

Chapter 01 Introduction to Financial Management

Multiple Choice Questions

1. In 2006, a significant indicator of the U.S. economic decline was:
 - A. a significant drop in interest rates
 - B. a sharp increase in unregulated Ponzi-type security sales
 - C. rising defaults by subprime mortgage borrowers
 - D. a large increase in loan default due to unemployment

2. The financial crisis that started in 2006 was magnified by which of the following:
 - A. Public concern over the war in Afghanistan
 - B. Consistently increasing oil and gas prices
 - C. Ethical issues affecting high value investment
 - D. Mortgage lenders securitizing large quantities of their loans

3. Not all cash a company generates will be returned to the investors. Which of the following will NOT reduce the amount of capital returned to the investors?
 - A. retained earnings
 - B. taxes
 - C. dividends
 - D. None of these will reduce the amount of capital returned to the investors.

4. This subarea of finance involves methods and techniques to make appropriate decisions about what kinds of securities to own, which firms' securities to buy, and how to be paid back in the form that the investor wishes.
 - A. real markets
 - B. investments
 - C. financial management
 - D. none of these

5. This subarea of finance looks at firm decisions in acquiring and utilizing cash received from investors or from retained earnings.

- A. investments
- B. financial management
- C. treasury management
- D. none of these

6. Financial management involves decisions about which of the following:

- A. Which projects to fund
- B. How to minimize taxation
- C. What type of capital should be raised
- D. All of these.

7. This subarea of finance helps facilitate the capital flows between investors and companies.

- A. investments
- B. financial management
- C. treasury management
- D. financial institutions and markets

8. This subarea of finance is important for adapting to the global economy.

- A. investments
- B. financial management
- C. international finance
- D. financial institutions and markets

9. A potential future negative impact to value and/or cash flows is often discussed in terms of probability of loss and the expected magnitude of the loss. This is called _____.

- A. options
- B. standard deviation
- C. coefficient of variation
- D. risk

10. This is a general term for securities like stocks, bonds, and other assets that represent ownership in a cash flow.

- A. investment
- B. financial asset
- C. real asset
- D. financial markets

11. Which of the following is the firm's highest-level financial manager?

- A. Chief Executive Officer
- B. Chief Financial Officer
- C. Board of Directors
- D. Corporate Governance

12. Which of the following managers would NOT use finance?

- A. Operational managers
- B. Marketing managers
- C. Human resource managers
- D. All of these would use finance.

13. Which of the following personal decisions is NOT impacted by finance?

- A. Borrowing money to purchase cars or homes
- B. Making credit card payments
- C. Making retirement decisions
- D. All of these are impacted by finance.

14. When determining a form of business organization, all of the following are considered EXCEPT:

- A. Who owns the firm.
- B. What are the owners' risks.
- C. What are the tax ramifications.
- D. The physical location of the business.

15. This type of business organization is relatively easy to start, and it is subject to much lighter regulatory and paperwork burden than other business forms.

- A. Sole proprietorship
- B. Partnership
- C. Corporation
- D. Hybrid organization

16. This type of business organization is legally independent entirely from its owners.

- A. Sole proprietorship
- B. Partnership
- C. Public Corporations
- D. Hybrid organizations

17. Which of the following is NOT considered a hybrid organization?

- A. S Corporation
- B. Limited Liability Partnership
- C. Limited Liability Company
- D. Limited Partnership
- E. All of these are considered hybrid organizations.

18. The practice generally known as double taxation is due to

- A. shareholders' dividends being taxed at both the federal and state levels.
- B. corporate income being taxed at both the federal and state levels.
- C. interest on shareholders' dividends being taxed as income.
- D. corporate incomes being taxed at the corporate level, then again at the shareholder level when corporate profits are paid out as dividends.

19. As individual legal entities, corporations assume liability for their own debts, so the shareholders hold

- A. only limited liability.
- B. unlimited liability.
- C. shared liability.
- D. joint liability.

20. For corporations, maximizing the value of owner's equity can also be stated as
- A. maximizing retained earnings.
 - B. maximizing earnings per share.
 - C. maximizing net income.
 - D. maximizing the stock price.
21. A metaphor used to illustrate how an individual pursuing his own interests also tends to promote the good of the community.
- A. agency theory
 - B. angel investor
 - C. invisible hand
 - D. perks/perquisites
22. This should be the primary objective of a firm as it may actually be the most beneficial for society in the long run.
- A. Minimizing layoffs
 - B. Maximizing market share
 - C. Minimizing costs
 - D. Maximizing shareholder value
23. Nonwage compensation which might actually enhance owner value, in that such items may boost managers' productivity.
- A. agency theory
 - B. angel investor
 - C. invisible hand
 - D. perks/prerequisites
24. Which of these are NOT basic approaches to minimizing the agency problem?
- A. Just ignore the conflict of interest.
 - B. Monitor managers' actions.
 - C. Align managers' personal interest with those of the owners by making the managers owners.
 - D. All of these are basic approaches to minimizing the agency problem.

25. Which of the following is an example of aligning managers' personal interests with those of the owners?

- A. Allow the managers to have as many perks as they request.
- B. Pay the managers high salaries.
- C. Offer the managers an equity stake in the firm.
- D. Trust the managers' actions as they will always act in the owners' best interest.

