Test Bank for Fundamentals of Corporate Finance 11th Brealey

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CORRECT ANSWERS ARE LOCATED IN THE 2ND HALF OF THIS DOC.

TRUE/FALSE - Write 'T' if the statement is true and 'F' if the statement is false.

1) Only small companies can go through financial markets to obtain financing.
   - ⦾ true
   - ⦾ false

2) The reinvestment of cash back into the firm's operations is an example of a flow of savings to investment.
   - ⦾ true
   - ⦾ false

3) Smaller businesses are especially dependent upon internally generated funds.
   - ⦾ true
   - ⦾ false

4) An individual can save and invest in a corporation by lending money to it or by purchasing additional shares.
   - ⦾ true
   - ⦾ false

5) Previously issued securities are traded among investors in the secondary markets.
   - ⦾ true
   - ⦾ false

6) Only the IPOs for large corporations are sold in primary markets.
   - ⦾ true
   - ⦾ false

7) Hedge fund managers, unlike mutual fund managers, do not receive fund-performance-related fees.
   - ⦾ true
   - ⦾ false

8) The markets for long-term debt and equity are called capital markets.
   - ⦾ true
   - ⦾ false

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9) The stocks of major corporations trade in many markets throughout the world on a continuous or near-continuous basis.
   - ◎ true
   - ◎ false

10) The market for derivatives is also a source of financing for corporations.
   - ◎ true
   - ◎ false

11) During the Financial Crisis of 2007-2009, the U.S. government bailed out all firms in danger of failing.
   - ◎ true
   - ◎ false

12) In the United States, banks are the most important source of long-term financing for corporations.
   - ◎ true
   - ◎ false

13) A financial intermediary invests in financial assets rather than real assets.
   - ◎ true
   - ◎ false

14) Households hold directly three quarters of U.S. corporate equities.
   - ◎ true
   - ◎ false

15) The key to the banks' ability to make illiquid loans is their ability to pool liquid deposits from thousands of depositors.
   - ◎ true
   - ◎ false

16) From June 2001 to June 2006, house prices in the United States rose sharply.
   - ◎ true
   - ◎ false

17) For corporate bonds, the higher the credit quality of an issuer, the higher the interest rate.
   - ◎ true
   - ◎ false

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18) The cost of capital is the interest rate paid on a loan from a bank or some other financial institution.
   - ◎ true
   - ◎ false

19) Like public companies, private companies can also use their stock price as a measure of performance.
   - ◎ true
   - ◎ false

20) The opportunity cost of capital is the expected rate of return that shareholders can obtain in the financial markets on investments with the same risk as the firm's capital investments.
   - ◎ true
   - ◎ false

21) Once Apple Computer had become a public company, it was able to raise financing from venture capital companies.
   - ◎ true
   - ◎ false

22) Insurance companies provide a mechanism for individuals to pool their risks.
   - ◎ true
   - ◎ false

23) Financial markets and intermediaries allow investors and businesses to reduce and reallocate risk.
   - ◎ true
   - ◎ false

24) The effects of the financial crisis of 2007-2009 were confined to the U.S. and domestic companies.
   - ◎ true
   - ◎ false

25) The cost of capital is the minimum acceptable rate of return for capital investment.
   - ◎ true
   - ◎ false

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26) One root of the financial crisis of 2007-2009 was the strict money policies promoted by the U.S. Federal Reserve and other central banks after the technology bubble burst (i.e., money was relatively expensive during this time).
- ⊚ true
- ⊚ false

27) The rates of return on investments outside the corporation set the minimum acceptable return for investment projects inside the corporation.
- ⊚ true
- ⊚ false

28) Financing for public corporations must flow through financial markets.
- ⊚ true
- ⊚ false

29) Financing for private companies must flow through financial intermediaries such as mutual funds.
- ⊚ true
- ⊚ false

30) Most securities sold via NASDAQ are sold in the secondary market
- ⊚ true
- ⊚ false

31) Almost all foreign exchange trading occurs on the floors of the FOREX exchanges in New York and London.
- ⊚ true
- ⊚ false

32) Exchange traded funds are tied to an index or basket of securities.
- ⊚ true
- ⊚ false

MULTIPLE CHOICE - Choose the one alternative that best completes the statement or answers the question.

33) Corporate financing comes ultimately from:
- A) savings by households and foreign investors.
- B) cash generated from the firm's operations.
- C) the financial markets and intermediaries.
- D) the issue of shares in the firm.

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34) A company can pay for its expansion in all the following ways *except*:
   A) by using the earnings generated from its sale of obsolete equipment.
   B) by persuading a director's mother to make a personal loan to the company.
   C) by purchasing bonds in the secondary market.
   D) by plowing back part of its profits.

