QUIZ 1

I. True or False

1. Social responsibility is usually in conflict with the objective of shareholder wealth maximization.
2. A security is an instrument that represents a financial liability to the holder and a financial asset to the issuer.
3. Equity financing has a tax advantage since dividends paid out to shareholders reduce a firm's taxable income.
4. A saving account at Bank A pays 6 percent interest, compounded annually. Bank B's savings account pays 6 percent compounded semiannually. Bank B is paying twice as much interest.
5. All other things remaining the same, an annuity received at the beginning of each period has more present value than does one received at the end of each period.
6. In valuing a security, we only need to know what the future cash flows will be.
7. You can reduce systematic risk by adding more common stocks to your portfolio.
8. A call provision allows the purchaser of a security to demand repayment of the principal.
9. A bond callable at 105 means that a 5 percent call premium will be paid on the face value if the bond is ever called.
10. If you were a common shareholder with minority interests, you would prefer a majority-rule rather than a cumulative voting system.

II. Multiple Choice

1. Which of the following finance activities are the responsibilities of the corporate treasurer?

i. Cash management   ii. Credit analysis   iii. Pension fund management

A. i only
B. ii only
C. iii only
D. i and iii only
E. i, ii and iii

2. Which of the following statements correctly reflects the objective of a firm?

   i. increase the earnings per share

   ii. maximize the market value of common shares

   iii. pay dividends at the highest level possible

A. i only

B. ii only

C. iii only

D. i and iii only

E. i, ii and iii

3. Which one of the following statements does *not* correctly describe a stock beta?

A. It reflects the business risk of a levered firm.

B. It measures the market or systematic risk of the stock.

C. It is used in the CAPM to calculate the cost of equity.

D. A beta less than 1 reflects a defensive security.

E. A stock with a beta of 1 has the same risk as the market portfolio.

4. A perpetual stock, par value $100, pays an annual dividend of $14.00. If investors desire a return of 12%, the current market price is :

A. $7.00

B. $14.00

C. $58.33

D. $100.00

E. $116.67

5. A firm paid a dividend of $2 per share yesterday and expects the growth rate of dividends to be 5% in the future. If the stock beta is 1.25, the risk-free 4% and the return on the market portfolio 15%, the current price of the common share is:

A. $10.67

B. $11.27

C. $11.83

D. $15.68

E. $16.47

6. Which of the following statements correctly describes the capital asset pricing model (CAPM)?

i. Investors have different expectations about risk and expected returns.

ii. The asset beta is the weighted-average of debt and equity betas.

iii. The asset beta reflects the business and financial risk of the firm.

A. i only

B. iii only

C. i and ii only

D. ii only

E. i, ii and iii

7. Usually, the yield on a 30-day federal treasury bill consists of the following components.

A. real interest rate

B. real interest rate and premium for expected inflation

C. real interest rate, liquidity premium for maturity and premium for expected inflation

D. real interest rate and premium for default risk

E. real interest rate and premium for political risks

8. The stock beta of a firm reflects:

A. the unsystematic risk of the firm

B. the market risk of the S&P 500 Stock Index

C. the unsystematic risk for the industry

D. the risk preferences of the board of directors

E. the non-diversifiable business and financial risks facing the firm

9. There are benefits to holding a diversified stock portfolio if the correlation coefficient between the expected returns on the component stocks:

A. exceeds two

B. exceeds one

C. equals one

D. is below one

E. correlation coefficients are irrelevant to the question of diversification.

10. For valuation of bonds, the following relationship exist except

A. As the current interest rate increases, the value of the bond increases.

B. The interest rate of long-term bonds is higher than that of short-term bonds.

C. The higher the coupon rate of bond, the higher the value of the bond.

D. Whether sold at discount or premium, as the maturity date approaches, the market value of the bond approaches its par value.