

1

Student: _____

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True False

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46. Which of the following is not a major area of concern and emphasis in modern financial management and in this text?

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- C. Commodity trading
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- A. financial forecasting more difficult.
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49. In the past, the study of finance has included

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

- A. it fails to consider the timing of the benefits.
- B. increased earnings may be accompanied by unacceptably higher levels of risk.
- C. earnings are subjective; they can be defined in various ways such as accounting or economic earnings.
- D. all of the other answers are correct

51. One of the major disadvantages of a sole proprietorship is

- A. that there is unlimited liability to the owner.
- B. the simplicity of decision making.
- C. low organizational costs.
- D. low operating costs.

52. The partnership form of organization

- 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.
- D. simplifies decision making.

53. A corporation is

- A. owned by shareholders who enjoy the privilege of limited liability.
- B. easily divisible between owners.
- C. a separate legal entity with perpetual life.

D. all of the other answers are correct

54. Inflation

- A. increases corporations' reliance on debt for capital expansion needs.
- B. creates larger asset values on the firm's historical balance sheet.
- C. makes it cheaper (in terms of interest costs) for firms to borrow money.
- D. all of the other answers are correct

55. Which of the following securities is not included as part of the capital market?

- A. common stock
- B. commercial paper
- C. government bonds
- D. preferred stock

56. Maximization of shareholder wealth is a concept in which

- A. increased earnings is of primary importance.
- B. profits are maximized on a quarterly basis.
- C. virtually all earnings are paid as dividends to common shareholders.
- D. optimally increasing the long-term value of the firm is emphasized.

57. The largest Canadian corporations are mainly

- A. widely held.
- B. family controlled.
- C. U.S. controlled.
- D. Japanese controlled.

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

- A. It takes into account the timing of cash-flows.
- B. It is a short-run point of view which takes risk into account.
- C. It considers risk as a factor.
- D. None of the other answers are correct.

59. Increased international competition can be seen as a motivator to emphasize

- A. asset diversification strategies.
- B. the risk side of the risk-return relationship.
- C. the return side of the risk-return relationship.
- D. None of the other answers are correct

60. Corporations can reduce portfolio risk by

- A. narrowing their focus on one successful product.
- B. merging with companies in unrelated industries.
- C. repurchasing their own stock.
- D. all of the other answers are correct

61. The shift to the return side of the risk return relationship has occurred because

- A. many conglomerates over diversified and held marginal and losing divisions.
- B. there has been an increase in international competition.
- C. there has been an increase in the use of advanced technology in the production process.
- D. all of the other answers are correct

62. A corporate buy-back, or the repurchasing of shares, is

- A. an example of balance sheet restructuring.
- B. an excellent source of profits when the firm's stock is over-priced.
- C. a method of reducing the debt-to-equity ratio.
- D. all of the other answers are correct

63. Which of the following is (are) a result of high inflation?

- A. phantom profits
- B. under-valued assets
- C. lower profitability
- D. all of the other answers are correct

64. A corporate restructuring can result in

- A. changes in the capital structure.
- B. selling of low-profit margin divisions.
- C. reductions in the work force.
- D. all of the other answers are correct

65. 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

66. Agency theory deals with the issue of

- A. when to hire an agent to represent the firm in negotiations.
- 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.
- D. the conflicts that can arise between the viewpoints and motivations of a firm's owners and managers.

67. As mergers, acquisitions, and restructurings have increased in importance, agency theory has become more important in assessing whether

- 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.

68. Insider trading occurs when

- 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 dealers, and others buy common stock in companies represented by their firms
- D. stock transactions occur with reduced brokerage fees.

69. 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 shareholders.

