Fundamentals Of Corporate Finance 8th Edition Richard Brealey Test Bank Solutions

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Chapter 01 (answers test key are from page 33)

Goals and Governance of the Corporation

True / False Questions

1. The liability of sole proprietors is limited to the amount of their investment in the company.

   True  False

2. General partners have limited personal liability for business debts in a limited partnership.

   True  False

3. The separation of ownership and management is one distinctive feature of corporations.

   True  False
4. A major disadvantage of partnerships is that they have double taxation of profits.
   True  False

5. Financial assets have value because they are claims on the firm's real assets and the cash that those assets will produce.
   True  False

6. Capital budgeting decisions are used to determine how to raise the cash necessary for investments.
   True  False

7. A successful investment is one that increases the value of the firm.
   True  False

8. Facebook's decision to spend $700 million to acquire Instagram is an investment decision.
   True  False

9. Boards of directors are generally appointed by the firm's senior officers.
   True  False

10. Financial analysts are involved in monitoring and controlling the risk associated with investment projects and financing decisions.
    True  False
11. The primary goal of any company should be to maximize current period profits.

   True    False

12. Maximizing profits is the same as maximizing the value of the firm.

   True    False

13. The Dodd-Frank financial reform law in 2010 granted shareholders a binding vote on executive compensation.

   True    False

14. Sole proprietorships face the same agency problems as those associated with corporations.

   True    False

15. Real assets can be intangible assets.

   True    False

16. Making good investment and financing decisions is the chief task of the financial manager.

   True    False

17. If a project's value is less than its required investment, then the project is financially attractive.

   True    False
18. GlaxoSmithKline’s spending of $6 billion in 2012 on research and development of new drugs is a capital budgeting decision but not a financing decision.

True  False

19. Volkswagen’s issuance of a 2.5 billion euro convertible bond is a financing decision.

True  False

20. An IOU (“I owe you”) from your brother-in-law is a financial asset.

True  False

21. The separation of ownership and management is one distinctive feature of both corporations and sole proprietors.

True  False

22. Shareholders welcome higher short-term profits even when they damage long-term profits.

True  False

23. A well-designed compensation package can help a firm achieve its goal of maximizing market value.

True  False

24. While control of large public companies in the United States is exercised through the board of directors and pressure from the stock market, in many other countries the stock market is less important and control shifts to major stockholders, typically banks and other companies.

True  False
25. Established firms can create value by developing long-term relationships and maintaining a good reputation.

   True   False

**Multiple Choice Questions**

26. Which one of these is a disadvantage of the corporate form of business?

   A. Access to capital  
   B. Unlimited personal liability for owners  
   C. Limited firm life  
   D. Legal requirements

27. Which one of the following gives a corporation its permanence?

   A. Multiple owners  
   B. Limited liability  
   C. Corporation taxation  
   D. Separation of ownership and control
28. In a partnership form of organization, income tax liability, if any, is incurred by:

A. the partnership itself.
B. the partners individually.
C. both the partnership and the partners.
D. neither the partnership nor the partners.

29. Which one of the following would correctly differentiate general partners from limited partners in a limited partnership?

A. General partners have more job experience.
B. General partners have an ownership interest.
C. General partners are subject to double taxation.
D. General partners have unlimited personal liability.

30. Which form of organization provides limited liability for the firm but yet allows the professionals working within that firm to be sued personally?

A. Limited liability partnership
B. Limited liability company
C. Sole proprietorship
D. Professional corporation
31. Which of the following is *least* likely to be discussed in the articles of incorporation?

   A. How the firm is to be financed  
   B. The purpose of the business  
   C. The price range of the shares of stock  
   D. How the board of directors is to be structured

32. When a corporation fails, the maximum that can be lost by an individual shareholder is:

   A. the amount of their initial investment.  
   B. the amount of their share of the profits.  
   C. their proportionate share required to pay the corporation's debts.  
   D. the amount of their personal wealth.

33. Which of the following is a disadvantage to incorporating a business?

   A. Easier access to financial markets  
   B. Limited liability  
   C. Becoming a permanent legal entity  
   D. Profits taxed at the corporate level and the shareholder level

34. Unlimited liability is faced by the owners of:

   A. corporations.  
   B. partnerships and corporations.  
   C. sole proprietorships and general partnerships.  
   D. all forms of business organization.
35. Which one of these statements correctly applies to a limited partnership?

A. All partners share the daily management duties.
B. All partners enjoy limited personal liability.
C. General partners have unlimited personal liability.
D. Taxes are imposed at both the firm and the personal level on profits earned.

36. In the case of a limited liability partnership, ________ has/have limited liability.

A. only some of partners
B. only the managing partner
C. all of the partners
D. none of the partners

37. A board of directors is elected as a representative of the corporation's:

A. top management.
B. stakeholders.
C. shareholders.
D. customers.

38. The legal "life" of a corporation is:

A. coincidental with that of its CEO.
B. equal to the life of its board of directors.
C. permanent, as long as shareholders don't change.
D. permanent, regardless of current ownership.
39. When the management of a business is conducted by individuals other than the owners, the business is most likely to be a:

A. corporation.
B. sole proprietorship.
C. partnership.
D. general partner.

40. "Double taxation" refers to:

A. all partners paying equal taxes on profits.
B. corporations paying taxes on both dividends and retained earnings.
C. paying taxes on profits at the corporate level and dividends at the personal level.
D. the fact that marginal tax rates are doubled for corporations.

41. A corporation is considered to be closely held when:

A. only a few shareholders exist.
B. the market value of the shares is stable.
C. it operates in a small geographic area.
D. management also serves as the board of directors.
42. Corporations are referred to as public companies when their:

A. shareholders have no tax liability.
B. shares are held by the federal or state government.
C. stock is publicly traded.
D. products or services are available to the public.

43. A common problem for closely held corporations is:

A. the lack of access to substantial amounts of capital.
B. the restriction that shareholders receive only one vote each.
C. the separation of ownership and management.
D. an abundance of agency problems.

44. Corporate managers are expected to make corporate decisions that are in the best interest of:

A. top corporate management.
B. the corporation's board of directors.
C. the corporation's shareholders.
D. all corporate employees.

45. Which one of the following is a financial asset?

A. A corporate bond
B. A machine
C. A patent
D. A factory
46. Which of the following statements best distinguishes the difference between real and financial assets?

A. Real assets have less value than financial assets.
B. Real assets are tangible; financial assets are not.
C. Financial assets represent claims to income that is generated by real assets.
D. Financial assets appreciate in value; real assets depreciate in value.

47. Which one of the following is a real asset?

A. A patent
B. A personal IOU
C. A checking account balance
D. A share of stock

48. Which one of these is not considered to be a security?

A. Shares of GE stock
B. A bond traded in the financial market
C. A mortgage loan issued and held by a bank
D. A convertible bond issued to the public
49. Corporations that issue financial securities such as stock or debt obligations to the public do so primarily to:

A. increase sales.
B. become profitable.
C. increase their access to funds.
D. avoid double taxation of their profits.

50. Which one of the following would be considered a capital budgeting decision?

A. Planning to issue common stock rather than issuing preferred stock
B. Deciding to expand into a new line of products, at a cost of $5 million
C. Repurchasing shares of common stock
D. Issuing debt in the form of long-term bonds

51. Which one of these is a capital budgeting decision?

A. Deciding between issuing stock or debt securities
B. Deciding whether or not the firm should go public
C. Deciding if the firm should repurchase some of its outstanding shares
D. Deciding whether to buy a new machine or repair the old machine
52. The best criterion for success in a capital budgeting decision would be to:

A. minimize the cost of the investment.
B. maximize the number of capital budgeting projects.
C. maximize the value added to the firm.
D. finance all capital budgeting projects with debt.

