Business Finance 1st edition Kidwell Test Bank

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Testbank

to accompany

Business finance

1st edition

by

Parrino et al.

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Chapter 2: The financial environment and the level of interest rates

True/False

1. The role of the financial system is to gather money from people and businesses that have funds to invest and to channel money to those that need it.

   *a. True
   b. False

Correct answer: a

2. The financial system is nothing more than a collection of financial markets.

   a. True
   *b. False

Correct answer: b

3. Without a financial market, purchasing a house would require a cash purchase.

   *a. True
   b. False

Correct answer: a

4. Governments are the principal SSUs in the economy.

   a. True
   *b. False

Correct answer: b

5. Businesses are the principal DSUs in the economy.

   *a. True
   b. False

Correct answer: a

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6. Direct financial markets could be broadly labelled as wholesale markets for funding.

*a. True
b. False

Correct answer: a

7. A privately held company securing a loan from its regional commercial bank is an example of a direct market transaction.

*a. True
b. False

Correct answer: a

8. A primary market is any financial market in which owners of outstanding securities can resell them to other investors.

a. True
*b. False

Correct answer: b

9. The vast preponderance of securities sales on the Australian Securities Exchange are classified as secondary market transactions.

*a. True
b. False

Correct answer: a

10. The existence of an active secondary market for a security will help enhance the price for a security in the primary market.

*a. True
b. False

Correct answer: a

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11. All securities listed on the ASX have been electronically traded since 2000 when floor trading was phased out.

    a. True
    *b. False

Correct answer: b

12. The Australian Securities and Investment Commission regulates public securities markets in Australia.

    *a. True
    b. False

Correct answer: a

13. Futures and options derive their value from some underlying asset.

    *a. True
    b. False

Correct answer: a

14. The S&P/ASX 200 index is considered the pre-eminent benchmark in Australia.

    *a. True
    b. False

Correct answer: a

15. The downside to a private placement transaction is that it does not require the fees and expenses associated with an ASIC registration.

    a. True
    *b. False

Correct answer: b

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16. Brokers are market specialists who do not bear risk.

*a. True
b. False

Correct answer: a

17. The term *money market* reflects the idea that the instruments traded in the money market are highly marketable and easily converted into cash.

*a. True
b. False

Correct answer: a

18. Equities are generally traded in the capital market.

*a. True
b. False

Correct answer: a

19. The nominal rate of interest is the interest rate in the economy in the absence of inflation.

a. True
*b. False

Correct answer: b

20. The method that most individuals use to fund their needs is through indirect financing.

*a. True
b. False

Correct answer: a

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21. The elimination of small financial institutions is primarily a by-product of deregulating the financial markets.

*a. True
b. False

Correct answer: a

22. Business finance companies obtain the majority of their funds by selling equity.

a. True
*b. False

Correct answer: b

23. The nominal rate of interest is indirectly related to real rates.

a. True
*b. False

Correct answer: b

24. Real rates of interest are perfectly observable.

a. True
*b. False

Correct answer: b

25. It is impossible for the nominal rate of interest to be below the real rate of interest.

a. True
*b. False

Correct answer: b

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Multiple-choice questions

Note: Rate of difficulty noted after learning objective (basic, moderate, challenging).

26. An economy with a large flow of funds requires:

    a. a lot of gold reserves.
    b. a tightly controlled central bank.
    *c. an efficient financial system.
    d. all of the above.

Correct answer: c
Learning Objective 2.1 ~ discuss the primary role of the financial system in the economy, and how fund transfers take place (Basic)

27. Financial markets and financial institutions are both part of:

    a. the Australian Reserve Bank.
    *b. the financial system.
    c. the Australian Securities and Investments Commission.
    d. none of the above.