26. This is the set of laws, policies, incentives, and monitors designed to handle the issues arising from the separation of ownership and control.

- A. agency theory
- B. corporate governance
- C. defined benefit plan
- D. invisible hand

27. This group is elected by stockholders to oversee management in a corporation.

- A. Chief Counselors
- B. Chief Executives
- C. Board of Directors
- D. Auditors

28. These individuals examine the firm's accounting systems and comment on whether financial statements fairly represent the firm's financial position.

- A. Accounting departments
- B. Chief Financial Officers
- C. Board of Directors
- D. Auditors

29. These individuals follow a firm, conduct their own evaluations of the company's business activities, and report to the investment community.

- A. Auditors
- B. Investment analysts
- C. Investment bankers
- D. Credit analysts

30. These individuals help firms access capital markets and advise managers about how to interact with those capital markets.

- A. Auditors
- B. Investment analysts
- C. Investment bankers
- D. Credit analysts

31. These individuals examine a firm's financial strength for its debt holders.

- A. Auditors
- B. Investment analysts
- C. Investment bankers
- D. Credit analysts

32. A legal duty between two parties where one party must act in the interest of the other party.

- A. Agency theory
- B. Angel Investor
- C. Fiduciary
- D. Investment banker

33. Between corporate managers and stockholders, this can create ethical dilemmas.

- A. Agency relationship
- B. Auditors
- C. Boards of Directors
- D. Venture capitalist

34. Individuals who provide small amounts of capital and expert business advice to small firms in exchange for an ownership stake in the firm are referred to as

-
- A. institutional investors
 - B. corporate investors
 - C. angel investors
 - D. capital investors

35. The opportunity to buy stock at a fixed price over a specific period of time is referred to as _____.

- A. Stock opportunities
- B. Stock options
- C. Real assets
- D. Restricted stock

36. The portion of a company's profits that are kept by the company rather than distributed to the stockholders as cash dividends is referred to as _____.

- A. Restricted earnings
- B. Venture capital
- C. Retained earnings
- D. Institutional investment

37. An employee stock option plan is _____.

- A. A perk usually only given to the board of directors as compensation
- B. A plan that only partnerships can use to defer compensation to partners
- C. A way to align the interests of employees with those of the owners
- D. None of these answers are correct.

38. Outside parties that monitor the firm include all of the following except _____.

- A. Credit Agencies
- B. New York Stock Exchange
- C. Analysts
- D. Bankers

39. All of the following are functions of the board of directors except _____.

- A. Hire the CEO
- B. Evaluate the CEO
- C. Design compensation contracts for the CEO
- D. Provide reports to the auditors

40. The overall goal of the financial manager is to _____.
- A. Minimize total costs
 - B. Maximize net income
 - C. Maximize earnings per share
 - D. Maximize shareholder wealth
41. Maximizing owners' equity value means carefully considering all of the following except _____.
- A. How to best bring additional funds into the firm
 - B. Which projects to invest in
 - C. How best to increase the firm's risk
 - D. How best to return the profits from those projects to the owners over time
42. The agency relationship in corporate finance refers to _____.
- A. when the shareholders hire a manager to run their company
 - B. when the corporate hires an advertising agency to market their new product/service
 - C. when the board of directors are elected to staggered terms
 - D. when the board of directors oversee the CEO
43. The most common type of business in the United States is the _____.
- A. Corporation
 - B. Partnership
 - C. Sole Proprietorship
 - D. Hybrid organization such as a limited liability company
44. The biggest disadvantage of the sole proprietorship is _____.
- A. Unlimited liability
 - B. Double taxation
 - C. Limited access to capital
 - D. Total control

45. Which of the following statements is incorrect?

- A. Sole proprietorships are subject to less regulation.
- B. Both angel investors and venture capitalists exchange capital for ownership.
- C. Shareholders are responsible for paying off the corporate bonds in the event of a bankruptcy.
- D. All of these statements are correct.

46. All of the following are advantages to organizing as a corporation except _____.

- A. Limited liability
- B. Double taxation
- C. Easy access to capital
- D. Easy to transfer ownership

47. Which of the following statements is correct?

- A. Sole proprietorships are easy to start.
- B. If the sole proprietorship gets sued, the owner is not liable.
- C. It is relatively easy for sole proprietorships to raise money.
- D. Profits from the sole proprietorship are subject to double taxation.

48. From a taxation perspective, the form of business organization with the highest business level taxes is the _____.

- A. Sole proprietorship
- B. Corporation
- C. Partnership
- D. S Corporation

49. From the perspective of access to capital, the best form of business organization is the _____.

- A. Sole proprietorship
- B. Corporation
- C. Partnership
- D. S Corporation

50. From the perspective of ownership risk, the best form of business organization is the

_____.

- A. Sole proprietorship
- B. Corporation
- C. Partnership
- D. S Corporation

51. From the perspective of control, the best form of business organization is the

_____.

- A. Sole proprietorship
- B. Corporation
- C. Partnership
- D. S Corporation

52. Which of the following statements is incorrect?

- A. Partnerships have unlimited liability.
- B. Most sole proprietors raise money by borrowing from banks.
- C. An advantage of sole proprietorships is that the owner has complete control.
- D. S corporations are considered a hybrid organization.