53. The overall goal of capital budgeting projects should be to:

A. decrease the firm's reliance on debt.
B. increase the firm's sales.
C. increase the firm's outstanding shares of stock.
D. increase the wealth of the firm's shareholders.

54. An example of a firm's financing decision would be:

A. acquiring a competitive firm.
B. determining how much to pay for a specific asset.
C. issuing 10-year versus 20-year bonds.
D. deciding whether or not to increase the price of its products.

55. Which of the following is a capital budgeting decision?

A. Should the firm borrow money from a bank or sell bonds?
B. Should the firm shut down an unprofitable factory?
C. Should the firm buy or lease a new machine that it is committed to acquiring?
D. Should the firm issue preferred stock or common stock?
56. Which of these duties are responsibilities of the corporate treasurer?

A. Financial statements and taxes
B. Cash management and tax reporting
C. Cash management and banking relationships
D. Raising capital and financial statements

57. The term "capital structure" refers to:

A. the manner in which a firm obtains its long-term sources of funding.
B. the length of time needed to repay debt.
C. whether or not the firm invests in capital budgeting projects.
D. the types of assets a firm acquires.

58. Firms can alter their capital structure by:

A. not accepting any new capital budgeting projects.
B. investing in intangible assets.
C. issuing stock to repay debt.
D. becoming a limited liability company.

59. Which one of these statements is correct?

A. Financial managers have a fiduciary duty to stockholders.
B. Financial managers are concerned only with funds that flow to investors.
C. The chief financial officer generally reports directly to the corporate treasurer.
D. The corporate controller is primarily responsible for overseeing a firm’s cash functions.
60. A firm decides to pay for a small investment project through a $1 million increase in short-term bank loans. This is best described as an example of a(n):

A. financing decision.
B. investment decision.
C. capital budgeting decision.
D. capital expenditure decision.

61. The short-term decisions of financial managers are comprised of:

A. capital structure decisions only.
B. investment decisions only.
C. financing decisions only.
D. both investment and financing decisions.

62. A block holder is commonly defined as an investor who:

A. owns 5 percent or more of a firm's outstanding shares.
B. invests in more than one firm within the same industry.
C. is another corporation.
D. is also one of the firm's managers or directors.
63. Which of the firm's financial managers is most likely to be involved with obtaining financing for the firm?

A. Treasurer
B. Controller
C. Chief Operating Officer
D. Board of directors

64. In a large corporation, budget preparation would most likely be conducted by the:

A. treasurer.
B. controller.
C. chief financial officer.
D. financial manager.

65. In a firm having both a treasurer and a controller, which of the following would most likely be handled by the controller?

A. Internal auditing
B. Credit management
C. Banking relationships
D. Insurance
66. Which one of the following statements more accurately describes the controller than the treasurer?

A. Reports directly to the chief executive officer  
B. Monitors capital expenditures to make sure that they are not misappropriated  
C. Responsible for investing the firm's spare cash  
D. Responsible for arranging any issue of common stock

67. A chief financial officer would typically:

A. report to the treasurer, but supervise the controller.  
B. report to the controller, but supervise the treasurer.  
C. report to both the treasurer and controller.  
D. supervise both the treasurer and controller.

68. Which one of these determines the minimum acceptable rate of return on a capital investment?

A. The available alternative investment opportunities  
B. The profit margin of the existing firm  
C. The rate of return on the firm's outstanding shares  
D. The rate of return on risk-free debt securities
69. A financial analyst in a corporation may be involved with all of the following EXCEPT:

A. analyzing a new investment project.
B. monitoring risk.
C. managing investment of the company's cash.
D. purchasing the firm's plant and equipment.

70. Investment banks like Morgan Stanley or Goldman Sachs:

A. collect deposits and relend the cash to corporations and individuals.
B. help companies sell their securities to investors.
C. design and sell insurance policies for businesses.
D. lend to corporations and investors in commercial real estate.

71. The primary goal of corporate management should be to:

A. maximize the number of shareholders.
B. maximize the firm's profits.
C. minimize the firm's costs.
D. maximize the shareholders' wealth.

72. A corporate board of directors should provide support for the top management team:

A. under all circumstances.
B. in all decisions related to cash dividends.
C. only when the board approves of management's actions.
D. if shareholders are pleased with the firm's performance.
73. Which of the following appears to be the most appropriate goal for corporate management?

A. Maximizing market value of the company’s shares
B. Maximizing the company’s market share
C. Maximizing the current profits of the company
D. Minimizing the company’s liabilities

74. How may a reduction in cash dividends be in the best interests of current shareholders?

A. A reduction of cash dividends is always in the best interests of current shareholders.
B. The firm will have available cash to increase current investment and future profits.
C. Reduced dividends increase managerial compensation, thus increasing managers’ motivation.
D. A reduction of cash dividends cannot be in the best interests of current shareholders.

75. Financial managers should only accept investment projects that:

A. increase the current profits of the firm.
B. can increase the firm’s market share.
C. earn a higher rate of return than the firm currently earns on its existing projects.
D. earn a higher rate of return than shareholders can get by investing on their own.

76. Agency problems can least be controlled by:

A. establishing good internal controls and procedures.
B. designing compensation packages that align manager’s goals with those of the shareholders.
C. corporate governance.
D. electing senior managers to the board of directors.
77. Which one of these best defines the objective of a well-functioning financial market?

A. Establishing accurate security prices
B. Creating higher security prices
C. Eliminating short-selling profits
D. Increasing shareholder value by any means possible

78. Corporate raiders will be looked upon most favorably if they:

A. divide up large profitable entities.
B. take actions that increase current shareholder wealth.
C. create value for themselves through their actions.
D. change the capital structure of a firm by increasing its debt.

79. Ethical decision making by management has a payoff for shareholders in terms of:

A. improved capital structure.
B. enhanced firm reputation value.
C. increased managerial benefits.
D. higher current dividend payments.

80. Ethical decision making in business:

A. reduces the firm's profits.
B. requires adherence to implied rules as well as written rules.
C. is not in the best interests of shareholders.
D. is less important than good capital budgeting decisions.
81. A corporate director:

A. is selected by and can be removed by management.
B. can be voted out of power by the shareholders.
C. has a lifetime appointment to the board.
D. is selected by a vote of all corporate stakeholders.

82. In which of the following organizations would agency problems be *least* likely to occur?

A. A sole proprietorship
B. A partnership
C. A corporation
D. A closely held corporation

83. Sole proprietorships resolve the issue of agency problems primarily by:

A. avoiding excessive expense accounts.
B. discharging those who violate the rules.
C. allowing owners to share the cost of their actions with others.
D. forcing owners to bear the full cost of their actions.

84. Agency problems can best be characterized as:

A. dislike of firm's bondholders by its equityholders.
B. differing incentives between managers and owners.
C. spending of corporate resources.
D. friction between managers and employees.
85. Which of the following is least likely to represent an agency problem?

A. Lavish spending on expense accounts
B. Plush remodeling of the executive suite
C. Excessive avoidance of taxes
D. Executive incentive compensation plans

86. When managers' compensation plans are tied in a meaningful manner to the profits of the firm, agency problems:

A. can be reduced.
B. will be created.
C. are shifted to other stakeholders.
D. are eliminated entirely from the firm.

87. A firm's reputation:

A. has no value.
B. is an important firm asset.
C. is irrelevant to shareholders.
D. can be easily restored once damaged.
88. Which of the following groups is least likely to be considered a stakeholder of the firm?

