the shareholders.* |

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| 41. | Insider trading involves the use of information not available to the general public to make profits from trading in a company's stock.  **TRUE** |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: BasicLearning Objective: 01-04 The primary goal of financial managers is to maximize the wealth of the shareholders.* |

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| 42. | Social responsibility and profit maximization are synonymous.  **FALSE** |

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| *AACSB: AnalyticAACSB: EthicsBlooms: UnderstandDifficulty: BasicLearning Objective: 01-04 The primary goal of financial managers is to maximize the wealth of the shareholders.* |

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| 43. | Financial markets exist as a vast global network of individuals and financial institutions that may be lenders, borrowers, or owners of public companies worldwide.  **TRUE** |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: BasicLearning Objective: 01-05 Financial managers attempt to achieve wealth maximization through daily activities such as credit and inventory management and through longer-term decisions related to raising funds.* |

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| 44. | Money markets refer to those markets dealing with short-term securities having a life of one year or less.  **TRUE** |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: BasicLearning Objective: 01-05 Financial managers attempt to achieve wealth maximization through daily activities such as credit and inventory management and through longer-term decisions related to raising funds.* |

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| 45. | Money markets refer to markets where excess corporate cash is exchanged for foreign currencies that can earn a higher return than domestic money.  **FALSE** |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: BasicLearning Objective: 01-05 Financial managers attempt to achieve wealth maximization through daily activities such as credit and inventory management and through longer-term decisions related to raising funds.* |

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| 46. | Capital markets refer to those markets dealing with short-term securities that have a life of one year or less.  **FALSE** |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: BasicLearning Objective: 01-05 Financial managers attempt to achieve wealth maximization through daily activities such as credit and inventory management and through longer-term decisions related to raising funds.* |

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| 47. | The primary market includes the sale of securities by way of initial public offerings.  **TRUE** |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: BasicLearning Objective: 01-05 Financial managers attempt to achieve wealth maximization through daily activities such as credit and inventory management and through longer-term decisions related to raising funds.* |

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| 48. | High-quality initial public offerings are usually sold in a primary market, such as the New York Stock Exchange. However, low-quality stocks must usually be sold in secondary markets, such as NASDAQ.  **FALSE** |

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| *AACSB: AnalyticBlooms: UnderstandDifficulty: BasicLearning Objective: 01-05 Financial managers attempt to achieve wealth maximization through daily activities such as credit and inventory management and through longer-term decisions related to raising funds.* |

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| 49. | Although NASDAQ is a secondary market, some of the firms traded there, such as Microsoft, are large enough to move to the primary market if they so desire.  **FALSE** |

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| *AACSB: AnalyticBlooms: UnderstandDifficulty: IntermediateLearning Objective: 01-05 Financial managers attempt to achieve wealth maximization through daily activities such as credit and inventory management and through longer-term decisions related to raising funds.* |

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| 50. | The secondary market characteristically has had stable prices over the past 20 years.  **FALSE** |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: BasicLearning Objective: 01-05 Financial managers attempt to achieve wealth maximization through daily activities such as credit and inventory management and through longer-term decisions related to raising funds.* |

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| 51. | In the United States, stocks sold on either the New York Stock Exchange or NASDAQ are considered sold in the primary market.  **FALSE** |

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| *AACSB: AnalyticBlooms: UnderstandDifficulty: IntermediateLearning Objective: 01-05 Financial managers attempt to achieve wealth maximization through daily activities such as credit and inventory management and through longer-term decisions related to raising funds.* |

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| 52. | New issues are sold in the secondary market.  **FALSE** |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: BasicLearning Objective: 01-05 Financial managers attempt to achieve wealth maximization through daily activities such as credit and inventory management and through longer-term decisions related to raising funds.* |

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| 53. | Existing securities are traded in the secondary market.  **TRUE** |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: BasicLearning Objective: 01-05 Financial managers attempt to achieve wealth maximization through daily activities such as credit and inventory management and through longer-term decisions related to raising funds.* |

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| 54. | Many companies have cross-listed their stock on multiple international stock exchanges and more than several hundred foreign companies have listed their shares on the New York Stock Exchange.  **TRUE** |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: BasicLearning Objective: 01-05 Financial managers attempt to achieve wealth maximization through daily activities such as credit and inventory management and through longer-term decisions related to raising funds.* |