53. Which statement is incorrect regarding hybrid organizations?

- A. They offer single taxation.
- B. They offer limited risk to the owners.
- C. They offer the same type of control as a sole proprietorship.
- D. All of these answers are correct statements.

54. Agency problems exist in which forms of business ownership?

- A. Sole proprietorship
- B. S corporation
- C. Partnership
- D. Corporation

55. Methods to minimize agency problem include all except _____.

- A. Offer the managers an equity stake in the firm
- B. Award the CEO stock options
- C. Allow the CEO to purchase stock via an employee stock option plan
- D. Allow the CEO to purchase bonds via an employee bond option plan

56. All of the following are an example of a fiduciary relationship except:

- A. a bank employee manages deposits
- B. a financial advisor advises her clients
- C. a CEO manages the firm
- D. the shareholder elects a board member

57. Restricted stock is:

- A. a special type of stock that is not transferable from the current holder to others until specific conditions are satisfied.
- B. a special type of stock that can be converted into corporate bonds after a specific amount of time has elapsed.
- C. a special type of stock that is a result of offering an employee stock ownership plan.
- D. None of these answers is correct.

58. The board of directors _____.

- A. are hired by the CEO
- B. are elected by shareholders
- C. have unlimited liability since they oversee the day-to-day operations of the firm
- D. are employed by the Securities Exchange Commission to ensure its rules and regulations have been met

59. An angel investor differs from a venture capitalist because of the:

- A. type of investment.
- B. investment time frame.
- C. size of investment.
- D. voting rights.

60. Corporate stakeholders include all of the following except:

- A. Employees
- B. Shareholders
- C. Suppliers
- D. Auditors

61. What is the difference in perspective between finance and accounting?

- A. Timing
- B. Risk
- C. Liability
- D. Ownership

62. Which of the following statements is correct?

- A. Accountants are focused on what happened in the past.
- B. Financial managers are focused on what happened in the past.
- C. Both accountants and financial managers use total quality management systems to standardize data.
- D. Financial managers double-check the accountant's statements.

Essay Questions

63. One approach to aligning managers' personal interest with those of the owners is to make the managers owners. List the avenues that a firm could use to offer managers an equity stake in the firm.

64. How do financial institutions impact business firms?

65. Explain what started the financial crisis of 2006 and why it escalated on a such a widespread scale.

Chapter 01 Introduction to Financial Management **Answer Key**

Multiple Choice Questions

1. In 2006, a significant indicator of the U.S. economic decline was:

- A. a significant drop in interest rates
- B. a sharp increase in unregulated Ponzi-type security sales
- C. rising defaults by subprime mortgage borrowers**
- D. a large increase in loan default due to unemployment

AACSB: Analytical

Blooms: Remember

Difficulty: 1 Basic

Learning Objective: 01-09 Explain the fundamental causes of the financial crisis that started in 2006.

Source: NEW

Topic: Financial Crisis

2. The financial crisis that started in 2006 was magnified by which of the following:

- A. Public concern over the war in Afghanistan
- B. Consistently increasing oil and gas prices
- C. Ethical issues affecting high value investment
- D. Mortgage lenders securitizing large quantities of their loans**

AACSB: Analytical

Blooms: Remember

Difficulty: 1 Basic

Learning Objective: 01-09 Explain the fundamental causes of the financial crisis that started in 2006.

Source: NEW

Topic: Financial Crisis

3. Not all cash a company generates will be returned to the investors. Which of the following will NOT reduce the amount of capital returned to the investors?

A. retained earnings

B. taxes

C. dividends

D. None of these will reduce the amount of capital returned to the investors.

AACSB: Reflective Thinking

Blooms: Remember

Blooms: Understand

Difficulty: 1 Basic

Learning Objective: 01-01 Define the major areas of finance as they apply to corporate financial management.

Source: NEW

Topic: Cash not returned to investors

4. This subarea of finance involves methods and techniques to make appropriate decisions about what kinds of securities to own, which firms' securities to buy, and how to be paid back in the form that the investor wishes.

A. real markets

B. investments

C. financial management

D. none of these

AACSB: Reflective Thinking

Blooms: Remember

Blooms: Understand

Difficulty: 1 Basic

Learning Objective: 01-01 Define the major areas of finance as they apply to corporate financial management.

Source: NEW

Topic: Subareas of Finance

5. This subarea of finance looks at firm decisions in acquiring and utilizing cash received from investors or from retained earnings.

- A. investments
- B. financial management**
- C. treasury management
- D. none of these

AACSB: Reflective Thinking

Blooms: Remember

Blooms: Understand

Difficulty: 1 Basic

Learning Objective: 01-01 Define the major areas of finance as they apply to corporate financial management.

Source: NEW

Topic: Subareas of Finance

6. Financial management involves decisions about which of the following:

- A. Which projects to fund
- B. How to minimize taxation
- C. What type of capital should be raised
- D. All of these.**

AACSB: Reflective Thinking

Blooms: Remember

Blooms: Understand

Difficulty: 1 Basic

Learning Objective: 01-01 Define the major areas of finance as they apply to corporate financial management.