A. Government  
B. Customers  
C. Competitors  
D. Employees

89. A manager’s compensation plan that offers financial incentives for increases in quarterly profitability may create agency problems in that:

A. the managers are not motivated by personal gain.  
B. the board of directors may claim the credit.  
C. short-term, not long-term profits become the focus.  
D. investors desire stable profits.

90. One continuing problem with managerial incentive compensation plans is that:

A. the plans increase agency problems.  
B. managers prefer guaranteed salaries.  
C. their effectiveness is difficult to evaluate.  
D. the plans do not reward shareholders.
91. Which one of the following forms of compensation is most apt to align the interests of managers and shareholders?

A. A fixed salary
B. A salary that is linked to current company profits
C. A salary that is paid partly in the form of the company's shares
D. A salary that is linked to the company's market share

92. Which of the following is a real asset?

A. A patent
B. A share of stock issued by Bank of New York
C. An IOU ("I owe you") from your brother-in-law
D. A mortgage loan taken out to help pay for a new home

93. Which one of these statements is correct?

A. A dollar received next year has the same value as a dollar received today.
B. Risky cash flows are more valuable than certain cash flows.
C. Smart investment decisions create more value than smart financing decisions.
D. Corporate governance is irrelevant.
94. Short selling involves selling a security:

A. you do not own.
B. that you have owned for less than one year.
C. at a price below current market value.
D. for less than you originally paid to purchase it.

Essay Questions

95. What general factors may influence the decision of whether to organize as a sole proprietorship, a partnership, or a corporation?
96. Discuss why corporations typically exhibit separation of ownership and management, as distinguished from sole proprietorships or partnerships.

97. Why is limited liability such an important aspect to investors?

98. Provide at least three examples each of real and financial assets that might appear on the balance sheet of General Motors.
99. Distinguish between a firm's capital budgeting decisions and its financing decisions by giving examples of each.

100. Discuss the interrelationship between a firm's financing and its capital structure decisions.

101. Who are the financial managers in large corporations?
102. Fritz and Frieda went to business school together 10 years ago. They have just been hired by a midsized corporation that wants to bring in new financial managers. Fritz studied finance, with an emphasis on financial markets and institutions. Frieda majored in accounting and became a CPA 5 years ago. Who is more suited to be treasurer and who controller? Briefly explain.

103. Provide examples of managerial goals other than the maximization of market value.
104. Provide at least two recent examples of unethical behavior by company executives and the results of that behavior.

105. Develop a case for the interrelationship of ethical decision making by corporate management and profitability of the firm.

106. Is there a conflict between "doing well" and "doing good"? When there are conflicts, how may government regulations or laws tilt the firm toward doing good?
107. Describe agency problems in general, and offer at least three examples from corporations.

108. Complete the table below that compares the differences among corporations, sole proprietorships, and general partnerships.

<table>
<thead>
<tr>
<th></th>
<th>Sole Proprietorship</th>
<th>General Partnership</th>
<th>Corporation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Who owns the business?</td>
<td></td>
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<tr>
<td>Are the managers and owner(s) separate?</td>
<td></td>
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<tr>
<td>What is the owner’s liability?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Are the owner(s) and business taxed separately?</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
109. What two major decisions are made by financial managers?

110. What does "real asset" mean?

111. Who is a financial manager?
112. Why does it make sense for corporations to maximize their market value?

113. Is value maximization always ethical?

114. How do corporations ensure that managers' and stockholders' interests coincide?
115. What actions can shareholders take when the corporation is underperforming and the board of directors is not aggressive in holding managers to task?
Chapter 01 Goals and Governance of the Corporation Answer Key

True / False Questions

1. The liability of sole proprietors is limited to the amount of their investment in the company.

   FALSE

   AACSB: Communication
   Accessibility: Keyboard Navigation
   Blooms: Understand
   Difficulty: 1 Easy
   Learning Objective: 01-03 Cite some of the advantages and disadvantages of organizing a business as a corporation.
   Topic: Forms of business organization

2. General partners have limited personal liability for business debts in a limited partnership.

   FALSE

   AACSB: Communication
   Accessibility: Keyboard Navigation
   Blooms: Understand
   Difficulty: 1 Easy
   Learning Objective: 01-03 Cite some of the advantages and disadvantages of organizing a business as a corporation.
   Topic: Forms of business organization
3. The separation of ownership and management is one distinctive feature of corporations.

TRUE

AACSB: Reflective Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 1 Easy

Learning Objective: 01-03 Cite some of the advantages and disadvantages of organizing a business as a corporation.
Topic: Forms of business organization

4. A major disadvantage of partnerships is that they have double taxation of profits.

FALSE

AACSB: Communication
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 1 Easy

Learning Objective: 01-03 Cite some of the advantages and disadvantages of organizing a business as a corporation.
Topic: Forms of business organization

5. Financial assets have value because they are claims on the firm's real assets and the cash that those assets will produce.

TRUE

AACSB: Reflective Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 1 Easy

Learning Objective: 01-02 Distinguish between real and financial assets.
Topic: Financial management decisions
6. Capital budgeting decisions are used to determine how to raise the cash necessary for investments.

FALSE

AACSB: Reflective Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 01-01 Give examples of the investment and financing decisions that financial managers make.
Topic: Financial management decisions

7. A successful investment is one that increases the value of the firm.

TRUE

AACSB: Reflective Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 01-01 Give examples of the investment and financing decisions that financial managers make.
Topic: Goal of financial management

8. Facebook's decision to spend $700 million to acquire Instagram is an investment decision.

TRUE

AACSB: Reflective Thinking
Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: 1 Easy

Learning Objective: 01-01 Give examples of the investment and financing decisions that financial managers make.
Topic: Financial management decisions
9. Boards of directors are generally appointed by the firm's senior officers.

**FALSE**

AACSB: Reflective Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 1 Easy

Learning Objective: 01-03 Cite some of the advantages and disadvantages of organizing a business as a corporation.
Topic: Management organization and roles

10. Financial analysts are involved in monitoring and controlling the risk associated with investment projects and financing decisions.

**TRUE**

AACSB: Communication
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 2 Medium

Learning Objective: 01-04 Describe the responsibilities of the CFO; treasurer; and controller.
Topic: Management organization and roles

11. The primary goal of any company should be to maximize current period profits.

**FALSE**

AACSB: Reflective Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 01-05 Explain why maximizing market value is the natural financial goal of the corporation.
Topic: Goal of financial management
12. Maximizing profits is the same as maximizing the value of the firm.

FALSE

AACSB: Reflective Thinking
Accessibility: Keyboard Navigation
Blooms: Analyze
Difficulty: 2 Medium

Learning Objective: 01-05 Explain why maximizing market value is the natural financial goal of the corporation.
Topic: Goal of financial management

13. The Dodd-Frank financial reform law in 2010 granted shareholders a binding vote on executive compensation.

FALSE

AACSB: Ethics
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 1 Easy

Learning Objective: 01-06 Understand what is meant by "agency problems" and cite some of the ways that corporate governance helps mitigate agency problems.
Topic: Ethics, governance, and regulation

14. Sole proprietorships face the same agency problems as those associated with corporations.

FALSE

AACSB: Ethics
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 1 Easy

Learning Objective: 01-06 Understand what is meant by "agency problems" and cite some of the ways that corporate governance helps mitigate agency problems.
Topic: Agency costs and problems
15. Real assets can be intangible assets.

TRUE

AACSB: Reflective Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 01-02 Distinguish between real and financial assets.
Topic: Financial management decisions

16. Making good investment and financing decisions is the chief task of the financial manager.

TRUE

AACSB: Reflective Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 01-01 Give examples of the investment and financing decisions that financial managers make.
Topic: Management organization and roles

17. If a project's value is less than its required investment, then the project is financially attractive.

FALSE

AACSB: Analytic
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 01-01 Give examples of the investment and financing decisions that financial managers make.
Topic: Goal of financial management
18. GlaxoSmithKline's spending of $6 billion in 2012 on research and development of new drugs is a capital budgeting decision but not a financing decision.

