***Financial Management: Core Concepts* (Brooks)**
Chapter 1 Financial Management

1.1 The Cycle of Money

1) At its most basic level, the function of financial intermediaries is to ________.
A) track and report interest rates.
B) move money from lenders to borrowers and back again.
C) report all financial transactions to the federal government.
D) effect a transfer of wealth in society.
Answer: B
Diff: 1
Topic: 1.1 The Cycle of Money

2) Which of the following is NOT an example of a financial transaction?
A) Your parents use their credit card to pay this term's college tuition.
B) You use the ATM to withdraw British pounds so you can fly to London.
C) Your roommate lends you $20 and you repay it in one week.
D) All of the above are financial transactions.
Answer: D
Diff: 2
Topic: 1.1 The Cycle of Money

3) The movement of money from lender to borrower and back again is known as ________.
A) the circle of life.
B) corporate finance.
C) the cycle of money.
D) money laundering.
Answer: C
Diff: 1
Topic: 1.1 The Cycle of Money
Hmwrk Questions: * Taken from "Prepping for Exams" questions at the end of the chapter.

4) The common objective of borrowing and lending is to ________.
A) make all parties better off.
B) gain a profit at the others' expense.
C) make a firm or individual appear more liquid than is really the case.
D) thwart regulatory authority.
Answer: A
Diff: 1
Topic: 1.1 The Cycle of Money

5) Which of the following is NOT a function of a financial intermediary in the lending/borrowing process?
A) To help establish terms of the lending/borrowing agreement.
B) To match the borrower and the lender.
C) To bear the risk that the borrower will not repay.
D) All of the above are functions of the financial intermediary.
Answer: D
Diff: 1
Topic: 1.1 The Cycle of Money

6) You place $500 into your checking account at First Bank and earn 1% APR on your deposit. Your professor borrows money at a rate of 8% from the same bank for a tuition loan for her son. Which of the following statements is true?
A) The bank is criminally liable to you for paying an interest rate lower than the expected rate of inflation.
B) You and your professor have an obvious conflict of interest because you have accounts at the same financial institution.
C) You benefit from earning interest on your deposit, safety for your funds, and having a recognizable means for paying for your financial obligations without having to hold cash.
D) Your professor is the only party to be made worse off by this example because she is the only party paying net interest.
Answer: C
Comment: Both you and your professor are using services typically provided by banks. There is no conflict of interest.
Diff: 2
Topic: 1.1 The Cycle of Money
Hmwrk Questions: * Taken from "Prepping for Exams" questions at the end of the chapter.

7) The basic function of financial intermediaries is to move advice from lenders to borrowers and back to lenders.
Answer: FALSE
Comment: The basic function of financial intermediaries is to move MONEY from lenders to borrowers and back to lenders.
Diff: 1
Topic: 1.1 The Cycle of Money

8) In the lending/borrowing process, a financial intermediary function is to bear the risk that the borrower will not repay.
Answer: TRUE
Diff: 1
Topic: 1.1 The Cycle of Money

9) Give three examples of a financial transaction.
Answer: (1) Your parents use their credit card to pay some of your college expenses.
(2) You use the ATM to withdraw funds so you can buy your best friend a birthday gift.
(3) Your roommate lends you $20 and you repay it back when you get your next pay check.
Diff: 2
Topic: 1.1 The Cycle of Money

1.2 Overview of Finance Areas

1) Which of the following best identifies the four main areas of finance?
A) Exchange rate management, investments, financial institutions and markets, international.
B) Corporate, investments, capital structure, international.
C) Corporate, investments, financial institutions and markets, international.
D) Corporate, capital budgeting, financial institutions and markets, regulation.
Answer: C
Comment: Exchange rate management, capital structure, and capital budgeting are activities within the functional areas of finance.
Diff: 2
Topic: 1.2 Overview of Finance Areas

2) Of the following, which is NOT one of the four main areas of finance?
A) International Finance
B) Corporate Finance
C) Investments
D) All are considered main areas of finance.
Answer: D
Diff: 1
Topic: 1.2 Overview of Finance Areas

3) The set of financial activities that support the OPERATIONS of a business is best described by which main area of finance?
A) Corporate Finance
B) Investments
C) Financial Institutions and Markets
D) International Finance
Answer: A
Diff: 1
Topic: 1.2 Overview of Finance Areas

4) ________ is the area of finance concerned with activities like borrowing funds to finance projects such as plant expansions or new product launches.
A) Working capital management
B) International finance
C) Investments
D) Corporate finance
Answer: D
Diff: 2
Topic: 1.2 Overview of Finance Areas

