

Exam

Name _____

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

- 1) Which statement best describes the role of financial intermediaries? 1) _____
- A) They facilitate the flow of funds from primary investors to ultimate borrowers at low cost.
 - B) They facilitate the flow of funds to primary investors from ultimate borrowers at low cost.
 - C) They minimise the costs of the flow of funds from ultimate borrowers to primary investors.
 - D) They maximise the cost benefits from the flow of funds from ultimate borrowers to primary investors.

Answer: A

Explanation: A)
B)
C)
D)

- 2) In firms that are attractive to shareholders the actions of senior management align with the interests of shareholders. What term is used to describe such a situation? 2) _____
- A) A Company congruence
 - B) Profit maximisation
 - C) Goal congruence
 - D) Competitive maximisation

Answer: C

Explanation: A)
B)
C)
D)

- 3) Which two of the following are classified as long - term savings institutions? 3) _____
- A) Insurance funds.
 - B) Wholesale banks.
 - C) Finance houses.
 - D) Pensions funds.

Answer: A, D

Explanation: A)
B)
C)
D)

- 4) Which three of the following generally describe the preferences and situation of a primary investor? 4) _____
- A) A preference for low risk
 - B) Having small amounts to invest
 - C) A wish for high agreement costs
 - D) A preference for high liquidity

Answer: A, B, D

Explanation: A)
B)
C)
D)

5) Which three of the following economies of scale enable intermediaries to transform assets effectively? 5) _____

- A) Risk spreading.
- B) Efficiencies in gathering information.
- C) Lower transaction costs.
- D) Low customer numbers.

Answer: A, B, C

Explanation: A)
B)
C)
D)

6) What is the main activity in the primary market of the stock exchange? 6) _____

- A) Investors raise funds from firms.
- B) Brokers sell shares for investors.
- C) The firm raises funds from investors.
- D) Investors buy and sell shares between each other.

Answer: C

Explanation: A)
B)
C)
D)

7) Which three of the following are reasons why a firm should use external finance to maximise shareholder wealth? 7) _____

- A) The shareholders own the firm.
- B) This approach encourages high levels of motivation in managers.
- C) It counters the tendency for management to pursue goals for their own benefit.
- D) To survive in a competitive world.

Answer: A, C, D

Explanation: A)
B)
C)
D)

8) Which three of the following act as financial intermediaries between primary investors and ultimate borrowers? 8) _____

- A) Brokers.
- B) Asset transformers.
- C) Financial managers.
- D) Financial markets.

Answer: A, B, C

Explanation: A)
B)
C)
D)

- 9) What does it mean when stakeholders have been 'satisfied'? 9) _____
- A) They have been given more than their contribution justified.
 - B) They are the only stakeholders who feel satisfied.
 - C) They have been given just enough to make their contribution worthwhile.
 - D) They have been given returns based on partial, biased information.

Answer: C

Explanation: A)
B)
C)
D)

- 10) Which of the following best identifies the main risk of having clear separation between ownership and control? 10) _____
- A) Profit maximisation, where managers adopt long-term views that conflict with the overall needs of the organisation.
 - B) Managerialism, where managers take decisions in their own interests rather than those of the shareholders.
 - C) Stakeholder control, where non-investors have excessive influence on management.
 - D) Agent-principle problems, where the agent may take uncontrolled, unprincipled actions.

Answer: B

Explanation: A)
B)
C)
D)

- 11) Which one of the following is the most important benefit of defining a firm's overall objectives. 11) _____
- A) To provide a focus for decision making.
 - B) To enable effective information flow.
 - C) To provide information to savers.
 - D) To enable progress to be assessed.