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| 55. | Higher return always induces stockholders to invest in a company.  **FALSE** |

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| *AACSB: AnalyticBlooms: UnderstandDifficulty: BasicLearning Objective: 01-03 The relationship of risk to return is a central focus of finance.* |

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| 56. | Social responsibility is an expense and thus should be avoided by financial managers because it will lead to loss of income.  **FALSE** |

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| *AACSB: AnalyticBlooms: UnderstandDifficulty: BasicLearning Objective: 01-03 The relationship of risk to return is a central focus of finance.* |

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| 57. | Financial management requires both short-term activities as well as long-term planning such as raising funds.  **TRUE** |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: BasicLearning Objective: 01-05 Financial managers attempt to achieve wealth maximization through daily activities such as credit and inventory management and through longer-term decisions related to raising funds.* |

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| 58. | One of the primary disadvantages of maximizing shareholder value is that it only provides a short-term perspective.  **FALSE** |

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| *AACSB: AnalyticBlooms: UnderstandDifficulty: BasicLearning Objective: 01-04 The primary goal of financial managers is to maximize the wealth of the shareholders.* |

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| 59. | If a company has a written code of ethics, they will generally avoid ethical problems.  **TRUE** |

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| *AACSB: EthicsBlooms: EvaluateDifficulty: IntermediateLearning Objective: 01-04 The primary goal of financial managers is to maximize the wealth of the shareholders.* |

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| 60. | Risk management will be an important factor over the next decade.  **TRUE** |

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| *AACSB: AnalyticBlooms: UnderstandDifficulty: BasicLearning Objective: 01-01 The field of finance integrates concepts from economics; accounting; and a number of other areas.* |

**Multiple Choice Questions**

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 61. | Which of the following did not contribute to the financial crisis?

|  |  |
| --- | --- |
| A.  | The use of market-to-market accounting standards |

|  |  |
| --- | --- |
| B.  | Solid credit ratings from the ratings agencies |

|  |  |
| --- | --- |
| C.  | The extension of credit to high-risk borrowers |

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| --- | --- |
| **D.**  | The merger of JPMorgan Chase and Bear Stearns |

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| E.  | All of the options contributed to the financial crisis. |

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| *AACSB: AnalyticBlooms: UnderstandDifficulty: IntermediateLearning Objective: 01-01 The field of finance integrates concepts from economics; accounting; and a number of other areas.* |

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| 62. | Credit swaps are

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| **A.**  | an insurance product designed to protect financial institutions from customers who default on their loans. |

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| --- | --- |
| B.  | securities with a maturity of less than one year. |

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| --- | --- |
| C.  | the result of a leveling off or slowing down of price increases. |

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| D.  | market trades in previously issued securities. |

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| *AACSB: AnalyticBlooms: UnderstandDifficulty: IntermediateLearning Objective: 01-01 The field of finance integrates concepts from economics; accounting; and a number of other areas.* |

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| 63. | What is the primary goal of financial management?

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| --- | --- |
| A.  | Increased earnings |

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| --- | --- |
| B.  | Maximizing cash flow |

|  |  |
| --- | --- |
| **C.**  | Maximizing shareholder wealth |

|  |  |
| --- | --- |
| D.  | Minimizing risk of the firm |

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| *AACSB: EthicsBlooms: RememberDifficulty: BasicLearning Objective: 01-04 The primary goal of financial managers is to maximize the wealth of the shareholders.* |

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| 64. | In the past, the study of finance has included

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| --- | --- |
| A.  | mergers and acquisitions. |

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| --- | --- |
| B.  | raising capital. |

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| --- | --- |
| C.  | bankruptcy. |

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| --- | --- |
| **D.**  | All of the options |

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| *AACSB: AnalyticBlooms: UnderstandDifficulty: BasicLearning Objective: 01-01 The field of finance integrates concepts from economics; accounting; and a number of other areas.* |

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| 65. | Professor Merton Miller received the Nobel Prize in Economics for his work on

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| --- | --- |
| A.  | dividend policy. |

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| --- | --- |
| B.  | investment theory. |

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| --- | --- |
| C.  | working capital management. |

