

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

- 1) Which of the following statements best represents what finance is about? 1) \_\_\_\_\_
- A) The study of how people and businesses make investment decisions and how to finance those decisions
  - B) How political, social, and economic forces affect corporations
  - C) Maximizing profits
  - D) Reducing risk

Answer: A

- 2) From a financial point of view, a company that decides to develop new product is making 2) \_\_\_\_\_
- A) a cash flow decision.
  - B) an investment decision.
  - C) a capital structure decision.
  - D) a financing decision.

Answer: B

- 3) Working capital management refers to 3) \_\_\_\_\_
- A) long-term financing decisions.
  - B) capital structure.
  - C) investing in product development.
  - D) the management of cash flows.

Answer: D

- 4) Finance managers need to interact constantly with 4) \_\_\_\_\_
- A) management information systems staff.
  - B) accounting staff.
  - C) marketing managers.
  - D) all of the above.

Answer: D

- 5) The personal decision to obtain a college degree in business is primarily a(n) \_\_\_\_\_ decision. 5) \_\_\_\_\_
- A) financing
  - B) social
  - C) ethical
  - D) investment

Answer: D

- 6) The area of finance that deals with long-term investment decisions is known as 6) \_\_\_\_\_
- A) financial strategy.
  - B) capital structure.
  - C) working capital management.
  - D) capital budgeting.

Answer: D

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

- 7) Capital structure refers to the financing of long-term investments. 7) \_\_\_\_\_

Answer:  True       False

- 8) Business financial decisions are fundamentally different from personal financial decisions. 8) \_\_\_\_\_

Answer:  True       False

**SHORT ANSWER. Write the word or phrase that best completes each statement or answers the question.**

9) What are the three basic questions addressed by the study of investments? 9) \_\_\_\_\_

- Answer: 1. What investments should the firm undertake?  
2. How should the firm fund these investments?  
3. How can the firm best manage cash flows in its day-to-day operations?

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

10) Which of the following is NOT an advantage of the sole proprietorship? 10) \_\_\_\_\_

- A) No legal requirements for starting the business
- B) Limited liability
- C) No time limit imposed on its existence
- D) None of the above

Answer: B

11) What is the chief disadvantage of the sole proprietorship as a form of business organization when compared to the corporate form? 11) \_\_\_\_\_

- A) Sole proprietorships are subject to double taxation of profits.
- B) Inadequate profit sharing.
- C) Owners have unlimited liability.
- D) The cost of formation.

Answer: C

12) Which of the following is NOT true for limited partnerships? 12) \_\_\_\_\_

- A) Limited partners may sell their interest in the company.
- B) Only the name of general partners can appear in the name of the firm.
- C) One general partner must exist who has unlimited liability.
- D) Limited partners can only manage the business.

Answer: D

13) The true owners of the corporation are the 13) \_\_\_\_\_

- A) preferred stockholders.
- B) board of directors of the firm.
- C) holders of debt issues of the firm.
- D) common stockholders.

Answer: D

14) In terms of organizational costs, which of the following sequences is generally correct, moving from lowest to highest cost? 14) \_\_\_\_\_

- A) Sole proprietorship, general partnership, limited partnership, corporation
- B) Sole proprietorship, general partnership, corporation, limited partnership
- C) Corporation, limited partnership, general partnership, sole proprietorship
- D) General partnership, sole proprietorship, limited partnership, corporation

Answer: A

15) Assume that you are starting a business. Further assume that the business is expected to grow very quickly and a great deal of capital will be needed soon. What type of business organization would you choose? 15) \_\_\_\_\_

- A) Sole proprietorship
- B) Corporation
- C) Limited partnership
- D) General Partnership

Answer: B

- 16) Which one of the following categories of owners enjoys limited liability? 16) \_\_\_\_\_  
A) General partners in a limited partnership or limited liability company  
B) Sole proprietors  
C) Shareholders (common stock) of a corporation  
D) Both A and B

Answer: C

- 17) Which of the following is a characteristic of a limited partnership? 17) \_\_\_\_\_  
A) It prohibits the limited partners from participating in the management of the partnership.  
B) It requires one or more of the partners to be a general partner to whom the privilege of limited liability does not apply.  
C) It allows one or more partners to have limited liability.  
D) All of the above.