5) ________ is the area of finance concerned with activities like repayment of borrowed funds through dividends or interest payments.
A) Investments
B) Corporate finance
C) Capital budgeting
D) International finance
Answer: B
Diff: 1
Topic: 1.2 Overview of Finance Areas

6) ________ is the area of finance concerned with the activities of buying and selling financial assets such as stocks and bonds.
A) Investments
B) Corporate finance
C) International finance
D) Financial markets and institutions
Answer: A
Diff: 1
Topic: 1.2 Overview of Finance Areas
Hmwrk Questions: * Taken from "Prepping for Exams" questions at the end of the chapter.

7) Which of the following is NOT typically thought of as an investment activity?
A) Accurately pricing financial assets.
B) The process of buying and selling financial assets.
C) Repaying borrowed funds.
D) Negotiating the rules and regulations of financial transactions.
Answer: C
Diff: 2
Topic: 1.2 Overview of Finance Areas

8) The organized financial intermediaries and the forums that promote the cycle of money is a good definition of which of the following main areas of finance?
A) Corporate finance
B) Investments
C) Financial institutions and markets
D) International finance
Answer: C
Diff: 1
Topic: 1.2 Overview of Finance Areas

9) Financial institutions and markets
A) are the organized financial intermediaries and the forums that promote the cycle of money.
B) compose the set of financial activities that support the operations of a business.
C) are the activities centered on the purchase and sale of financial assets.
D) are concerned only with the addition of a multinational element to all finance activities.
Answer: A
Diff: 1
Topic: 1.2 Overview of Finance Areas

10) Of the following, which is NOT an example of a financial intermediary?
A) Commercial bank
B) Insurance company
C) Investment bank
D) All of the above are financial intermediaries.
Answer: D
Diff: 2
Topic: 1.2 Overview of Finance Areas

11) Of the following, which is NOT an activity engaged in by a financial intermediary?
A) Matching borrowers and lenders.
B) Bearing risk.
C) Managing retirement portfolios for large classes of employees.
D) All of the above are activities of financial intermediaries.
Answer: D
Diff: 2
Topic: 1.2 Overview of Finance Areas

12) "Concern with the multinational elements of financial activities" best describes which of the four main areas of finance?
A) Investments
B) International finance
C) Corporate finance
D) Financial institutions and markets
Answer: B
Diff: 1
Topic: 1.2 Overview of Finance Areas

13) Which of the following is a reason why an expertise in international finance is important?
A) Because the process of assessing risk among many countries is more difficult than assessing risk for a single country.
B) Because financial regulatory rules and requirements differ from country to country.
C) Because changes in economic conditions impact the relative values of currency among countries.
D) All of the above are reasons for gaining expertise in international finance.
Answer: D
Diff: 1
Topic: 1.2 Overview of Finance Areas

14) Which of the following is NOT an activity of a financial institution or market?
A) Bringing together buyers and sellers of financial assets.
B) Providing a market for the transaction of financial assets.
C) Providing information to buyers and/or sellers of financial assets.
D) All are activities of financial institutions.
Answer: D
Diff: 1
Topic: 1.2 Overview of Finance Areas

15) Corporate Finance is the set of activities generally concerned with the buying and selling of financial assets such as stocks and bonds.
Answer: FALSE
Comment: Investsments are the set of activities generally concerned with the buying and selling of financial assets such as stocks and bonds.
Diff: 1
Topic: 1.2 Overview of Finance Areas

16) Financial institutions and markets are the organized financial intermediaries and the forums that promote the cycle of money.
Answer: TRUE
Diff: 1
Topic: 1.2 Overview of Finance Areas

17) The four main areas of finance (corporate, investments, financial markets and institutions, and international finance) are mutually exclusive topics.
Answer: FALSE
Comment: The four main areas of finance (corporate, investments, financial markets and institutions, and international finance) are NOT mutually exclusive topics.
Diff: 1
Topic: 1.2 Overview of Finance Areas

18) What are the four main areas of finance? Give a brief definition of each.
Answer: The four main areas of finance are corporate, investments, financial institutions and markets, and international finance. Corporate finance deals with the financial operations of the firm and focuses on capital budgeting, capital structure, and working capital management. It is the primary focus of this text. Investments focuses on the activities associated with the buying, selling, pricing, and risk evaluation of financial assets. It is commonly the part of finance most interesting to students. Financial institutions and markets is the study of the firms and organizations that facilitate and regulate the trading of financial assets as well as the markets that make the trading possible. International finance is really a hybrid of the first three. This area of finance must consider what the first three do and then develop a framework for understanding in multiple markets with multiple institutions and products in multiple currencies.
Diff: 3
Topic: 1.2 Overview of Finance Areas

