Test Bank for Corporate Finance 9th Edition by Ross

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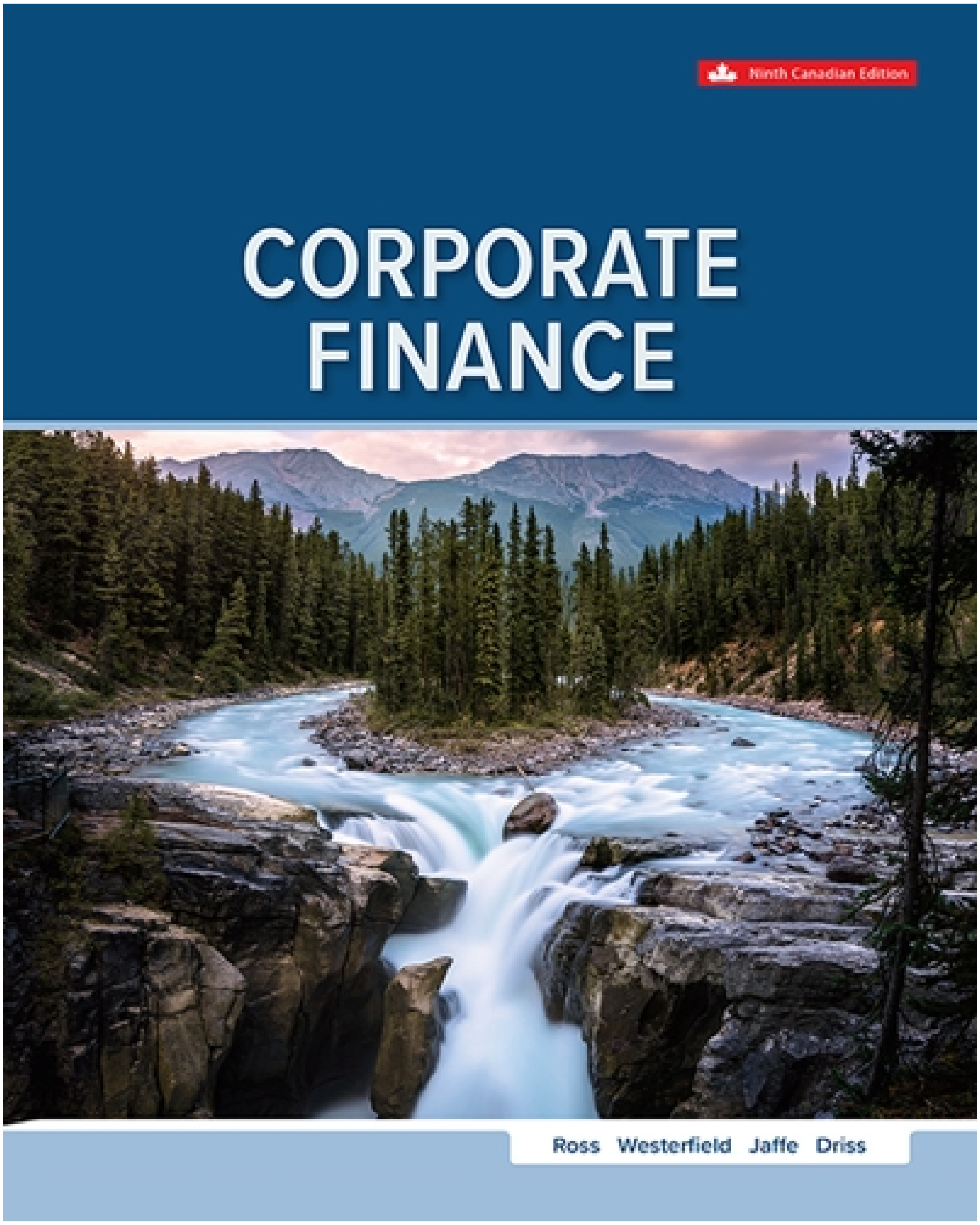

Test Bank

Corporate Finance 9ce Edition by Ross Ch01

1) The balance sheet is made up of what five key components:

A) fixed assets, current liabilities, long term debt, tangible current assets and shareholders' equity.
B) intangible fixed assets, current liabilities, long term debt, net income and current assets.
C) fixed assets, long term debt, current assets, current liabilities and shareholders' equity.
D) current assets, fixed assets, long term debt, shareholders equity and retained earnings.

