

1. The form of organizing a business is an unimportant issue, as this decision has very little effect on the income and wealth of the firm's owners.

- a. True
- b. False

ANSWER: False

2. Two disadvantages of a proprietorship are (1) the relative difficulty of raising new capital and (2) the owner's unlimited personal liability for the business's debts.

- a. True
- b. False

ANSWER: True

3. By being too involved in the business operation, limited partners can lose their limited liability status.

- a. True
- b. False

ANSWER: True

4. The best way to maximize the intrinsic value of a company and thus shareholders' wealth is to maximize its earnings per share.

- a. True
- b. False

ANSWER: False

5. If Firm A's business is to obtain savings from individuals and then invest them in financial assets issued by other firms or individuals, Firm A is a financial intermediary.

- a. True
- b. False

ANSWER: True

6. Today, trustee services can be arranged only with trust companies.

- a. True
- b. False

ANSWER: False

7. If an individual investor trades currently outstanding common shares through a broker, this is a secondary market transaction.

- a. True
- b. False

ANSWER: True

8. With the more formal nature of the partnership agreement and the commitment of all partners' personal assets, partnerships have no difficulty raising large amounts of capital as do proprietorships.

- a. True
- b. False

ANSWER: False

9. Two key advantages to proprietorship are that, as a business, it pays no corporate income tax and is easily and inexpensively formed.

- a. True

b. False

ANSWER: True

10. Fighting recession with low interest rates is technically impossible when a country has large trade deficits and huge national debt.

a. True

b. False

ANSWER: True

11. Which of the following statements best describes firm organization?

a. One of the disadvantages of incorporating a business is that the owners have personal liabilities when firm goes bankrupt.

b. Sole proprietorships are subject to more regulations than corporations.

c. In any type of partnership, every partner has the same rights, privileges, and liability exposure as every other partner.

d. Sole proprietorships and partnerships generally have a tax advantage over corporations, especially large ones.

ANSWER: d

12. Which of the following statements best describes firm organization?

a. One of the disadvantages of a sole proprietorship is that the proprietor is exposed to unlimited liability.

b. It is generally easier to transfer one's ownership interest in a partnership than in a corporation.

c. One of the advantages of the corporate form of organization is that it avoids double taxation.

d. One of the advantages of a corporation from a social standpoint is that every shareholder has equal voting rights, i.e., "one person, one vote."

ANSWER: a

13. Which of the following statements best describes firm organization?

a. It is generally more expensive to form a proprietorship than a corporation because a proprietorship requires extensive legal documents.

b. One disadvantage of operating a business as a sole proprietorship is that the firm is subject to double taxation, at both the firm level and the owner level.

c. One advantage of forming a corporation is that equity investors are usually exposed to less liability than in a regular partnership.

d. If a regular partnership goes bankrupt, each partner is exposed to liabilities only up to the amount of his or her investment in the business.

ANSWER: c

14. Cheers Canada Inc. operates as a partnership. Now the partners have decided to convert the business into a regular corporation. What will be the effect?

a. Assuming Cheers Canada Inc. is profitable, less of its income will be subject to taxes.

b. Cheers Canada Inc. will now be subject to fewer regulations.

c. Cheers' Canada Inc. shareholders (the ex-partners) will now be exposed to less liability.

d. Cheers Canada Inc. will find it more difficult to raise additional capital.

ANSWER: c

15. Which of the following statements best describes firm organization?
- a. It is usually easier to transfer ownership in a corporation than it is to transfer ownership in a sole proprietorship.
  - b. Corporate shareholders are exposed to unlimited liability.
  - c. Corporations generally face fewer regulations than sole proprietorships.
  - d. Corporate shareholders are exposed to unlimited liability, and this factor may be compounded by the tax disadvantages of incorporation.