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| **D.**  | capital structure theory. |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: IntermediateLearning Objective: 01-01 The field of finance integrates concepts from economics; accounting; and a number of other areas.* |

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| 66. | Professors Harry Markowitz and William Sharpe received their Nobel Prize in Economics for their contributions to the

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| --- | --- |
| A.  | options pricing model. |

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| --- | --- |
| B.  | theories of working capital management. |

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| **C.**  | theories of risk-return and portfolio management. |

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| D.  | theories of international capital budgeting. |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: IntermediateLearning Objective: 01-01 The field of finance integrates concepts from economics; accounting; and a number of other areas.Learning Objective: 01-03 The relationship of risk to return is a central focus of finance.* |

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| 67. | Which of the following is NOT addressed by the Dodd-Frank Act?

|  |  |
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| A.  | Liquidation of non-bank financial companies such as insurance companies. |

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| --- | --- |
| B.  | Limits upon speculative investing by federally insured banks. |

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| **C.**  | Written certifications of financial statements by the CEO and CFO. |

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| D.  | Registration of hedge funds with the SEC. |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: IntermediateLearning Objective: 01-01 The field of finance integrates concepts from economics; accounting; and a number of other areas.* |

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| 68. | Proper risk-return management means that

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| --- | --- |
| A.  | the firm should take as few risks as possible. |

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| **B.**  | the firm must determine an appropriate trade-off between risk and return. |

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| C.  | the firm should earn the highest return possible. |

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| D.  | the firm should value future profits more highly than current profits. |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: BasicLearning Objective: 01-03 The relationship of risk to return is a central focus of finance.* |

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| 69. | One of the major disadvantages of a sole proprietorship is

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| --- | --- |
| **A.**  | that there is unlimited liability to the owner. |

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| --- | --- |
| B.  | the simplicity of decision making. |

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| --- | --- |
| C.  | low organizational costs. |

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| --- | --- |
| D.  | low operating costs. |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: BasicLearning Objective: 01-02 A firm can have many different forms of organization.* |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 70. | One of the major advantages of a sole proprietorship is

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| --- | --- |
| A.  | that the owner has limited liability. |

|  |  |
| --- | --- |
| B.  | that stock in the proprietorship can be easily transferred. |

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| C.  | that it is exempt from many tax rules that would otherwise apply when employees are hired by the firm. |

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| **D.**  | low operating costs. |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: BasicLearning Objective: 01-02 A firm can have many different forms of organization.* |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 71. | The partnership form of an organization

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| --- | --- |
| **A.**  | avoids the double taxation of earnings and dividends found in the corporate form of organization. |

|  |  |
| --- | --- |
| B.  | usually provides limited liability to the partners. |

|  |  |
| --- | --- |
| C.  | has unlimited life. |

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| --- | --- |
| D.  | simplifies decision making. |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: BasicLearning Objective: 01-02 A firm can have many different forms of organization.* |

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| 72. | A corporation is

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| --- | --- |
| A.  | owned by stockholders who enjoy the privilege of limited liability. |

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| --- | --- |
| B.  | easily divisible between owners. |

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| --- | --- |
| C.  | a separate legal entity with perpetual life. |

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| --- | --- |
| **D.**  | All of the options |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: BasicLearning Objective: 01-02 A firm can have many different forms of organization.* |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 73. | With an S corporation

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| **A.**  | income is taxed as direct income to stockholders. |

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| --- | --- |
| B.  | stockholders have the same liability as members of a partnership. |

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| --- | --- |
| C.  | the number of stockholders is unlimited. |

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| D.  | the life of the corporation is limited. |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: IntermediateLearning Objective: 01-02 A firm can have many different forms of organization.* |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 74. | An S corporation

|  |  |
| --- | --- |
| A.  | is similar to a partnership in that it carries unlimited liability. |

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| --- | --- |
| B.  | is a separate legal entity that is treated like a normal corporation. |

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| --- | --- |
| **C.**  | has all the organizational benefits of a corporation and its income is only taxed once. |

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| D.  | All of the options |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: IntermediateLearning Objective: 01-02 A firm can have many different forms of organization.* |

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| 75. | Corporate governance is the

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| --- | --- |
| **A.**  | relationship and exercise of oversight by the board of directors of the company. |