Correct answer: b
Learning Objective 2.1 ~ discuss the primary role of the financial system in the economy, and how fund transfers take place (Basic)

28. Savings by _____ is the origin of much of the money that funds large business loans in the economy.

    *a. consumers
    b. the Australian government
    c. small businesses
    d. none of the above

Correct answer: a
Learning Objective 2.1 ~ discuss the primary role of the financial system in the economy, and how fund transfers take place (Moderate)

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29. The financial system's primary concern is funnelling money from _____ to _____.

a. wealthy individuals, individuals.
*b. SSUs, DSUs
c. DSUs, SSUs
d. the government, wealthy individuals

Correct answer: b
Learning Objective 2.1 ~ discuss the primary role of the financial system in the economy, and how fund transfers take place (Moderate)

30. _____ is/are the principal SSUs in the economy.

*a. Households
b. The federal government
c. State governments
d. Businesses

Correct answer: a
Learning Objective 2.1 ~ discuss the primary role of the financial system in the economy, and how fund transfers take place (Moderate)

31. Elf Toy Products increased the amount of cash in its bank account this year. Elf is a:

a. DSU.
*b. SSU.
c. neither a DSU nor a SSU.
d. both a DSU and a SSU.

Correct answer: b
Learning Objective 2.1 ~ discuss the primary role of the financial system in the economy, and how fund transfers take place (Moderate)

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32. An important function of the financial system is:

*a. to direct money to the best investment opportunities in the economy.
b. to allow the federal government to view all financial transactions.
c. to help state governments to coordinate state tax levies.
d. all of the above.

Correct answer: a
Learning Objective 2.1 ~ discuss the primary role of the financial system in the economy, and how fund transfers take place (Basic)

33. A surplus budget position means that an entity's:

a. income and expenditures are equal.
*b. income for the period exceeds expenses.
c. expenditures for the period exceed revenues.
d. none of the above.

Correct answer: b
Learning Objective 2.1 ~ discuss the primary role of the financial system in the economy, and how fund transfers take place (Moderate)

34. Direct financing occurs when:

a. an SSU borrows directly from a DSU.
*b. a DSU borrows directly from a SSU.
c. an SSU borrows from the federal government.
d. a DSU borrows from the federal government.

Correct answer: b
Learning Objective 2.2 ~ discuss direct financing and the role investment banks play in this process (Moderate)

35. Which types of individuals are able to participate in the direct financial market?

a. entrepreneurs
*b. wealthy individuals
c. venture capitalists
d. all of the above.

Correct answer: b
Learning Objective 2.2 ~ discuss direct financing and the role investment banks play in this process (Moderate)

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36. The major players in the direct financial markets are:

    a. investment banks.
    b. commercial banks.
    c. regional banks.
    *d. both a and b.

Correct answer: d
Learning Objective 2.1 ~ discuss the primary role of the financial system in the economy, and how fund transfers take place (Moderate)

37. What is the generally recognised minimum denominated transaction in the direct financial markets?

    a. $10,000
    b. $100,000
    *c. $1,000,000
    d. $10,000,000

Correct answer: c
Learning Objective 2.2 ~ discuss direct financing and the role investment banks play in this process (Challenging)

38. Wesfarmers needs to raise $720 million for an expansion and approaches an investment banker. If the issue is 480,000 bonds and it raises $840 million on a stand-by basis, what is the underwriter's per share compensation?

    *a. $120
    b. $140
    c. $240
    d. $250

Correct answer: a.
Learning Objective 2.2 ~ discuss direct financing and the role investment banks play in this process (Basic)

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39. The financial market where a new security is sold for the first time is:

*a. a primary market.
b. a secondary market.
c. an indirect market.
d. none of the above.

Correct answer: a
Learning Objective 2.3 ~ describe the primary, secondary and money markets, and explain why these markets are so important to businesses (Basic)

40. Secondary financial markets are similar to:

a. direct auction markets.
b. new-car markets.
*c. used-car markets.
d. all of the above.