1.3 Financial Markets

1) ________ are the forums where buyers and sellers of financial assets and commodities meet.
A) Housing markets
B) Federal Reserve Banks
C) Financial markets
D) Automotive shows
Answer: C
Diff: 1
Topic: 1.3 Financial Markets

2) Financial markets can be classified by which of the following?
A) Type of asset traded.
B) Maturity of the financial asset.
C) Owner of the financial asset.
D) All of the above can be classified as financial markets.
Answer: D
Diff: 2
Topic: 1.3 Financial Markets

3) Stocks are bought and sold in ________ markets.
A) equity
B) debt
C) derivatives
D) foreign exchange
Answer: A
Diff: 1
Topic: 1.3 Financial Markets
Hmwrk Questions: * Taken from "Prepping for Exams" questions at the end of the chapter.

4) Bonds are bought and sold in ________ markets.
A) equity
B) debt
C) derivatives
D) foreign exchange
Answer: B
Diff: 1
Topic: 1.3 Financial Markets

5) Options are bought and sold in ________ markets.
A) equity
B) debt
C) derivatives
D) foreign exchange
Answer: C
Diff: 1
Topic: 1.3 Financial Markets

6) Currencies are bought and sold in ________ markets.
A) equity
B) debt
C) derivatives
D) foreign exchange
Answer: D
Diff: 1
Topic: 1.3 Financial Markets

7) Which of the following is NOT an example of an equity market transaction?
A) Mary sells her shares of Apple stock.
B) Mark contacts his broker and requests a purchase of IBM bonds.
C) Sahid buys shares of a small company stock traded on the NASDAQ.
D) All of the above are equity market transactions.
Answer: B
Comment: Mark contacts his broker and requests a purchase of IBM bonds - this is a debt market transaction.
Diff: 2
Topic: 1.3 Financial Markets

8) Financial assets that will mature within a year are bought and sold in the ________ market.
A) debt
B) capital
C) stock
D) money
Answer: D
Comment: Debt, capital, and the stock markets are longer term in nature.
Diff: 1
Topic: 1.3 Financial Markets

9) The sale of "new" securities, where the financial asset is being traded for the very first time, is said to take place in the ________ market.
A) primary
B) money
C) secondary
D) capital
Answer: A
Diff: 1
Topic: 1.3 Financial Markets

10) The sale of "used" securities, where the financial asset is being traded from one individual to another and the proceeds do not go to the original issuer of the security, is said to take place in the ________ market.
A) primary
B) money
C) secondary
D) capital
Answer: C
Diff: 1
Topic: 1.3 Financial Markets

11) Which of the following is true of a dealer market?
A) The dealer buys and sells assets out of his own inventory.
B) The dealer acts as a broker, lining up the owners of assets with the purchasers of assets.
C) The dealer acts as an auctioneer of securities and takes a percentage of the sale as compensation.
D) None of the above are true of a dealer market.
Answer: A
Comment: Broker markets are characterized by brokers bringing buyers and sellers together with the brokers earning a commission. Auction markets involve the purchase and sale of securities not currently held in the dealer's portfolio.
Diff: 1
Topic: 1.3 Financial Markets

12) Which of the following is NOT a characteristic of a dealer market?
A) Dealers make a profit on the spread between what they pay for financial assets and what they sell them for.
B) Securities are auctioned off to the highest bidder.
C) Dealers buy and sell from their own portfolio.
D) All of the above are characteristics of the dealer market .
Answer: B
Comment: Dealers buy and sell to customers; they do not auction to the highest bidder.
Diff: 2
Topic: 1.3 Financial Markets

13) Financial markets are the forums where buyers and sellers of financial assets come together.
Answer: TRUE
Diff: 1
Topic: 1.3 Financial Markets

14) When a company offers stock for sale for the first time and the proceeds go to the company, then this is a sale in the <u>primary</u> market.
Answer: TRUE
Diff: 1
Topic: 1.3 Financial Markets

15) Auction markets consist of dealers buying and selling from their own portfolios.
Answer: FALSE
Comment: DEALER markets consist of dealers buying and selling from their own portfolios.
Diff: 1
Topic: 1.3 Financial Markets