Question Details
Accessibility : Keyboard Navigation
Topic : 01-01 What is Corporate Finance?
Bloom's : Remember
Difficulty : Medium

2) In terms of the balance sheet model of the firm, the value of the firm in financial markets is equal to:

A) tangible fixed assets plus intangible fixed assets.
B) sales minus costs.
C) cash inflow minus cash outflow.
D) the value of the debt plus the value of the equity.
E) the value of the debt minus the value of the equity.

Question Details
Accessibility : Keyboard Navigation
Topic : 01-01 What is Corporate Finance?
Bloom's : Understand
Difficulty : Easy

3) Inventory is a component of:

A) current assets.
B) current liabilities.
C) equity.
D) fixed assets.

Question Details
Accessibility : Keyboard Navigation
Topic : 01-01 What is Corporate Finance?
Bloom's : Remember
Difficulty : Easy

4) Using the balance sheet model of the firm, finance may be thought of as analysis of three primary subject areas. Which of the following groups correctly lists these three areas?

A) Capital budgeting, capital structure, net working capital.
B) Capital budgeting, capital structure, security marketing.
C) Capital budgeting, net working capital, tax analysis.
D) Capital budgeting, tax analysis, security marketing.
E) Net working capital, tax analysis, security marketing.

Question Details
Accessibility : Keyboard Navigation
Topic : 01-01 What is Corporate Finance?
Bloom's : Remember
Difficulty : Easy

5) Which of the following is not considered one of the basic questions of corporate finance?

A) What long-lived assets should the firm invest?
B) How much inventory should the firm hold?
C) How can the firm raise cash for required capital expenditures?
D) How should the short-term operating cash flows be managed?
E) What amount of long term debt and equity should the company issue to the market in the following years?

Question Details
Accessibility : Keyboard Navigation
Topic : 01-01 What is Corporate Finance?
Bloom's : Understand
Difficulty : Easy

6) The need to manage net working capital arises because:

A) financial management is naturally broken into those areas.
B) shareholders want to ensure they receive dividend payments.
C) there is a mismatch between the timing of cash inflows and cash outflows.
D) the sum of current assets and current liabilities usually is zero.
E) the capital structure pie is limited in size.

Question Details
Accessibility : Keyboard Navigation
Topic : 01-01 What is Corporate Finance?
Bloom's : Understand
Difficulty : Easy

7) Which one of these is a cash outflow from a corporation?

A) sale of an asset
B) dividend payment
C) sale of common stock
D) issuance of debt
E) profit retained by the firm

Question Details
Accessibility : Keyboard Navigation
Topic : 01-01 What is Corporate Finance?
Bloom's : Understand
Difficulty : Easy

8) Which one of these is a cash inflow to a corporation?

A) Purchase of a long-term asset
B) Repurchase of shares
C) Collection of account receivables
D) Reduction of accounts payables

Question Details
Accessibility : Keyboard Navigation
Topic : 01-01 What is Corporate Finance?
Bloom's : Understand
Difficulty : Easy

9) In the managerial structure of the corporation the two officers and their responsibilities that report directly to the Chief Financial Officer are:

A) the credit manager who handles accounts receivable and the tax manager who minimizes tax payments.
B) the personnel manager who manages salaries and compensation and the production operations manager who manages facility operations.
C) the treasurer who is responsible handling cash flow and making financial decisions and the tax manager who minimizes tax payments.
D) the controller who manages the accounting function and the treasurer who is responsible handling cash flow and making financial decisions.