Correct answer: c
Learning Objective 2.3 ~ describe the primary, secondary and money markets, and explain why these markets are so important to businesses (Moderate)

41. If you just purchased a share of BHP through an Australia Securities Exchange-based transaction, you participated in:

a. a primary market transaction.
*b. a secondary market transaction.
c. a futures market transaction.
d. a tertiary market transaction.

Correct answer: b
Learning Objective 2.3 ~ describe the primary, secondary and money markets, and explain why these markets are so important to businesses (Moderate)

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42. The ease with which a security can be sold and converted into cash is called:

a. convertibility.
b. book value.
*c. marketability.
d. none of the above.

Correct answer: c
Learning Objective 2.3 ~ describe the primary, secondary and money markets, and explain why these markets are so important to businesses (Basic)

43. The key difference between liquidity and marketability is that:

a. the securities are easier to trade
b. the securities can be converted into cash.
*c. the securities preserve their value.
d. the securities have lower funding costs.

Correct answer: c
Learning Objective 2.3 ~ describe the primary, secondary and money markets, and explain why these markets are so important to businesses (Challenging)

44. The presence of a financial market increases the marketability of a financial security by:

a. essentially insuring the price of the security.
*b. reducing the transaction costs for selling the security.
c. guaranteeing the accuracy of information produced by the issuer of the security.
d. none of the above.

Correct answer: b
Learning Objective 2.3 ~ describe the primary, secondary and money markets, and explain why these markets are so important to businesses (Moderate)

45. Which law is administered by the Australian Securities and Investment Commission?

a. the Securities Act of 1933
*b. Corporations Act of 2001
c. Stocks and Markets Act 1984
d. the Financial Services Modernisation Act of 1999

Correct answer: b
Learning Objective 2.3 ~ describe the primary, secondary and money markets, and explain why these markets are so important to businesses (Basic)

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46. The S&P/200 Index represents what percentage of the market capitalisation of the Australian market?

a. 50%
b. 65%
*c. 75%
d. 95%

Correct answer: c
Learning Objective 2.3 ~ describe the primary, secondary and money markets, and explain why these markets are so important to businesses (Moderate)

47. One of the main services offered by investment banks to companies is:

*a. helping companies sell new debt or equity issues in the security markets.
b. making loans to companies.
c. taking deposits from companies.
d. all of the above.

Correct answer: a
Learning Objective 2.3 ~ describe the primary, secondary and money markets, and explain why these markets are so important to businesses (Basic)

48. Which of the following would most likely be involved in a public securities underwriting service?

a. a regional commercial banker
b. a broker
*c. a dealer
d. none of the above would ever be involved in underwriting.

Correct answer: c
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49. The ASX is an example of:

a. an over-the-counter market exchange.
*b. an electronic organised exchange.
c. a physical exchange.
d. all of the above.

Correct answer: b
Learning Objective 2.3 ~ describe the primary, secondary and money markets, and explain why these markets are so important to businesses (Basic)

50. Which of the following share exchange organisational forms has no physical location?

a. a futures exchange
*b. an over-the-counter market
c. an auction market.
d. none of the above.

Correct answer: b
Learning Objective 2.3 ~ describe the primary, secondary and money markets, and explain why these markets are so important to businesses (Basic)

51. A highly liquid financial instrument with a maturity of 90 days would be traded in:

*a. the money market.
b. the bond market.
c. the share market.
d. none of the above.

Correct answer: a
Learning Objective 2.3 ~ describe the primary, secondary and money markets, and explain why these markets are so important to businesses (Moderate)

52. Money market instruments are generally issued by:

a. companies in dire need of cash to maintain their credit rating.
*b. companies of the highest credit rating.
c. companies of the lower credit ratings.
d. all of the above.

Correct answer: b
Learning Objective 2.3 ~ describe the primary, secondary and money markets, and explain why these markets are so important to businesses (Basic)

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53. If a company needs to adjust its liquidity position, then it would participate in:

*a. the money market.
b. the bond market.
c. the share market.
d. all of the above.