TRUE

AACSB: Reflective Thinking
Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: 2 Medium

Learning Objective: 01-01 Give examples of the investment and financing decisions that financial managers make.
Topic: Financial management decisions

19. Volkswagen's issuance of a 2.5 billion euro convertible bond is a financing decision.

TRUE

AACSB: Reflective Thinking
Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: 2 Medium

Learning Objective: 01-01 Give examples of the investment and financing decisions that financial managers make.
Topic: Financial management decisions

20. An IOU ("I owe you") from your brother-in-law is a financial asset.

TRUE

AACSB: Reflective Thinking
Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: 2 Medium

Learning Objective: 01-02 Distinguish between real and financial assets.
Topic: Financial management decisions
21. The separation of ownership and management is one distinctive feature of both corporations and sole proprietors.

**FALSE**

AACSB: Reflective Thinking  
Accessibility: Keyboard Navigation  
Blooms: Understand  
Difficulty: 2 Medium

**Learning Objective:** 01-03 Cite some of the advantages and disadvantages of organizing a business as a corporation.  
**Topic:** Forms of business organization

22. Shareholders welcome higher short-term profits even when they damage long-term profits.

**FALSE**

AACSB: Reflective Thinking  
Accessibility: Keyboard Navigation  
Blooms: Apply  
Difficulty: 2 Medium

**Learning Objective:** 01-05 Explain why maximizing market value is the natural financial goal of the corporation.  
**Topic:** Goal of financial management

23. A well-designed compensation package can help a firm achieve its goal of maximizing market value.

**TRUE**

AACSB: Ethics  
Accessibility: Keyboard Navigation  
Blooms: Apply  
Difficulty: 2 Medium

**Learning Objective:** 01-06 Understand what is meant by “agency problems” and cite some of the ways that corporate governance helps mitigate agency problems.  
**Topic:** Agency costs and problems
24. While control of large public companies in the United States is exercised through the board of directors and pressure from the stock market, in many other countries the stock market is less important and control shifts to major stockholders, typically banks and other companies.

**TRUE**

AACSB: Diversity
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 2 Medium

Learning Objective: 01-03 Cite some of the advantages and disadvantages of organizing a business as a corporation.

Topic: Management organization and roles

25. Established firms can create value by developing long-term relationships and maintaining a good reputation.

**TRUE**

AACSB: Ethics
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 01-06 Understand what is meant by "agency problems" and cite some of the ways that corporate governance helps mitigate agency problems.

Topic: Goal of financial management

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Multiple Choice Questions
26. Which one of these is a disadvantage of the corporate form of business?

A. Access to capital  
B. Unlimited personal liability for owners  
C. Limited firm life  
D. Legal requirements

AACSB: Reflective Thinking  
Accessibility: Keyboard Navigation  
Blooms: Understand  
Difficulty: 1 Easy

Learning Objective: 01-03 Cite some of the advantages and disadvantages of organizing a business as a corporation.  
Topic: Forms of business organization

27. Which one of the following gives a corporation its permanence?

A. Multiple owners  
B. Limited liability  
C. Corporation taxation  
D. Separation of ownership and control

AACSB: Reflective Thinking  
Accessibility: Keyboard Navigation  
Blooms: Understand  
Difficulty: 2 Medium

Learning Objective: 01-03 Cite some of the advantages and disadvantages of organizing a business as a corporation.  
Topic: Forms of business organization
28. In a partnership form of organization, income tax liability, if any, is incurred by:

A. the partnership itself.
B. the partners individually.
C. both the partnership and the partners.
D. neither the partnership nor the partners.

AACSB: Communication
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 2 Medium

Learning Objective: 01-03 Cite some of the advantages and disadvantages of organizing a business as a corporation.
Topic: Forms of business organization

29. Which one of the following would correctly differentiate general partners from limited partners in a limited partnership?

A. General partners have more job experience.
B. General partners have an ownership interest.
C. General partners are subject to double taxation.
D. General partners have unlimited personal liability.

AACSB: Communication
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 2 Medium

Learning Objective: 01-03 Cite some of the advantages and disadvantages of organizing a business as a corporation.
Topic: Forms of business organization
30. Which form of organization provides limited liability for the firm but yet allows the professionals working within that firm to be sued personally?

A. Limited liability partnership
B. Limited liability company
C. Sole proprietorship
D. Professional corporation

31. Which of the following is least likely to be discussed in the articles of incorporation?

A. How the firm is to be financed
B. The purpose of the business
C. The price range of the shares of stock
D. How the board of directors is to be structured
32. When a corporation fails, the maximum that can be lost by an individual shareholder is:

   A. the amount of their initial investment.
   B. the amount of their share of the profits.
   C. their proportionate share required to pay the corporation's debts.
   D. the amount of their personal wealth.

33. Which of the following is a disadvantage to incorporating a business?

   A. Easier access to financial markets
   B. Limited liability
   C. Becoming a permanent legal entity
   D. Profits taxed at the corporate level and the shareholder level
34. Unlimited liability is faced by the owners of:

A. corporations.
B. partnerships and corporations.
C. sole proprietorships and general partnerships.
D. all forms of business organization.

Learning Objective: 01-03 Cite some of the advantages and disadvantages of organizing a business as a corporation.
Topic: Forms of business organization

35. Which one of these statements correctly applies to a limited partnership?

A. All partners share the daily management duties.
B. All partners enjoy limited personal liability.
C. General partners have unlimited personal liability.
D. Taxes are imposed at both the firm and the personal level on profits earned.

Learning Objective: 01-03 Cite some of the advantages and disadvantages of organizing a business as a corporation.
Topic: Forms of business organization
36. In the case of a limited liability partnership, ________ has/have limited liability.

A. only some of partners
B. only the managing partner
C. all of the partners
D. none of the partners

AACSB: Reflective Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 2 Medium
Learning Objective: 01-03 Cite some of the advantages and disadvantages of organizing a business as a corporation.
Topic: Forms of business organization

37. A board of directors is elected as a representative of the corporation's:

A. top management.
B. stakeholders.
C. shareholders.
D. customers.

AACSB: Reflective Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 2 Medium
Learning Objective: 01-03 Cite some of the advantages and disadvantages of organizing a business as a corporation.
Topic: Management organization and roles
38. The legal "life" of a corporation is:

A. coincidental with that of its CEO.
B. equal to the life of its board of directors.
C. permanent, as long as shareholders don't change.
D. permanent, regardless of current ownership.

39. When the management of a business is conducted by individuals other than the owners, the business is most likely to be a:

A. corporation.
B. sole proprietorship.
C. partnership.
D. general partner.
40. "Double taxation" refers to:

A. all partners paying equal taxes on profits.
B. corporations paying taxes on both dividends and retained earnings.
C. paying taxes on profits at the corporate level and dividends at the personal level.
D. the fact that marginal tax rates are doubled for corporations.

Learning Objective: 01-03 Cite some of the advantages and disadvantages of organizing a business as a corporation.
Topic: Forms of business organization

41. A corporation is considered to be closely held when:

A. only a few shareholders exist.
B. the market value of the shares is stable.
C. it operates in a small geographic area.
D. management also serves as the board of directors.

Learning Objective: 01-03 Cite some of the advantages and disadvantages of organizing a business as a corporation.
Topic: Forms of business organization
42. Corporations are referred to as public companies when their:

A. shareholders have no tax liability.
B. shares are held by the federal or state government.
C. stock is publicly traded.
D. products or services are available to the public.