ANSWER: a

16. Why might a business choose to operate as a corporation rather than as a sole proprietorship or a partnership?
- a. Less of a corporation's income is generally subjected to taxes than would be true if the firm were a partnership.
  - b. Corporate shareholders escape liability for the firm's debts, but this factor may be offset by the tax disadvantages of the corporate form of organization.
  - c. Corporate investors are exposed to limited growth potential.
  - d. Corporations generally face relatively few regulations.

ANSWER: b

17. What should be done to maximize shareholder wealth and thus the value of the firm?
- a. Decrease the size of expected cash flow of the company.
  - b. Slow down the cash receipt of the organization.
  - c. Increase the risk level of the firm.
  - d. Raise the free cash flows of the business.

ANSWER: d

18. You recently sold 100 shares of your new company, XYZ Corporation, to your brother at a family reunion. At the reunion your brother gave you a cheque for the shares and you gave your brother the share certificates. Which statement best describes this transaction?
- a. This is an example of an exchange of physical assets.
  - b. This is an example of a primary market transaction.
  - c. This is an example of a direct transfer of capital.
  - d. This is an example of a money market transaction.

ANSWER: c

19. Which of the following statements best describes interest rates?
- a. The cost of money to fund users is basically determined by the rate of return required by fund providers.
  - b. If individuals in general increase the percentage of their income that they save, interest rates are likely to increase.
  - c. If companies have fewer good investment opportunities, interest rates are likely to increase.
  - d. If expected inflation increases, interest rates are likely to decrease.

ANSWER: a

20. Which of the following statements best describes hedge funds?
- a. Hedge funds are risky, although they may be market-neutral.
  - b. Hedge funds are open to everyone.

- c. Hedge funds have low risk because they hedge their investments.
- d. Hedge funds are legal only in Canada, and they are not permitted to operate in Europe or Asia.

ANSWER: a

21. What is traded on money markets?

- a. foreign stocks
- b. consumer automobile loans
- c. short-term debt securities
- d. long-term bonds

ANSWER: c

22. Which of the following is an example of a primary market transaction?

- a. You sell 200 shares of IBM stock on the TSX through your broker.
- b. IBM issues 2,000,000 shares of new stock and sells them to the public through an investment banker.
- c. One financial institution buys 200,000 shares of IBM share from another institution with help of an investment banker.
- d. You invest \$10,000 in a mutual fund, which then uses the money to buy \$10,000 of IBM shares on the TSX.

ANSWER: b

23. Which of the following statements best describes financial markets?

- a. If Disney issues additional shares of common stock through an investment banker, this would be a secondary market transaction.
- b. The IPO market is a major part of the secondary market.
- c. Only institutions, not individuals, can participate in derivatives market transactions.
- d. Money market transactions involve debt securities with maturities of less than one year.

ANSWER: d

24. You recently sold to your brother 200 shares of Disney stock; the transfer was made through a broker, and the trade occurred on the TSX. Which type of transaction is this?

- a. a futures market transaction
- b. a primary market transaction
- c. a secondary market transaction
- d. a money market transaction

ANSWER: c

25. Which of the following statements best describes financial markets?

- a. Capital market transactions involve only the purchase and sale of equity securities, i.e., common stocks.
- b. If an investor sells shares of stock through a broker, then this would be an indirect finance transaction.
- c. Money market mutual funds have a high degree of default risk.
- d. Commercial papers have maturities longer than one year.

ANSWER: b

26. Which of the following statements best describes financial markets?

- a. Capital market instruments include both long-term debt and common stocks.
- b. Banker's acceptance has no default risk.
- c. Foreign banks are more restricted from operating in Canada.
- d. The original maturity of a commercial loan can go up to 10 years.

ANSWER: a

27. Which of the following statements best describes financial markets?
- a. Rates of return on T-bills are the highest among all major financial securities.
  - b. Money market mutual funds are illiquid.
  - c. Money markets are markets for long-term debt and common stocks.
  - d. Euro-Canadian market time deposits are instruments issued by banks outside Canada.