Answer: D

- 18) Which of the following forms of organization blends elements of partnerships and corporations? 18) \_\_\_\_\_  
A) General partnership  
B) Sole proprietorships  
C) D.B.A.'s  
D) Limited liability companies (LLC's)

Answer: D

- 19) Which of the following types of business forms is least risky to investors? 19) \_\_\_\_\_  
A) General partnership  
B) Limited partnership  
C) Sole proprietorship  
D) A public corporation

Answer: D

- 20) Which forms of organization are free of initial legal requirements? 20) \_\_\_\_\_  
A) Sole proprietorship  
B) General partnership  
C) Corporation  
D) Both A and B

Answer: D

- 21) For these types of organization, no distinction is made between business and personal assets. 21) \_\_\_\_\_  
A) Sole proprietorship  
B) General partnership  
C) Limited partnership  
D) Both A and B

Answer: D

- 22) Which of the following is a significant disadvantage of a general partnership? 22) \_\_\_\_\_  
A) Each partner is fully responsible for the liabilities incurred by the partnership.  
B) Forming the business is very complex.  
C) The cost of forming it is high.  
D) There is a risk associated with the industry in which it operates.

Answer: A

- 23) Which of the following forms of business organization is the dominant economic force in the United States? 23) \_\_\_\_\_  
A) The joint venture  
B) The general partnership  
C) The sole proprietorship  
D) The limited partnership  
E) The corporation

Answer: E

24) A limited partner is liable 24) \_\_\_\_\_  
A) for none of the partnership's debts.  
B) only up to the amount invested by that partner.  
C) for only his or her own share of the partnership's debts.  
D) for his or her own share of the partnership's debts and contingently liable for the other partners shares.

Answer: B

25) A corporation is owned by 25) \_\_\_\_\_  
A) the Board of Directors.  
B) its Chief Executive Officer.  
C) the shareholders who hold the company's stock.  
D) shareholders and partners.

Answer: C

26) The major sources of financing for corporations are 26) \_\_\_\_\_  
A) partners contributions. B) debt and equity.  
C) interest and dividends. D) exchanges between shareholders.

Answer: B

27) The term stockholder is equivalent to 27) \_\_\_\_\_  
A) creditor. B) general partner.  
C) shareholder. D) stakeholder.

Answer: C

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

28) The sole proprietorship is the same as the individual for liability purposes. 28) \_\_\_\_\_  
Answer:  True  False

29) In a general partnership, all partners have unlimited liability for the actions of any one partner when that partner is conducting business for the firm. 29) \_\_\_\_\_  
Answer:  True  False

30) There is no legal distinction made between the assets of the business and the personal assets of the owners in the limited partnership. 30) \_\_\_\_\_  
Answer:  True  False

31) The owners of a corporation are liable for the corporation's obligations up to the amount of their investment. 31) \_\_\_\_\_  
Answer:  True  False

32) General partners have unrestricted transferability of ownership, while limited partners must have the consent of all partners to transfer their ownership. 32) \_\_\_\_\_  
Answer:  True  False

33) Ultimate control in a corporation is vested in the board of directors. 33) \_\_\_\_\_  
Answer:  True  False

- 34) Owners must register and pay yearly fees to their State of residence when establishing a sole proprietorship. 34) \_\_\_\_\_  
 Answer: True  False
- 35) Limited partners may actively manage the business. 35) \_\_\_\_\_  
 Answer: True  False
- 36) The life of a corporation is not dependent upon the status of the investors. 36) \_\_\_\_\_  
 Answer:  True False
- 37) A sole proprietorship is the most desirable business form in all circumstances. 37) \_\_\_\_\_  
 Answer: True  False
- 38) In a sole proprietorship, the owner is personally responsible without limitation for the liabilities incurred. 38) \_\_\_\_\_  
 Answer:  True False
- 39) In a limited partnership, at least one general partner must remain in the association; the privilege of limited liability still applies to this partner. 39) \_\_\_\_\_  
 Answer: True  False
- 40) In a general partnership, each partner is liable for the partnership's obligations only up to a percentage of the obligation equal to that partner's percentage of ownership of the partnership. 40) \_\_\_\_\_  
 Answer: True  False