Answer: A

Explanation: A)
B)
C)
D)

- 12) In which two ways do households most directly provide investment funds for business? 12) _____
- A) Through taxes
 - B) By direct purchase of shares
 - C) Through returns on bonds and shares
 - D) By making deposits with financial institutions

Answer: B, D

Explanation: A)
B)
C)
D)

- 13) In which type of market is one currency most commonly exchanged for another? 13) _____
A) Bond markets. B) Foreign exchange.
C) Derivatives. D) Money market.
Answer: B
Explanation: A)
B)
C)
D)
- 14) Which three of the following institutions are classified as being part of the banking sector? 14) _____
A) Retail banks B) Insurance funds
C) Building societies D) Finance houses
Answer: A, C, D
Explanation: A)
B)
C)
D)
- 15) Which of the following best describes the overall objective of the firm, according to contractual theory? 15) _____
A) Short-term maximisation of profit
B) Long-term maximisation of profit
C) A maximisation of returns to all stakeholders
D) Maximisation of shareholder wealth over the long-term
Answer: D
Explanation: A)
B)
C)
D)
- 16) Which three of the following are types of asset transformation? 16) _____
A) Volume transformation. B) Risk transformation.
C) Maturity transformation. D) Saver transformation.
Answer: A, B, C
Explanation: A)
B)
C)
D)
- 17) What term is used to describe a situation in which investors can sell quickly at low cost? 17) _____
A) Investment opportunity. B) Market liquidity.
C) Free markets. D) Market minimisation.
Answer: B
Explanation: A)
B)
C)
D)

- 18) Which of the following are essential aspects of a financial managers knowledge? 18) _____
- A) Cash and risk management B) Financial markets
C) Investment appraisal methods D) All of the above
- Answer: D
- Explanation: A)
 B)
 C)
 D)
- 19) Which of the following is not a main area of activity for a wholesale bank? 19) _____
- A) Eurocurrency transfers. B) Raising external finance for companies.
C) Fund management. D) Broking and dealing.
- Answer: A
- Explanation: A)
 B)
 C)
 D)
- 20) Which three of the following statements concerning financial intermediaries are correct? 20) _____
- A) They are able to reduce the transaction costs of transferring funds from savers to borrowers in society compared with the primary lenders.
B) They generally display efficiencies in gathering information as compared with primary investors.
C) They are often more able to spread risk than primary investors.
D) They only act as agents between savers and borrowers.
- Answer: A, B, C
- Explanation: A)
 B)
 C)
 D)
- 21) Profit maximisation is not the same as shareholder wealth maximisation. Select the two things that a profit comparison does not take into account? 21) _____
- A) Communication. B) Risk.
C) Management expertise. D) Future prospects.
- Answer: B, D
- Explanation: A)
 B)
 C)
 D)

- 22) Arnold discusses four vital financial issues facing management. The first is "What type of finance should we raise?". What are the other three? 22) _____
- A) How can we maximise profit?
 - B) In what projects are we going to invest our shareholders' money?
 - C) How do we create and measure shareholder value?
 - D) How do we manage risk?
- Answer: B, C, D
- Explanation: A)
B)
C)
D)
- 23) In the banking sector, which organisations generally carry out hire purchase, factoring and leasing? 23) _____
- A) Building societies.
 - B) Investment banks.
 - C) Financial advisers.
 - D) Finance houses.
- Answer: D
- Explanation: A)
B)
C)
D)
- 24) What is meant by a balanced stakeholder approach? 24) _____
- A) Aiming to involve creditors, customers, employees, shareholders and society in general in decision making.
 - B) Ensuring that a company has a wide spread of investors.
 - C) Aiming to satisfy the needs of creditors, customers, employees, shareholders and society in general.
 - D) Ensuring that investors spread their risk in a balanced way.
- Answer: C
- Explanation: A)
B)
C)
D)
- 25) Which of the following best describes the situation in an economy without financial intermediaries? 25) _____
- A) Search costs are low.
 - B) Agreement costs are high.
 - C) Monitoring costs are low.
 - D) Risk to investors is high..
- Answer: B
- Explanation: A)
B)
C)
D)