ANSWER: d

28. What is one of the drawbacks of switching from a partnership to the corporate form of organization?
- a. It subjects the firm to additional regulations.
  - b. It makes it more difficult for the firm to raise additional capital.
  - c. It makes the firm's investors subject to greater potential personal liabilities.
  - d. It makes it more difficult for the firm's investors to transfer their ownership interests.

ANSWER: a

29. Which of the following statements best describes partnerships?
- a. In a regular partnership, liability for other partners' misdeeds is limited to the amount of a particular partner's investment in the business.
  - b. Partnerships have trouble attracting large capital due to factors such as unlimited liability, and the illiquidity of partnership interests.
  - c. A slow-growth company, with little need for new capital, would be more likely to organize as a corporation than would a faster-growing company.
  - d. A major disadvantage of all partnerships relative to all corporations is the fact that taxes must be paid by the partners rather than by the firm itself.

ANSWER: b

30. Which of the following statements best describes partnerships?
- a. Corporations are at a disadvantage relative to partnerships because they have to file more reports to regulatory agencies, even if they are not publicly owned.
  - b. In a regular partnership, liability for the firm's debts is limited to the amount a particular partner has invested in the business.
  - c. A fast-growth company would be more likely to set up as a partnership for its business organization than would a slow-growth company.
  - d. There must be at least one person acting as a general partner in a limited partnership.

ANSWER: d

31. Prior to changes in 2011, what was the main perceived attraction of income trusts?
- a. reducing double taxation
  - b. unregulated business environment
  - c. fewer layers in the organizational structure
  - d. maintenance-free business assets

ANSWER: a

32. Which statement regarding corporations is most accurate?

- a. Due to limited liability, unlimited lives, and ease of ownership transfer, the vast majority of businesses are organized as corporations.
- b. Due to legal considerations related to ownership transfers and limited liability, most business is conducted by corporations in spite of large corporations' often less favourable tax treatment.
- c. Large corporations are taxed more favourably than sole proprietorships.
- d. Corporate stockholders are exposed to unlimited liability.

ANSWER: b

33. Which of the following statements best describes articles of incorporation and bylaws?

- a. The corporate bylaws are a standard set of rules established by the state of incorporation. These rules are identical for all corporations, and their purpose is to ensure that the firm's managers run the firm in accordance with government laws.
- b. Companies must establish a home office in a particular province, and that province must be the one in which most of their business is conducted.
- c. Attorney fees are generally involved when a company develops its articles of incorporation and bylaws, but since these documents are voluntary, a new corporation can avoid these costs by deciding not to have any.
- d. The articles of incorporation are concerned with things like what business the company will engage in, whereas the bylaws are concerned with things like procedures for electing the board of directors.

ANSWER: d

34. Which of the following statements would most people in business agree with?

- a. Firms should not be punished because they have unintentionally built incentive schemes that induce unethical behaviour.
- b. Firms and government agencies almost always agree with one another regarding the restrictions that should be placed on hiring and firing employees.
- c. Although moral characters are developed differently, it is useful to educate people about the adverse consequences of unethical behaviour to themselves, their firms, and the nation.
- d. Because of the courage it takes to blow the whistle, whistle blowers are generally promoted more rapidly than other employees.

ANSWER: c

35. What should be the primary operating goal of a publicly owned firm interested in serving its shareholders?

- a. maximize the stock price per share, which is the stock's intrinsic value, over the long run
- b. maximize the firm's expected EPS
- c. maximize the firm's expected total income
- d. maximize the stock price on a specific target date

ANSWER: a

36. Which of the following statements best describes corporate goals?

- a. The proper goal of the financial manager should be to attempt to maximize the firm's expected cash flows, because this will add the most to the wealth of the individual shareholders.
- b. The financial manager should seek that combination of assets, liabilities, and capital that will generate the largest expected projected after-tax income over the relevant time horizon, generally the

coming year.

- c. The riskiness inherent in a firm's earnings per share (EPS) depends on the characteristics of the projects the firm selects, and thus on the firm's assets. However, EPS is not affected by the manner in which those assets are financed.
- d. Potential agency problems can arise between shareholders and managers, because managers hired as agents to act on behalf of the owners may instead make decisions favourable to themselves rather than the shareholders.