Question Details
Accessibility : Keyboard Navigation
Topic : 01-01 What is Corporate Finance?
Bloom's : Remember
Difficulty : Easy

10) Value is created and recognized over time if:

A) cash raised is invested in the investment activities of the firm.
B) funds are raised in the capital markets.
C) cash paid to shareholders and bondholders, is greater than cash raised in the financial markets.
D) management pursues activities to reduce taxes to zero.

Question Details
Accessibility : Keyboard Navigation
Topic : 01-01 What is Corporate Finance?
Difficulty : Medium
Bloom's : Understand

11) Time preference refers to the fact that:

A) corporations match current assets with current liabilities to minimize the short-term financing cost.
B) corporations match both current and long-term assets with current and long-term liabilities to minimize the change of bankruptcy.
C) investors prefer current cash flows to future cash flows.
D) investors seek to time cash flows to minimize tax liabilities.

Question Details
Accessibility : Keyboard Navigation
Topic : 01-01 What is Corporate Finance?
Difficulty : Medium
Bloom's : Understand

12) A corporate security can be viewed as a contingent claim on the firm's value. This means that:

A) debt holders will receive their payoff from the firm based on their fixed claim or the firm's value if less than the fixed claim.
B) debt holders will receive the maximum between the firm's value and the fixed claim.
C) no payoff will be made to the debtholders unless the firm's value is greater than the fixed claim of the debt.
D) no debt payoff will be made if there is an equity payoff.

Question Details
Accessibility : Keyboard Navigation
Difficulty : Medium
Bloom's : Understand
Topic : 01-02 The Balance-Sheet Model of the Firm

13) If a firm has debt outstanding, the shareholders contingent claim payoff is:

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A) equal to the promised payment to the debtholders
B) equal to the firm's value minus the fixed debt payment, if the residual value is positive.
C) equal to the firm value minus the fixed debt payment, whether it is positive or negative.
D) equal to the debt payment plus the residual value of the firm.
E) equal to the payment provided by the stockholders when the equity was issued

Question Details
Accessibility : Keyboard Navigation
Difficulty : Medium
Bloom's : Understand
Topic : 01-02 The Balance-Sheet Model of the Firm

14) The Simple Corporation has outstanding obligation to the Complex Corporation of $250. It is year-end and the total cash flow of Simple from all sources is $325. The contingent payoff to the debtholders and the equity shareholders is:

A) $250; $325.
B) $75; $250.
C) $250; $75.
D) $325; $250.

Question Details
Accessibility : Keyboard Navigation
Difficulty : Medium
Topic : 01-02 The Balance-Sheet Model of the Firm
Bloom's : Analyze

15) The general partner(s) in a general partnership agree to share work, costs and profits and losses. Each partner:

A) has liability only up to the amount of their investment.
B) has liability for the debts of the partnership.
C) has liability only if it is formally documented.
D) never has any liability but the limited partners do.

Question Details
Accessibility : Keyboard Navigation
Bloom's : Remember
Difficulty : Medium
Topic : 01-03 Capital Structure

16) In a general partnership, the general partners have _____ liability and have _____ control over day-to-day operations.

A) limited; no
B) unlimited; total
C) limited; total
D) unlimited; no
E) no; total

Question Details
Accessibility : Keyboard Navigation
Bloom's : Remember
Difficulty : Medium
Topic : 01-03 Capital Structure

17) The ultimate control of a corporation lies in the hands of the corporate:

A) board of directors.
B) shareholders
C) CEO of the firm
D) chairman of the board
E) government

Question Details
Accessibility : Keyboard Navigation
Bloom's : Remember
Difficulty : Easy
Topic : 01-03 Capital Structure

18) The division of profits and losses among the members of a partnership is formalized in the:

A) indemnity clause
B) indenture contract
C) statement of purpose
D) partnership agreement

Question Details
Accessibility : Keyboard Navigation
Bloom's : Remember
Difficulty : Easy
Topic : 01-03 Capital Structure

19) The cheapest business entity to form is typically the:

A) limited liability company.
B) joint stock company.
C) general partnership.
D) limited partnership.
E) sole proprietorship.