70. The 1990 Nobel Prize in economics was given to three finance professors. They are:

- A. Harry Markowitz, Merton Miller, William Sharpe
- B. Harry Markowitz, Franco Modigliani, Paul Samuelson
- C. Merton Miller, Franco Modigliani, Robert Merton
- D. William Sharpe, Richard Roll, Steve Ross

71. Future financial managers will need to understand

- A. international cash flows.
- B. computerized funds transfers.
- C. international currency hedging strategies.
- D. all of the other answers are correct

72. Professors Harry Markowitz and William Sharpe received their Nobel prize in economics for their contributions to the

- A. options pricing model.
- B. theories of working capital management.
- C. theories of risk-return and portfolio theory.
- D. theories of international capital budgeting.

73. In the 1930s, financial practices focused on

- A. maintenance of liquidity.
- B. reorganization of financially distressed companies.
- C. the bankruptcy process.
- D. all of the other answers are correct

74. 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.
- D. taken away the voice of the individual investor.

75. Money markets would 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 other answers are correct

76. 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. on-line market.
- D. third market.

77. 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 other answers are correct

78. The financial markets allocate capital to corporations by

- A. reflecting expectations of the market participants in the corporation's share price.
- 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 dealers.

79. Corporate restructuring has been one result of more institutional ownership. Restructuring can cause

- A. changes in the asset 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 other answers are correct

80. Corporate restructuring in the late 1990s more often took the form of

- A. leveraged buyouts.
- B. mergers to refocus on core businesses.
- C. a change in capital structure.
- D. none of the other answers are correct

81. 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 Canadian companies listing on the New York Stock Exchange.
- C. an increase in debt obligations denominated in foreign currency on Canadian corporate balance sheets.
- D. all of the other answers are correct

82. The internationalization of the financial markets has

- A. allowed firms such as Nortel to raise capital around the world.
- B. raised the cost of capital.
- C. forced companies to value everything in U.S. dollars.
- D. all of the other answers are correct

83. Increased use of technology has increased corporate efficiency by

- A. increasing the firm's reliance on debt.
- B. creating larger asset values on the firm's balance sheet.
- C. made it cheaper (in terms of interest costs) for firms to borrow money.
- D. helped to keep corporate costs in check.

84. Maximization of shareholder wealth is a concept in which

- A. increased earnings are of primary importance
- B. increased cash flows are of primary importance
- C. increased dividends are of primary importance
- D. increased share price is of primary importance

85. Capital structure is

- A. the relative mix of capital and intangible assets held by the firm.
- B. the relative importance of debt and equity in the firm's financing.
- C. the relative importance of long-term investment decisions.
- D. the terms required to borrow money.

86. Financial markets allocate capital based on

- A. the pricing mechanism.
- B. the efforts of financial intermediaries.
- C. intervention by the Bank of Canada.
- D. the number of treasury bills outstanding.

87. Corporate governance is the

- A. relationship and exercise of oversight by the board of directors of the company.
- B. relationship between the chief financial officer and institutional investors.
- C. operation of the firm by the chief executive officer (CEO) and other senior executives on the management team.
- D. strategically directing the company through the board of directors with a focus on social responsibility.

88. Agency theory examines the relationship between

- A. shareholders of the firm and its investment dealers.
- B. shareholders of the firm and its managers.

- C. the board of directors and large institutional investors.
- D. shareholders of the firm and its transfer agent.

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

- 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).
- D. the board of directors exerts strong and involved oversight of managers.

90. Match each key term with its most correct definition.

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

91. Match each key term with its most correct definition.

- | | | |
|--|----------------|-------|
| | financial | |
| 1. A market where the securities being traded are new public offerings. | capital | _____ |
| 2. This market trades previously issued securities. | inflation | _____ |
| 3. This form of capital is found on the balance sheet under long-term liabilities and equity. | primary | |
| | market | _____ |
| 4. Market composed of common stock, preferred stock, corporations and government bonds and other long-term securities. | money market | _____ |
| 5. Redeploying the asset and liability structure of the firm. | restructuring | _____ |
| 6. The purchasing power of the dollar shrinks over time. | disinflation | _____ |
| 7. A levelling off or slowing down of price increases. | capital market | _____ |
| | secondary | |
| 8. Securities with a maturity of less than 1 year. | market | _____ |
| 9. 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. | real capital | _____ |

92. The internationalization of the financial markets has

- A. lowered the cost of capital
- B. raised the cost of capital.
- C. forced companies to value everything in U.S. dollars.
- D. had no effect on the cost of capital.