16) Equity markets are where bonds are bought and sold.
Answer: FALSE
Comment: Equity markets are where STOCKS are bought and sold.
Diff: 1
Topic: 1.3 Financial Markets

17) Give an example of how a corporate manager might use the capital markets in the operation of his/her corporation. Be sure to define capital market in your answer.
Answer: The capital market is the market for longer-term financial assets such as stocks and bonds. The financial manager must finance the purchase of long-term assets and will often enter the capital market to raise sufficient funds by issuing new stock or bonds.
Comment: NOTE: There are several good reasons a student can list for this question.
Diff: 3
Topic: 1.3 Financial Markets

18) Define "money market" and "capital market" and give an example of a security that trades in each.
Answer: The money market is the term for the market for short-term, low risk, highly liquid, homogeneous securities such as Treasury Bills, negotiable certificates of deposit or commercial paper. The capital market consists of longer-term financial assets such as stocks and bonds.
Diff: 3
Topic: 1.3 Financial Markets

1.4 The Finance Manager and Financial Management

1) ________ is the typical title of the corporate executive charged with determining the best repayment structure for borrowed funds to ensure timely repayment and sufficient cash for daily operations.
A) Chief Executive Officer (CEO)
B) Chief Financial Officer (CFO)
C) Chairman
D) Chief Operating Officer (COO)
Answer: B
Diff: 1
Topic: 1.4 The Finance Manager and Financial Management

2) ________ is NOT a main category of financial management.
A) Capital budgeting
B) Capital structure
C) Accounts receivable management
D) Working capital management
Answer: C
Diff: 2
Topic: 1.4 The Finance Manager and Financial Management

3) The process of planning, evaluating, selecting, and managing the long-term operating projects of the company is termed ________.
A) capital budgeting.
B) capital structure.
C) accounts receivable management.
D) working capital management.
Answer: A
Diff: 1
Topic: 1.4 The Finance Manager and Financial Management

4) The means by which a company is financed refers to the firm's ________.
A) capital budgeting.
B) capital structure.
C) accounts receivable management.
D) working capital management.
Answer: B
Diff: 2
Topic: 1.4 The Finance Manager and Financial Management
Hmwrk Questions: * Taken from "Prepping for Exams" questions at the end of the chapter.

5) Managing the firm's short-term financing activities is known as ________.
A) capital budgeting.
B) capital structure.
C) accounts receivable management.
D) working capital management.
Answer: D
Diff: 1
Topic: 1.4 The Finance Manager and Financial Management

6) Which of the following is NOT a capital structure question?
A) A delivery company chooses to buy more trucks.
B) A manufacturing firm chooses to take the discount for paying accounts payable early.
C) A retail firm chooses to use a new supplier.
D) None of the above are capital structure questions.
Answer: D
Diff: 2
Topic: 1.4 The Finance Manager and Financial Management

7) Capital budgeting is best defined by which of the following questions?
A) How will we fund our product and service choices?
B) What business are we in?
C) How will we manage our day-to-day financial needs?
D) What is our firm's best choice for corporate governance?
Answer: B
Diff: 1
Topic: 1.4 The Finance Manager and Financial Management

8) Capital structure is best defined by which of the following questions?
A) How will we fund our product and service choices?
B) What business are we in?
C) How will we manage our day-to-day financial needs?
D) What is our firm's best choice for corporate governance?
Answer: A
Diff: 1
Topic: 1.4 The Finance Manager and Financial Management

9) Which of the following is NOT an activity of working capital management?
A) Establishing the firm's receivable policies.
B) Establishing the firm's payment policies.
C) Choosing the appropriate level of inventory.
D) All of the above are working capital management activities.
Answer: D
Diff: 1
Topic: 1.4 The Finance Manager and Financial Management

10) Which of the following is NOT a capital budgeting question?
A) The choice of which long-term assets to purchase to meet the firm's business goals.
B) The choice of what type of business a firm wants to operate.
C) The proper mix of stocks and bonds to issue for financing assets.
D) None of the above are capital budgeting questions.
Answer: C
Comment: The proper mix of stocks and bonds to issue for financing assets is a capital structure question.
Diff: 2
Topic: 1.4 The Finance Manager and Financial Management
Hmwrk Questions: * Taken from "Prepping for Exams" questions at the end of the chapter.