Source: NEW

Topic: Subareas of Finance

7. This subarea of finance helps facilitate the capital flows between investors and companies.

- A. investments
- B. financial management
- C. treasury management
- D. financial institutions and markets**

AACSB: Reflective Thinking

Blooms: Remember

Blooms: Understand

Difficulty: 1 Basic

Learning Objective: 01-01 Define the major areas of finance as they apply to corporate financial management.

Source: NEW

Topic: Subareas of Finance

8. This subarea of finance is important for adapting to the global economy.
- A. investments
 - B. financial management
 - C. international finance**
 - D. financial institutions and markets

AACSB: Reflective Thinking

Blooms: Remember

Blooms: Understand

Difficulty: 1 Basic

Learning Objective: 01-01 Define the major areas of finance as they apply to corporate financial management.

Source: NEW

Topic: Subareas of Finance

9. A potential future negative impact to value and/or cash flows is often discussed in terms of probability of loss and the expected magnitude of the loss. This is called _____.
- A. options
 - B. standard deviation
 - C. coefficient of variation
 - D. risk**

AACSB: Reflective Thinking

Blooms: Remember

Blooms: Understand

Difficulty: 1 Basic

Learning Objective: 01-01 Define the major areas of finance as they apply to corporate financial management.

Source: NEW

Topic: Application and theory for financial decisions

10. This is a general term for securities like stocks, bonds, and other assets that represent ownership in a cash flow.
- A. investment
 - B. financial asset**
 - C. real asset
 - D. financial markets

AACSB: Reflective Thinking

Blooms: Remember

Blooms: Understand

Difficulty: 1 Basic

Learning Objective: 01-01 Define the major areas of finance as they apply to corporate financial management.

Source: NEW

Topic: Financial Assets

11. Which of the following is the firm's highest-level financial manager?

- A. Chief Executive Officer
- B. Chief Financial Officer**
- C. Board of Directors
- D. Corporate Governance

AACSB: Reflective Thinking

Blooms: Remember

Blooms: Understand

Difficulty: 1 Basic

Learning Objective: 01-02 Show how finance is at the heart of sound business decisions.

Source: NEW

Topic: Financial Manager

12. Which of the following managers would NOT use finance?

- A. Operational managers
- B. Marketing managers
- C. Human resource managers
- D. All of these would use finance.**

AACSB: Reflective Thinking

Blooms: Remember

Blooms: Understand

Difficulty: 1 Basic

Learning Objective: 01-02 Show how finance is at the heart of sound business decisions.

Source: NEW

Topic: Finance in relation to other business functions

13. Which of the following personal decisions is NOT impacted by finance?

- A. Borrowing money to purchase cars or homes
- B. Making credit card payments
- C. Making retirement decisions
- D. All of these are impacted by finance.**

AACSB: Reflective Thinking

Blooms: Remember

Blooms: Understand

Difficulty: 1 Basic

Learning Objective: 01-03 Learn the financial principles that govern your personal decisions.

Source: NEW

Topic: Finance in personal life

14. When determining a form of business organization, all of the following are considered EXCEPT:

- A. Who owns the firm.
- B. What are the owners' risks.
- C. What are the tax ramifications.
- D.** The physical location of the business.

AACSB: Reflective Thinking

Blooms: Remember

Blooms: Understand

Difficulty: 1 Basic

Learning Objective: 01-04 Examine the three most common forms of business organization in the United States today.

Source: NEW

Topic: Business Organization

15. This type of business organization is relatively easy to start, and it is subject to much lighter regulatory and paperwork burden than other business forms.

- A.** Sole proprietorship
- B. Partnership
- C. Corporation
- D. Hybrid organization

AACSB: Reflective Thinking

Blooms: Remember

Blooms: Understand

Difficulty: 1 Basic

Learning Objective: 01-04 Examine the three most common forms of business organization in the United States today.

Source: NEW

Topic: Business Organization

16. This type of business organization is legally independent entirely from its owners.

- A. Sole proprietorship
- B. Partnership
- C.** Public Corporations
- D. Hybrid organizations

AACSB: Reflective Thinking

Blooms: Remember

Blooms: Understand

Difficulty: 1 Basic

Learning Objective: 01-04 Examine the three most common forms of business organization in the United States today.

Source: NEW

Topic: Business Organization

17. Which of the following is NOT considered a hybrid organization?

- A. S Corporation
- B. Limited Liability Partnership
- C. Limited Liability Company
- D. Limited Partnership
- E. All of these are considered hybrid organizations.**

AACSB: Reflective Thinking

Blooms: Remember

Blooms: Understand

Difficulty: 1 Basic

Learning Objective: 01-04 Examine the three most common forms of business organization in the United States today.

Source: NEW

Topic: Business Organization

18. The practice generally known as double taxation is due to

- A. shareholders' dividends being taxed at both the federal and state levels.
- B. corporate income being taxed at both the federal and state levels.
- C. interest on shareholders' dividends being taxed as income.
- D. corporate incomes being taxed at the corporate level, then again at the shareholder level when corporate profits are paid out as dividends.**

AACSB: Reflective Thinking

Blooms: Remember

Blooms: Understand

Difficulty: 2 Intermediate

Learning Objective: 01-04 Examine the three most common forms of business organization in the United States today.