35) "Reinvestment" means:
   A) new investment in new operations.
   B) additional investment in existing operations.
   C) new investment by new shareholders.
   D) the reinvestment of earnings into new projects.

36) Financing for public corporations flows through:
   A) the financial markets only.
   B) financial intermediaries only.
   C) derivatives markets.
   D) the financial markets, financial intermediaries, or both.

37) Which security is more efficient because it allows trading throughout the day and does not have managers with discretionary investment authority?
   A) Bond fund

   B) Exchange traded fund
   C) Mutual fund
   D) Stock fund

38) When corporations need to raise funds through stock issues, they rely on the:
   A) primary market.
   B) secondary market.
   C) tertiary market.
   D) centralized NASDAQ exchange.

39) A primary market would be utilized when:
   A) investors buy or sell existing securities.
   B) shares of common stock are exchanged.
   C) securities are initially issued.
   D) a commission must be paid on the transaction.

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40) The primary distinction between securities sold in the primary and secondary markets is:
   A) the riskiness of the securities.
   B) the price of the securities.
   C) whether the securities are new or already exist.
   D) the profitability of the issuing corporation.

41) The New York Stock Exchange mostly serves as what kind of financial market?
   A) Foreign exchange market
   B) Over-the-counter market
   C) Primary market
   D) Secondary market

42) Which of the following are both a financial intermediary and a financial institution?
   A) Mutual funds
   B) Pension funds
   C) Insurance companies
   D) Hedge funds

43) A share of IBM stock is purchased by an individual investor for $75 and later sold to another investor for $125. Who profits from this sale?
   A) IBM
   B) The first investor
   C) The second investor
   D) IBM and both investors

44) Which of the following financial assets is *least* likely to have an active secondary market?
   A) Common stock of a large public firm
   B) Bank loans made to smaller firms
   C) Bonds of a major, multinational corporation
   D) Debt issued by the U.S. Treasury

45) When Patricia sells her General Motors common stock at the same time that Brian purchases the same amount of GM stock, GM receives:
   A) the dollar value of the transaction.
   B) the dollar amount of the transaction, less brokerage fees.
   C) only the par value of the common stock.
   D) nothing.

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46) Which one of these is a money market security?
   - A) Commercial paper
   - B) Common stock
   - C) 2-year bond
   - D) 20-year bond

47) A mother in a developing country wants to borrow the equivalent of $20 to enable her to start a small restaurant run by her family. Which type of financing is she looking to obtain?
   - A) Public bond issue
   - B) IPO
   - C) Micro loan
   - D) Futures contract on a commodity

48) Corporate debt instruments are most commonly traded:
   - A) on the NYSE.
   - B) on NASDAQ.
   - C) in the money market.
   - D) in the over-the-counter market.

49) A bond differs from a share of stock in that a bond:
   - A) represents a claim on the firm.
   - B) has more risk.
   - C) has guaranteed returns.
   - D) has a maturity date.

50) Short-term financing transactions commonly occur in the:
   - A) primary markets.
   - B) secondary markets.
   - C) capital markets.
   - D) money markets.

51) Long-term financing decisions commonly occur in the:
   - A) option markets.
   - B) secondary markets.
   - C) capital markets.
   - D) money markets.

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52) You can buy silver in the:
   A) capital markets.
   B) foreign exchange markets.
   C) commodities markets.
   D) option markets.

53) Commodity and derivative markets:
   A) are additional sources of financing for corporate projects.
   B) enable the financial manager to adjust a firm's exposure to various business risks.
   C) are always over-the-counter markets.
   D) deal only in foreign currencies.

54) Foreign currencies are traded:
   A) only by banks in New York and London.
   B) over-the-counter.
   C) on both the NYSE and NASDAQ.
   D) on the Intercontinental Exchange.

55) Which one of the following statements is *not* characteristic of mutual funds?
   A) They are always considered to be financial institutions.
   B) They raise money by selling shares to investors.
   C) They pool the savings of many investors.
   D) They offer professional management and portfolio diversification.

56) In which of the following financial markets is an investor *least* likely to interact with a public corporation?
   A) Bond market
   B) Foreign exchange market
   C) Primary market
   D) Secondary market

57) Which one of these correctly applies to mutual funds?
   A) Mutual funds are a costly means of achieving portfolio diversification.
   B) Funds are required to limit their annual fees and expenses to less than 1 percent of the portfolio value.
   C) You can generally buy additional shares in the fund at any time.
   D) Shareholders sell their shares to other shareholders.

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58) "Balanced" mutual funds:
   A) invest in both stocks and bonds.
   B) spread their investments equally over a specified geographic area.
   C) spread their investments equally over various industries.
   D) charge a management fee that is proportionate to the investment return.

