

# CHAPTER 1: THE ROLE AND OBJECTIVE OF FINANCIAL MANAGEMENT

1. The primary objective of the firm is:
  - a. Shareholder wealth maximization
  - b. Social responsibility
  - c. Long run survival
  - d. Profit maximization

*ANSWER: a*

2. The shareholder wealth maximization goal states that management should seek to maximize the\_\_\_\_\_of the expected future returns to the owners of the firm.
  - a. Future value
  - b. Compound value
  - c. Percentage value
  - d. Present value

*ANSWER: d*

3. Financial managers can take a variety of actions to influence the market value of a company's stock. All of the following are classifications of actions taken EXCEPT:
  - a. investing decisions
  - b. financing decisions
  - c. dividend decisions
  - d. tax implication decisions

*ANSWER: d*

4. Shareholder wealth is measured by the\_\_\_\_\_of the shareholders' common stock holdings.
  - a. Book value
  - b. Market value
  - c. Historic value
  - d. Compound value

*ANSWER: b*

5. The limitations of the profit maximization goal include:
  - a. It lacks a time dimension (i.e., it is static)
  - b. It fails to consider risk
  - c. The definition of profit is ambiguous
  - d. All the above are limitations

*ANSWER: d*

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6. The objective of maximizing shareholder wealth, as measured by the market value of the firm's stock
- a. does not consider the timing of the benefits received
  - b. provides a way to consider the risk of the returns being offered
  - c. benefits only certain stockholders
  - d. neither considers the timing of the benefits received nor benefits only certain stockholders

*ANSWER: b*

7. The two most important disciplines on which financial management relies are
- a. accounting and production
  - b. accounting and marketing
  - c. economics and marketing
  - d. accounting and economics

*ANSWER: d*

8. The most widely accepted objective of the firm is to
- a. minimize risk
  - b. maximize profits
  - c. maximize shareholder wealth
  - d. maximize earnings per share

*ANSWER: c*

9. When considering the risk of receiving cash flows, financial managers must be aware that:
- a. investors want higher returns for perceived greater risk.
  - b. investors want a lower valued firm to discourage future investors which might dilute their existing control.
  - c. investors expect dividends and capital gains regardless of the risks associated with achieving them.
  - d. investors always want lower returns so that the risk is minimized.

*ANSWER: a*

10. A major advantage of using the maximization of shareholder wealth as the primary goal of the firm is that this goal considers
- a. the timing and the risk of the expected benefits to be received
  - b. the investor's consumption utility
  - c. the value of closely held partnerships
  - d. all the above

*ANSWER: a*

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11. The primary reason for the divergence between the shareholder wealth maximization goal and the actual goals pursued by management has been attributed to
- a. separation of social responsibility and stakeholders' concerns
  - b. separation of ownership and control
  - c. separation of personal welfare and long-run profit goals
  - d. the granting of "golden parachute" contracts

*ANSWER:* b

12. Giving top management \_\_\_\_\_ is one method that ensures managers will act in the interest of shareholders in merger decisions.
- a. "golden parachute" contracts
  - b. excellent pay
  - c. executive perks
  - d. job security

*ANSWER:* a

13. \_\_\_\_\_ arise from the divergent objectives between owners and managers.
- a. Shareholder relationships
  - b. Stakeholder problems
  - c. Creditor problems
  - d. Agency problems

*ANSWER:* d

14. Agency costs include all of the following except:
- a. expenditures to monitor management's actions
  - b. providing stock as part of management's compensation
  - c. flotation costs
  - d. bonding expenditures

*ANSWER:* c

15. A potential agency conflict can arise between stockholders and creditors because owners may
- a. increase the risk of a firm's investments
  - b. decrease the amount of debt outstanding
  - c. decrease the risk of a firm's investments
  - d. increase the firm's net worth

*ANSWER:* a

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16. Creditors have a fixed financial claim on a company's resources through all of the following EXCEPT:
- a. long term debt
  - b. bank loans
  - c. preferred stock
  - d. commercial paper

*ANSWER: c*

17. Agency problems may give rise to costs that\_\_\_\_\_the market value of firms.
- a. increase
  - b. decrease
  - c. do not affect
  - d. are not important to