Source: NEW

Topic: Business Organization

19. As individual legal entities, corporations assume liability for their own debts, so the shareholders hold

- A. only limited liability.**
- B. unlimited liability.
- C. shared liability.
- D. joint liability.

AACSB: Reflective Thinking

Blooms: Remember

Blooms: Understand

Difficulty: 1 Basic

Learning Objective: 01-04 Examine the three most common forms of business organization in the United States today.

Source: NEW

Topic: Business Organization

20. For corporations, maximizing the value of owner's equity can also be stated as
- A. maximizing retained earnings.
 - B. maximizing earnings per share.
 - C. maximizing net income.
 - D.** maximizing the stock price.

AACSB: Reflective Thinking

Blooms: Remember

Blooms: Understand

Difficulty: 1 Basic

Learning Objective: 01-05 Distinguish among appropriate and inappropriate goals for financial managers.

Source: NEW

Topic: Firm goals

21. A metaphor used to illustrate how an individual pursuing his own interests also tends to promote the good of the community.
- A. agency theory
 - B. angel investor
 - C.** invisible hand
 - D. perks/perquisites

AACSB: Reflective Thinking

Blooms: Remember

Blooms: Understand

Difficulty: 2 Intermediate

Learning Objective: 01-05 Distinguish among appropriate and inappropriate goals for financial managers.

Source: NEW

Topic: Firm goals

22. This should be the primary objective of a firm as it may actually be the most beneficial for society in the long run.
- A. Minimizing layoffs
 - B. Maximizing market share
 - C. Minimizing costs
 - D.** Maximizing shareholder value

AACSB: Reflective Thinking

Blooms: Remember

Blooms: Understand

Difficulty: 2 Intermediate

Learning Objective: 01-05 Distinguish among appropriate and inappropriate goals for financial managers.

Source: NEW

Topic: Firm goals

23. Nonwage compensation which might actually enhance owner value, in that such items may boost managers' productivity.

- A. agency theory
- B. angel investor
- C. invisible hand
- D.** perks/prerequisites

AACSB: Reflective Thinking

Blooms: Remember

Blooms: Understand

Difficulty: 1 Basic

Learning Objective: 01-06 Identify a firm's primary agency relationship and discuss the possible conflicts that may arise.

Source: NEW

Topic: Corporate governance

24. Which of these are NOT basic approaches to minimizing the agency problem?

- A. Just ignore the conflict of interest.
- B. Monitor managers' actions.
- C. Align managers' personal interest with those of the owners by making the managers owners.
- D.** All of these are basic approaches to minimizing the agency problem.

AACSB: Reflective Thinking

Blooms: Remember

Blooms: Understand

Difficulty: 2 Intermediate

Learning Objective: 01-06 Identify a firm's primary agency relationship and discuss the possible conflicts that may arise.

Source: NEW

Topic: Agency theory

25. Which of the following is an example of aligning managers' personal interests with those of the owners?

- A. Allow the managers to have as many perks as they request.
- B. Pay the managers high salaries.
- C.** Offer the managers an equity stake in the firm.
- D. Trust the managers' actions as they will always act in the owners' best interest.

AACSB: Reflective Thinking

Blooms: Remember

Blooms: Understand

Difficulty: 2 Intermediate

Learning Objective: 01-06 Identify a firm's primary agency relationship and discuss the possible conflicts that may arise.

Source: NEW

Topic: Agency theory

26. This is the set of laws, policies, incentives, and monitors designed to handle the issues arising from the separation of ownership and control.

- A. agency theory
- B. corporate governance**
- C. defined benefit plan
- D. invisible hand

AACSB: Reflective Thinking

Blooms: Remember

Blooms: Understand

Difficulty: 1 Basic

Learning Objective: 01-06 Identify a firm's primary agency relationship and discuss the possible conflicts that may arise.

Source: NEW

Topic: Corporate governance

27. This group is elected by stockholders to oversee management in a corporation.

- A. Chief Counselors
- B. Chief Executives
- C. Board of Directors**
- D. Auditors

AACSB: Reflective Thinking

Blooms: Remember

Blooms: Understand

Difficulty: 1 Basic

Learning Objective: 01-06 Identify a firm's primary agency relationship and discuss the possible conflicts that may arise.

Source: NEW

Topic: Corporate governance monitors

28. These individuals examine the firm's accounting systems and comment on whether financial statements fairly represent the firm's financial position.

- A. Accounting departments
- B. Chief Financial Officers
- C. Board of Directors
- D. Auditors**

AACSB: Reflective Thinking

Blooms: Remember

Blooms: Understand

Difficulty: 1 Basic

Learning Objective: 01-06 Identify a firm's primary agency relationship and discuss the possible conflicts that may arise.

Source: NEW

Topic: Corporate governance monitors

29. These individuals follow a firm, conduct their own evaluations of the company's business activities, and report to the investment community.

- A. Auditors
- B. Investment analysts**
- C. Investment bankers
- D. Credit analysts

AACSB: Reflective Thinking

Blooms: Remember

Blooms: Understand

Difficulty: 2 Intermediate

Learning Objective: 01-06 Identify a firm's primary agency relationship and discuss the possible conflicts that may arise.