Question Details
Accessibility : Keyboard Navigation
Bloom's : Remember
Difficulty : Easy
Topic : 01-03 Capital Structure

20) The Splitz Corporation has borrowed $5 million in debt with a promise to repay $5.5 million in one year. The corporation had 10 million shares outstanding worth $2 each at the time of the borrowing. Splitz earns $6 million during the year. What is the debtholder's contingent claim; how much do the debtholders receive; and, how much do the equity holders receive?

A) $5.5 million; $6 million; $20 million
B) $5 million; $5.5 million; $0
C) $5 million; $5.5 million; $20 million
D) $5.5 million; $5.5 million; $0.5 million

Question Details
Accessibility : Keyboard Navigation
Difficulty : Medium
Bloom's : Analyze
Topic : 01-03 Capital Structure

21) The Splitz Corporation has borrowed $5 million in debt with a promise to repay $5.5 million in one year. The corporation had 10 million shares outstanding worth $2 each at the time of the borrowing. Splitz earns $5 million during the year. What is the debtholder's contingent claim; how much does the debtholder receive; and, how much do the equity holders receive?

A) $5 million; $5.5 million; $20 million
B) $5.5 million; $5 million; $0
C) $5 million; $-0.5 million; $20 million
D) $-0.5 million; $5 million; $0

Question Details
Accessibility : Keyboard Navigation
Difficulty : Medium
Bloom's : Analyze
Topic : 01-03 Capital Structure

22) Corporate securities are contingent claims because:

A) they don't represent a direct claim on the firm.
B) the firm may be bought out.
C) the securities value is derived from the total value of the firm.
D) book value can be negative.

Question Details
Accessibility : Keyboard Navigation
Bloom's : Understand
Topic : 01-02 The Balance-Sheet Model of the Firm
Difficulty : Hard

23) If a firm promised a payment to the debtholders greater than the firm's value, then:

A) the firm will be broke and the debtholder will receive the firm's value.
B) the debtholders receive the promised payment while the shareholders pay the difference between the firm's value and the payment to the debtholders.
C) the firm's value will be shared between equity and debtholders and shareholders according to the payment promised by the firm.
D) the shareholders will get nothing from the firm.
E) A and D are correct.

Question Details
Accessibility : Keyboard Navigation
Bloom's : Understand
Topic : 01-02 The Balance-Sheet Model of the Firm
Difficulty : Hard

24) Agency costs as the sum costs of:

A) monitoring costs of the shareholders and the residual loss of wealth due to divergent management behavior.
B) the costs of implementing control devices and the monitoring costs of the shareholders.
C) the costs of implementing control devices and the residual loss of wealth due to divergent management behavior.
D) the set-of-contracts needed to structure the firm and residual wealth.

Question Details
Accessibility : Keyboard Navigation
Bloom's : Understand
Difficulty : Hard
Topic : 01-04 The Financial Manager

25) Which one of these best fits the description of an agency cost?

A) increasing the dividend payments per share
B) the benefits received from reducing production costs per unit
C) the payment of corporate income taxes
D) the payment required for an outside audit of the firm
E) the payment of interest on a firm's debts

Question Details
Accessibility : Keyboard Navigation
Difficulty : Medium
Bloom's : Understand
Topic : 01-04 The Financial Manager

26) Agency costs refer to:

A) the total dividends paid to stockholders over the lifetime of a firm.
B) the costs that result from default and bankruptcy of a firm.
C) corporate income subject to double taxation.
D) the costs of any conflicts of interest between stockholders and management.
E) the total interest paid to creditors over the lifetime of the firm.