*ANSWER: b*

18. All of the following are problems with the microeconomic profit maximization model except:
- a. the absence of a time dimension
  - b. offers financial managers insights to a wide range of problems
  - c. does not consider the risk of alternative decisions
  - d. the problem of defining profits

*ANSWER: b*

19. \_\_\_\_\_are largely outside of the direct control of managers.
- a. investment strategies
  - b. economic environment factors
  - c. major policy decisions
  - d. dividend policies

*ANSWER: b*

20. The success of a firm is linked to its stakeholders. This group includes:
- a. community neighbors
  - b. suppliers
  - c. employees
  - d. all of these

*ANSWER: d*

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21. Techniques identified by John Casey that managers could keep in mind when addressing the ethical dimensions of a business problem include all of the following except:
- a. collect all the facts bearing on the problem
  - b. clarify the parameters of the problem
  - c. involve all parties with a financial interest in the outcome
  - d. seek equity for those who may be affected

*ANSWER: c*

22. Many small business owners are \_\_\_\_\_ diversified with respect to their personal wealth.
- a. poorly
  - b. highly
  - c. well
  - d. 90%

*ANSWER: a*

23. \_\_\_\_\_ deals with economic decisions of individuals, households, and firms.
- a. Economic accounting
  - b. Microeconomics
  - c. Blue Chip econometrics
  - d. Macroeconomics

*ANSWER: b*

24. Financial management draws heavily on the following related disciplines:
- a. accounting
  - b. macroeconomics
  - c. microeconomics
  - d. all of these

*ANSWER: d*

25. The chief financial officer (CFO) normally has responsibility for all the following except:
- a. advertising strategy
  - b. managing interest rate risk
  - c. trading foreign currencies
  - d. accounting functions

*ANSWER: a*

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26. The controller normally has responsibility for all\_\_\_\_related activities, while the treasurer is normally concerned with\_\_\_\_.
- a. acquisition, data processing
  - b. tax, cost accounting
  - c. tax, financial accounting
  - d. accounting, expenditure of funds

*ANSWER:* d

27. According to the shareholder wealth maximization goal, management should seek to maximize the\_\_\_\_of the to\_\_\_\_owners.
- a. present value; expected pretax cash flows
  - b. future value; expected pretax cash flows
  - c. present value; expected future returns
  - d. future value; expected future returns

*ANSWER:* c

28. Shareholder wealth is measured by the\_\_\_\_.
- a. book value of the shareholders' common stock holdings
  - b. market value of the shareholders' common stock holdings
  - c. book value of the company's assets
  - d. market value of the company's assets

*ANSWER:* b

29. Among the most important agency relationships in the context of finance is (are) the relationship(s) between\_\_\_\_\_.
- a. stockholders and creditors
  - b. management and workers
  - c. stockholders and creditors, and management and workers
  - d. management and creditors

*ANSWER:* a

30. Protective covenants in a company's bond indentures are used in agency relationships involving\_\_\_\_\_.
- a. stockholders and managers
  - b. stockholders and creditors
  - c. management and workers
  - d. management and creditors

*ANSWER:* b

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31. The chief financial officer (CFO) of a corporation normally reports to the\_\_\_\_\_of the company.
- a. chairman of the board of directors
  - b. chief operating officer
  - c. controller
  - d. chief executive officer

*ANSWER:* d

32. The\_\_\_\_\_has a goal of serving as a bridge between academic study of finance and the application of financial principles by financial managers.
- a. Financial Executives Institute
  - b. Financial Management Association
  - c. American Finance Association
  - d. Institution of Financial Analysts

*ANSWER:* b

33. All of the following economic environment factors affect stock prices except:
- a. investment strategies
  - b. competition
  - c. tax rates
  - d. currency exchange rates

*ANSWER:* a

34. The major factors that determine the market value of a company's shares of stock include the\_\_\_\_\_.
- a. risk of its cash flows
  - b. timing of its cash flows
  - c. book value of its assets
  - d. risk of its cash flows and the timing of its cash flows

*ANSWER:* d

35. There is often a divergence between the shareholder wealth maximization goal and the actual goals pursued by management. The primary reason for this is\_\_\_\_\_.
- a. geographical dispersion of shareholders
  - b. separation of ownership and control
  - c. age differences between managers and shareholders
  - d. that both have their own agendas