AACSB: Communication
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Easy

Learning Objective: 01-03 Cite some of the advantages and disadvantages of organizing a business as a corporation.
Topic: Forms of business organization

43. A common problem for closely held corporations is:

A. the lack of access to substantial amounts of capital.
B. the restriction that shareholders receive only one vote each.
C. the separation of ownership and management.
D. an abundance of agency problems.

AACSB: Reflective Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 01-03 Cite some of the advantages and disadvantages of organizing a business as a corporation.
Topic: Forms of business organization
44. Corporate managers are expected to make corporate decisions that are in the best interest of:

A. top corporate management.
B. the corporation's board of directors.
C. the corporation's shareholders.
D. all corporate employees.

AACSB: Reflective Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 01-05 Explain why maximizing market value is the natural financial goal of the corporation.
Topic: Goal of financial management

45. Which one of the following is a financial asset?

A. A corporate bond
B. A machine
C. A patent
D. A factory

AACSB: Reflective Thinking
Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: 2 Medium

Learning Objective: 01-02 Distinguish between real and financial assets.
Topic: Financial management decisions
46. Which of the following statements best distinguishes the difference between real and financial assets?

A. Real assets have less value than financial assets.
B. Real assets are tangible; financial assets are not.
C. Financial assets represent claims to income that is generated by real assets.
D. Financial assets appreciate in value; real assets depreciate in value.

AACSB: Reflective Thinking  
Accessibility: Keyboard Navigation  
Blooms: Understand  
Difficulty: 2 Medium  
Learning Objective: 01-02 Distinguish between real and financial assets.
Topic: Financial management decisions

47. Which one of the following is a real asset?

A. A patent
B. A personal IOU
C. A checking account balance
D. A share of stock

AACSB: Reflective Thinking  
Accessibility: Keyboard Navigation  
Blooms: Apply  
Difficulty: 2 Medium  
Learning Objective: 01-02 Distinguish between real and financial assets.
Topic: Financial management decisions
48. Which one of these is *not* considered to be a security?

A. Shares of GE stock  
B. A bond traded in the financial market  
C. A mortgage loan issued and held by a bank  
D. A convertible bond issued to the public

AACSB: Reflective Thinking  
Accessibility: Keyboard Navigation  
Blooms: Apply  
Difficulty: 2 Medium  
Learning Objective: 01-02 Distinguish between real and financial assets.  
Topic: Financial management decisions

49. Corporations that issue financial securities such as stock or debt obligations to the public do so primarily to:

A. increase sales.  
B. become profitable.  
C. increase their access to funds.  
D. avoid double taxation of their profits.

AACSB: Reflective Thinking  
Accessibility: Keyboard Navigation  
Blooms: Understand  
Difficulty: 2 Medium  
Learning Objective: 01-01 Give examples of the investment and financing decisions that financial managers make.  
Topic: Forms of business organization
50. Which one of the following would be considered a capital budgeting decision?

A. Planning to issue common stock rather than issuing preferred stock
B. Deciding to expand into a new line of products, at a cost of $5 million
C. Repurchasing shares of common stock
D. Issuing debt in the form of long-term bonds

51. Which one of these is a capital budgeting decision?

A. Deciding between issuing stock or debt securities
B. Deciding whether or not the firm should go public
C. Deciding if the firm should repurchase some of its outstanding shares
D. Deciding whether to buy a new machine or repair the old machine
52. The best criterion for success in a capital budgeting decision would be to:

A. minimize the cost of the investment.
B. maximize the number of capital budgeting projects.
C. maximize the value added to the firm.
D. finance all capital budgeting projects with debt.

AACSB: Reflective Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 2 Medium
Learning Objective: 01-01 Give examples of the investment and financing decisions that financial managers make.
Topic: Goal of financial management

53. The overall goal of capital budgeting projects should be to:

A. decrease the firm's reliance on debt.
B. increase the firm's sales.
C. increase the firm's outstanding shares of stock.
D. increase the wealth of the firm's shareholders.

AACSB: Reflective Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 2 Medium
Learning Objective: 01-01 Give examples of the investment and financing decisions that financial managers make.
Topic: Goal of financial management
54. An example of a firm's financing decision would be:

A. acquiring a competitive firm.
B. determining how much to pay for a specific asset.
C. issuing 10-year versus 20-year bonds.
D. deciding whether or not to increase the price of its products.

55. Which of the following is a *capital budgeting* decision?

A. Should the firm borrow money from a bank or sell bonds?
B. Should the firm shut down an unprofitable factory?
C. Should the firm buy or lease a new machine that it is committed to acquiring?
D. Should the firm issue preferred stock or common stock?
56. Which of these duties are responsibilities of the corporate treasurer?

A. Financial statements and taxes
B. Cash management and tax reporting
C. Cash management and banking relationships
D. Raising capital and financial statements

AACSB: Communication
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Easy

Learning Objective: 01-04 Describe the responsibilities of the CFO; treasurer; and controller.
Topic: Management organization and roles

57. The term "capital structure" refers to:

A. the manner in which a firm obtains its long-term sources of funding.
B. the length of time needed to repay debt.
C. whether or not the firm invests in capital budgeting projects.
D. the types of assets a firm acquires.

AACSB: Reflective Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 1 Easy

Learning Objective: 01-01 Give examples of the investment and financing decisions that financial managers make.
Topic: Capital structure
58. Firms can alter their capital structure by:

A. not accepting any new capital budgeting projects.
B. investing in intangible assets.
C. issuing stock to repay debt.
D. becoming a limited liability company.

AACSB: Reflective Thinking
Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: 1 Easy
Learning Objective: 01-01 Give examples of the investment and financing decisions that financial managers make.
Topic: Capital structure

59. Which one of these statements is correct?

A. Financial managers have a fiduciary duty to stockholders.
B. Financial managers are concerned only with funds that flow to investors.
C. The chief financial officer generally reports directly to the corporate treasurer.
D. The corporate controller is primarily responsible for overseeing a firm's cash functions.

AACSB: Reflective Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 2 Medium
Learning Objective: 01-04 Describe the responsibilities of the CFO; treasurer; and controller.
Topic: Management organization and roles
60. A firm decides to pay for a small investment project through a $1 million increase in short-term bank loans. This is best described as an example of a(n):

A. financing decision.
B. investment decision.
C. capital budgeting decision.
D. capital expenditure decision.

AACSB: Reflective Thinking
Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: 1 Easy

Learning Objective: 01-01 Give examples of the investment and financing decisions that financial managers make.

Topic: Financial management decisions

61. The short-term decisions of financial managers are comprised of:

A. capital structure decisions only.
B. investment decisions only.
C. financing decisions only.
D. both investment and financing decisions.

AACSB: Reflective Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 01-01 Give examples of the investment and financing decisions that financial managers make.

Topic: Financial management decisions
62. A block holder is commonly defined as an investor who:

A. owns 5 percent or more of a firm's outstanding shares.
B. invests in more than one firm within the same industry.
C. is another corporation.
D. is also one of the firm's managers or directors.

AACSB: Communication
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Easy
Learning Objective: 01-03 Cite some of the advantages and disadvantages of organizing a business as a corporation.
Topic: Forms of business organization

63. Which of the firm's financial managers is most likely to be involved with obtaining financing for the firm?

A. Treasurer
B. Controller
C. Chief Operating Officer
D. Board of directors

AACSB: Communication
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Easy
Learning Objective: 01-04 Describe the responsibilities of the CFO; treasurer; and controller.
Topic: Management organization and roles
64. In a large corporation, budget preparation would most likely be conducted by the:

A. treasurer.
B. controller.
C. chief financial officer.
D. financial manager.

AACSB: Communication
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Easy
Learning Objective: 01-04 Describe the responsibilities of the CFO; treasurer; and controller.
Topic: Management organization and roles

65. In a firm having both a treasurer and a controller, which of the following would most likely be handled by the controller?