- 26) Which three of the following properties best describe the investment characteristics of ultimate borrowers (businesses)? 26) _____
- A) Large amounts. B) High search costs.
C) High risk. D) Low liquidity.
- Answer: A, C, D
- Explanation: A)
B)
C)
D)
- 27) What are the two most important possible uses for cash created by a firm's operations ? 27) _____
- A) Purchase of new shares B) Selling assets to investors
C) Reinvestment D) Cash return to investors
- Answer: C, D
- Explanation: A)
B)
C)
D)
- 28) Which three of the following statements are correct? 28) _____
- A) Foreign banking in the UK is UK banks conducting transactions in sterling with non-UK residents.
B) The main function and source of profits of wholesale banks is to take deposits and lend money.
C) Unit trusts are open-ended collective investment funds.
D) Pension funds typically invest between 40 and 80 per cent of their funds in shares.
- Answer: A, C, D
- Explanation: A)
B)
C)
D)
- 29) The 'conflict of preferences' occurs because: 29) _____
- A) Preference shares do not carry a sufficiently high dividend, given their risk.
B) Primary investors want a completely risk-free investment with high returns and borrowing firms offer only high risk/low returns as their securities.
C) Primary investors want low-cost liquidity and certainty, and the ultimate borrowers want long-term risk-bearing capital.
D) Customers of firms have different needs to those assumed by suppliers.
- Answer: C
- Explanation: A)
B)
C)
D)

30) What name is given to the theory which views the firm as a network of contracts which specify the roles played by various participants and their returns, with shareholders entitled to any surplus after other participants have received their contractual return? 30) _____

- A) Stakeholder theory
- B) Contractual theory
- C) Network theory
- D) Participant-role theory

Answer: B

Explanation: A)
B)
C)
D)

31) Which one of the following statements correctly applies to the type of market described? 31) _____

- A) Euronext.liffe is a market set up to permit the purchase and sale of life assurance policies.
- B) Investment trusts are not limited companies.
- C) Bond markets are primarily concerned with financing imports and exports.
- D) Wholesale banks deal primarily with low-volume, high-value transactions.

Answer: D

Explanation: A)
B)
C)
D)

32) Which three of the following are most likely to be solutions to the principal-agent problem? 32) _____

- A) Corporate governance regulation.
- B) Selling shares and the takeover threat.
- C) Link managerial rewards to shareholder wealth improvement.
- D) Increasing management pay levels.

Answer: A, B, C

Explanation: A)
B)
C)
D)

33) OEICs are a hybrid between which two types of investment? 33) _____

- A) Annuities.
- B) Unit trusts.
- C) Cash investments.
- D) Investment trusts.

Answer: B, D

Explanation: A)
B)
C)
D)

34) Which three of the following are classified as 'risk-spreaders'? 34) _____

- A) Money markets.
- B) OEICs.
- C) Unit trusts.
- D) Investments trusts.

Answer: B, C, D

Explanation: A)
B)
C)
D)

35) Which type of organisation most commonly works to alleviate the conflict of preferences between primary investors and ultimate borrowers? 35) _____

- A) Firms
- B) Financial institutions
- C) Transformed asset holders
- D) Government

Answer: B

Explanation: A)
B)
C)
D)

36) Select the two alternative factors that can be said to demonstrate that shareholder wealth has been maximised. 36) _____

- A) Discounted cash flow has been minimised.
- B) Management and production costs have been minimised.
- C) Purchasing power has been maximised.
- D) The sum of discounted cash flows has been maximised.

Answer: C, D

Explanation: A)
B)
C)
D)

37) Which of the following options best describes how financial managers primarily contribute to their firms' success? 37) _____

- A) Through investment and finance decisions based on a search for profit maximisation over the next five years.
- B) Through finance decisions that aim to reduce costs of production.
- C) Through investment and finance decisions based on a search for company growth and stability.
- D) Through investment in sound advice from independent advisers.

Answer: C

Explanation: A)
B)
C)
D)

38) What is the key aim when maximising shareholder wealth? 38) _____

- A) To minimise the flow of cash in the forms of dividends over a long time period.
- B) To maximise the flow of discounted cash flow over a long time period.
- C) To maximise the size of dividends over a short time period.
- D) To maximise the flow of discounted cash flow over a short time period.

Answer: B

Explanation: A)
B)
C)
D)

39) What is the main activity in the secondary market of the stock exchange?

39) _____

- A) Brokers sell shares for investors.
- B) Investors raise funds from firms.
- C) Investors buy and sell shares between each other.
- D) The firm raises funds from investors.

Answer: C

Explanation: A)
B)
C)
D)

40) What is the key reason why financial institutions can transform assets and encourage transfer of funds?

40) _____

- A) They can work individually with savers' funds.
- B) They can use their own funds for investment.
- C) They can invest the dividends.
- D) They have economies of scale.