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

- 41) Maximization of shareholder wealth as a goal is superior to accounting profit maximization because 41) \_\_\_\_\_  
 A) it considers the time value of the money.  
 B) following the shareholder wealth maximization goal will ensure high stock prices.  
 C) accounting profits are not the same as cash flows.  
 D) A and C.  
 Answer: D
- 42) Which of the following best describes the goal of the firm? 42) \_\_\_\_\_  
 A) Risk minimization  
 B) Profit maximization  
 C) The maximization of the total market value of the firm's common stock  
 D) None of the above  
 Answer: C
- 43) Profit maximization does not adequately describe the goal of the firm because 43) \_\_\_\_\_  
 A) profit maximization does not require the consideration of risk.  
 B) profit maximization ignores the timing of a project's return.  
 C) maximization of dividend payout ratio is a better description of the goal of the firm.  
 D) A and B.  
 Answer: D

- 44) Which of the following goals of the firm is equivalent to the maximization of shareholder wealth? 44) \_\_\_\_\_
- A) Risk minimization
  - B) Profit maximization
  - C) Maximization of the total market value of the firm's common stock
  - D) None of the above

Answer: C

- 45) If managers are making decisions to maximize shareholder wealth, then they are primarily concerned with making decisions that should 45) \_\_\_\_\_
- A) increase the market value of the firm's common stock.
  - B) positively affect profits.
  - C) either increase or have no effect on the value of the firm's common stock.
  - D) accomplish all of the above.

Answer: A

- 46) Profit maximization is not an adequate goal of the firm when making financial decisions because 46) \_\_\_\_\_
- A) it ignores the risk inherent in different projects that will generate the profits.
  - B) it ignores the timing of a project's returns.
  - C) it does not necessarily reflect shareholder wealth maximization.
  - D) all of the above are correct.

Answer: D

- 47) Which of the following goals is in the best long-term interest of stockholders? 47) \_\_\_\_\_
- A) Profit maximization
  - B) Maximizing sales revenues
  - C) Maximizing of the market value of the existing shareholders' common stock
  - D) Risk minimization

Answer: C

- 48) If managers do not pursue the goal of maximizing shareholder wealth 48) \_\_\_\_\_
- A) they concentrate on more important matters like growing market share.
  - B) they can focus more on social responsibilities.
  - C) they can focus more on long-term profitability.
  - D) they are likely to lose their jobs.

Answer: D

- 49) What does the agency problem refer to? 49) \_\_\_\_\_
- A) The problem that results from potential conflicts of interest between the manager of a business and the stockholders.
  - B) The conflict that exists between the board of directors and the employees of the firm.
  - C) The conflict that exists between stockbrokers and investors.
  - D) The problem associated with financial managers and Internal Revenue agents.

Answer: A

- 50) Managers of corporations need to act in an ethical manner 50) \_\_\_\_\_
- A) because ethics violations will be punished by the law.
  - B) because a business must be trusted by investors, customer and the public if it is to succeed.
  - C) because business managers must answer to a higher authority.
  - D) because ethical behavior is its own justification.

Answer: B

51) In regard to the agency problem, \_\_\_\_\_ are the principal owners of a corporation. 51) \_\_\_\_\_  
A) shareholders                      B) managers                      C) suppliers                      D) employees

Answer: A

52) Serious ethical violations by corporations such as Enron led to the passage of 52) \_\_\_\_\_  
A) the Sarbanes–Oxley Act.                      B) the Dodd–Frank Act.  
C) the Insider Trading Act of 1988.                      D) All of the above.