Source: NEW

Topic: Corporate governance monitors

30. These individuals help firms access capital markets and advise managers about how to interact with those capital markets.

- A. Auditors
- B. Investment analysts
- C. Investment bankers**
- D. Credit analysts

AACSB: Reflective Thinking

Blooms: Remember

Blooms: Understand

Difficulty: 2 Intermediate

Learning Objective: 01-06 Identify a firm's primary agency relationship and discuss the possible conflicts that may arise.

Source: NEW

Topic: Corporate governance monitors

31. These individuals examine a firm's financial strength for its debt holders.

- A. Auditors
- B. Investment analysts
- C. Investment bankers
- D. Credit analysts**

AACSB: Reflective Thinking

Blooms: Remember

Blooms: Understand

Difficulty: 2 Intermediate

Learning Objective: 01-06 Identify a firm's primary agency relationship and discuss the possible conflicts that may arise.

Source: NEW

Topic: Corporate governance monitors

32. A legal duty between two parties where one party must act in the interest of the other party.

- A. Agency theory
- B. Angel Investor
- C. Fiduciary**
- D. Investment banker

AACSB: Reflective Thinking

Blooms: Remember

Blooms: Understand

Difficulty: 2 Intermediate

Learning Objective: 01-07 Discuss how ethical decision making is part of the study of financial management.

Source: NEW

Topic: Ethics

33. Between corporate managers and stockholders, this can create ethical dilemmas.

- A. Agency relationship**
- B. Auditors
- C. Boards of Directors
- D. Venture capitalist

AACSB: Reflective Thinking

Blooms: Remember

Blooms: Understand

Difficulty: 2 Intermediate

Learning Objective: 01-07 Discuss how ethical decision making is part of the study of financial management.

Source: NEW

Topic: Agency relationship

34. Individuals who provide small amounts of capital and expert business advice to small firms in exchange for an ownership stake in the firm are referred to as

-
- A. institutional investors
 - B. corporate investors
 - C. angel investors**
 - D. capital investors

AACSB: Analytical

Blooms: Remember

Difficulty: 1 Basic

Learning Objective: 01-04 Examine the three most common forms of business organization in the United States today.

Source: NEW

Topic: Business Organization

35. The opportunity to buy stock at a fixed price over a specific period of time is referred to as _____.

- A. Stock opportunities
- B. Stock options**
- C. Real assets
- D. Restricted stock

AACSB: Analytical

Blooms: Remember

Difficulty: 1 Basic

Learning Objective: 01-06 Identify a firm's primary agency relationship and discuss the possible conflicts that may arise.

Source: NEW

Topic: Stock options

36. The portion of a company's profits that are kept by the company rather than distributed to the stockholders as cash dividends is referred to as _____.

- A. Restricted earnings
- B. Venture capital
- C. Retained earnings**
- D. Institutional investment

AACSB: Analytical

Blooms: Remember

Difficulty: 1 Basic

Learning Objective: 01-01 Define the major areas of finance as they apply to corporate financial management.

Source: NEW

Topic: Finance in Business

37. An employee stock option plan is _____.

- A. A perk usually only given to the board of directors as compensation
- B. A plan that only partnerships can use to defer compensation to partners
- C. A way to align the interests of employees with those of the owners**
- D. None of these answers are correct.

AACSB: Analytical

Blooms: Remember

Difficulty: 1 Basic

Learning Objective: 01-06 Identify a firm's primary agency relationship and discuss the possible conflicts that may arise.

Source: NEW

Topic: Agency theory

38. Outside parties that monitor the firm include all of the following except _____.

- A. Credit Agencies
- B. New York Stock Exchange**
- C. Analysts
- D. Bankers

AACSB: Analytical

Blooms: Remember

Difficulty: 1 Basic

Learning Objective: 01-06 Identify a firm's primary agency relationship and discuss the possible conflicts that may arise.

Source: NEW

Topic: Agency theory

39. All of the following are functions of the board of directors except _____.

- A. Hire the CEO
- B. Evaluate the CEO
- C. Design compensation contracts for the CEO
- D. Provide reports to the auditors**

AACSB: Analytical

Blooms: Remember

Difficulty: 1 Basic

Learning Objective: 01-06 Identify a firm's primary agency relationship and discuss the possible conflicts that may arise.

Source: NEW

Topic: Agency theory

40. The overall goal of the financial manager is to _____.

- A. Minimize total costs
- B. Maximize net income
- C. Maximize earnings per share
- D. Maximize shareholder wealth**

AACSB: Analytical

Blooms: Remember

Difficulty: 1 Basic

Learning Objective: 01-01 Define the major areas of finance as they apply to corporate financial management.

Source: NEW

Topic: Firm goals

41. Maximizing owners' equity value means carefully considering all of the following except _____.

- A. How to best bring additional funds into the firm
- B. Which projects to invest in
- C. How best to increase the firm's risk**
- D. How best to return the profits from those projects to the owners over time

AACSB: Analytical

Blooms: Remember

Difficulty: 1 Basic

Learning Objective: 01-01 Define the major areas of finance as they apply to corporate financial management.