93. In analysis of a firm's market share value, an investor should consider:

- A. the risk inherent in the firm.
- B. the time pattern of the firm's earnings and cash flow.
- C. the quality and reliability of reported earnings.
- D. All of the other answers are correct.

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

- A. had no effect on corporate management.
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- D. None of the other answers are correct.

95. Financial management builds upon the disciplines of economics and accounting. Describe what

- a: economics provides the financial manager
- b: accounting provides the financial manager

96. Selecting profit maximization as the primary goal of the firm may not increase its value, because a profit-only focus has several drawbacks.

List and describe these drawbacks.

97. What 4 factors will investors consider in the analysis of a firm market share value?

98. According to agency theory, other than maximizing shareholder wealth what other self-interests do financial managers have?

99. Besides maximizing shareholder wealth, what should corporations consider to be goals? List and briefly explain.

100. What are the 4 components of good corporate governance?

101. List the 4 components of good corporate governance and identify additional measures that could be added to strengthen corporate governance.

102. List the occasional functions of the finance manager connected to the efficient raising and investing of funds.

103. What are the characteristics of a sole proprietorship? What are the drawbacks?

104. What are the characteristics of a partnership? What are the advantages compared to a sole proprietorship?

105. What are the characteristics of a corporation?

106. What 2 choices does the board of directors have to distribute earnings of a corporation?

1 KEY

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TRUE

*Block - Chapter 001 #1
Difficulty: Easy
Learning Objective: 2
Type: Con*

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Difficulty: Easy
Learning Objective: 1
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*Block - Chapter 001 #3
Difficulty: Easy
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*Block - Chapter 001 #4
Difficulty: Easy
Learning Objective: 4
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*Block - Chapter 001 #5
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*Block - Chapter 001 #6
Difficulty: Easy
Learning Objective: 3
Type: Mem*

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41. Honesty in business requires timely and full disclosure of pertinent firm developments.

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42. Businesses will increasingly rely on B2B Internet applications to speed up cash flows.

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- A. Increased earnings
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- C. Maximizing shareholder wealth**
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Difficulty: Easy
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- A. Inflation and its effect on profits
- B. Stable short-term interest rates**
- C. Changing international environment
- D. Increased reliance on debt

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Learning Objective: 2
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- D. all of the other answers are correct**

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- B. raising capital.
- C. mergers and acquisitions.
- D. all of the other answers are correct**

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

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- B. increased earnings may be accompanied by unacceptably higher levels of risk.
- C. earnings are subjective; they can be defined in various ways such as accounting or economic earnings.
- D. all of the other answers are correct**

Block - Chapter 001 #50
Difficulty: Med
Learning Objective: 3
Type: App

51. One of the major disadvantages of a sole proprietorship is

- A. that there is unlimited liability to the owner.**
- B. the simplicity of decision making.
- C. low organizational costs.
- D. low operating costs.

Block - Chapter 001 #51

Difficulty: Easy
Learning Objective: 1
Type: Mem

52. The partnership form of organization

- 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.
- D. simplifies decision making.

Block - Chapter 001 #52
Difficulty: Easy
Learning Objective: 1
Type: Mem

53. A corporation is

- A. owned by shareholders who enjoy the privilege of limited liability.
- B. easily divisible between owners.
- C. a separate legal entity with perpetual life.
- D. all of the other answers are correct

Block - Chapter 001 #53
Difficulty: Easy
Learning Objective: 1
Type: Mem

54. Inflation

- A. increases corporations' reliance on debt for capital expansion needs.
- B. creates larger asset values on the firm's historical balance sheet.
- C. makes it cheaper (in terms of interest costs) for firms to borrow money.
- D. all of the other answers are correct

Block - Chapter 001 #54
Difficulty: Med
Learning Objective: 1
Type: Con

55. Which of the following securities is not included as part of the capital market?

- A. common stock
- B. commercial paper
- C. government bonds
- D. preferred stock

Block - Chapter 001 #55
Difficulty: Med
Learning Objective: 1
Type: Mem

56. Maximization of shareholder wealth is a concept in which

- A. increased earnings is of primary importance.
- B. profits are maximized on a quarterly basis.
- C. virtually all earnings are paid as dividends to common shareholders.
- D. optimally increasing the long-term value of the firm is emphasized.