59) Who was responsible for the financial crisis of 2007-2009?
   A) The U.S. Federal Reserve, only, for its policy of easy money
   B) The U.S. government, only, for pushing banks to expand credit for low-income housing
   C) Bankers, only; they aggressively promoted and resold subprime mortgages
   D) The U.S. Federal Reserve, the U.S. government, rating agencies, and bankers

60) Which one of the following funds provides a tax advantage to individual investors?
   A) Balanced funds
   B) Pension funds
   C) Bond funds
   D) Funds that invest in foreign countries

61) A financial institution:
   A) is a kind of financial intermediary.
   B) simply pools and invests savings.
   C) raises financing by selling shares.
   D) invests primarily in commodities.

62) Which type of financial institution generally does not accept deposits but does underwrite stock offerings?
   A) Insurance company
   B) Mutual fund
   C) Commercial bank
   D) Investment bank

63) Which one of the following financial intermediaries has shown the greatest preference for investing in *long-term* financial assets?
   A) Commercial banks
   B) Insurance companies
   C) Finance companies
   D) Savings banks

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64) Which one of these may provide a financial return to some investors (based on contingency) while not providing any financial return to other investors?
- A) Mutual funds
- B) Pension funds
- C) Insurance companies
- D) Hedge fund

65) Insurance companies can usually cover the claims of policyholders because:
- A) the incidence of claims normally averages out across all policyholders.
- B) they issue a very limited number of policies.
- C) they are fully insured by the U.S. government.
- D) their stockholders will cover any cash shortfalls encountered by the company.

66) Which of the following is *not* typically considered a function of financial intermediaries?
- A) Providing a payment mechanism
- B) Investing in real assets
- C) Accumulating funds from smaller investors
- D) Spreading, or pooling risk among individuals

67) U.S. bonds and other debt securities are mostly held by:
- A) institutional investors.
- B) households.
- C) foreign investors.
- D) state and local governments.

68) Approximately what percentage of U.S. corporate equities are held by households?
- A) 28%
- B) 38%
- C) 48%
- D) 68%

69) Which of the following are major holders of corporate bonds?
- A) Households
- B) Banks
- C) Insurance companies
- D) New York Stock Exchange

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70) Which of the following is not a function of financial markets?
   A) Allow individuals to diversify their risk
   B) Provide convenient ways to make large payments
   C) Allow individuals to purchase a range of goods online
   D) Provide funds to companies that wish to expand

71) Which one of these transports income forward in time?
   A) Retirement savings
   B) Car loan
   C) Bank line of credit
   D) Credit card purchase

72) Which one of these is generally a key difference between U.S. and foreign commercial banks?
   A) Pooling and investing savings
   B) Accepting investor deposits
   C) Providing debt financing to corporations
   D) Making equity investments in corporations

73) One reason suggesting that banks may be better than individuals at matching lenders to borrowers is that banks:
   A) can shift loan risk to their deposit customers.
   B) are motivated by the potential for profit.
   C) do not have any income tax liability.
   D) have information to evaluate creditworthiness.

74) Which one of the following is *least* liquid?
   A) Foreign currency
   B) U.S. Treasury bonds
   C) Real estate
   D) Bank deposit

75) Financial markets and intermediaries:
   A) channel savings to real investment.
   B) increase risks for businesses.
   C) generally reduce the liquidity of securities.
   D) prevent the transportation of cash across time.

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76) Which of the following functions does *not* require financial markets?
   A) Retention of cash by corporations
   B) Provision of liquidity
   C) Risk reduction by investment in diversified portfolios
   D) Provision of pricing information

77) Liquidity is important to a mutual fund primarily because:
   A) a fund that is less liquid will attract more investors.
   B) the fund's shareholders may want to redeem their shares at any time.
   C) new investors may invest in the fund at any time.
   D) the fund requires cash to pay its taxes.

78) Which one of the following is the biggest provider of payment mechanisms?
   A) Hedge funds
   B) Banks
   C) Mutual funds
   D) Insurance companies

79) Which of the following actions does *not* help reduce risk?
   A) Extending the service warranty for your notebook
   B) Converting your money market account to a mutual fund account
   C) Contracting to sell your farm produce to the neighborhood grocery
   D) Buying Japanese yen now when you plan to study in Japan next year when you know the yen value will be increasing

80) Insurance companies primarily reduce an individual's risk by:
   A) transporting that risk forward in time.
   B) providing payment services.
   C) spreading that risk across many individuals.
   D) providing low-interest-rate loans.

81) Which of the following information is *not* provided by the financial markets?
   A) The price of six ounces of gold
   B) The cost of borrowing $500,000 for 5 years
   C) Microsoft's earnings in 2030
   D) The cost of one million yen in U.S. dollars

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82) A capital investment that generates a 10% rate of return is worthwhile if:
   - A) corporate bonds of similar risk offer 8% rates of return.
   - B) corporate bonds of similar risk offer 11% rates of return.
   - C) top-quality corporate bonds offer 10% rates of return.
   - D) the expected rate of return on the stock market is 12%.