11) Capital budgeting is the means by which a company is financed.
Answer: FALSE
Comment: Capital STRUCTURE is the means by which a company is financed.
Diff: 1
Topic: 1.4 The Finance Manager and Financial Management

12) Capital structure is the process of planning, evaluating, selecting, and managing the long-term operating projects of the company.
Answer: FALSE
Comment: Capital BUDGETING is the process of planning, evaluating, selecting, and managing the long-term operating projects of the company.
Diff: 1
Topic: 1.4 The Finance Manager and Financial Management

13) Working capital management is the day-to-day management of the operating needs of the company via current assets and current liabilities.
Answer: TRUE
Diff: 1
Topic: 1.4 The Finance Manager and Financial Management

14) Provide definitions for capital budgeting, capital structure, and working capital management. Give an example of a capital budgeting type decision and then do the same for capital structure and working capital management.
Answer: Capital budgeting is the process of choosing which long-term assets a firm should purchase to best meet the goal of maximizing shareholders' wealth. A firm might need to choose among several processes to produce a product for sale. The manager needs to choose the process that will be most valuable for the company.

Capital structure is choosing the optimal mix of long-run debt and equity to minimize the cost of capital. Here, a manager looking to finance a capital budgeting project might have to choose between a mixture of internal financing and external debt and equity.

Working capital management is the day-to-day management of short-term assets and liabilities, for example, what level of inventory to carry or what credit terms to extend to potential customers.
Comment: This question is very open ended in that there are many different examples a student can provide for each of the three categories.
Diff: 3
Topic: 1.4 The Finance Manager and Financial Management

1.5 Objective of the Finance Manager

1) When there are conflicts among managerial goals in U.S. markets, the most important priority is to ________.
A) increase the current market value of equity.
B) keep all of the company's customers happy.
C) foster good relationships with the community.
D) maintain a safe and happy work place.
Answer: A
Comment: Anglo-American markets emphasize that managers should maximize shareholders' wealth.
Diff: 2
Topic: 1.5 Objective of the Finance Manager

2) Maximizing the market value of firm equity and which of the following are mutually exclusive?
A) Maximizing market value and a safe and happy work place are mutually exclusive.
B) Maximizing market value and good relationships with the local community are mutually exclusive.
C) Maximizing market value and customer satisfaction are mutually exclusive.
D) None of the above are mutually exclusive with maximizing the value of market equity.
Answer: D
Diff: 1
Topic: 1.5 Objective of the Finance Manager

3) A firm's stock price most closely reflects which of the following?
A) Current interest rates.
B) Expected future cash flows of the firm.
C) The amount of debt held by the firm.
D) None of the above.
Answer: B
Diff: 1
Topic: 1.5 Objective of the Finance Manager
Hmwrk Questions: * Taken from "Prepping for Exams" questions at the end of the chapter.

4) Which of the following can lead to increased expected cash flow over time to the firm?
A) Open and collaborative relations with the community.
B) Qualified and motivated employees.
C) Greater customer satisfaction.
D) All of the above.
Answer: D
Diff: 2
Topic: 1.5 Objective of the Finance Manager

5) According to the textbook, a good manager treats shareholders, customers, creditors, and employees equally.
Answer: FALSE
Comment: According to the author a good manager treats shareholders above all others.
Diff: 1
Topic: 1.5 Objective of the Finance Manager

6) The primary objective of the finance manager is to maximize the market value of equity of the company.
Answer: TRUE
Diff: 1
Topic: 1.5 Objective of the Finance Manager

7) Stock prices reflect the expected future cash flow of the company.
Answer: TRUE
Diff: 1
Topic: 1.5 Objective of the Finance Manager

8) What is the primary goal of a financial manager? When you see firms like Enron imploding from the behavior of executive management, how can you justify your definition?
Answer: The primary goal of a financial manager is to maximize shareholders' wealth. In some ways, Enron is the exception that proves the rule. When management strays from its primary objective of maximizing shareholder wealth and resorts to deception in an effort to satisfy greed or ego, that is a newsworthy event.
Diff: 3
Topic: 1.5 Objective of the Finance Manager

9) The author claims that the goals of keeping customers happy, employees happy, and shareholders happy are not mutually exclusive, even though the first two goals identified may be costly and come at the expense of shareholders. How can this be?
Answer: Simply put, the marginal benefits of providing a pleasing and productive work environment for qualified workers, keeping customer satisfaction, and meeting customer expectations is greater than the marginal cost. The result of having unhappy workers and displeased customers could well cost the company in terms of shareholder value.
Diff: 3
Topic: 1.5 Objective of the Finance Manager

