Name: ______________________________ Class: ______________________ Date: ____________

Chapter 01: The Role and Objective of Financial Management

Multiple Choice

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 _____ decisions.
   a. investing
   b. financing
   c. dividend
   d. tax implication

ANSWER: d

4. Shareholder wealth is measured by the ____ value of the shareholders' common stock holdings.
   a. book
   b. market
   c. historic
   d. compound

ANSWER: b

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

ANSWER: d

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 benefits expected
   c. benefits only certain stockholders

d. does not provide a standard against which to judge actual decisions

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. Which of the following is NOT a professional certification for careers in the field of finance?

a. Certified Financial Manager (CFM)
b. Certified Financial Planner (CFP)
c. Certified Financial Analyst (CFA)
d. Certified Treasury Professional (CTP)

ANSWER: c

9. When considering the risk of receiving cash flows, financial managers must be aware that investors _____.

a. want higher returns for perceived greater risk
b. want a lower valued firm to discourage future investors which might dilute their existing control
c. expect dividends and capital gains regardless of the risks associated with achieving them
d. 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 of these are correct

ANSWER: a

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 expenditures to structure the organization
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

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 constraints 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. communities in which they operate
b. suppliers
c. employees
d. All of these are correct

ANSWER: d

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. collecting all the facts bearing on the problem
b. clarifying the parameters of the problem
c. involving all parties with a financial interest in the outcome
d. seeking equity for those who may be affected

ANSWER: c

22. Many entrepreneurs 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 disciplines are applicable

ANSWER: d

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

ANSWER: a

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. Per 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

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 all of the following EXCEPT ____.
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: c

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

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 objective of the firm is to _____.

a. make MC=MR
b. maximize profits
c. minimize agency costs
d. None of these are correct

ANSWER: d

39. Firms normally recognize responsibilities to various constituencies, such as each of the following EXCEPT _____.

a. To sustain an optimum return on investment for stockholders
b. To be perceived by customers as a provider of quality service
c. To demonstrate that investors are the firm's most valuable resource
d. To provide corporate leadership in the communities it serves

ANSWER: c

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

41. Accounting is concerned primarily with matching _____.

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

ANSWER: a

42. The bottom-line earnings figure from the accounting system is misleading 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

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 stakeholders 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. All of these are correct

ANSWER: d

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 and lower tax rates
b. permanency and lower tax rates
c. limited liability and permanency
d. lower tax rates and permanency

ANSWER: c

58. Although this type of business generates 4.1% of the total U.S. business revenue, ____ make up approximately 72% of all businesses.

a. general partnerships
b. corporations
c. limited partnerships
d. sole-proprietorships

ANSWER: d

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

a. permanent legal existence
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 the risks associated with alternative decisions.

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 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. amount of cash flows expected
b. sales generated
c. timing of cash flows
d. risk taken to generate cash flows

ANSWER: b

63. A microeconomic concept used in financial management is _____.

a. full utilization of data processing
b. setting marginal costs equal to marginal revenues
c. accrual basis of recognizing revenues and expenses
d. target capital structure

ANSWER: b

64. All of the following are responsibilities of a controller EXCEPT _____.

a. financial accounting
b. taxes
c. data processing
d. pension fund management

ANSWER: d

65. Which of the following forms of business organization have unlimited liability?
I. Corporation
II. General partnership

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: b

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

a. Marginal Costs < Marginal Revenues
b. Marginal Costs = Profits
c. Marginal Revenues > Marginal Costs
d. 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 _____.

a. 10K & 14B Corporations
b. section 8 and Subchapter S Corporations
c. subchapter S and LLCs
d. 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 _____.

a. preferred stock
b. debt securities
c. equity securities
d. fixed asset loans

ANSWER: b

69. What one of the following is a function of the CFO?

a. Control of the marketing functions of the firm
b. Effective communication with the investment community about the firm's performance
c. Oversight of engineering
d. Determination of effective manufacturing strategies

ANSWER: b

70. Per 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 which of the following?

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. Because of accounting scandals, several methods have been developed to deal with the issues of corporate governance and include all 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. The majority of members on the Board of Directors should be independent directors
d. The Board of Directors must disclose whether it has adopted 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 _____ value.

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

ANSWER: c

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. reduced litigation expense
b. greater agency costs
c. reduced damages expenses
d. a more favorable impression by customers and investors

ANSWER: b

75. Examples of agency costs incurred by shareholders to minimize agency problems are expenditures associated with _____.

a. independent auditing
b. SEC approval
c. monitoring management's actions
d. inventory control

ANSWER: c

76. Choose the correct option below.
I. Macroeconomics deals with the economic decisions of individuals, households, and firms.
II. Microeconomics looks at the economy as a whole.

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

77. In recent years, front-page stories of ethical issues have exploded and focused attention on ethical practices. 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

78. ____ 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

Essay

79. Explain the organization and governance in a corporation.

ANSWER: The stockholders 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 selected 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.

80. Identify the 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

81. 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 under GAAP. There is much latitude permitted in recognizing and accounting for costs and revenues.
3. There is a question as to which of the following 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.

82. 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 regarding the firm's earnings and assets. Preferred stockholders are paid cash dividends before common stockholders. In the event of bankruptcy or dissolution, preferred stockholders are ahead of common stockholders in the distribution of the corporation's assets.

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

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

1. It 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.

84. List examples of agency costs that 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