Answer: D

Explanation: A)
B)
C)
D)

41) Which three of the following statements are correct?

41) _____

- A) Unit trusts are open-ended collective investment funds.
- B) The foreign exchange markets are those markets in which one currency is exchanged for another.
- C) The money markets are markets in lending and borrowing money for more than two years.
- D) Pension funds typically invest between 40 and 80 per cent of their funds in shares.

Answer: A, B, D

Explanation: A)
B)
C)
D)

42) Financial institutions encourage the flow of savings into investment by acting in two key roles? What are those roles?

42) _____

- | | |
|-----------------------|-------------|
| A) Asset transformers | B) Auditors |
| C) Brokers | D) Savers |

Answer: A, C

Explanation: A)
B)
C)
D)

- 43) Which two of the following properties best describe the savings characteristics of primary investors (households)? 43) _____
- A) Low liquidity. B) Small amounts.
C) Low risk. D) High search costs.
- Answer: B, C
Explanation: A)
B)
C)
D)
- 44) Which three statements correctly relate, according to the finance theory view, to the maximisation of shareholder wealth? 44) _____
- A) In an efficient market it is equivalent to maximising the share price.
B) It can be ensured by maximising profit-based bonuses for senior management.
C) It is equivalent to maximising the discounted cash flow to shareholders over a long time horizon.
D) It is equivalent to maximising the purchasing power available from a shareholding in a firm.
- Answer: A, C, D
Explanation: A)
B)
C)
D)
- 45) Which three of the following are economies of scale available to intermediaries but not small investors? 45) _____
- A) Ability to spread risk. B) Reduced transaction costs.
C) Ability to benefit from low liquidity. D) Efficiency in gathering information.
- Answer: A, B, D
Explanation: A)
B)
C)
D)
- 46) What particular benefit do brokers offer when matching a provider of finance with a user of funds? 46) _____
- A) Agreement costs are increased. B) Search costs are reduced.
C) Risk is reduced. D) Monitoring costs are reduced.
- Answer: B
Explanation: A)
B)
C)
D)
- 47) Which three out of the following are reduced by financial markets? 47) _____
- A) Liquidity. B) Risk.
C) Search costs. D) Monitoring costs.
- Answer: B, C, D
Explanation: A)
B)
C)
D)

- 48) Which one of the following options best describes the principal-agent problem? 48) _____
- A) When there is a breakdown of communication between shareholders and brokers.
 - B) When stockbrokers fail to collect principal payments on a financial security on behalf of the owner.
 - C) When brokers ask for additional payments to carry out a transaction.
 - D) When the shareholders have to incur the expense of ensuring that managers act in the interest of the shareholders.

Answer: D

Explanation: A)
B)
C)
D)

- 49) In which two ways do financial institutions and markets encourage growth and progress? 49) _____
- A) By controlling interest rates
 - B) By mobilising savings
 - C) By discouraging small savers
 - D) By encouraging investment

Answer: B, D

Explanation: A)
B)
C)
D)

- 50) What name is given to the process of creating intermediate securities for the primary investor while transferring funds to the ultimate borrower. 50) _____
- A) Security provision.
 - B) Fund transfer.
 - C) Financial intermediacy.
 - D) Asset transformation.

Answer: D

Explanation: A)
B)
C)
D)

Answer Key
Testname: C1

- 1) A
- 2) C
- 3) A, D
- 4) A, B, D
- 5) A, B, C
- 6) C
- 7) A, C, D
- 8) A, B, C
- 9) C
- 10) B
- 11) A
- 12) B, D
- 13) B
- 14) A, C, D
- 15) D
- 16) A, B, C
- 17) B
- 18) D
- 19) A
- 20) A, B, C
- 21) B, D
- 22) B, C, D
- 23) D
- 24) C
- 25) B
- 26) A, C, D
- 27) C, D
- 28) A, C, D
- 29) C
- 30) B
- 31) D
- 32) A, B, C
- 33) B, D
- 34) B, C, D
- 35) B
- 36) C, D
- 37) C
- 38) B
- 39) C
- 40) D
- 41) A, B, D
- 42) A, C
- 43) B, C
- 44) A, C, D
- 45) A, B, D
- 46) B
- 47) B, C, D
- 48) D
- 49) B, D
- 50) D