Question Details
Accessibility : Keyboard Navigation
Bloom's : Understand
Difficulty : Easy
Topic : 01-04 The Financial Manager

27) Managerial goals may differ from those of the shareholders. It is noted that managers may:

A) have a preference for expense consumption.
B) be motivated by controlling sufficient resources to stay in business.
C) avoid the control of the capital market and rely on internally generated funds.
D) be wanted to depend on external parties.

Question Details
Accessibility : Keyboard Navigation
Bloom's : Understand
Difficulty : Hard
Topic : 01-04 The Financial Manager

28) What is the primary goal of the corporation?

A) Maximize the pay and compensation of employees and managers of the firm.
B) Maximize the value of the stockholders as they are the owners of the corporation.
C) Minimize the wealth of the shareholders and maximize the wealth of managers.
D) Maximize the societal value to minimize governmental interference.

Question Details
Accessibility : Keyboard Navigation
Bloom's : Remember
Difficulty : Easy
Topic : 01-04 The Financial Manager

29) Financial markets are composed of:

A) capital markets and equity markets.
B) capital markets and debt markets.
C) capital markets and money markets.
D) equity markets and money markets.

Question Details
Accessibility : Keyboard Navigation
Bloom's : Remember
Difficulty : Easy
Topic : 01-05 Identification of Cash Flows

30) The primary market is defined as:

A) the market for insured securities.
B) the market for new issues.
C) the market for securities of the largest firms.
D) the over-the-counter market.

Question Details
Accessibility : Keyboard Navigation
Bloom's : Remember
Difficulty : Easy
Topic : 01-05 Identification of Cash Flows

31) Which one of the following is a primary market transaction?

A) A dealer selling shares of stock to an individual investor.
B) A dealer buying newly issued shares of stock from a corporation.
C) An individual investor selling shares of stock to another individual.
D) A bank selling shares of a medical firm to an individual.

Question Details
Accessibility : Keyboard Navigation
Difficulty : Medium
Bloom's : Understand
Topic : 01-05 Identification of Cash Flows

32) Flea Fall Inc., a maker of dog flea collars, paid $125,000 cash for inventory on January 1, 2014. On December 31, 2014, the company's sales total $147,000 of which $117,000 has been collected. If inventory represents Flea Falls only cost, calculate the firms accounting profit as well as its cash flow as of December 31.

Question Details
Accessibility : Keyboard Navigation
Topic : 01-01 What is Corporate Finance?
Difficulty : Medium
Bloom's : Analyze

33) The Harlow Corporation has promised to pay its debtholders an amount of $2,700 over the next year. The firm's shareholders hold claim to whatever is left after the debtholders' claims have been satisfied. Calculate Harlow's debt and equity level if its assets total $1,100 at the end of the year. Recalculate for asset levels of $2,200 and $6,000.

Question Details
Accessibility : Keyboard Navigation
Topic : 01-01 What is Corporate Finance?
Difficulty : Medium
Bloom's : Analyze

34) A financial manager's most important job is to create value from capital budgeting, financing, and liquidity activities. Explain how financial managers create value.

Question Details
Accessibility : Keyboard Navigation
Topic : 01-01 What is Corporate Finance?
Difficulty : Medium
Bloom's : Understand

35) List and briefly describe the three basic areas addressed by a financial manager.

Question Details
Accessibility : Keyboard Navigation
Topic : 01-01 What is Corporate Finance?
Bloom's : Remember
Difficulty : Medium

36) The decision to incorporate must consider the fact that earnings will be taxed at both the corporate and personal levels. Since this is disadvantageous, provide three reasons why one may want to incorporate.

Question Details
Accessibility : Keyboard Navigation
Bloom's : Understand
Topic : 01-03 Capital Structure
Difficulty : Hard

37) How can shareholders attempt to control managerial behavior to match shareholder interest?

Question Details
Accessibility : Keyboard Navigation
Bloom's : Understand
Difficulty : Hard
Topic : 01-04 The Financial Manager

38) Do you think agency problems arise in sole proprietorships and/or partnerships?

