

QUIZ 1

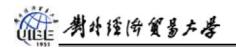
I. True or False

- 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.

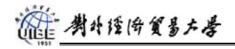
II . Multiple Choice

- 1. Which of the following finance activities are the responsibilities of the corporate treasurer?
 - i. Cash management
- ii. Credit analysis
- iii. Pension fund management

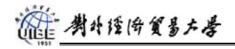
- A. i only
- B. ii only
- C. iii only
- D. i and iii only
- E. i, ii and iii



- 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.