Answer: A

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

53) The goal of the firm should be the maximization of profit. 53) \_\_\_\_\_  
Answer: True       False

54) One of the problems associated with profit maximization is that it ignores the timing of a project's return. 54) \_\_\_\_\_  
Answer:  True                      False

55) The goal of profit maximization is equivalent to the goal of maximization of share value. 55) \_\_\_\_\_  
Answer: True       False

56) The goal of profit maximization ignores the timing of profit. 56) \_\_\_\_\_  
Answer:  True                      False

57) The goal of maximize shareholder wealth inevitably conflicts with socially responsible behavior on the part of corporation. 57) \_\_\_\_\_  
Answer: True       False

58) The Sarbane–Oxley Act addresses insider trading by members of Congress. 58) \_\_\_\_\_  
Answer: True       False

59) A reputation for unethical behavior can negatively affect the value of a company's stock. 59) \_\_\_\_\_  
Answer:  True                      False

60) The agency problem arises due to the separation of ownership and control in a corporation. 60) \_\_\_\_\_  
Answer:  True                      False

**SHORT ANSWER. Write the word or phrase that best completes each statement or answers the question.**

61) Briefly discuss the incentives for financial managers to conduct their business in an ethical manner. 61) \_\_\_\_\_

Answer: Extreme ethical lapses such as those evident in the Madoff Ponzi scheme may also break laws and result in fines or imprisonment. In less extreme cases, deceptive accounting practices or sales techniques once exposed lead to a loss of trust. Because individuals and firms are reluctant to do business with those they mistrust, a reputation for unethical behavior over the long run leads to adversarial relations with business partners, a loss of customers, and destruction of the firm's value.

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

62) Consider the following equally likely project outcomes:

62) \_\_\_\_\_

|                        | Profit |       |
|------------------------|--------|-------|
|                        | X      | Y     |
| Pessimistic prediction | \$ 0   | \$500 |
| Expected outcome       | \$ 500 | \$500 |
| Optimistic prediction  | \$1000 | \$500 |

- A) Since Projects X and Y have the same expected outcomes of \$500, investors will view them as identical in value.
- B) Investors will prefer project X because it potentially offers a higher profit.
- C) Investors will prefer project Y because the expected return is the same as for project X but the outcome is certain.
- D) Investors will reject both projects because the profit is too low.

Answer: C

63) Consider the timing of the profits of the following certain investment projects:

63) \_\_\_\_\_

|        | Profit  |         |
|--------|---------|---------|
|        | L       | S       |
| Year 1 | \$ 0    | \$ 3000 |
| Year 2 | \$ 3000 | \$ 0    |

- A) A goal of profit maximization would favor Project S only.
- B) Projects S and L are equally desirable.
- C) Project S is preferred to Project L.
- D) Project L is preferred to Project S.

Answer: C

64) In finance, we assume that investors are generally

64) \_\_\_\_\_

- A) fond of risk.
- B) neutral to risk.
- C) averse to risk.
- D) none of the above.

Answer: C

65) Consider cash flows for Projects X and Y such as:

65) \_\_\_\_\_

|        | Project X | Project Y |
|--------|-----------|-----------|
| Year 1 | \$3000    | \$ 0      |
| Year 2 | \$ 0      | \$3000    |

A rational person would prefer receiving cash flows sooner because

- A) the money is nice to have around.
- B) the investor is indifferent to either proposal.
- C) the investor may be tired of a particular investment.
- D) the money can be reinvested.

Answer: D

- 66) Which of the following should be considered when assessing the financial impact of business decisions? 66) \_\_\_\_\_
- A) The risk–return tradeoff
  - B) The timing of projected earnings; i.e., when they are expected to occur
  - C) The amount of projected earnings
  - D) All of the above
- Answer: D
- 67) Which of the following is most likely to motivate executives to maximize shareholder wealth? 67) \_\_\_\_\_
- A) Compensating them with stock options that can only be exercised after five years
  - B) Tying bonuses to cost reductions and meeting budget goals
  - C) Tying annual bonuses to increases in annual profits
  - D) Offering them relatively high salaries
- Answer: A
- 68) If one security has a greater risk than another security, how will investors respond? 68) \_\_\_\_\_
- A) They would be indifferent regarding their expectation of rates of return for either investment.
  - B) They will require a higher rate of return for the investment that has greater risk.
  - C) They will require a lower rate of return for the investment that has greater risk.
  - D) None of the above.
- Answer: B
- 69) How could you compensate an investor for taking on a significant amount of risk? 69) \_\_\_\_\_
- A) Raise more debt capital
  - B) Offer stock at a higher price
  - C) Increase the expected rate of return
  - D) Increase sales
- Answer: C
- 70) If an investor had a choice of receiving \$1,000 today, or \$1,000 in five years, which would the average investor prefer? 70) \_\_\_\_\_
- A) \$1,000 in five years because they are not good at saving money.
  - B) \$1,000 in five years because it will be worth more than \$1,000 received today.
  - C) \$1,000 today because it will be worth more than \$1,000 received in five years.
  - D) Investors would be indifferent to when they would receive the \$1,000.
  - E) None of the above.
- Answer: C
- 71) Why do investors prefer receiving cash sooner rather than later, according to finance theory? 71) \_\_\_\_\_
- A) Diversification leads to increased value.
  - B) Incremental profits are greater than accounting profits.
  - C) Money received earlier can be reinvested and returns can be increased.
  - D) Tax considerations are important when investing.
- Answer: C
- 72) Investors choose to invest in higher risk investments because these investments offer higher 72) \_\_\_\_\_
- A) expected returns.
  - B) future consumption.
  - C) inflation.
  - D) actual returns.
- Answer: A