ANSWER: d

37. Suppose the Bank of Canada announces plans to issue \$50 billion of new bonds. Assuming the announcement was not expected, what effect, other things held constant, would that have on bond prices and interest rates?

- a. Prices and interest rates would both rise.
- b. Prices would decline and interest rates would rise.
- c. Prices and interest rates would both decline.
- d. Prices would rise and interest rates would decline.

ANSWER: b

38. Which circumstance would be most likely to lead to higher interest rates on all debt securities in the economy?

- a. Households start saving a larger percentage of their income.
- b. The economy moves from a boom to a recession.
- c. The level of inflation begins to decline.
- d. With expansion plans, corporate increase their demand for capital.

ANSWER: d

39. Which circumstance would be most likely to lead to an increase in interest rates in the economy?

- a. Households reduce their consumption and increase their savings.
- b. The federal government decides to try to stimulate the economy.
- c. There is an increase in expected inflation.
- d. The economy falls into a recession.

ANSWER: c

40. Which of the following financial intermediaries is **NOT** a depository institution?

- a. commercial bank
- b. investment bank
- c. trust company
- d. credit union

ANSWER: b

41. In 2011, the Canadian government made significant changes to its treatment of income trusts. What was the principal reason for this action?

- a. Trusts were becoming too large compared to corporations.
- b. Trusts offered unfair tax advantages compared to corporations.
- c. The government did not have adequate legislative power to manage the activities of income trusts.
- d. Corporations were able to successfully influence government policymakers to bring about these

changes.

ANSWER: b

42. In Canada, the Canadian Deposit Insurance Corporation (CDIC) insures personal bank account balances up to \$100,000. What is the primary reason for this provision?

- a. This can prevent a “bank run” in times of economic uncertainty.
- b. This can provide additional support to the shareholders of banking institutions.
- c. This provides an opportunity for the government to increase its influence over the banking system.
- d. This mirrors practices followed in all other developed economies.

ANSWER: a

43. Which of the following statements is true regarding hedge funds and private equity funds?

- a. Both operate primarily by buying stock (equity) to gain controlling interest in companies.
- b. Both have a limited number of investors.
- c. Hedge funds are highly regulated, while there are few controls over the activities of private equity funds.
- d. The risks involved in investing in private equity funds are significantly less than the risks involved in investing in hedge funds.

ANSWER: b

44. Which of the following services will **NOT** be offered by insurance companies?

- a. taking deposits
- b. selling policies with saving features
- c. administrating pension funds
- d. making payments to beneficiaries

ANSWER: a

45. Which of the following statements is correct?

- a. A good goal for a firm’s management is maximization of expected EPS.
- b. Like corporations, the board of directors for an income trust supervises the operating entity on behalf of unitholders.
- c. There is a legal obligation to pay cash distributions for income trusts.
- d. Agency conflicts easily arise between shareholders and managers.

ANSWER: d

46. Which of the following statements is **NOT** correct?

- a. When a corporation’s shares are owned by a few individuals and are not traded on public markets, we say that the firm is “closely, or privately, held.”
- b. “Going public” establishes a firm’s true intrinsic value, and it also ensures that a highly liquid market will always exist for the firm’s shares.
- c. When stock in a closely held corporation is offered to the public for the first time, the transaction is called “going public,” and the market for such stock is called the new issue market.
- d. Publicly owned companies have shares owned by investors who are not associated with management, and public companies must register with and report to a regulatory agency such as the SEC.

ANSWER: b

47. Which of the following represents the most significant reason for the collapse of the U.S. banking system in



2008?

- a. In the 1990s, most large U.S. investment banks were reorganized into public trading companies.
- b. In the 2000s, most investment banks started to generate most of their income from fees charged for underwriting, consulting, and brokerage activities.
- c. New regulations introduced in the 2000s resulted in restrictions that restrained the operations of investment banks.
- d. New regulations in the 2000s allowed investment banks to issue unprecedented amounts of debt to finance their operations.