Block - Chapter 001 #56
Difficulty: Med
Learning Objective: 3
Type: Con

57. The largest Canadian corporations are mainly

- A. widely held.
- B. family controlled.
- C. U.S. controlled.
- D. Japanese controlled.

Block - Chapter 001 #57
Difficulty: Easy
Learning Objective: 1
Type: Mem

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

- A. It takes into account the timing of cash-flows.
- B. It is a short-run point of view which takes risk into account.
- C. It considers risk as a factor.
- D. None of the other answers are correct.

Block - Chapter 001 #58
Difficulty: Med
Learning Objective: 3
Type: Con

59. Increased international competition can be seen as a motivator to emphasize

- A. asset diversification strategies.
- B. the risk side of the risk-return relationship.

- C. the return side of the risk-return relationship.
D. None of the other answers are correct

Block - Chapter 001 #59
Difficulty: Med
Learning Objective: 1
Type: Mem

60. Corporations can reduce portfolio risk by

- A. narrowing their focus on one successful product.
B. merging with companies in unrelated industries.
C. repurchasing their own stock.
D. all of the other answers are correct

Block - Chapter 001 #60
Difficulty: Med
Learning Objective: 2
Type: App

61. The shift to the return side of the risk return relationship has occurred because

- A. many conglomerates over diversified and held marginal and losing divisions.
B. there has been an increase in international competition.
C. there has been an increase in the use of advanced technology in the production process.
D. all of the other answers are correct

Block - Chapter 001 #61
Difficulty: Med
Learning Objective: 2
Type: Con

62. A corporate buy-back, or the repurchasing of shares, is

- A. an example of balance sheet restructuring.
B. an excellent source of profits when the firm's stock is over-priced.
C. a method of reducing the debt-to-equity ratio.
D. all of the other answers are correct

Block - Chapter 001 #62
Difficulty: Med
Learning Objective: 5
Type: Con

63. Which of the following is (are) a result of high inflation?

- A. phantom profits
B. under-valued assets
C. lower profitability
D. all of the other answers are correct

Block - Chapter 001 #63
Difficulty: Med
Learning Objective: 1
Type: Con

64. A corporate restructuring can result in

- A. changes in the capital structure.
B. selling of low-profit margin divisions.
C. reductions in the work force.
D. all of the other answers are correct

Block - Chapter 001 #64
Difficulty: Med
Learning Objective: 4
Type: Mem

65. 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

Block - Chapter 001 #65
Difficulty: Med
Learning Objective: 4
Type: Con

66. Agency theory deals with the issue of

- A. when to hire an agent to represent the firm in negotiations.
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.
D. the conflicts that can arise between the viewpoints and motivations of a firm's owners and managers.

Block - Chapter 001 #66
Difficulty: Hard
Learning Objective: 3
Type: Con

67. As mergers, acquisitions, and restructurings have increased in importance, agency theory has become more important in assessing whether

- 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.

Block - Chapter 001 #67
 Difficulty: Hard
 Learning Objective: 3
 Type: App

68. Insider trading occurs when

- 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 dealers, and others buy common stock in companies represented by their firms
- D. stock transactions occur with reduced brokerage fees.

Block - Chapter 001 #68
 Difficulty: Med
 Learning Objective: 5
 Type: Mem

69. 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 shareholders.