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| --- | --- |
| B.  | relationship between the chief financial officer (CFO) and institutional investors. |

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| --- | --- |
| C.  | operation of a company by the chief executive officer (CEO) and other senior executives on the management team. |

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| D.  | governance of the company by the board of directors with a focus on social responsibility. |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: BasicLearning Objective: 01-04 The primary goal of financial managers is to maximize the wealth of the shareholders.* |

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| 76. | Many companies such as Tyco, Enron, and WorldCom that suffered financial distress in the late 1990s and early 2000s

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| --- | --- |
| A.  | committed fraud. |

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| --- | --- |
| B.  | had failed corporate governance oversight. |

|  |  |
| --- | --- |
| C.  | went bankrupt. |

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| **D.**  | All of the options are true. |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: BasicLearning Objective: 01-04 The primary goal of financial managers is to maximize the wealth of the shareholders.* |

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| 77. | Agency theory examines the relationship between the

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| --- | --- |
| A.  | shareholders of the firm and the firm's investment banker. |

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| --- | --- |
| **B.**  | owners of the firm and the managers of the firm. |

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| --- | --- |
| C.  | board of directors and large institutional investors. |

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| --- | --- |
| D.  | shareholders and the firm's transfer agent. |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: BasicLearning Objective: 01-04 The primary goal of financial managers is to maximize the wealth of the shareholders.* |

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| 78. | Agency theory would imply that conflicts are more likely to occur between management and shareholders when

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| --- | --- |
| A.  | the company is owned and operated by the same person. |

|  |  |
| --- | --- |
| B.  | management acts in the best interests of maximizing shareholder wealth. |

|  |  |
| --- | --- |
| **C.**  | the chairman of the board is also the chief executive officer (CEO). |

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| D.  | the board of directors exerts strong and involved oversight of management. |

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| *AACSB: EthicsBlooms: UnderstandDifficulty: IntermediateLearning Objective: 01-04 The primary goal of financial managers is to maximize the wealth of the shareholders.* |

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| 79. | Agency theory deals with the issue of

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| --- | --- |
| A.  | when to hire an agent to represent the firm in negotiations. |

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| --- | --- |
| B.  | the legal liabilities of a firm if an employee, acting as the firm's agent, injures someone. |

|  |  |
| --- | --- |
| C.  | the limitations placed on an employee acting as the firm's agent to obligate or bind the firm. |

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| --- | --- |
| **D.**  | the conflicts that can arise between the viewpoints and motivations of a firm's owners and managers. |

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| *AACSB: EthicsBlooms: UnderstandDifficulty: ChallengeLearning Objective: 01-04 The primary goal of financial managers is to maximize the wealth of the shareholders.* |

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| 80. | Agency problems are least likely to arise in which organizational form?

|  |  |
| --- | --- |
| **A.**  | Sole proprietorship |

|  |  |
| --- | --- |
| B.  | Limited partnership |

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| --- | --- |
| C.  | Corporation |

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| --- | --- |
| D.  | Subchapter S corporation |

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| *AACSB: EthicsBlooms: UnderstandDifficulty: IntermediateLearning Objective: 01-02 A firm can have many different forms of organization.* |

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| 81. | Institutional investors are important in today's business world because

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| --- | --- |
| A.  | as large investors, they have more say in how businesses are managed. |

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| --- | --- |
| B.  | they have a fiduciary responsibility to the workers and investors that they represent to see that the firms they own are managed in an ethical way. |

|  |  |
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| C.  | as a group they can vote large blocks of stock for the election of board members. |

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| --- | --- |
| **D.**  | All of the options |

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| *AACSB: AnalyticBlooms: UnderstandDifficulty: IntermediateLearning Objective: 01-04 The primary goal of financial managers is to maximize the wealth of the shareholders.* |

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| 82. | The increasing percentage ownership of public corporations by institutional investors has

|  |  |
| --- | --- |
| A.  | had no effect on corporate management. |

|  |  |
| --- | --- |
| B.  | created higher returns for the stock market in general. |

|  |  |
| --- | --- |
| **C.**  | created more pressure on public companies to manage their firms more efficiently. |

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| D.  | taken away the voice of the individual investor. |