ANSWER: d

48. Besides skillful workers, what else supports good businesses?

- a. adequate capital
- b. adequate regulation
- c. adequate self-interest
- d. adequate government intervention

ANSWER: a

49. Which of the following best describes the position of the bondholders of an incorporated firm?

- a. They are owners of the corporation.
- b. They are creditors of the firm and thus expect to be paid interest on their investment according to their bond indenture (contract).
- c. They have the same rights and privileges of preferred shareholders of the firm.
- d. They are equity owners of the firm but they receive interest payments, not dividends.

ANSWER: b

50. Which of the following best describes the market price of a stock?

- a. the price observed by investors in the financial media
- b. the price observed in the OTC markets only
- c. the price observed in the broad financial markets
- d. the firm's book value as reported in its financial statements

ANSWER: c

51. If the market price of a stock reflects all relevant information, what does its market price reflect?

- a. the stock's exogenous value
- b. the stock's extrinsic value
- c. the stock's par value
- d. the stock's intrinsic value

ANSWER: d

52. Which of the following is true of stock ownership in Canada?

- a. 61% of Canadian households directly own stock.
- b. 10% of Canadian households directly own stock.
- c. 90% of Canadian households directly own stock.
- d. Most Canadian households do not own or participate, directly or indirectly, in the stock market.

ANSWER: b

53. Share price maximization is good for society because consumers benefit. Which of the following best describes this idea?

- a. Firms that maximize share price minimize costs and produce low-quality goods, which only benefits producers.
- b. Firms that maximize share price minimize costs and produce high quality goods that consumers demand.
- c. Firms that maximize share price maximize costs and produce low-quality goods, which benefits society.
- d. Most Canadian households do not own or participate, directly or indirectly, in the stock market and as such they do not benefit from the production of quality goods produced at low cost.

ANSWER: b

54. What does the separation theorem demonstrate?

- a. Firms that separate share price and cost minimize costs and thus produce more goods, which benefits society.
- b. Firms should separate their management decisions between those that benefit society and those that benefit shareholders.
- c. All investors are better off when firms separate their investment decisions from the preferences of their owner/investors.
- d. Investors that own shares directly should be separated from investors that own shares indirectly.

ANSWER: c

55. Which of the following is **NOT** a variable used in the calculation of free cash flow (FCF)?

- a. sales (revenues)
- b. operating expenses and taxes
- c. expected (required) investments in operating capital
- d. interest and other financing costs

ANSWER: d

56. Which of the following is **NOT** a primary disadvantage of a regular partnership?

- a. unlimited liability
- b. limited life of the organization
- c. difficulty in transferring ownership
- d. unlimited life of the organization

ANSWER: d

57. Recently, Hale Corporation announced the sale of 2.5 million newly issued shares of its stock at a price of \$21 per share. Hale sold the stock to an investment banker, which in turn sold it to individual and institutional investors. Where did this stock sale take place?

- a. over-the-counter market
- b. secondary market
- c. forex market
- d. primary market

ANSWER: b

58. In which type of organization do all partners enjoy limited liability in regards to negligence and potential losses limited to their original investment?

- a. general partnership
- b. REIT
- c. sole proprietorship
- d. limited liability partnership (LLP)

ANSWER: d

59. What is the rate of return normally required by investors when investing in a firm?

- a. capital required ROI
- b. capitalization rate
- c. weighted average cost of capital (WACC)\_
- d. current yield

ANSWER: c

60. Which of the following best defines an income trust?

- a. a fund that is set up for the purchase of debt for the company
- b. a fund that is set up to receive the after-tax dividends of the corporation
- c. a fund that is set up to receive the before-tax cash payments of the corporation
- d. a fund that holds assets for the corporation

ANSWER: c

61. The primary goal of a company's management is the maximization of which of the following?

- a. reported profit
- b. fundamental share price
- c. market share
- d. personal wealth

ANSWER: b