Block - Chapter 001 #69
 Difficulty: Hard
 Learning Objective: 5
 Type: Con

70. The 1990 Nobel Prize in economics was given to three finance professors. They are:

- A.** Harry Markowitz, Merton Miller, William Sharpe
- B. Harry Markowitz, Franco Modigliani, Paul Samuelson
- C. Merton Miller, Franco Modigliani, Robert Merton
- D. William Sharpe, Richard Roll, Steve Ross

Block - Chapter 001 #70
 Difficulty: Med
 Learning Objective: 1
 Type: Mem

71. Future financial managers will need to understand

- A. international cash flows.
- B. computerized funds transfers.
- C. international currency hedging strategies.
- D.** all of the other answers are correct

Block - Chapter 001 #71
 Difficulty: Easy
 Learning Objective: 5
 Type: App

72. Professors Harry Markowitz and William Sharpe received their Nobel prize in economics for their contributions to the

- A. options pricing model.
- B. theories of working capital management.
- C.** theories of risk-return and portfolio theory.
- D. theories of international capital budgeting.

Block - Chapter 001 #72
 Difficulty: Med
 Learning Objective: 1
 Type: Mem

73. In the 1930s, financial practices focused on

- A. maintenance of liquidity.
- B. reorganization of financially distressed companies.
- C. the bankruptcy process.
- D.** all of the other answers are correct

Block - Chapter 001 #73
 Difficulty: Easy
 Learning Objective: 1
 Type: Mem

74. 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.
- D. taken away the voice of the individual investor.

Block - Chapter 001 #74
 Difficulty: Med
 Learning Objective: 6

75. Money markets would 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 other answers are correct

Block - Chapter 001 #75
 Difficulty: Easy
 Learning Objective: 5
 Type: Mem

76. 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. on-line market.
- D. third market.

Block - Chapter 001 #76
 Difficulty: Easy
 Learning Objective: 5
 Type: Mem

77. 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 other answers are correct

Block - Chapter 001 #77
 Difficulty: Med
 Learning Objective: 5
 Type: Con

78. The financial markets allocate capital to corporations by

- A.** reflecting expectations of the market participants in the corporation's share price.
- 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 dealers.

Block - Chapter 001 #78
 Difficulty: Med
 Learning Objective: 6
 Type: Con

79. Corporate restructuring has been one result of more institutional ownership. Restructuring can cause

- A. changes in the asset 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 other answers are correct

Block - Chapter 001 #79
 Difficulty: Easy
 Learning Objective: 4
 Type: Mem

80. Corporate restructuring in the late 1990s more often took the form of

- A. leveraged buyouts.
- B.** mergers to refocus on core businesses.
- C. a change in capital structure.
- D. none of the other answers are correct

Block - Chapter 001 #80
 Difficulty: Easy
 Learning Objective: 4
 Type: Mem

81. 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 Canadian companies listing on the New York Stock Exchange.
- C. an increase in debt obligations denominated in foreign currency on Canadian corporate balance sheets.
- D.** all of the other answers are correct

Block - Chapter 001 #81
 Difficulty: Easy
 Learning Objective: 5
 Type: Mem

82. The internationalization of the financial markets has

- A.** allowed firms such as Nortel to raise capital around the world.
- B. raised the cost of capital.
- C. forced companies to value everything in U.S. dollars.
- D. all of the other answers are correct

Block - Chapter 001 #82
 Difficulty: Med
 Learning Objective: 5
 Type: Con

83. Increased use of technology has increased corporate efficiency by
- A. increasing the firm's reliance on debt.
 - B. creating larger asset values on the firm's balance sheet.
 - C. made it cheaper (in terms of interest costs) for firms to borrow money.
 - D.** helped to keep corporate costs in check.

Block - Chapter 001 #83
 Difficulty: Med
 Learning Objective: 2
 Type: Con

84. Maximization of shareholder wealth is a concept in which

- A. increased earnings are of primary importance
- B. increased cash flows are of primary importance
- C. increased dividends are of primary importance
- D.** increased share price is of primary importance

Block - Chapter 001 #84
 Difficulty: Med
 Learning Objective: 3
 Type: Con

85. Capital structure is

- A. the relative mix of capital and intangible assets held by the firm.
- B.** the relative importance of debt and equity in the firm's financing.
- C. the relative importance of long-term investment decisions.
- D. the terms required to borrow money.