*ANSWER:* b

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36. The existence of divergent objectives between owners and managers is one example of a class of problems arising from \_\_\_\_.
- a. social responsibility concerns
  - b. age differences between managers and owners
  - c. agency relationships
  - d. union-management relations

*ANSWER: c*

37. The activities of the treasurer include all of the following except:
- a. financial planning
  - b. tax preparation
  - c. credit analysis
  - d. pension fund management

*ANSWER: b*

38. The most important managerial objective is to:
- a. make  $MC=MR$
  - b. maximize profits
  - c. minimize agency costs
  - d. none of these

*ANSWER: d*

39. \_\_\_\_are important because the financial health of a firm depends on the firm being able to generate sufficient cash to pay its creditors, employees, suppliers, and owners.
- a. cash sales
  - b. cash flows
  - c. cash profits
  - d. net profits

*ANSWER: b*

40. One method of decreasing the cash outflows of a firm is to
- a. decrease depreciation
  - b. increase capital expenditures
  - c. decrease dividends
  - d. increase debt repayment

*ANSWER: c*



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41. Accounting is concerned primarily with matching:

- a. cost-based revenue and expenses
- b. tax liability and future cash flows
- c. revenue and long term debt
- d. inventory and cost of sales

*ANSWER: a*

42. Generally accepted accounting principles are ambiguous in the determination of a firm's net income because:

- a. it does not reflect actual cash inflows and outflows of the firm
- b. stock dividends are difficult to forecast
- c. depreciation is a cash outlay but is not reflected as such
- d. tax laws change regularly which cause the firm to misjudge its true tax obligation

*ANSWER: a*

43. The accountant's role in the firm is to do all of the following except:

- a. prepare financial statements
- b. determine the feasibility of certain investment decisions
- c. determine the tax liability of the firm
- d. keep records of the firm's performance

*ANSWER: b*

44. The financial manager uses\_\_\_\_\_when determining the firm's most appropriate capital structure.

- a. accounting data
- b. employment benefit data
- c. federal regulations
- d. computer software design

*ANSWER: a*

45. The net present value rule provides appropriate guidance for financial decision makers when costs are incurred immediately but

- a. future cash flows are not known with certainty
- b. marginal costs are equal to marginal revenue
- c. result in a stream of benefits over several future time periods
- d. marginal costs are greater than marginal revenue

*ANSWER: c*

46. Corporate officers normally include all the following except:

- a. Secretary
- b. Chief operating officer
- c. Treasurer
- d. Financial analyst

*ANSWER: d*

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47. The difference between a firm's annual after-tax operating profit and its total annual cost of capital is known as:
- a. earned income
  - b. Economic Value Added
  - c. Managerial Value Added
  - d. operating income

*ANSWER: b*

48. \_\_\_\_\_ equals the number of shares outstanding times the market price per share.
- a. Book value
  - b. Stakeholders wealth
  - c. Total shareholder wealth
  - d. Economic value

*ANSWER: c*

49. Concern for the interests of the shareholder can be viewed as the means to the end of:
- a. maximizing long-term shareholder wealth
  - b. diminishing marginal return
  - c. maximizing risk
  - d. continuing legal litigation

*ANSWER: a*

50. The net present value of an investment made by a firm represents the contribution of that investment to the \_\_\_ of the firm.
- a. book value
  - b. profit
  - c. value
  - d. cash flow

*ANSWER: c*

51. A major advantage of the corporate form of business over both sole proprietorships and partnerships is the
- a. limited liability
  - b. reduction in taxes
  - c. ease of formation
  - d. ability to maintain ownership

*ANSWER: a*

52. An advantage that the corporate form of business has over either the sole proprietorship or partnership is the:
- a. ability to raise capital
  - b. ease of changing ownership
  - c. limited liability
  - d. elimination of double taxes

*ANSWER: d*

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53. A major disadvantage of a sole proprietorship is the fact that
- a. it is expensive to establish
  - b. the owner has unlimited personal liability
  - c. it is easy to finance growth
  - d. the owner pays taxes on all the income

*ANSWER: b*

54. In a limited partnership, the limited partners may limit their:
- a. tax liability
  - b. liability
  - c. tax write-off
  - d. ability to attract new products