Source: NEW

Topic: Firm goals

42. The agency relationship in corporate finance refers to _____.

- A. when the shareholders hire a manager to run their company**
- B. when the corporate hires an advertising agency to market their new product/service
- C. when the board of directors are elected to staggered terms
- D. when the board of directors oversee the CEO

AACSB: Analytical

Blooms: Remember

Difficulty: 1 Basic

Learning Objective: 01-06 Identify a firm's primary agency relationship and discuss the possible conflicts that may arise.

Source: NEW

Topic: Agency theory

43. The most common type of business in the United States is the _____.

- A. Corporation
- B. Partnership
- C. Sole Proprietorship**
- D. Hybrid organization such as a limited liability company

AACSB: Analytical

Blooms: Remember

Difficulty: 1 Basic

Learning Objective: 01-04 Examine the three most common forms of business organization in the United States today.

Source: NEW

Topic: Business Organization

44. The biggest disadvantage of the sole proprietorship is _____.

- A.** Unlimited liability
- B. Double taxation
- C. Limited access to capital
- D. Total control

AACSB: Analytical

Blooms: Remember

Difficulty: 1 Basic

Learning Objective: 01-04 Examine the three most common forms of business organization in the United States today.

Source: NEW

Topic: Business Organization

45. Which of the following statements is incorrect?

- A. Sole proprietorships are subject to less regulation.
- B. Both angel investors and venture capitalists exchange capital for ownership.
- C.** Shareholders are responsible for paying off the corporate bonds in the event of a bankruptcy.
- D. All of these statements are correct.

AACSB: Analytical

Blooms: Remember

Difficulty: 1 Basic

Learning Objective: 01-04 Examine the three most common forms of business organization in the United States today.

Source: NEW

Topic: Business Organization

46. All of the following are advantages to organizing as a corporation except _____.

- A. Limited liability
- B.** Double taxation
- C. Easy access to capital
- D. Easy to transfer ownership

AACSB: Analytical

Blooms: Remember

Difficulty: 1 Basic

Learning Objective: 01-04 Examine the three most common forms of business organization in the United States today.

Source: NEW

Topic: Business Organization

47. Which of the following statements is correct?

- A.** Sole proprietorships are easy to start.
- B. If the sole proprietorship gets sued, the owner is not liable.
- C. It is relatively easy for sole proprietorships to raise money.
- D. Profits from the sole proprietorship are subject to double taxation.

AACSB: Analytical

Blooms: Remember

Difficulty: 1 Basic

Learning Objective: 01-04 Examine the three most common forms of business organization in the United States today.

Source: NEW

Topic: Business Organization

48. From a taxation perspective, the form of business organization with the highest business level taxes is the _____.

- A. Sole proprietorship
- B.** Corporation
- C. Partnership
- D. S Corporation

AACSB: Analytical

Blooms: Remember

Difficulty: 1 Basic

Learning Objective: 01-04 Examine the three most common forms of business organization in the United States today.

Source: NEW

Topic: Business Organization

49. From the perspective of access to capital, the best form of business organization is the _____.

- A. Sole proprietorship
- B.** Corporation
- C. Partnership
- D. S Corporation

AACSB: Analytical

Blooms: Remember

Difficulty: 1 Basic

Learning Objective: 01-04 Examine the three most common forms of business organization in the United States today.

Source: NEW

Topic: Business Organization

50. From the perspective of ownership risk, the best form of business organization is the

_____.

- A. Sole proprietorship
- B. Corporation**
- C. Partnership
- D. S Corporation

AACSB: Analytical

Blooms: Remember

Difficulty: 1 Basic

Learning Objective: 01-04 Examine the three most common forms of business organization in the United States today.

Source: NEW

Topic: Business Organization

51. From the perspective of control, the best form of business organization is the

_____.

- A. Sole proprietorship**
- B. Corporation
- C. Partnership
- D. S Corporation

AACSB: Analytical

Blooms: Remember

Difficulty: 1 Basic

Learning Objective: 01-04 Examine the three most common forms of business organization in the United States today.

Source: NEW

Topic: Business Organization

52. Which of the following statements is incorrect?

- A. Partnerships have unlimited liability.
- B. Most sole proprietors raise money by borrowing from banks.**
- C. An advantage of sole proprietorships is that the owner has complete control.
- D. S corporations are considered a hybrid organization.

AACSB: Analytical

Blooms: Remember

Difficulty: 1 Basic

Learning Objective: 01-04 Examine the three most common forms of business organization in the United States today.

Source: NEW

Topic: Business Organization

53. Which statement is incorrect regarding hybrid organizations?

- A. They offer single taxation.
- B. They offer limited risk to the owners.
- C.** They offer the same type of control as a sole proprietorship.
- D. All of these answers are correct statements.

AACSB: Analytical

Blooms: Remember

Difficulty: 1 Basic

Learning Objective: 01-04 Examine the three most common forms of business organization in the United States today.

Source: NEW

Topic: Business Organization

54. Agency problems exist in which forms of business ownership?

- A. Sole proprietorship
- B. S corporation
- C. Partnership
- D.** Corporation

AACSB: Analytical

Blooms: Remember

Difficulty: 1 Basic

Learning Objective: 01-06 Identify a firm's primary agency relationship and discuss the possible conflicts that may arise.