10) How does maximizing the long-run expected cash flows to the firm translate into maximizing shareholders' wealth?
Answer: Shareholders invest in firms to realize a return. The returns from investing in a firm result from cash flows such as dividends or capital gains on the resale of shares of stock. Increasing the amount of money a shareholder can expect to receive increases the value of the shares of stock, thus increasing shareholders' wealth through a larger stream of cash flows and a larger expected capital gain.
Diff: 3
Topic: 1.5 Objective of the Finance Manager

1.6 Internal and External Players

1) Of the following activities which is MOST likely to be an interaction between the financial manager and the information systems manager?
A) Developing a system to bill customers, pay suppliers, and track inventory.
B) Costing of products.
C) Setting credit policies.
D) Determining the appropriate pricing of products.
Answer: A
Comment: Costing of products is done in conjunction with the manufacturing manager. Human resources helps to ensure enough qualified workers. IT works on billing, paying, and tracking.
Diff: 1
Topic: 1.6 Internal and External Players

2) Of the following activities, which is NOT likely to be an interaction between the financial manager and the marketing manager?
A) Costing of products.
B) Setting credit policies.
C) Determining that there are a sufficient number of trained workers to develop the product.
D) Setting advertising budgets.
Answer: C
Diff: 1
Topic: 1.6 Internal and External Players
Hmwrk Questions: * Taken from "Prepping for Exams" questions at the end of the chapter.

3) Of the following activities, which is MOST likely to be an interaction between the financial manager and the manufacturing manager?
A) Setting of credit policies.
B) Developing a system to bill customers, pay suppliers, and track inventory.
C) Budgeting the timing and amount of cash needed for the production schedule.
D) Determining that there are a sufficient number of trained workers to develop the product.
Answer: C
Diff: 1
Topic: 1.6 Internal and External Players

4) On a basic organizational chart for a company, the Finance Manager would be on the third line, where the first line is the CEO and the second line contains titles such as Marketing Manager and Human Resources Manager.
Answer: FALSE
Comment: The Finance Manager would be on the second line with the other managers.
Diff: 1
Topic: 1.6 Internal and External Players

5) The Finance Manager works with the Human Resources Manager to set credit policies for targeted customers.
Answer: FALSE
Comment: The Finance Manager works with the MARKETING Manager to set credit policies for targeted customers.
Diff: 1
Topic: 1.6 Internal and External Players

6) What does the standard organizational chart show? In your answer, point out the functions needed for a successful business.
Answer: The standard organizational chart shows a bottom-up reporting relationship, but the reality is that the functions of marketing, finance, manufacturing, information systems, and human resources are all interconnected in a successful business.
Diff: 2
Topic: 1.6 Internal and External Players

1.7 The Legal Forms of Business

1) A ________ is a business that is owned entirely by an individual.
A) sole proprietorship
B) partnership
C) sub-chapter s corporation
D) corporation
Answer: A
Diff: 1
Topic: 1.7 The Legal Forms of Business

2) Which of the following is NOT an ADVANTAGE of a sole proprietorship?
A) The owner receiving all the after-tax profit.
B) Limited liability.
C) Quick decision making.
D) All are advantages of a sole proprietorship.
Answer: B
Comment: Sole proprietorships have UNLIMITED liability.
Diff: 1
Topic: 1.7 The Legal Forms of Business
Hmwrk Questions: * Taken from "Prepping for Exams" questions at the end of the chapter.

3) Which of the following is an ADVANTAGE of a sole proprietorship?
A) The owner's unlimited liability.
B) The lack of continuity upon death of the owner.
C) The ease of start up.
D) The ability to raise capital.
Answer: C
Comment: A) and B) are disadvantages, and D) is an advantage of a corporation.
Diff: 1
Topic: 1.7 The Legal Forms of Business

4) A ________ has limited liability, is a legal entity, and has the greatest potential to raise capital.
A) sole proprietorship
B) general partnership
C) limited partnership
D) corporation
Answer: D
Diff: 1
Topic: 1.7 The Legal Forms of Business

5) A ________ is a business that is jointly owned by two or more individuals.
A) partnership
B) sole proprietorship
C) sub-chapter s corporation
D) corporation
Answer: A
Diff: 1
Topic: 1.7 The Legal Forms of Business

6) Which of the following is NOT a DISADVANTAGE of a partnership?
A) Unlimited liability to at least some of the owners.
B) The limited life of the business.
C) The potential difficulty in transferring ownership.
D) All are disadvantages of a partnership.
Answer: D
Diff: 1
Topic: 1.7 The Legal Forms of Business

