Self Assessment for Finance QuickStart

1. The process of planning and managing a firm's long-term, fixed investments in property, plant and equipment is called:

   a) Working capital management.
   b) Financial analysis.
   c) Net working capital management.
   d) Capital budgeting.
   e) Management of capital structure.

2. The possibility of conflict of interest between the stockholders and management of the firm is called:

   a) Business as usual.
   b) The incentive/compensation problem
   c) The agency problem.
   d) The monitoring problem.
   e) Legal liability.

3. The first-ever or original sale of securities by corporations occurs in the _________ markets, and subsequent trading in these securities takes place in the __________ markets.

   a) Primary; secondary.
   b) Secondary; primary.
   c) Auction; Dealer.
   d) Short-term; long-term
   e) Money: capital.

4. Financial leverage refers to:

   a) The amount of debt a firm uses in its financial structure.
   b) The ratio of retained earnings to net income
   c) The ratio of dividends paid to current stock price.
   d) The ratio of the cost-of-goods sold to the firm's total revenue.
   e) Net working capital as a percentage of the firm's total current liabilities.

5. The retention ratio is defined as

   a) The dividend payout ratio divided by 1.0.
   b) Additions to retained earnings as a percentage of net income.
   c) Additions to retained earnings as a percentage of the book value of equity.
   d) Net income minus additions to retained earnings.
   e) Net income minus cash dividends.

6. On your first birthday, you were given a $10,000 savings account that has earned, and will continue to earn, 5% per year. How much will you have in the account on your thirtieth birthday if you don't withdraw any money before then?

   a) $43,219 b) $42,631 c) $4,116 d) $41,161 e) $14,500

7. How much would you need to invest today in order to have $25,000 available for the purchase of a car four years from now? Assume that you will be able to earn interest at a compound annual rate of 8%, and that all interest earnings will be reinvested at 8% per year.

   a) $18,267 b) $18,376 c) $19,147 d) $21,370 e) $22,150

8. Your parents placed $200,000 in a trust fund for you. In 10 years they expect that the fund will be worth $500,000. What is the implicit expected annual rate of return on the trust fund?

   a) 5.98% b) 8.76% c) 9.60% d) 9.98% e) 10.14%

9. Annuities in which the payments are made at the end of each year are called __________, and those in which the payments are made at the beginning of each year are called_____________ .

   a) ordinary annuities; early annuities
   b) late annuities; straight annuities
   c) straight annuities; annuities in arrears
   d) annuities due; ordinary annuities
   e) ordinary annuities; annuities due

10. The rate of return required by investors in the market for owning a bond is called the:

    a) Current rate b) Current yield. c) Maturity. d) Yield to maturity. e) Coupon rate.

11. In the event of a firm's default, _____________ debt holders must give preference to more __________ debt holders in the priority of repayment distributions.

    a) short-term; long-term
    b) long-term; short-term
    c) senior; junior
    d) senior; subordinated
    e) subordinated; senior

12. The return on a financial asset can be broken down into two components. The ____________ reflects the income the holder receives while he or she owns the investment.

    a) the capital gain component
    b) the income component
    c) reward for bearing risk
    d) total dollar return
    e) gross return on that investment

13. Which of the following is *true* about risk and return?

    a) Riskier assets tend, on average, to earn lower returns.
    b) The reward for bearing risk is measured by the standard deviation.
    c) Based on historical data, there is no reward for bearing risk.
    d) An increase in the risk of an investment will usually result in a smaller risk premium.
    e) In general, the higher the risk, the higher the expected return.

14. ________ risk is the portion of a stock's total risk that reflects the degree to which the stock's returns tend to be correlated with the returns on the overall stock market.

    a) Idiosyncratic risk.
    b) Diversifiable risk.
    c) Systematic risk.
    d) Asset-specific risk.
    e) Total risk.

15. Which of the following statements regarding the concept of portfolio diversification is true?

    a) Forming a portfolio of two or three large stocks will eliminate all of your risk.
    b) Forming a portfolio of two or three large stocks will reduce your overall risk.
    c) Spreading an investment across many diverse assets cannot (in an efficient market) eliminate any risk.
    d) Spreading an investment across many diverse assets will eliminate all of the risk.
    e) Spreading an investment across many diverse assets will eliminate the stock's diversifiable risk, but not its systematic risk.

16. The proportions of the market value of the firm's assets financed via debt, common stock, and preferred stock are called the firm's ______________________.

    a) financing costs
    b) portfolio weights
    c) financial ratios
    d) capital structure weights
    e) costs of capital

17. When a firm issues new bonds or shares, it incurs costs in the issuance process. These costs are called:

    a) Required rates of return.
    b) Costs of capital.
    c) Flotation costs.
    d) Capital structure weights.
    e) Costs of equity and debt.

18. When a firm is planning to issue new securities, it must provide potential investors with a legal document that describes the details of the issuing corporation and its security offering. This document is called the:

    a) offering prospectus
    b) tombstone advertisement
    c) letter of comment
    d) Regulation A statement
    e) rights offering

19. A group of underwriters formed to share the risk in marketing and distributing a sale of securities to the investing public is ___________________.

    a) a cartel
    b) a syndicate
    c) illegal
    d) an oligopoly
    e) an insider consortium

20. When a firm invests in a new capital project, it must fund the project with financial capital. The cost of this capital is measured by the weighted average cost of capital (WACC). Which of the following is true regarding the WACC?

    a) The WACC is a measure of the firm's cost of capital before taxes.
    b) The higher the yield to maturity on the firm's outstanding debt, the lower will be its WACC.
    c) The WACC is always equal to the firm's cost of equity capital.
    d) The WACC measures the marginal cost of capital to the firm on an after-tax basis.

21. Savings are transferred to business firms by which of the following methods?

    a) Indirect transfer using the investment banker
    b) Direct transfer of funds
    c) Indirect transfer using the financial intermediary

d) All of the above

22. What is the role of the SEC as it relates to the issuance of new securities by U.S. corporations?

a) To guaranty the sale of securities to the public
b) To provide investment advice to the purchasing public
c) To ensure accurate and complete disclosure of information about the issuing firm to the public
d) To reduce the cost of issuing securities to the public

23. ________ is a financial specialist who underwrites and distributes new securities of public corporations.

a) An investment banker
b) A commercial banker
c) The Federal Reserve Board
d) The SEC

24. The traditional role of a commercial bank is ____________

a) Securitization
b) Advising
c) Trading
d) Monitoring

25. What is systemic risk?

a) Bank runs
b) Idiosyncratic risk
c) Company unique risk
d) Market risk

Answer Key

1. d capital budgeting.
2. c the agency problem.
3. a primary; secondary.
4. a the amount of debt used in a firm's capital structure.
5. b additions to retained earnings divided by net income.
6. d $41,161 Note that there are 29 years from your first to your thirtieth birthdays.
7. b $18,376
8. c 9.60%
9. e ordinary annuities; annuities due
10. d yield to maturity.
11. e subordinated; senior
12. b the income component
13. e In general, the higher the risk the higher the expected return.
14. c systematic risk.
15. e Spreading an investment across many diverse assets will eliminate some of the risk.
16. d capital structure weights
17. c flotation costs
18. a offering prospectus
19. b a syndicate
20. d The WACC measures the marginal cost of capital to the firm on an after-tax basis.
21. d All of the above
22. c To ensure accurate and complete disclosure of information about the issuing firm to the public
23. a An investment banker
24. d Monitoring
25. a Bank runs