Correct answer: a
Learning Objective 2.3 ~ describe the primary, secondary and money markets, and explain why these markets are so important to businesses (Basic)

54. If a company needs to finance a new corporate headquarters building, then it would most likely seek the funds in the:

a. money market.
*b. capital market.
c. futures market.
d. all of the above.

Correct answer: b
Learning Objective 2.3 ~ describe the primary, secondary and money markets, and explain why these markets are so important to businesses (Basic)

55. Which of the following is **NOT** a component of the financial system?

a. money market.
*b. leasing market.
c. bond market.
d. share market.

Correct answer: b
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56. The most common reason that corporate companies use the futures and options markets is:

*a. to hedge risk.
b. to take risk.
c. to make deposits.
d. none of the above.

Correct answer: a
Learning Objective 2.3 ~ describe the primary, secondary and money markets, and explain why these markets are so important to businesses (Basic)

57. Which of the following grants the owner the right to purchase an asset at a pre-specified price for a pre-specified period of time?

*a. a call option
b. a put option
c. a futures contract
d. all of the above

Correct answer: a
Learning Objective 2.3 ~ describe the primary, secondary and money markets, and explain why these markets are so important to businesses (Moderate)

58. If you have an asset that you will be selling during the next two weeks, then you might be able to hedge the proceeds from the asset sale by:

a. purchasing a call option on the asset.
*b. purchasing a put option on the asset.
c. purchasing more of the asset.
d. none of the above.

Correct answer: b
Learning Objective 2.3 ~ describe the primary, secondary and money markets, and explain why these markets are so important to businesses (Moderate)

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59. If your company primarily borrows from commercial banks, then it primarily accesses the capital markets through:

a. direct financing.
*b. indirect financing.
c. a legal loophole that allows all commercial banks the ability to underwrite securities.
d. none of the above.

Correct answer: b
Learning Objective 2.4 ~ explain how financial institutions serve small businesses that are unable to participate in the direct financial markets and describe how firms use the financial system (Basic)

60. The process of converting financial securities with one set of characteristics into securities with another set of characteristics is called:

a. financial bundling.
*b. financial intermediation.
c. financial disintermediation.
d. none of the above.

Correct answer: b
Learning Objective 2.4 ~ explain how financial institutions serve small businesses that are unable to participate in the direct financial markets and describe how firms use the financial system (Moderate)

61. Which of the following is NOT true regarding finance companies?

a. they obtain the majority of their funds by selling short-term debt.
*b. their funds are used to make a variety of long term loans and leases.
c. typically willing to make loans to companies with higher levels of default risk.
d. none of the above.

Correct answer: b
Learning Objective 2.4 ~ explain how financial institutions serve small businesses that are unable to participate in the direct financial markets and describe how firms use the financial system (Basic)

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62. A line of credit to a business is like _____ to an individual.

a. a term loan
b. a bond
*c. a credit card
d. none of the above

Correct answer: c
Learning Objective 2.4 ~ explain how financial institutions serve small businesses that are unable to participate in the direct financial markets and describe how firms use the financial system (Basic)

63. Which of the following are the primary investment vehicles for the funds in which life insurance companies must invest?

a. cash
b. money market securities
*c. capital market securities
d. foreign investments

Correct answer: c
Learning Objective 2.4 ~ explain how financial institutions serve small businesses that are unable to participate in the direct financial markets and describe how firms use the financial system (Challenging)

64. General insurance companies sell:

a. protection against loss of income in the event of the death of the insured.
*b. protection against loss of property from fire, theft, accidents, and other predictable causes.
c. protection against a loss of pension revenue for retirees.
d. all of the above.

Correct answer: b
Learning Objective 2.4 ~ explain how financial institutions serve small businesses that are unable to participate in the direct financial markets and describe how firms use the financial system (Basic)

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65. Which of the following would not make up a major proportion of a superannuation fund investment portfolio?