Block - Chapter 001 #85
 Difficulty: Hard
 Learning Objective: 6
 Type: Mem

86. Financial markets allocate capital based on

- A.** the pricing mechanism.
- B. the efforts of financial intermediaries.
- C. intervention by the Bank of Canada.
- D. the number of treasury bills outstanding.

Block - Chapter 001 #86
 Difficulty: Easy
 Learning Objective: 6
 Type: Con

87. Corporate governance is the

- A.** relationship and exercise of oversight by the board of directors of the company.
- B. relationship between the chief financial officer and institutional investors.
- C. operation of the firm by the chief executive officer (CEO) and other senior executives on the management team.
- D. strategically directing the company through the board of directors with a focus on social responsibility.

Block - Chapter 001 #87
 Difficulty: Easy
 Learning Objective: 4
 Type: Mem

88. Agency theory examines the relationship between

- A. shareholders of the firm and its investment dealers.
- B.** shareholders of the firm and its managers.
- C. the board of directors and large institutional investors.
- D. shareholders of the firm and its transfer agent.

Block - Chapter 001 #88
 Difficulty: Easy
 Learning Objective: 3
 Type: Mem

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

- 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).
- D. the board of directors exerts strong and involved oversight of managers.

Block - Chapter 001 #89
 Difficulty: Med
 Learning Objective: 3
 Type: Con

90. Match each key term with its most correct definition.

1. A system to reduce the effect of double taxation.

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

Block - Chapter 001 #90
 Difficulty: Med
 Learning Objective: 1
 Type: Mem

91. Match each key term with its most correct definition.

- | | |
|--|----------------------------|
| 1. A market where the securities being traded are new public offerings. | financial capital <u>3</u> |
| 2. This market trades previously issued securities. | inflation <u>6</u> |
| 3. This form of capital is found on the balance sheet under long-term liabilities and equity. | primary market <u>1</u> |
| 4. Market composed of common stock, preferred stock, corporations and government bonds and other long-term securities. | money market <u>8</u> |
| 5. Redeploying the asset and liability structure of the firm. | restructuring <u>5</u> |
| 6. The purchasing power of the dollar shrinks over time. | disinflation <u>7</u> |
| 7. A levelling off or slowing down of price increases. | capital market <u>4</u> |
| 8. Securities with a maturity of less than 1 year. | secondary market <u>2</u> |
| 9. 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. | real capital <u>9</u> |

Block - Chapter 001 #91
 Difficulty: Med
 Learning Objective: 1
 Type: Mem

92. The internationalization of the financial markets has

- A. lowered the cost of capital
 B. raised the cost of capital.
 C. forced companies to value everything in U.S. dollars.
 D. had no effect on the cost of capital.

Block - Chapter 001 #92
 Difficulty: Med
 Learning Objective: 5
 Type: Con

93. In analysis of a firm's market share value, an investor should consider:

- A. the risk inherent in the firm.
 B. the time pattern of the firm's earnings and cash flow.
 C. the quality and reliability of reported earnings.
D. All of the other answers are correct.

Block - Chapter 001 #93
 Difficulty: Easy
 Learning Objective: 5
 Type: Mem

94. 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 less pressure on public companies to manage their firms more efficiently.
D. None of the other answers are correct.

Block - Chapter 001 #94
 Difficulty: Med
 Learning Objective: 6
 Type: Con

95. Financial management builds upon the disciplines of economics and accounting. Describe what

- a: economics provides the financial manager
 b: accounting provides the financial manager

Economics provides the financial manager with

- A broad picture of the economy and the key measures that influence the corporation's decisions and performance (gross domestic product,

industrial production, disposable income, unemployment, inflation, interest rates, taxes).