A. Internal auditing
B. Credit management
C. Banking relationships
D. Insurance

AACSB: Communication
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 2 Medium
Learning Objective: 01-04 Describe the responsibilities of the CFO; treasurer; and controller.
Topic: Management organization and roles
66. Which one of the following statements more accurately describes the controller than the treasurer?

A. Reports directly to the chief executive officer  
B. Monitors capital expenditures to make sure that they are not misappropriated  
C. Responsible for investing the firm's spare cash  
D. Responsible for arranging any issue of common stock

67. A chief financial officer would typically:

A. report to the treasurer, but supervise the controller.  
B. report to the controller, but supervise the treasurer.  
C. report to both the treasurer and controller.  
D. supervise both the treasurer and controller.
68. Which one of these determines the minimum acceptable rate of return on a capital investment?

A. The available alternative investment opportunities
B. The profit margin of the existing firm
C. The rate of return on the firm's outstanding shares
D. The rate of return on risk-free debt securities

AACSB: Reflective Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 1 Easy

Learning Objective: 01-01 Give examples of the investment and financing decisions that financial managers make.

Topic: Introduction to corporate finance

69. A financial analyst in a corporation may be involved with all of the following \textit{EXCEPT}:

A. analyzing a new investment project.
B. monitoring risk.
C. managing investment of the company's cash.
D. purchasing the firm's plant and equipment.

AACSB: Reflective Thinking
Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: 1 Easy

Learning Objective: 01-04 Describe the responsibilities of the CFO; treasurer; and controller.

Topic: Management organization and roles
70. Investment banks like Morgan Stanley or Goldman Sachs:

A. collect deposits and relend the cash to corporations and individuals.
B. help companies sell their securities to investors.
C. design and sell insurance policies for businesses.
D. lend to corporations and investors in commercial real estate.

AACSB: Reflective Thinking
Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: 1 Easy

Learning Objective: 01-04 Describe the responsibilities of the CFO; treasurer; and controller.
Topic: Introduction to corporate finance

71. The primary goal of corporate management should be to:

A. maximize the number of shareholders.
B. maximize the firm’s profits.
C. minimize the firm’s costs.
D. maximize the shareholders’ wealth.

AACSB: Reflective Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 01-05 Explain why maximizing market value is the natural financial goal of the corporation.
Topic: Goal of financial management
72. A corporate board of directors should provide support for the top management team:

A. under all circumstances.
B. in all decisions related to cash dividends.
C. only when the board approves of management's actions.
D. if shareholders are pleased with the firm's performance.

AACSB: Ethics
Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: 2 Medium

Learning Objective: 01-07 Explain why unethical behavior does not maximize market value.
Topic: Management organization and roles

73. Which of the following appears to be the most appropriate goal for corporate management?

A. Maximizing market value of the company's shares
B. Maximizing the company's market share
C. Maximizing the current profits of the company
D. Minimizing the company's liabilities

AACSB: Reflective Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 01-05 Explain why maximizing market value is the natural financial goal of the corporation.
Topic: Goal of financial management
74. How may a reduction in cash dividends be in the best interests of current shareholders?

A. A reduction of cash dividends is always in the best interests of current shareholders.
B. The firm will have available cash to increase current investment and future profits.
C. Reduced dividends increase managerial compensation, thus increasing managers’ motivation.
D. A reduction of cash dividends cannot be in the best interests of current shareholders.

75. Financial managers should only accept investment projects that:

A. increase the current profits of the firm.
B. can increase the firm's market share.
C. earn a higher rate of return than the firm currently earns on its existing projects.
D. earn a higher rate of return than shareholders can get by investing on their own.
76. Agency problems can \textit{least} be controlled by:

\begin{itemize}
  \item[A.] establishing good internal controls and procedures.
  \item[B.] designing compensation packages that align manager's goals with those of the shareholders.
  \item[C.] corporate governance.
  \item[D.] electing senior managers to the board of directors.
\end{itemize}

\textit{AACSB: Ethics}
\textit{Accessibility: Keyboard Navigation}
\textit{Blooms: Understand}
\textit{Difficulty: 2 Medium}
\textit{Learning Objective: 01-06 Understand what is meant by "agency problems" and cite some of the ways that corporate governance helps mitigate agency problems.}
\textit{Topic: Agency costs and problems}

77. Which one of these best defines the objective of a well-functioning financial market?

\begin{itemize}
  \item[A.] Establishing accurate security prices
  \item[B.] Creating higher security prices
  \item[C.] Eliminating short-selling profits
  \item[D.] Increasing shareholder value by any means possible
\end{itemize}

\textit{AACSB: Ethics}
\textit{Accessibility: Keyboard Navigation}
\textit{Blooms: Understand}
\textit{Difficulty: 1 Easy}
\textit{Learning Objective: 01-06 Understand what is meant by "agency problems" and cite some of the ways that corporate governance helps mitigate agency problems.}
\textit{Topic: Introduction to corporate finance}
78. Corporate raiders will be looked upon most favorably if they:

A. divide up large profitable entities.

B. take actions that increase current shareholder wealth.

C. create value for themselves through their actions.

D. change the capital structure of a firm by increasing its debt.

79. Ethical decision making by management has a payoff for shareholders in terms of:

A. improved capital structure.

B. enhanced firm reputation value.

C. increased managerial benefits.

D. higher current dividend payments.
80. Ethical decision making in business:

A. reduces the firm’s profits.

B. requires adherence to implied rules as well as written rules.

C. is not in the best interests of shareholders.

D. is less important than good capital budgeting decisions.

AACSB: Ethics
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 3 Hard

Learning Objective: 01-07 Explain why unethical behavior does not maximize market value.
Topic: Ethics, governance, and regulation

81. A corporate director:

A. is selected by and can be removed by management.

B. can be voted out of power by the shareholders.

C. has a lifetime appointment to the board.

D. is selected by a vote of all corporate stakeholders.

AACSB: Communication
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 2 Medium

Learning Objective: 01-06 Understand what is meant by "agency problems" and cite some of the ways that corporate governance helps mitigate agency problems.
Topic: Management organization and roles
82. In which of the following organizations would agency problems be *least* likely to occur?

A. A sole proprietorship  
B. A partnership  
C. A corporation  
D. A closely held corporation

83. Sole proprietorships resolve the issue of agency problems primarily by:

A. avoiding excessive expense accounts.  
B. discharging those who violate the rules.  
C. allowing owners to share the cost of their actions with others.  
D. forcing owners to bear the full cost of their actions.
84. Agency problems can best be characterized as:

A. dislike of firm’s bondholders by its equityholders.
B. differing incentives between managers and owners.
C. spending of corporate resources.
D. friction between managers and employees.

85. Which of the following is least likely to represent an agency problem?

A. Lavish spending on expense accounts
B. Plush remodeling of the executive suite
C. Excessive avoidance of taxes
D. Executive incentive compensation plans
86. When managers’ compensation plans are tied in a meaningful manner to the profits of the firm, agency problems:

A. can be reduced.
B. will be created.
C. are shifted to other stakeholders.
D. are eliminated entirely from the firm.

AACSB: Ethics
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 01-06 Understand what is meant by "agency problems" and cite some of the ways that corporate governance helps mitigate agency problems.
Topic: Agency costs and problems

87. A firm's reputation:

A. has no value.
B. is an important firm asset.
C. is irrelevant to shareholders.
D. can be easily restored once damaged.

AACSB: Ethics
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 01-07 Explain why unethical behavior does not maximize market value.
Topic: Goal of financial management
88. Which of the following groups is least likely to be considered a stakeholder of the firm?