*ANSWER: b*

55. Corporate securities represent claims against the
- a. corporate officers of the firm
  - b. agents of the corporation
  - c. liabilities and net worth of the firm
  - d. assets and future earnings of the firm

*ANSWER: d*

56. \_\_\_\_\_ is (are) referred to as a residual form of ownership in a corporation.
- a. Common stock
  - b. Preferred stock
  - c. Bonds
  - d. Dividends

*ANSWER: a*

57. The advantages of the corporate form of organization over both sole proprietorships and partnerships include\_\_\_\_\_.
- a. limited liability
  - b. permanency
  - c. limited liability and permanency
  - d. lower tax rates

*ANSWER: c*

58. Although this type of business generates less than 6% of the total U.S. business revenue,\_\_\_\_\_make up approximately 75% of all businesses.
- a. general partnerships
  - b. corporations
  - c. limited partnerships
  - d. sole-proprietorships

*ANSWER: d*

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59. All of the following are advantages of the corporate form of business organization EXCEPT:

- a. unlimited life
- b. unlimited liability
- c. flexibility in ownership change
- d. ability to raise capital

ANSWER: b

60. There are problems with using the “profit maximization” criterion. Which of the following is/are correct?

*I. Profit maximization has an ambiguous definition of “maximizing profits”.*

*II. Profit maximization fails to consider risk.*

- a. Only statement I is correct
- b. Only statement II is correct
- c. Both statements I and II are correct
- d. Neither statement I nor II is correct

ANSWER: c

61. Which of the following statements is/are correct?

*I. Shareholders elect the Chairman of the Board*

*II. The board of directors has no control over whether or not dividends will be paid.*

- a. Only statement I is correct
- b. Only statement II is correct
- c. Both statements I and II are correct
- d. Neither statement I nor II is correct

ANSWER: d

62. There are three major factors that determine the market value of a company’s share of stock. All of the following are factors EXCEPT:

- a. Cash flows
- b. Sales generated
- c. Timing of cash flows
- d. Risk taken to generate cash flows

ANSWER: b

63. An economic principle used in finance is:

- a. Full utilization of data processing
- b. Marginal analysis where marginal costs are set equal to marginal revenues.
- c. Accrual basis of recognizing revenues and expenses
- d. Target capital structure

ANSWER: b

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64. The definition of the marginal analysis principle is that financial decisions are made and actions are taken
- within the global economic viewpoint.
  - with regard to governmental laws and cultural effectiveness.
  - when the added benefits exceed the added costs.
  - based on the impact of public opinion.

*ANSWER: c*

65. There are three forms of business organization. Which of the following has unlimited liability?

*I. Corporation*

*II. General partnership*

- Only statement I is correct
- Only statement II is correct
- Both statements I and II are correct
- Neither statement I nor II is correct

*ANSWER: b*

66. The managerial decision that emerges from the microeconomic profit maximization model is:

- Marginal Costs < Marginal Revenues
- Marginal Costs = Profits
- Marginal Revenues > Marginal Costs
- Marginal Costs = Marginal Revenue

*ANSWER: d*

67. Sole proprietorships, partnerships and corporations are the three main forms of business organization. There are other types which are referred to as hybrids. Examples of hybrid business forms are:

- 10K & 14B Corporations
- Section 8 and Subchapter S Corporations
- Subchapter S and LLCs
- 10K Corporations and LLCs

*ANSWER: c*

68. The type of corporate security that pays periodic interest as well as the eventual return of principal is:

- Preferred stock
- Debt Securities
- Equity Securities
- Fixed asset loans

*ANSWER: b*

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69. What is the function of the CFO?

- a. Control of the accounting functions of the firm.
- b. Effective communication with the investment community about the firm's performance.
- c. Oversight of the financial statements.
- d. Determination of effective tax reduction strategies.

*ANSWER: b*

70. According to the Small Business Administration, what percent of all businesses are considered small businesses?

- a. >20%
- b. >75%
- c. >95%
- d. >50%

*ANSWER: c*

71. Financial decisions should be consistent with the goal of shareholder wealth maximization. However, there may be a divergence between shareholder wealth maximization and the actual goals of management. The primary reason for this is:

- a. Management wants to ensure good public relations.
- b. The Board of Directors is becoming increasingly uninvolved within the corporation.
- c. Shareholders do not feel that wealth maximization is relevant.
- d. There is a separation of ownership and control in corporations.