- An understanding of the institutional structure of our mixed capitalist system (government regulation, Bank of Canada, chartered banks, investment dealers, trusts, insurance companies, financial markets). Capital is accumulated and valued in competitive financial markets, affecting its cost and availability to the firm.
- A structure for decision making (risk analysis, pricing theory through supply and demand relationships, comparative return analysis).

Accounting provides the financial manager with

- Much of the language of finance (assets, liabilities, cash flow).
- Financial data (income statements, balance sheets, statement of cash flows). The financial manager must know how to interpret and use this data in allocating the firm's financial resources to generate the best value on the basis of return and risk.

Finance links economic theory with the numbers of accounting, and all corporate managers—whether in the area of production, sales, research, marketing, management, or long run strategic planning—must know what it means to assess the financial performance of the firm.

*Block - Chapter 001 #95
Difficulty: Hard
Learning Objective: 1
Type: Mem*

96. Selecting profit maximization as the primary goal of the firm may not increase its value, because a profit-only focus has several drawbacks. List and describe these drawbacks.

1. **Risk may increase as profit changes.** More debts or investment in projects with cyclical earnings to increase profits also increase risk.

Shareholders may consider the increase in risk insufficient for the increased earnings.

2. **Profit fails to take into account the timing of benefits.** We might be indifferent between the following alternatives if our emphasis were solely on maximizing earnings, as the total is the same. However, alternative B is clearly superior, because larger benefits occur earlier; we could reinvest the difference in earnings for alternative B for an extra period.

Earnings per Share

	Period 1	Period 2	Total
Alternative A	\$1.50	\$2.00	\$3.50
Alternative B	\$2.00	1.50	3.50

3. **Accurately measuring profit is almost impossible.** Economics and accounting define profit (earnings) differently. Furthermore, earnings may not correspond to current values due to the methods used to capture accounting accruals and the amortization of capital expenditures. As well, financial statements are subject to manipulation by managers, so reported earnings may be misleading.

*Block - Chapter 001 #96
Difficulty: Med
Learning Objective: 3
Type: Mem*

97. What 4 factors will investors consider in the analysis of a firm market share value?

- The risk inherent in the firm (nature of its operations and how the firm is financed)
- The time pattern of the firm's earnings and cash flows
- The quality and reliability of reported earnings (as a guidepost to future earning power)
- Economic and political factors

*Block - Chapter 001 #97
Difficulty: Med
Learning Objective: 3
Type: Mem*

98. According to agency theory, other than maximizing shareholder wealth what other self-interests do financial managers have?

Financial managers are interested in:

- Maintaining their jobs (may discourage value-enhancing takeovers)
- Protecting "private spheres of influence"
- Maximizing their own compensation package
- Arbitrating among the firm's different stakeholders (shareholders, creditors, employees, unions, environmentalists, consumer groups, Canada Revenue Agency, government regulatory bodies, customers)

Pursuit of these interests may emphasize short-term results over long-term wealth building.

Management may also perceive the risk of investment decisions differently from shareholders, leading to different points of view as to the best decision regarding the investment of the firm's resources.

*Block - Chapter 001 #98
Difficulty: Med
Learning Objective: 3
Type: Mem*

99. Besides maximizing shareholder wealth, what should corporations consider to be goals? List and briefly explain.

Corporations, which receive their operational charters from society, should consider socially desirable actions that include:

- Community works (charitable giving, employment opportunities for marginalized groups)
- Customer respect (safe products, fair pricing, appropriate advertising and communication)
- Strong employee relations (fair benefits and compensation, equitable hiring, education, health and safety)
- Environmental health (pollution controls, appropriate use and renewal of resources)
- Human rights promotion (respecting the dignity of individuals globally)

*Block - Chapter 001 #99
Difficulty: Med
Learning Objective: 4
Type: Mem*

100. What are the 4 components of good corporate governance?

Good corporate governance results from:

- Board composition (strong leadership, competent education, balanced competencies)

- Director and officers ownership positions in the firm (other than by stock options)
- A published code of ethics
- Independent audits and a financially literate audit committee

Block - Chapter 001 #100
 Difficulty: Med
 Learning Objective: 4
 Type: Mem

101. List the 4 components of good corporate governance and identify additional measures that could be added to strengthen corporate governance.