7) Which of the following is NOT an ADVANTAGE of a partnership?
A) A potential increase in available capital over a sole proprietorship.
B) The commingling with the general partner's personal assets.
C) The potential for more talent and skills in the business.
D) All are advantages of a partnership.
Answer: B
Comment: This is considered a disadvantage of a partnership.
Diff: 1
Topic: 1.7 The Legal Forms of Business

8) Which of the following is NOT true of a sole proprietorship?
A) Sole proprietorships are the least regulated form of business.
B) Sole proprietorships are the easiest form of business to establish.
C) Sole proprietorships are the most popular form of business organization (more sole proprietorships than other forms of business).
D) All of the above are true.
Answer: D
Diff: 1
Topic: 1.7 The Legal Forms of Business

9) ________ is a major disadvantage of the corporate form of business.
A) Double taxation
B) Unlimited liability
C) Lack of ability to raise capital
D) Transfer of ownership
Answer: A
Diff: 1
Topic: 1.7 The Legal Forms of Business

10) The form of business organization in the United States that has the greatest amount of capital is ________.
A) the sole proprietorship.
B) the partnership.
C) the sub-chapter corporation.
D) the publicly traded corporation.
Answer: D
Diff: 1
Topic: 1.7 The Legal Forms of Business

11) Double taxation refers to which of the following scenarios?
A) Both bondholders AND shareholders of a corporation must pay taxes on proceeds received.
B) The corporation pays taxes on its earnings, and creditors pay taxes on interest received.
C) The corporation pays taxes on its earnings, and shareholders pay taxes on dividends received.
D) All of the above.
Answer: C
Diff: 1
Topic: 1.7 The Legal Forms of Business
Hmwrk Questions: * Taken from "Prepping for Exams" questions at the end of the chapter.

12) In practice:
A) The structure of the corporation separates owners from managers.
B) The corporate board selects the main corporate officers.
C) The corporate board is elected by the shareholders.
D) All of the above are true.
Answer: D
Diff: 1
Topic: 1.7 The Legal Forms of Business

13) Limited liability is an advantage of the sole proprietorship.
Answer: FALSE
Comment: UNLIMITED liability is a DISADVANTAGE of the sole proprietorship.
Diff: 1
Topic: 1.7 The Legal Forms of Business

14) The ability to raise capital is an advantage of the corporate form of business organization.
Answer: TRUE
Diff: 1
Topic: 1.7 The Legal Forms of Business

15) The sum of all the market value of publicly traded corporations in the United States exceeds the combined value of partnerships and sole proprietorships.
Answer: TRUE
Diff: 1
Topic: 1.7 The Legal Forms of Business

16) Why are sole proprietorships so much more popular in terms of the number of firms than corporations? (This answer should identify the significant advantages to the sole proprietorship versus those of other forms of business organization.)
Answer: Sole proprietorships are popular because they are easy to start up, with fewer regulations and reporting requirements than other forms of business organization. Sole proprietorships are also popular because they give individuals the opportunity to be their own boss, to make all of the decisions, and to realize 100% of the after-tax proceeds of the business.
Diff: 3
Topic: 1.7 The Legal Forms of Business

17) Define the term "limited liability" and state why you think it is an important feature of the corporate form of organization.
Answer: From a corporate standpoint, limited liability results from the corporation being defined as a legal entity with its own assets and liabilities. Limited liability thus occurs because the shareholders are responsible for no more than their investment in the corporation. Should the firm acquire greater debt than assets and declare bankruptcy, the shareholders do not have personal assets at risk for creditors to acquire.
Diff: 3
Topic: 1.7 The Legal Forms of Business

1.8 The Financial Management Setting: The Agency Model

1) ________ is the name given to the processes surrounding recognition of the principal-agent problem and ways to align agents with the interests of the principals.
A) Principal theory
B) Interested party theory
C) Agency theory
D) Compensation process theory
Answer: C
Diff: 1
Topic: 1.8 The Financial Management Setting: The Agency Model

2) In agency theory, the owners of the business are referred to as ________, and the managers are referred to as ________.
A) bondholders, principals.
B) stockholders, bondholders.
C) agents, principals.
D) principals, agents.
Answer: D
Diff: 1
Topic: 1.8 The Financial Management Setting: The Agency Model
Hmwrk Questions: * Taken from "Prepping for Exams" questions at the end of the chapter.