*ANSWER: d*

72. As a result of accounting scandals, several methods have been developed to deal with the issues of corporate governance. They are all of the following EXCEPT:

- a. The Board must select only SEC approved consultants.
- b. Chairman of the Board position should be split from the CEO position.
- c. Board of Directors should have a majority of independent directors.
- d. The Board of Directors must explain its approach for adopting a code of ethics for the CEO and senior financial officers.

*ANSWER: a*

73. Maximization of shareholder wealth is not an accounting concept. A corporation's value should be based on

- a. liquidation value
- b. book value
- c. market value
- d. stock value

*ANSWER: c*

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74. A corporation that operates ethically will notice certain benefits as it applies to shareholder wealth maximization. With shareholder wealth maximization in mind, all of the following could be experienced by an ethical corporation EXCEPT:
- a. The corporation can expect to have reduced litigation expense.
  - b. The cooperation can expect to have greater agency costs.
  - c. The corporation can expect to have reduced damages expenses.
  - d. The corporation can expect to have a more favorable impression by customers and investors.

*ANSWER:* b

75. Examples of agency costs incurred by shareholders to minimize agency problems are:
- a. Expenditures associated with independent auditing.
  - b. Expenditures associated with SEC approval.
  - c. Expenditures associated with monitoring management's actions
  - d. Expenditures associated with inventory control.

*ANSWER:* c

76. Explain the chain of command in a corporation.

*ANSWER:* The stockholders, who own a pro-rata share of the company, elect the board of directors. The board makes broad decisions affecting the direction of the company, leaving the day-to-day decisions to the corporate officers, who are elected by the board. Corporate officers are: the chairman of the board, the chief executive officer, the chief operating officer, chief financial officer, president, vice-president(s), treasurer and secretary.

77. There are five competitive forces that influence an industry's structure.

*ANSWER:*

1. The threat of new entrants.
2. The threat of substitute products
3. The bargaining power of buyers
4. The bargaining power of suppliers
5. The rivalry among current competitors

78. What are the shortcomings in the profit maximization objective as a managerial strategy?

*ANSWER:*

1. Profit maximization lacks a time dimension.
2. There are many definitions of profit for a firm. There is much latitude permitted in recognizing and accounting for costs and revenues.
3. There is a question as to which profit is to be maximized: total profit, rate of profit or EPS.
4. There is no direct way to consider the risk associated with alternative decisions.

79. Preferred stock is considered priority stock. Explain this priority.

*ANSWER:* Common stock is a residual form of ownership. Preferred stock has priority over common stockholders with regard to the firm's earnings and assets. Preferred stockholders are paid cash dividends before common stockholders. In the event of bankruptcy or liquidation, preferred stockholders are ahead of common stockholders in the distribution of the corporation's assets.

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80. What is the advantage of an LLC over an LLP business form?

*ANSWER:* An LLC (or limited liability company) has three advantages:

1. Has better access to capital to finance growth.
2. It enables broad employee ownership of the firm.
3. It enables the firm to engage in strategic acquisitions.

81. List examples of agency costs which are incurred by shareholders in trying to minimize agency problems.

*ANSWER:*

1. Expenditures to structure the organization in such a way as to minimize the incentives for management to take actions contrary to shareholders interests.
2. Expenditures to monitor management's actions, such as paying for audits of managerial performance and internal audits of the firm's expenditures.
3. Bonding expenditures to protect the owners from managerial dishonesty.
4. The opportunity cost of lost profits arising from complex organizational structures that prevent management from making timely responses to opportunities.

82. Since small business owners have much of their own money tied up in their business, small business owners are most concerned with:

- a. avoiding risk
- b. making a profit
- c. expanding
- d. inventory control

*ANSWER:* d

83. Between 2008-2009 there were several ethical issues that caused the financial collapse. All of the following are a breach of financial ethics except:

- a. collateralized mortgage obligation scandal
- b. Treasury bond trading scandal
- c. insider stock trading scandal
- d. economic stimulus package scandal

*ANSWER:* d

84. \_\_\_\_\_ provide a direct measure of the success of decisions made by a firm's managers.

- a. profits
- b. stock prices
- c. sales
- d. dividends per share

*ANSWER:* b