A. Government
B. Customers
C. Competitors
D. Employees

89. A manager's compensation plan that offers financial incentives for increases in quarterly profitability may create agency problems in that:

A. the managers are not motivated by personal gain.
B. the board of directors may claim the credit.
C. short-term, not long-term profits become the focus.
D. investors desire stable profits.
90. One continuing problem with managerial incentive compensation plans is that:

A. the plans increase agency problems.
B. managers prefer guaranteed salaries.
C. their effectiveness is difficult to evaluate.
D. the plans do not reward shareholders.

AACSB: Reflective Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 01-06 Understand what is meant by “agency problems” and cite some of the ways that corporate governance helps mitigate agency problems.

Topic: Agency costs and problems

91. Which one of the following forms of compensation is most apt to align the interests of managers and shareholders?

A. A fixed salary
B. A salary that is linked to current company profits
C. A salary that is paid partly in the form of the company’s shares
D. A salary that is linked to the company’s market share

AACSB: Reflective Thinking
Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: 2 Medium

Learning Objective: 01-06 Understand what is meant by “agency problems” and cite some of the ways that corporate governance helps mitigate agency problems.

Topic: Agency costs and problems
92. Which of the following is a real asset?

A. A patent
B. A share of stock issued by Bank of New York
C. An IOU ("I owe you") from your brother-in-law
D. A mortgage loan taken out to help pay for a new home

AACSB: Reflective Thinking
Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: 2 Medium
Learning Objective: 01-02 Distinguish between real and financial assets.
Topic: Financial management decisions

93. Which one of these statements is correct?

A. A dollar received next year has the same value as a dollar received today.
B. Risky cash flows are more valuable than certain cash flows.
C. Smart investment decisions create more value than smart financing decisions.
D. Corporate governance is irrelevant.

AACSB: Reflective Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 2 Medium
Learning Objective: 01-01 Give examples of the investment and financing decisions that financial managers make.
Topic: Introduction to corporate finance
94. Short selling involves selling a security:

A. you do not own.
B. that you have owned for less than one year.
C. at a price below current market value.
D. for less than you originally paid to purchase it.

AACSB: Ethics
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 1 Easy

Learning Objective: 01-07 Explain why unethical behavior does not maximize market value.
Topic: Introduction to corporate finance

Essay Questions
95. What general factors may influence the decision of whether to organize as a sole proprietorship, a partnership, or a corporation?

Factors that may influence the decision concerning organizational form would include the amount of capital needed in relation to amount of capital that can be raised, estimated sales volume, extent of managerial expertise, willingness to share profits, importance of limited liability, desire for the permanence of the organization, and the issue of double taxation.

AACSB: Analytic
Blooms: Analyze
Difficulty: 2 Medium

Learning Objective: 01-03 Cite some of the advantages and disadvantages of organizing a business as a corporation.

Topic: Forms of business organization
96. Discuss why corporations typically exhibit separation of ownership and management, as distinguished from sole proprietorships or partnerships.

One reason corporations typically exhibit a separation of ownership and management is that ownership often includes a diverse number of relatively small investors and it would be nearly impossible to coordinate their decision making. Also, many small investors prefer not to take on management responsibilities, and to relinquish those duties to managers who have been hired specifically for that function, resulting in higher quality management. Finally, the separation minimizes managerial disruptions that would occur with changing or deceased investors. On the other hand, most sole proprietorships and partnerships are smaller firms that do not need, may not be able to afford, and may not desire separate management.

AACSB: Analytic
Blooms: Analyze
Difficulty: 2 Medium

Learning Objective: 01-03 Cite some of the advantages and disadvantages of organizing a business as a corporation.
Topic: Forms of business organization
Many investors would not be willing to commit their funds to projects if they knew that they were risking more than those specific funds. Specifically in the case of separated ownership and management, shareholders may be unwilling to remain liable for decisions they did not have a hand in making. With the aversion to risk that is witnessed in general for many investors, it is questionable whether investors would direct their funds into financial assets that did not offer limited liability. Thus, the existence of limited liability may greatly affect the demand for corporate shares.

AACSB: Analytic
Blooms: Analyze
Difficulty: 2 Medium

Learning Objective: 01-03 Cite some of the advantages and disadvantages of organizing a business as a corporation.

Topic: Forms of business organization
Provide at least three examples each of real and financial assets that might appear on the balance sheet of General Motors.

Examples of real assets for General Motors include cash, raw materials inventory, production facilities, tools and machines, and finished inventory of automobiles. Examples of financial assets that could have been issued by General Motors are common stock (different classes), preferred stock, corporate bonds, and bank loans. Of course, GM could show financial assets on the left side of its balance sheet also, such as short-term investments in U.S. government securities, contracts receivable from the financing of its automobiles, or possibly residential mortgages (GM, through its subsidiaries, is a large originator of residential mortgages, although most would eventually be sold in the secondary market).
99. Distinguish between a firm's capital budgeting decisions and its financing decisions by giving examples of each.

Examples of a firm's capital budgeting decisions include the decision to replace all of the firm's personal computers, to expand the size of the production facility, to buy a corporate jet, to expand production into two new product lines, and so on. Examples of a firm's financing decisions include the decision to issue corporate bonds rather than expand a bank loan, to float a new issue of common stock, to denominate a loan in Japanese yen rather than U.S. dollars, to roll over short-term financing rather than borrow for a longer term, and so forth.

AACSB: Communication
Blooms: Remember
Difficulty: 2 Medium

Learning Objective: 01-01 Give examples of the investment and financing decisions that financial managers make.
Topic: Financial management decisions
100. Discuss the interrelationship between a firm’s financing and its capital structure decisions.

Although capital budgeting decisions consider what to invest in and specifically how much to invest, capital structure decisions are related to how the necessary funds should be raised. For example, if many other firms of similar risk have recently issued bonds, the supply of loanable funds may be low, which could affect the interest rate on such funds. Or, the current market value of common stock may be so low that management would prefer not to issue additional shares at this time. Alternatively, the existence of loan or bond covenants could restrict certain forms of borrowing. Finally, although certain forms of financing may appear attractive, they may not represent the targeted capital structure. Thus, elements of the financing decision need to be considered simultaneously with the capital budgeting decision.

AACSB: Analytic
Blooms: Analyze
Difficulty: 2 Medium

Learning Objective: 01-01 Give examples of the investment and financing decisions that financial managers make.

Topic: Financial management decisions
101. Who are the financial managers in large corporations?

The treasurer is responsible for looking after the firm's cash, raising new capital, and maintaining relationships with banks and other investors who hold the firm's securities. Larger corporations usually also have a controller, who prepares the financial statements, manages the firm's internal budgets and accounting, and looks after its tax affairs. Large corporations often appoint a chief financial officer (CFO) to oversee both the treasurer's and the controller's work.

*AACSB: Communication*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 01-04 Describe the responsibilities of the CFO; treasurer; and controller.*

*Topic: Management organization and roles*
102. Fritz and Frieda went to business school together 10 years ago. They have just been hired by a midsized corporation that wants to bring in new financial managers. Fritz studied finance, with an emphasis on financial markets and institutions. Frieda majored in accounting and became a CPA 5 years ago. Who is more suited to be treasurer and who controller? Briefly explain.

Fritz would more likely be the treasurer and Frieda the controller. The treasurer raises money from the financial markets and requires a background in financial institutions. The controller requires a background in accounting.

AACSB: Analytic
Blooms: Analyze
Difficulty: 1 Easy

Learning Objective: 01-04 Describe the responsibilities of the CFO; treasurer; and controller.
Topic: Management organization and roles
Provide examples of managerial goals other than the maximization of market value.