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| *AACSB: AnalyticBlooms: UnderstandDifficulty: IntermediateLearning Objective: 01-04 The primary goal of financial managers is to maximize the wealth of the shareholders.* |

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| 83. | The Sarbanes-Oxley Act was passed in an effort to

|  |  |
| --- | --- |
| A.  | protect small business from large corporations dominating the market. |

|  |  |
| --- | --- |
| B.  | ensure that partnerships divide profits among partners in a fair manner. |

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| C.  | guarantee that outside auditors can control corporate accounting practices. |

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| **D.**  | control corrupt corporate behavior. |

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| *AACSB: EthicsBlooms: UnderstandDifficulty: IntermediateLearning Objective: 01-04 The primary goal of financial managers is to maximize the wealth of the shareholders.* |

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| 84. | The Sarbanes-Oxley Act set up the Public Company Accounting Oversight Board with the responsibility for all of the following except

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| A.  | auditing standards within companies. |

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| B.  | controlling the quality of audits. |

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| **C.**  | certifying the competence of financial executives. |

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| D.  | setting rules and standards for the independence of auditors. |

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| *AACSB: EthicsBlooms: UnderstandDifficulty: IntermediateLearning Objective: 01-04 The primary goal of financial managers is to maximize the wealth of the shareholders.* |

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| 85. | A financial manager's goal of maximizing current or short-term earnings may not be appropriate because

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| A.  | it fails to consider the timing of the benefits. |

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| B.  | increased earnings may be accompanied by unacceptably higher levels of risk. |

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| C.  | earnings are subjective; they can be defined in various ways such as accounting or economic earnings. |

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| **D.**  | All of the options |

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| *AACSB: EthicsBlooms: ApplyDifficulty: IntermediateLearning Objective: 01-04 The primary goal of financial managers is to maximize the wealth of the shareholders.* |

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| 86. | Maximization of shareholder wealth is a concept in which

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| A.  | increased earnings is of primary importance. |

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| B.  | profits are maximized on a quarterly basis. |

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| C.  | virtually all earnings are paid as dividends to common stockholders. |

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| **D.**  | optimally increasing the long-term value of the firm is emphasized. |

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| *AACSB: AnalyticBlooms: UnderstandDifficulty: IntermediateLearning Objective: 01-04 The primary goal of financial managers is to maximize the wealth of the shareholders.* |

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| 87. | Which of the following is not a true statement about the goal of maximizing shareholder wealth?

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| --- | --- |
| A.  | It takes into account the timing of cash-flows. |

|  |  |
| --- | --- |
| **B.**  | It is a short-run point of view that takes risk into account. |

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| C.  | It considers risk as a factor. |

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| D.  | None of the options is a false statement. |

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| *AACSB: EthicsBlooms: UnderstandDifficulty: IntermediateLearning Objective: 01-04 The primary goal of financial managers is to maximize the wealth of the shareholders.* |

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| 88. | As mergers, acquisitions, and restructuring have increased in importance, agency theory has become more important in assessing whether

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| --- | --- |
| A.  | a stock repurchase should be undertaken. |

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| **B.**  | shareholder goals are truly being achieved by managers in the long run. |

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| C.  | managers are actually agents or only employees of the firm. |

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| D.  | managers and owners are actually the same people with the same interests. |

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| *AACSB: AnalyticBlooms: EvaluateDifficulty: ChallengeLearning Objective: 01-04 The primary goal of financial managers is to maximize the wealth of the shareholders.* |

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| 89. | Insider trading occurs when

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| **A.**  | someone has information not available to the public which they use to profit from trading in stocks. |

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| B.  | corporate officers buy stock in their company. |

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| --- | --- |
| C.  | lawyers, investment bankers, and others buy common stock in companies represented by their firms. |

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| --- | --- |
| D.  | any stock transactions occur in violation of the Federal Trade Commissions restrictions on monopolies. |

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| *AACSB: EthicsBlooms: RememberDifficulty: IntermediateLearning Objective: 01-04 The primary goal of financial managers is to maximize the wealth of the shareholders.* |

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| 90. | The major difficulty in most insider-trading cases has been

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| A.  | that lenient judges have simply released the guilty individuals. |

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| --- | --- |
| B.  | that insider trading, even though illegal, actually serves a beneficial economic and financial purpose. |

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| --- | --- |
| **C.**  | that inside trades have not been legally well-defined. |

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| D.  | inside trades actually have a beneficial effect on the wealth of all stockholders. |

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| *AACSB: EthicsBlooms: UnderstandDifficulty: ChallengeLearning Objective: 01-04 The primary goal of financial managers is to maximize the wealth of the shareholders.* |

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| 91. | Money markets include which of the following securities?