Question Details
Accessibility : Keyboard Navigation
Bloom's : Understand
Difficulty : Hard
Topic : 01-04 The Financial Manager

39) If the corporate form of business organization has so many advantages over the sole proprietorship, why is it so common for small businesses to initially be formed as sole proprietorships?

Question Details
Accessibility : Keyboard Navigation
Difficulty : Medium
Bloom's : Understand
Topic : 01-03 Capital Structure

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40) One thing lenders sometimes require when loaning money to a small corporation is an assignment of the common stock as collateral on the loan. Then, if the business fails to repay its loan, the ownership of the stock certificates can be transferred directly to the lender. Why might a lender want such an assignment? What advantage of the corporate form of organization comes into play here?

Question Details
Accessibility : Keyboard Navigation
Difficulty : Medium
Bloom's : Understand
Topic : 01-03 Capital Structure

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Answer Key

Test name: Ch01

1) C
2) D
the value of the debt plus the value of the equity.

3) A
4) A
5) B
How much inventory should the firm hold?

6) C
7) B
8) C
9) D
10) C
cash paid to shareholders and bondholders, is greater than cash raised in the financial markets.

11) C
investors prefer current cash flows to future cash flows.

12) A
debt holders will receive their payoff from the firm based on their fixed claim or the firm's value if less than the fixed claim.

13) B
equal to the firm's value minus the fixed debt payment, if the residual value is positive.

14) C

15) B
16) B
17) B
18) D
19) E
20) D
21) B
22) C
23) E
A and D are correct.
 A. the firm will be broke and the debtholder will receive the firm's value.
 D. the shareholders will get nothing from the firm.

24) B
25) D
26) D
27) C
28) B
29) C
30) B
31) B
32) Accounting Profit = Sales - Cost ($147,000 - $125,000 = $22,000)
Cash Flow = Cash Inflow - Cash Outflow ($117,000 - $125,000 = $8,000)

33) If assets total $1,100: Value of Debt = $1,100, Value of Equity = $0
If assets total $2,200: Value of Debt = $2,200, Value of Equity = $0
If assets total $6,000: Value of Debt = $2,700, Value of Equity = $3,300

34) Buy assets that generate more than their cost.
Sell financial securities that raise more cash than they cost.
Minimize cash payouts to non-investors, ie., taxes to governments.

35) The three areas are:

1. Capital budgeting: The financial manager tries to identify investment opportunities that are worth more to the firm than they cost to acquire.
2. Capital structure: This refers to the specific mixture of current and long-term debt and equity a firm uses to finance its operations.
3. Working capital management: This refers to a firm's short-term assets and short-term liabilities. Managing the firm's working capital is a day-to-day activity that ensures the firm has sufficient resources to continue its operations and avoid costly interruptions.

36) Easier access to capital markets.
Retention of funds for reinvestment opportunities.
Market pricing and trading of securities.

37) Vote for directors with shareholder's interest to select management.
Provide incentive contracts; performance shares or options.
Outside threat of takeover, (Board should not be willing to launch poison pills.)
Managerial labor market.

38) Agency conflicts typically arise when there is a separation of ownership and management of a business. In a sole proprietorship and a small partnership, such separation is not likely to exist to the degree it does in a corporation. However, there is still potential for agency conflicts. For example, as employees are hired to represent the firm, there is once again a separation of ownership and management.

39) A significant advantage of the sole proprietorship is that it is cheap and easy to form. If the sole proprietor has limited capital to start with, it may not be desirable to spend part of that capital forming a corporation. Also, limited liability for business debts may not be a significant advantage if the proprietor has limited capital, most of which is tied up in the business anyway. Finally, for a typical small business, the heart and soul of the business is the person who founded it, so the life of the business may effectively be limited to the life of the founder during its early years.

40) In the event of a loan default, a lender may wish to liquidate the business. Often it is time consuming and difficult to take title of all of the business assets individually. By taking control of the stock, the lender is able to sell the business simply by reselling the stock in the business. This illustrates the ease of transfer of ownership of a corporation.