*a. commercial paper
b. long-term corporate bonds
c. shares
d. none of the above

Correct answer: a
Learning Objective 2.4 ~ explain how financial institutions serve small businesses that are unable to participate in the direct financial markets and describe how firms use the financial system (Moderate)

66. A hedge fund is an example of:

a. a commercial bank.
b. a superannuation fund.
*c. an investment fund.
d. a pension fund.

Correct answer: c
Learning Objective 2.4 ~ explain how financial institutions serve small businesses that are unable to participate in the direct financial markets and describe how firms use the financial system (Moderate)

67. If a small business opts not to borrow from a commercial bank, then what is probably its next best alternative?

a. an insurance company.
b. a superannuation fund.
c. an investment fund.
*d. a finance company.

Correct answer: d
Learning Objective 2.4 ~ explain how financial institutions serve small businesses that are unable to participate in the direct financial markets and describe how firms use the financial system (Basic)

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68. The price of borrowing money is called:

a. inflation.
b. return.
*c. interest.
d. all of the above.

Correct answer: c
Learning Objective 2.5 ~ explain how interest rates are determined and calculate the nominal and real rate of interest (Basic)

69. The nominal rate of interest is:

a. the inflation-adjusted return rate.
b. the inflation adjusted cost rate.
c. a commodity cross-indexed return rate.
*d. the unadjusted return rate.

Correct answer: d
Learning Objective 2.5 ~ explain how interest rates are determined and calculate the nominal and real rate of interest (Moderate)

70. The real rate of return can be justified, at a basic level, by:

a. compensation for inflation.
*b. compensation for deferring consumption.
c. compensation for the level of international borrowing.
d. all of the above.

Correct answer: b
Learning Objective 2.5 ~ explain how interest rates are determined and calculate the nominal and real rate of interest (Moderate)

71. If you are a borrower, which would you prefer to occur during the life of your loan?

*a. a level of inflation that is higher than that anticipated at the outset of the loan
b. a level of inflation that is lower than that anticipated at the outset of the loan
c. a level of inflation that is exactly as anticipated at the outset of the loan
d. no inflation at all

Correct answer: a
Learning Objective 2.5 ~ explain how interest rates are determined and calculate the nominal and real rate of interest (Challenging)

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72. If inflation is anticipated to be 5 per cent during the next year, while the real rate of interest for a one-year loan is 5 per cent, then what should the nominal rate of interest be for a risk-free one-year loan?

a. 5 per cent
*b. 10 per cent
c. 25 per cent
d. none of the above

Correct answer: b
Learning Objective 2.5 ~ explain how interest rates are determined and calculate the nominal and real rate of interest (Moderate)

73. The general level of interest rates tends to follow:

a. deflation.
*b. the business cycle.
c. the default cycle.
d. all of the above.

Correct answer: b
Learning Objective 2.5 ~ explain how interest rates are determined and calculate the nominal and real rate of interest (Moderate)

74. During an economic expansion, we would expect:

*a. interest rates to increase.
b. interest rates to decrease.
c. interest rates to remain the same.
d. the price of money to decrease.

Correct answer: a
Learning Objective 2.5 ~ explain how interest rates are determined and calculate the nominal and real rate of interest (Moderate)

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75. In Australia, the real rate of interest is generally about:

a. 1 per cent.
*b. 3 per cent.
c. 5 per cent.
d. 7 per cent.

Correct answer: b
Learning Objective 2.5 ~ explain how interest rates are determined and calculate the nominal and real rate of interest (Basic)

76. If the supply of loanable funds decreases relative to the demand for those funds, then we would expect:

a. interest rates to remain unchanged.
*b. interest rates to increase.
c. interest rates to decrease.
d. the price of money to remain unchanged.

Correct answer: b
Learning Objective 2.5 ~ explain how interest rates are determined and calculate the nominal and real rate of interest (Moderate)

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