Source: NEW

Topic: Agency theory

55. Methods to minimize agency problem include all except _____.

- A. Offer the managers an equity stake in the firm
- B. Award the CEO stock options
- C. Allow the CEO to purchase stock via an employee stock option plan
- D.** Allow the CEO to purchase bonds via an employee bond option plan

AACSB: Analytical

Blooms: Remember

Difficulty: 1 Basic

Learning Objective: 01-06 Identify a firm's primary agency relationship and discuss the possible conflicts that may arise.

Source: NEW

Topic: Agency theory

56. All of the following are an example of a fiduciary relationship except:

- A. a bank employee manages deposits
- B. a financial advisor advises her clients
- C. a CEO manages the firm
- D. the shareholder elects a board member**

AACSB: Analytical

Blooms: Remember

Blooms: Understand

Difficulty: 1 Basic

Learning Objective: 01-07 Discuss how ethical decision making is part of the study of financial management.

Source: NEW

Topic: Role of Ethics

57. Restricted stock is:

- A. a special type of stock that is not transferable from the current holder to others until specific conditions are satisfied.**
- B. a special type of stock that can be converted into corporate bonds after a specific amount of time has elapsed.
- C. a special type of stock that is a result of offering an employee stock ownership plan.
- D. None of these answers is correct.

AACSB: Analytical

Blooms: Remember

Difficulty: 1 Basic

Learning Objective: 01-07 Discuss how ethical decision making is part of the study of financial management.

Source: NEW

Topic: Role of Ethics

58. The board of directors _____.

- A. are hired by the CEO
- B. are elected by shareholders**
- C. have unlimited liability since they oversee the day-to-day operations of the firm
- D. are employed by the Securities Exchange Commission to ensure its rules and regulations have been met

AACSB: Analytical

Blooms: Remember

Difficulty: 1 Basic

Learning Objective: 01-06 Identify a firm's primary agency relationship and discuss the possible conflicts that may arise.

Source: NEW

Topic: Agency theory

Chapter 01 - Introduction to Financial Management

59. An angel investor differs from a venture capitalist because of the:
- A. type of investment.
 - B. investment time frame.
 - C. size of investment.**
 - D. voting rights.

AACSB: Analytical

Blooms: Remember

Difficulty: 1 Basic

Learning Objective: 01-04 Examine the three most common forms of business organization in the United States today.

Source: NEW

Topic: Business Organization

60. Corporate stakeholders include all of the following except:
- A. Employees
 - B. Shareholders
 - C. Suppliers
 - D. Auditors**

AACSB: Analytical

Blooms: Remember

Difficulty: 1 Basic

Learning Objective: 01-05 Distinguish among appropriate and inappropriate goals for financial managers.

Source: NEW

Topic: Firm goals

61. What is the difference in perspective between finance and accounting?
- A. Timing**
 - B. Risk
 - C. Liability
 - D. Ownership

AACSB: Analytical

Blooms: Remember

Difficulty: 1 Basic

Learning Objective: 01-02 Show how finance is at the heart of sound business decisions.

Source: NEW

Topic: Finance Function

62. Which of the following statements is correct?

- A.** Accountants are focused on what happened in the past.
- B. Financial managers are focused on what happened in the past.
- C. Both accountants and financial managers use total quality management systems to standardize data.
- D. Financial managers double-check the accountant's statements.

AACSB: Analytical

Blooms: Remember

Difficulty: 1 Basic

Learning Objective: 01-02 Show how finance is at the heart of sound business decisions.

Source: NEW

Topic: Finance Function

Essay Questions

63. One approach to aligning managers' personal interest with those of the owners is to make the managers owners. List the avenues that a firm could use to offer managers an equity stake in the firm.

Corporations may take the following approaches:

- a. explicitly granting shares to managers, or
- b. awarding them options on the firm's stock, or
- c. allowing them to purchase shares at a subsidized price through ESOPs

AACSB: Reflective Thinking

Blooms: Remember

Blooms: Understand

Difficulty: 2 Intermediate

Learning Objective: 01-06 Identify a firm's primary agency relationship and discuss the possible conflicts that may arise.

Source: NEW

Topic: Agency relationship

64. How do financial institutions impact business firms?

Financial institutions assist business firms with transactions involving financial assets in the financial markets. For the financial institutions to be successful at the execution of these services, they must possess unique assets and expertise.

AACSB: Reflective Thinking

Blooms: Analyze

Blooms: Apply

Difficulty: 2 Intermediate

Learning Objective: 01-08 Describe the complex; necessary relationships among firms; financial institutions; and financial markets.

Source: NEW

Topic: Impact of financial institutions on firms

65. Explain what started the financial crisis of 2006 and why it escalated on a such a widespread scale.

Homes price dropped substantially and homeowners that borrowed more than they could afford began to default on mortgage loans in large quantities. Due to the large number of these loans, the original lenders had securitized these loans to a widespread variety of investors so the effects of the defaults were also widespread. This affected consumer confidence and lending causing credit restrictions to be tightened reducing demand for products and in turn driving workforce reductions and unemployment.

AACSB: Analytical

Blooms: Remember

Blooms: Understand

Difficulty: 2 Intermediate

Learning Objective: 01-09 Explain the fundamental causes of the financial crisis that started in 2006.

Source: NEW

Topic: Financial Crisis