83) The cost of capital:
   - A) is the expected rate of return on a capital investment.
   - B) is an opportunity cost determined by the risk-free rate of return.
   - C) is the interest rate that the firm pays on a loan from a bank or insurance company.
   - D) for risky investments is normally higher than the firm's borrowing rate.

84) Excess cash held by a firm should be:
   - A) reinvested by the firm in projects offering the highest rate of return, regardless of risk.
   - B) reinvested by the firm in projects offering rates of return higher than the cost of capital.
   - C) reinvested by the firm in the financial markets.
   - D) distributed to bondholders in the form of extra coupon payments.

85) One contributing factor to the 2007-2009 financial crisis was the structuring of mortgage loans with:
   - A) high initial payments, offset by significantly lower payments later.
   - B) low initial payments, offset by significantly higher payments later.
   - C) high initial payments, offset by high payments later.
   - D) very short maturities.

86) The opportunity cost of capital:
   - A) is the interest rate that the firm pays on a loan from a financial institution.
   - B) is the maximum acceptable rate of return on a project.
   - C) is the minimum acceptable rate of return on a project.
   - D) is always less than 10%.

87) During the Financial Crisis of 2007-2009, the U.S. government bailed out all of the following firms *except:*
   - A) AIG.
   - B) Fannie Mae.
   - C) Lehman Brothers.
   - D) Freddie Mac.

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88) If Apple Computer Incorporated is used as the model, then new firms should expect to raise capital in which one of these orders? Start with the first money raised.

A) Owners, venture capitalists, suppliers, public investors
B) Owners, suppliers, venture capitalists, public investors
C) Venture capitalists, owners, public investors, suppliers
D) Owners, public investors, venture capitalists, suppliers

89) Which one of these parties *cannot* invest in a hedge fund?

A) Small retail investors
B) Pension funds
C) Insurance companies
D) Wealthy individuals

90) Which one of these enterprises generally acts as an underwriter for an initial public offering?

A) Commercial bank
B) Government
C) Investment bank
D) Insurance company

91) Which of these institutions are not major investors in U.S. equities?

A) Mutual funds
B) Banks
C) Pension funds
D) Hedge funds

92) Firms can often determine the price of any commodities they use in their production process by consulting the price quotes provided by:

A) their investment bank.
B) the New York Mercantile Exchange.
C) the New York Stock Exchange.
D) the Standard & Poor's market indexes.

93) How is the relationship between a bond's credit rating and its interest rate best defined?

A) Inverse relationship
B) Direct relationship
C) Unrelated
D) Logarithmic

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94) The financial crisis of 2007-2009 contributed to the largest sovereign default in history by which one of these countries?

A) Italy
B) Portugal
C) Ireland
D) Greece

95) Which one of these was a contributing factor to the need for many foreign banks to seek aid from their governments as a result of the financial crisis of 2007-2009?

A) Decrease in their exchange rates
B) Investments in U.S. subprime mortgages
C) Interest rate spikes
D) Currency controls

96) Which one of these was a major cause of the deep recession and severe unemployment throughout much of Europe that followed the financial crisis of 2007-2009?

A) Government actions to raise interest rates
B) Investor speculation
C) Risk-adverse investor attitudes
D) Government actions to lower government debt

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Answer Key

Test name: Chapter 02

1) FALSE
2) TRUE
3) TRUE
4) TRUE
5) TRUE
6) FALSE
7) FALSE
8) TRUE
9) TRUE
10) FALSE
11) FALSE
12) FALSE
13) TRUE
14) FALSE
15) TRUE
16) TRUE
17) FALSE
18) FALSE
19) FALSE
20) TRUE
21) FALSE
22) TRUE
23) TRUE
24) FALSE
25) TRUE
26) FALSE
27) TRUE
28) FALSE
29) FALSE
30) TRUE
31) FALSE
32) TRUE
33) A
34) C
35) D
36) D
37) B

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38) A
39) C
40) C
41) D
42) C
43) B
44) B
45) D
46) A
47) C
48) D
49) D
50) D
51) C
52) C
53) B
54) B
55) A
56) B
57) C
58) A
59) D
60) B
61) A
62) D
63) B
64) C
65) A
66) B
67) A
68) B
69) C
70) C
71) A
72) D
73) D
74) C
75) A
76) A
77) B

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78) B
79) B
80) C
81) C
82) A
83) D
84) B
85) B
86) C
87) C
88) B
89) A
90) C
91) B
92) B
93) A
94) D
95) B
96) D