3) The problem of motivating one party to act in the best interest of another party is known as the ________.
A) leadership directive.
B) management priority.
C) principal-agent problem.
D) sigma six structure.
Answer: C
Diff: 1
Topic: 1.8 The Financial Management Setting: The Agency Model

4) Which of the following compensation packages is likely to work best for executive managers?
A) piece-meal
B) stock options
C) quarterly bonuses
D) commission
Answer: B
Diff: 2
Topic: 1.8 The Financial Management Setting: The Agency Model

5) According to the annual *Fortune Magazine* list of top paid executives in America, what percentage of annual compensation for the very highest paid managers comes in the form of performance bonuses or stock options?
A) Less than 10%.
B) Between 10% and 40%.
C) Between 50% and 60%.
D) Nearly 70%.
Answer: D
Diff: 2
Topic: 1.8 The Financial Management Setting: The Agency Model

6) In the agency model, the owners of corporations are the agents and the stockholders are the principals.
Answer: FALSE
Comment: In the agency model, the owners of corporations are the PRINCIPALS and the AGENTS are the MANAGERS.
Diff: 1
Topic: 1.8 The Financial Management Setting: The Agency Model

7) The problem of motivating one party to act in the best interest of another party is known as the principal-agent problem.
Answer: TRUE
Diff: 1
Topic: 1.8 The Financial Management Setting: The Agency Model

8) Describe the principal-agent relationship. In your answer, give an example of how a principal-agent problem arises in the corporate world. Can such a problem become costly? Explain.
Answer: The principal-agent relationship is a relationship between one party (principal) who hires another party (agent) to perform a task. Problems with a principal-agent relationship arise when the agent has interests that conflict with those of the principal. Any problem becomes costly when the principal cannot always know for sure if an agent is behaving in a trustworthy manner. If a principal fears the agent is not properly fulfilling the assigned duties, then the principal has to decide what costs should be undertaken to monitor the agent. Costs might include hiring another party to watch the agent or offering the agent pay based on certain performance criteria. A common performance cost for large companies is the giving of stock options to employees so that their wealth is tied to how well they do their job.
Diff: 3
Topic: 1.8 The Financial Management Setting: The Agency Model

1.9 Corporate Governance and Business Ethics

1) ________ is the area of business that deals with how a company conducts its business and implements controls to ensure proper procedures and ethical behavior.
A) Leadership
B) Agency Relationship
C) Corporate Governance
D) None of the above
Answer: C
Diff: 1
Topic: 1.9 Corporate Governance and Business Ethics

2) Of the following, which is the most recent example of legislation passed by the federal government to deal with a major economic or highly visible corporate event?
A) The Federal Deposit Insurance Corporation Improvement Act
B) The Securities and Exchange Act
C) The Sarbanes-Oxley Act
D) The Securities Act
Answer: C
Diff: 1
Topic: 1.9 Corporate Governance and Business Ethics

3) Which of the following is NOT a feature of the ?
A) The company and auditors must annually assess the effectiveness of financial controls.
B) The company must maintain effective internal financial controls.
C) The CEO and CFO must attest to the fairness of the financial reports.
D) All of the above are features of the Sarbanes-Oxley Act.
Answer: D
Diff: 1
Topic: 1.9 Corporate Governance and Business Ethics

4) Which of the following is NOT a generally accepted way to remove ineffective management of a publicly traded firm?
A) The Board of Directors can vote to remove management.
B) The shareholders can vote out directors who won't discipline managers.
C) Outside management teams can "take over" the company.
D) All of the above are recognized methods for the removal of ineffective management.
Answer: D
Diff: 2
Topic: 1.9 Corporate Governance and Business Ethics

5) The Sarbanes-Oxley Act (SOX) establishes requirements for documentation and procedures within a company, especially as they relate to financial reporting.
Answer: TRUE
Diff: 1
Topic: 1.9 Corporate Governance and Business Ethics

6) The Sarbanes-Oxley Act (SOX) established the Securities and Exchange Commission (SEC).
Answer: FALSE
Diff: 1
Topic: 1.9 Corporate Governance and Business Ethics

7) What three major requirements resulted from the Sarbanes-Oxley Act?
Answer: (1) The CEO and CFO attest to the fairness of the financial reports.
(2) The company maintains an effective internal control structure around financial reporting.
(3) The company and auditors assess the effectiveness of the controls over the most recent fiscal year.
Diff: 2
Topic: 1.9 Corporate Governance and Business Ethics