Managers may attempt to maximize profits, or to maximize market share, or even to maximize their own benefits! Problems with maximizing profits can include the method of maximizing (i.e., is it in the long-run or short-run best interests of the firm?), the maintenance of product quality, ethical decision making, customer satisfaction, and so on. Problems with market share can include economies of scale (i.e., low average cost of production), maintained profitability, increased liabilities, and so forth. Agency problems that relate to managerial compensation or perquisites that are not in the long-run interest of shareholders are another example of misguided goals.

AACSB: Reflective Thinking
Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 01-05 Explain why maximizing market value is the natural financial goal of the corporation.

Topic: Goal of financial management
Provide at least two recent examples of unethical behavior by company executives and the results of that behavior.

Denis Kozlowski, the former CEO of Tyco, charged $1 million to the firm for a birthday party for his wife and as a result, was sentenced to jail. Bernard Madoff ran a Ponzi scheme, bilked investors out of millions, and is currently sentenced to jail for essentially the remainder of his life. His firm no longer exists. (These are just two examples, students may have more.)

AACSB: Ethics
Blooms: Apply
Difficulty: 2 Medium

Learning Objective: 01-07 Explain why unethical behavior does not maximize market value.

Topic: Ethics, governance, and regulation
105. Develop a case for the interrelationship of ethical decision making by corporate management and profitability of the firm.

Ethical decision making can have an important impact on employee attitudes, investor actions, and customer retention. Further, all of these factors can have a large impact on the bottom line. The list of potential benefits for a firm that has developed a reputation for ethical operations can be long—easier employee recruitment, lower employee turnover, easier issue of primary securities, repeat business, and good word of mouth. In other words, the actions of all stakeholders can be positively affected when they perceive the firm to be ethical in its decisions.

AACSB: Ethics
Blooms: Analyze
Difficulty: 2 Medium

Learning Objective: 01-07 Explain why unethical behavior does not maximize market value.

Topic: Ethics, governance, and regulation
106. Is there a conflict between "doing well" and "doing good"? When there are conflicts, how may government regulations or laws tilt the firm toward doing good?

The first step in doing well is doing good by your customers. Businesses cannot prosper for long if they do not provide to their customers the products and services they desire. In addition, reputation effects often make it in the firm's own interest to act ethically toward its business partners and employees since the firm's ability to make deals and to hire skilled labor depends on its reputation for dealing fairly. In some circumstances, when firms have incentives to act in a manner inconsistent with the public interest, taxes or fees can align private and public interests. For example, taxes or fees charged on pollution make it more costly for firms to pollute, thereby affecting the firm's decisions regarding activities that cause pollution. Other "incentives" used by governments to align private interests with public interests include legislation to provide for worker safety and product or consumer safety, building code requirements enforced by local governments, and pollution and gasoline mileage requirements imposed on automobile manufacturers.

AACSB: Ethics
Blooms: Analyze
Difficulty: 2 Medium

Learning Objective: 01-07 Explain why unethical behavior does not maximize market value.

Topic: Ethics, governance, and regulation
Describe agency problems in general, and offer at least three examples from corporations.

Whenever the firm's managers are different than the firm's owners, the potential exists for agency problems. Management may be taking advantage of the fact that corporate ownership is often quite diverse, such that none of the owners appears to be "minding the store." In those cases, it may be easy for top management to vote itself an excessive raise, or to redecorate the corporate suite, or to be lax on the justification of expense reports, or even to invest in projects that are "too safe." Why might managers choose safe projects? For example, the executive may have one year remaining on an employment contract and be more concerned with stable profits than with rising profits.

AACSB: Reflective Thinking
Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 01-06 Understand what is meant by "agency problems" and cite some of the ways that corporate governance helps mitigate agency problems.
Topic: Agency costs and problems
108. Complete the table below that compares the differences among corporations, sole proprietorships, and general partnerships.

<table>
<thead>
<tr>
<th></th>
<th>Sole Proprietorship</th>
<th>General Partnership</th>
<th>Corporation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Who owns the business?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Are the managers and owner(s) separate?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>What is the owner’s liability?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Are the owner(s) and business taxed separately?</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Sole Proprietorship</th>
<th>General Partnership</th>
<th>Corporation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Who owns the business?</td>
<td>Proprietor</td>
<td>Partners</td>
<td>Shareholders</td>
</tr>
<tr>
<td>Are the managers and owner(s) separate?</td>
<td>No</td>
<td>No</td>
<td>Usually</td>
</tr>
<tr>
<td>What is the owner’s liability?</td>
<td>Unlimited</td>
<td>Unlimited</td>
<td>Limited</td>
</tr>
<tr>
<td>Are the owner(s) and business taxed separately?</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
</tbody>
</table>

AACSB: Reflective Thinking
Blooms: Understand
Difficulty: 1 Easy

Learning Objective: 01-03 Cite some of the advantages and disadvantages of organizing a business as a corporation.

Topic: Forms of business organization
109. What two major decisions are made by financial managers?

Financial management can be broken down into (1) the investment, or capital budgeting, decision and (2) the financing decision. The firm has to decide (1) how much to invest and which real assets to invest in and (2) how to raise the necessary cash.

AACSB: Reflective Thinking
Blooms: Understand
Difficulty: Easy

Learning Objective: 01-01 Give examples of the investment and financing decisions that financial managers make.
Topic: Financial management decisions

110. What does "real asset" mean?

Real assets include all assets used in the production or sale of the firm's products or services. Real assets can be tangible (plant and equipment, for example) or intangible (patents or trademarks, for example).

AACSB: Communication
Blooms: Understand
Difficulty: Easy

Learning Objective: 01-02 Distinguish between real and financial assets.
Topic: Financial management decisions
111. Who is a financial manager?

Almost all managers are involved to some degree in investment decisions, but some managers specialize in finance—for example, the treasurer, controller, and CFO.

112. Why does it make sense for corporations to maximize their market value?

Value maximization is the natural financial goal of the firm. Maximizing value maximizes the wealth of the firm’s current owners, its shareholders. Shareholders can invest or consume that wealth as they wish.
113. Is value maximization always ethical?

Modern finance does not condone attempts to pump up stock prices by unethical means, but there need be no conflict between ethics and value maximization. The surest route to maximum value starts with products and services that satisfy customers. A good reputation with customers, employees, and other stakeholders is also important for the firm's long-run profitability and value.

AACSB: Ethics  
Blooms: Apply  
Difficulty: 2 Medium  
Learning Objective: 01-07 Explain why unethical behavior does not maximize market value.  
Topic: Ethics, governance, and regulation

114. How do corporations ensure that managers’ and stockholders’ interests coincide?

Conflicts of interest between managers and stockholders can lead to agency problems. These problems are kept in check by compensation plans that link the well-being of employees to that of the firm; by monitoring of management by the board of directors, security holders, and creditors; and by the threat of takeover.

AACSB: Reflective Thinking  
Blooms: Understand  
Difficulty: 2 Medium  
Learning Objective: 01-06 Understand what is meant by “agency problems” and cite some of the ways that corporate governance helps mitigate agency problems.  
Topic: Agency costs and problems
What actions can shareholders take when the corporation is underperforming and the board of directors is not aggressive in holding managers to task?

If shareholders believe that the corporation is underperforming and the board of directors is not sufficiently aggressive in holding managers to task, they can try to replace the board in the next election. The dissident shareholders will attempt to convince the other shareholders to vote for their slate of candidates to the board. If they succeed, a new board will be elected and it can replace the current management team. Short of that, unhappy shareholders can attempt to elect representatives to the board to make their voices heard.

AACSB: Reflective Thinking
Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 01-06 Understand what is meant by "agency problems" and cite some of the ways that corporate governance helps mitigate agency problems.
Topic: Management organization and roles

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