73) Foregoing the earning potential of a dollar today is referred to as the 73) \_\_\_\_\_  
A) creation of wealth. B) opportunity cost concept.  
C) risk/return tradeoff. D) time value of money.

Answer: B

74) In measuring value, the focus should be on 74) \_\_\_\_\_  
A) time value of money. B) earnings per share.  
C) cash flow. D) accounting profits.

Answer: C

75) Which of the following is a characteristic of an efficient market? 75) \_\_\_\_\_  
A) Immediate response occurs for new public information.  
B) Security prices reflect fair value of the firm.  
C) Opportunities exist for investors to profit from publicly available information.  
D) Small number of individuals

Answer: B

76) Which of the following factors is most important in investment decisions? 76) \_\_\_\_\_  
A) The change in net income. B) The change in gross sales revenue.  
C) The change in earnings before taxes. D) The change in after-tax cash flow.

Answer: D

77) Investors prefer \$1 today versus \$1 in the future due to 77) \_\_\_\_\_  
A) the need for immediate gratification. B) time value of money.  
C) response to incentives. D) A and B.

Answer: B

78) The price of Netflix stock dropped sharply after customers responded negatively to a change in pricing policies. The change in stock price illustrates which principle? 78) \_\_\_\_\_  
A) Individuals respond to incentives. B) Market prices reflect information.  
C) The time-value of money. D) Cash flows are the source of value.

Answer: B

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

79) For the risk-return principle implies that the more risky a given course of action, the higher the expected return must be. 79) \_\_\_\_\_

Answer:  True  False

80) The financial manager should examine available risk-return trade-offs and make his decision based upon the greatest expected return. 80) \_\_\_\_\_

Answer:  True  False

81) Only a few financial decisions involve some sort of risk-return tradeoff. 81) \_\_\_\_\_

Answer:  True  False

82) In efficient markets, price adjustments to new information are gradual. 82) \_\_\_\_\_

Answer:  True  False

83) Rewarding executives for increasing quarterly earnings will motivate them to act in the long-term best interests of shareholders. 83) \_\_\_\_\_  
Answer: True  False

84) In an efficient market, prices will quickly adjust to new information. 84) \_\_\_\_\_  
Answer:  True  False

**SHORT ANSWER. Write the word or phrase that best completes each statement or answers the question.**

85) Briefly discuss why financial decision makers must focus on incremental cash flows when evaluating new projects. 85) \_\_\_\_\_  
Answer: Incremental cash flows describe the total cash effect on the company, looking at the difference between total cash flow to the company with the cash flow, and without the cash flow. The company can then value these cash flows and see if the company is worth more with the project or without the project.

86) Discuss the risk/return tradeoff and how it relates to finance. 86) \_\_\_\_\_  
Answer: As people are risk averse, they need a higher return as the risk gets higher. This means that investors will need a higher return on bonds that they do not consider to be as safe as other bonds, and they will need a higher return on stock when the company in question's stock seems to be riskier than the stock of other companies.

87) Why do you think many companies compensate executives with options based on long-term increases in the value of the company's stock? 87) \_\_\_\_\_  
Answer: Tying executive compensation to long-term increases in the stock price makes sense because they are supposed to be working to maximize shareholder wealth. Stock-based compensation plans imply that decisions made to benefit shareholders will also benefit themselves.