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| --- | --- |
| A.  | Common stock and corporate bonds. |

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| --- | --- |
| **B.**  | Treasury bills and commercial paper. |

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| --- | --- |
| C.  | Certificates of deposit and preferred stock. |

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| --- | --- |
| D.  | All of the options |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: BasicLearning Objective: 01-05 Financial managers attempt to achieve wealth maximization through daily activities such as credit and inventory management and through longer-term decisions related to raising funds.* |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 92. | Capital markets do not include which of the following securities?

|  |  |
| --- | --- |
| A.  | Common stock |

|  |  |
| --- | --- |
| **B.**  | Commercial paper |

|  |  |
| --- | --- |
| C.  | Government bonds |

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| --- | --- |
| D.  | Preferred stock |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: IntermediateLearning Objective: 01-05 Financial managers attempt to achieve wealth maximization through daily activities such as credit and inventory management and through longer-term decisions related to raising funds.* |

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| 93. | When a corporation uses the financial markets to raise new funds, the sale of securities is made in the

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| --- | --- |
| **A.**  | primary market. |

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| --- | --- |
| B.  | secondary market. |

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| --- | --- |
| C.  | online market. |

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| --- | --- |
| D.  | third market. |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: BasicLearning Objective: 01-05 Financial managers attempt to achieve wealth maximization through daily activities such as credit and inventory management and through longer-term decisions related to raising funds.* |

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| 94. | Companies that have higher risk than a competitor in the same industry will generally have

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| --- | --- |
| A.  | to pay a higher interest rate than its competitors. |

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| --- | --- |
| B.  | a lower relative stock price than its competitors. |

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| --- | --- |
| C.  | a higher cost of funds than its competitors. |

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| --- | --- |
| **D.**  | All of the options |

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| *AACSB: AnalyticBlooms: EvaluateDifficulty: IntermediateLearning Objective: 01-05 Financial managers attempt to achieve wealth maximization through daily activities such as credit and inventory management and through longer-term decisions related to raising funds.* |

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| 95. | The financial markets allocate capital to corporations by

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| --- | --- |
| **A.**  | reflecting expectations of the market participants in the price of the corporation's stock. |

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| --- | --- |
| B.  | requiring higher returns from companies with lower risk than their competitors. |

|  |  |
| --- | --- |
| C.  | rewarding companies with expected high returns with lower relative stock prices. |

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| --- | --- |
| D.  | relying on the opinion of investment bankers. |

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| *AACSB: AnalyticBlooms: EvaluateDifficulty: IntermediateLearning Objective: 01-05 Financial managers attempt to achieve wealth maximization through daily activities such as credit and inventory management and through longer-term decisions related to raising funds.* |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 96. | Corporate restructuring has been one result of more institutional ownership. Restructuring can cause

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| --- | --- |
| A.  | changes in the assets and liabilities of the firm. |

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| --- | --- |
| B.  | the sale of low-profit margin divisions. |

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| --- | --- |
| C.  | the removal of current management and/or large reductions in the workforce. |

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| **D.**  | All of the options |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: BasicLearning Objective: 01-05 Financial managers attempt to achieve wealth maximization through daily activities such as credit and inventory management and through longer-term decisions related to raising funds.* |

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| 97. | A corporate restructuring can result in

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| --- | --- |
| A.  | changes in the capital structure. |

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| --- | --- |
| B.  | selling of low-profit margin divisions. |

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| --- | --- |
| C.  | reductions in the workforce. |

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| --- | --- |
| **D.**  | All of the options |

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| *AACSB: Reflective ThinkingBlooms: RememberDifficulty: IntermediateLearning Objective: 01-05 Financial managers attempt to achieve wealth maximization through daily activities such as credit and inventory management and through longer-term decisions related to raising funds.* |