Good corporate governance results from:

- Board composition (strong leadership, competent education, balanced competencies)
- Director and officers ownership positions in the firm (other than by stock options)
- A published code of ethics
- Independent audits and a financially literate audit committee

There have been increased demands for additional corporate governance practices by firms, despite the increased costs of compliance and sometimes delays in timely reporting of financial results. These measures include:

- Separating the roles of CEO and chair of the board
- Independent board of directors members
- Improved accounting standards (stock options, internal audit controls, "off-balance sheet items")
- More stringent reporting and disclosure requirements
- Closer monitoring by regulatory bodies (securities commissions)
- Questioning the use of "dual class" shares

Block - Chapter 001 #101
 Difficulty: Hard
 Learning Objective: 4
 Type: Mem

102. List the occasional functions of the finance manager connected to the efficient raising and investing of funds.

Intermediate financing, bond issues, leasing, stock issues, capital budgeting, dividend decisions, forecasting

Block - Chapter 001 #102
 Difficulty: Easy
 Learning Objective: 5
 Type: Mem

103. What are the characteristics of a sole proprietorship? What are the drawbacks?

A sole proprietorship is characterized by:

- Single-person ownership
- Simplicity of decision making
- Low organizational and operating costs
- Unlimited liability to the owner (can lose personal assets in settlement of firm's debts)
- Profits or losses taxed in hands of individual owner

Most small businesses with one to ten employees are sole proprietorships. The unlimited liability is a serious drawback and few lenders are willing to advance funds to a small business without a personal liability commitment from the owner.

Block - Chapter 001 #103
 Difficulty: Med
 Learning Objective: 2
 Type: Con

104. What are the characteristics of a partnership? What are the advantages compared to a sole proprietorship?

A partnership is characterized by

- Multiple ownership
- Ability to raise more capital and share ownership responsibilities
- Unlimited liability for the owners (one wealthy partner may have to bear a disproportionate share of losses in a **general partnership**)
- Taxation of profits or losses are allocated in percentages to partners

To circumvent the unlimited liability feature, a special form of partnership, called a **limited partnership**, can be utilized. Under this arrangement one or more partners are designated general partners and have unlimited liability for the debts of the firm; other partners are designated limited partners and are liable only for their initial contribution. The limited partners are normally prohibited from being active in the management of the firm.

Block - Chapter 001 #104
 Difficulty: Med
 Learning Objective: 2
 Type: Con

105. What are the characteristics of a corporation?

A **corporation** is characterized by:

- A legal entity unto itself (may sue or be sued, engage in contracts, acquire property)
- Ownership by shareholders (each with limited liability, although bankers may require small business owners to give their personal guarantee)
- Divisibility of the ownership (many shareholders)
- Continuous life span (not dependent on life of one shareholder)
- Taxation on its own income (individual shareholders pay tax on dividends or capital gain tax when shares are sold)

In terms of revenue and profits produced, the corporation is by far the most important form of economic unit.

Block - Chapter 001 #105
 Difficulty: Med
 Learning Objective: 2
 Type: Mem

106. What 2 choices does the board of directors have to distribute earnings of a corporation?

Earnings generated by the corporation are owned equally by each shareholder, and the board of directors has two choices for these earnings. Earnings can be:

- Paid out as dividends (shareholders pay tax on dividends: a dividend tax credit reduces the effect of double taxation)
- Reinvested in the firm (recorded as retained earnings)

*Block - Chapter 001 #106
Difficulty: Easy
Learning Objective: 2
Type: Mem*

1 Summary

<i>Category</i>	<i># of Questions</i>
Block - Chapter 001	106
Difficulty: Easy	54
Difficulty: Hard	6
Difficulty: Med	46
Learning Objective: 1	22
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Learning Objective: 5	24
Learning Objective: 6	10
Type: App	6
Type: Con	40
Type: Mem	60