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| 98. | Which of the following is not an example of restructuring as discussed in the text?

|  |  |
| --- | --- |
| A.  | Repurchase of common stock |

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| --- | --- |
| **B.**  | Creating a new organizational chart |

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| --- | --- |
| C.  | Merging with companies in related industries |

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| --- | --- |
| D.  | Divesting of an unprofitable division |

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| *AACSB: AnalyticBlooms: UnderstandDifficulty: IntermediateLearning Objective: 01-05 Financial managers attempt to achieve wealth maximization through daily activities such as credit and inventory management and through longer-term decisions related to raising funds.* |

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| 99. | Future financial managers will need to understand

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| --- | --- |
| A.  | international cash flows. |

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| --- | --- |
| B.  | computerized funds transfers. |

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| --- | --- |
| C.  | international currency hedging strategies. |

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| --- | --- |
| **D.**  | All of the options |

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| *AACSB: AnalyticBlooms: EvaluateDifficulty: BasicLearning Objective: 01-05 Financial managers attempt to achieve wealth maximization through daily activities such as credit and inventory management and through longer-term decisions related to raising funds.* |

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| 100. | The increase in the internationalization of financial markets has led to

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| --- | --- |
| A.  | companies searching the global financial markets for low-cost funds. |

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| --- | --- |
| B.  | an increase in American Depository Receipts (ADRs) on the New York Stock Exchange. |

|  |  |
| --- | --- |
| C.  | an increase in debt obligations denominated in foreign currency on U.S. corporate balance sheets. |

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| --- | --- |
| **D.**  | All of the options |

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| *AACSB: AnalyticBlooms: UnderstandDifficulty: BasicLearning Objective: 01-05 Financial managers attempt to achieve wealth maximization through daily activities such as credit and inventory management and through longer-term decisions related to raising funds.* |

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| 101. | The internationalization of the financial markets has

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| **A.**  | allowed firms such as McDonald's to raise capital around the world. |

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| --- | --- |
| B.  | raised the cost of capital. |

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| --- | --- |
| C.  | forced companies to price everything in U.S. dollars. |

|  |  |
| --- | --- |
| D.  | All of the options |

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| *AACSB: AnalyticBlooms: UnderstandDifficulty: IntermediateLearning Objective: 01-05 Financial managers attempt to achieve wealth maximization through daily activities such as credit and inventory management and through longer-term decisions related to raising funds.* |

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| 102. | The Internet has affected the financial markets by

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| --- | --- |
| A.  | creating more competition between markets. |

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| --- | --- |
| B.  | pushing the cost of trading down. |

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| --- | --- |
| C.  | forcing brokerage companies to consolidate. |

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| --- | --- |
| **D.**  | All of the options |

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| *AACSB: AnalyticBlooms: UnderstandDifficulty: BasicLearning Objective: 01-05 Financial managers attempt to achieve wealth maximization through daily activities such as credit and inventory management and through longer-term decisions related to raising funds.* |

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| 103. | Increased productivity due to technology has

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| --- | --- |
| A.  | increased corporations' reliance on debt for capital expansion needs. |

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| --- | --- |
| B.  | created larger asset values on the firm's historical balance sheet. |

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| --- | --- |
| C.  | made it cheaper (in terms of interest costs) for firms to borrow money. |

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| --- | --- |
| **D.**  | helped to keep corporate costs in check. |

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| *AACSB: AnalyticBlooms: UnderstandDifficulty: IntermediateLearning Objective: 01-05 Financial managers attempt to achieve wealth maximization through daily activities such as credit and inventory management and through longer-term decisions related to raising funds.* |

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| 104. | Companies that perform well

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| --- | --- |
| A.  | can sell their stock for a lower price. |

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| --- | --- |
| B.  | can minimize dilution when issuing new shares. |

|  |  |
| --- | --- |
| C.  | can issue debt at a lower interest rate. |

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| --- | --- |
| **D.**  | can minimize dilution when issuing new shares and can issue debt at a lower interest rate. |

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| *AACSB: AnalyticBlooms: UnderstandDifficulty: IntermediateLearning Objective: 01-04 The primary goal of financial managers is to maximize the wealth of the shareholders.* |

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| 105. | The entity that is responsible for establishing the allocation and cost of capital is/are

|  |  |
| --- | --- |
| A.  | the corporation. |

|  |  |
| --- | --- |
| B.  | the economy. |

|  |  |
| --- | --- |
| **C.**  | investors. |

|  |  |
| --- | --- |
| D.  | customers. |

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| *AACSB: AnalyticBlooms: UnderstandDifficulty: IntermediateLearning Objective: 01-04 The primary goal of financial managers is to maximize the wealth of the shareholders.* |

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| 106. | The benefits of social responsibility often include

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| --- | --- |
| **A.**  | a better reputation. |

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| --- | --- |
| B.  | higher short-term earnings. |

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| --- | --- |
| C.  | lower expenses. |

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| --- | --- |
| D.  | None of the options |

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| *AACSB: EthicsBlooms: UnderstandDifficulty: IntermediateLearning Objective: 01-04 The primary goal of financial managers is to maximize the wealth of the shareholders.* |

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| 107. | Regarding risk levels, financial managers should

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| --- | --- |
| A.  | pursue higher-risk projects because they increase value. |

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| --- | --- |
| B.  | avoid higher-risk projects because they destroy value. |

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| C.  | focus primarily on market fluctuations. |

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| **D.**  | evaluate investors' desire for risk. |

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| *AACSB: AnalyticBlooms: AnalyzeDifficulty: IntermediateLearning Objective: 01-03 The relationship of risk to return is a central focus of finance.* |

**Matching Questions**

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 108. | Match the following with the questions below:

|  |  |  |
| --- | --- | --- |
| 1. corporation  |      The ability to make profits on financial securities because of having knowledge not available to the public.  |   **8**  |
| 2. subchapter S corporation  |      An agreement of partners specifying the ownership interest of a company.  |   **4**  |
| 3. partnership  |      A form of organization that represents single-person ownership and offers the advantages of simplicity of decision making and low organizational and operating costs.  |   **5**  |
| 4. articles of partnership  |      Separate legal entity owned by shareholders who only have limited liability.  |   **1**  |
| 5. sole proprietorship  |      The study of the relative importance of debt and equity.  |   **7**  |
| 6. agency theory  |      Examines the relationship between the owners of the firm and the managers of the firm.  |   **6**  |
| 7. capital structure theory  |      A form of ownership in which profit is taxed as direct income to the stockholders and thus is only taxed once.  |   **2**  |
| 8. insider trading  |      A form of ownership that carries unlimited liability to the owners and where the profits are taxed at the individual tax rates of the owners.  |   **3**  |

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| *AACSB: AnalyticBlooms: UnderstandDifficulty: IntermediateLearning Objective: 01-01 The field of finance integrates concepts from economics; accounting; and a number of other areas.Learning Objective: 01-02 A firm can have many different forms of organization.Learning Objective: 01-04 The primary goal of financial managers is to maximize the wealth of the shareholders.* |

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| 109. | Match the following with the questions below:

|  |  |  |
| --- | --- | --- |
| 1. inflation  |      This form of capital is found on the balance sheet under long-term liabilities and equity.  |   **5**  |
| 2. secondary market  |      When the purchasing power of the dollar is shrinking over time.  |   **1**  |
| 3. real capital  |      A market where the securities being traded are new public offerings.  |   **7**  |
| 4. capital market  |      Securities with a maturity of less than one year.  |   **8**  |
| 5. financial capital  |      Redeploying the asset and liability structure of the firm.  |   **6**  |
| 6. restructuring  |      A leveling off or slowing down of price increases.  |   **9**  |
| 7. primary market  |      Market composed of common stock, preferred stock, commercial and government bonds, and other long-term securities.  |   **4**  |
| 8. money market  |      This market trades previously issued securities.  |   **2**  |
| 9. disinflation  |      The high inflation rates of the 1980s caused this form of capital to hold its value better than other forms of capital during this time period.  |   **3**  |

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| *AACSB: AnalyticBlooms: UnderstandDifficulty: IntermediateLearning Objective: 01-01 The field of finance integrates concepts from economics; accounting; and a number of other areas.Learning Objective: 01-05 Financial managers attempt to achieve wealth maximization through daily activities such as credit and inventory management and through longer-term decisions related to raising funds.* |