Fundamentals of Corporate Finance 4th edition Parrino Test Bank

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Chapter 2: The Financial System and the Level of Interest Rates

Format: True/False
Learning Objective: LO 1
Level of Difficulty: Easy
Bloomcode: Knowledge
AACSB: Analytic
IMA: Business Economics
AICPA: Industry/Sector Perspective

1. The role of the financial system is to gather money from people, businesses and government that have funds to invest and to channel that money to those who need it.
   A) True
   B) False
   Ans: A

Format: True/False
Learning Objective: LO 1
Level of Difficulty: Easy
Bloomcode: Knowledge
AACSB: Analytic
IMA: Business Economics
AICPA: Industry/Sector Perspective

2. The financial system is nothing more than a collection of financial markets.
   A) True
   B) False
   Ans: B

Format: True/False
Learning Objective: LO 1
Level of Difficulty: Easy
Bloomcode: Knowledge
AACSB: Analytic
IMA: Business Economics
AICPA: Industry/Sector Perspective

3. Without a financial market, purchasing a house would require a cash purchase.
   A) True
   B) False
   Ans: A

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Format: True/False
Learning Objective: LO 1
Level of Difficulty: Easy
Bloomcode: Knowledge
AACSB: Analytic
IMA: Business Economics
AICPA: Industry/Global Perspective

4. The financial markets where direct transactions take place are retail markets with a typical minimum transaction size of $1 million.
   A) True
   B) False
   Ans: B

   Level of Difficulty: Easy
   Learning Objective: LO 1
   Bloomcode: Knowledge
   AACSB: Analytic
   IMA: Business Economics
   AICPA: Industry/Sector Perspective

5. Major buyers and sellers of securities in direct financial markets include commercial banks, large corporations, the federal government, hedge funds, and some wealthy individuals.
   A) True
   B) False
   Ans: A

   Level of Difficulty: Easy
   Learning Objective: LO 1
   Bloomcode: Knowledge
   AACSB: Analytic
   IMA: Business Economics
   AICPA: Industry/Sector Perspective

6. Governments are the principal lender-savers in the economy.
   A) True
   B) False
   Ans: B

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Format: True/False
Learning Objective: LO 1
Level of Difficulty: Medium
Bloomcode: Comprehension
AACSB: Analytic
IMA: Business Economics
AICPA: Industry/Sector Perspective

7. Businesses are the principal borrower-spenders in the economy.
   A) True
   B) False
   Ans: A

   Format: True/False
   Learning Objective: LO 1
   Level of Difficulty: Medium
   Bloomcode: Comprehension
   AACSB: Analytic
   IMA: Business Economics
   AICPA: Industry/Sector Perspective

8. Primary markets are markets where securities are resold. They provide the means for investors to sell their securities to other investors.
   A) True
   B) False
   Ans: B

   Level of Difficulty: Easy
   Learning Objective: LO 3
   Bloomcode: Knowledge
   AACSB: Analytic
   IMA: Business Economics
   AICPA: Industry/Sector Perspective

9. Secondary markets are where the owners of outstanding securities can resell them to other investors. They provide the means for investors to convert their securities into cash.
   A) True
   B) False
   Ans: A

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Level of Difficulty: Easy
Learning Objective: LO 1
Bloomcode: Knowledge
AACSB: Analytic
IMA: Business Economics
AICPA: Industry/Sector Perspective

10. Direct financial markets could be broadly labeled as wholesale markets for funding.
A) True
B) False
Ans: A

Format: True/False
Learning Objective: LO 2
Level of Difficulty: Medium
Bloomcode: Comprehension
AACSB: Analytic
IMA: Business Economics
AICPA: Industry/Sector Perspective

11. A privately held corporation who borrows from a regional commercial bank is an example of a direct market transaction.
A) True
B) False
Ans: B

Format: True/False
Learning Objective: LO 2
Level of Difficulty: Medium
Bloomcode: Comprehension
AACSB: Analytic
IMA: FSA
AICPA: Legal/Regulatory Perspective

12. The law that prohibited commercial banks from engaging investment banking activities is the Financial Services Modernization Act of 1999.
A) True
B) False
Ans: B

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Format: True/False
Learning Objective: LO 2
Level of Difficulty: Easy
Bloomcode: Knowledge
AACSB: Analytic
IMA: FSA
AICPA: Legal/Regulatory Perspective

13. Today, major money center banks in the U.S are allowed to provide investment banking services.
A) True
B) False
Ans: A

Format: True/False
Learning Objective: LO 3
Level of Difficulty: Easy
Bloomcode: Knowledge
AACSB: Analytic
IMA: Business Economics
AICPA: Industry/Sector Perspective

14. A primary market is any market in which owners of outstanding securities can resell them to other investors.
A) True
B) False
Ans: B

Solution: A primary market is a financial market in which new security issues are sold by companies directly to investors. A secondary market is any market in which owners of outstanding securities can resell them to other investors.
Format: True/False
Learning Objective: LO 3
Level of Difficulty: Easy
Bloomcode: Knowledge
AACSB: Analytic
IMA: Business Economics
AICPA: Industry/Sector Perspective

15. Most securities sales on the New York Stock Exchange are secondary market transactions.
A) True
B) False
Ans: A

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Format: True/False
Learning Objective: LO 3
Level of Difficulty: Medium
Bloomcode: Knowledge
AACSB: Analytic
IMA: Business Economics
AICPA: Industry/Sector Perspective

16. An active secondary market for a security will help to enhance the price of that particular security in the primary market.
A) True
B) False
Ans: A

Format: True/False
Learning Objective: LO 3
Level of Difficulty: Medium
Bloomcode: Comprehension
AACSB: Analytic
IMA: Corporate Finance
AICPA: Industry/Sector Perspective

17. The downside to a private placement transaction is that, it does not require the fees and expenses associated with an SEC registration.
A) True
B) False
Ans: B

Format: True/False
Learning Objective: LO 3
Level of Difficulty: Easy
Bloomcode: Knowledge
AACSB: Analytic
IMA: Business Economics
AICPA: Industry/Sector Perspective

18. Brokers are market specialists who do not bear the risk of owning securities.
A) True
B) False
Ans: A

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Format: True/False
Learning Objective: LO 3
Level of Difficulty: Easy
Bloomcode: Knowledge
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IMA: Business Economics
AICPA: Industry/Sector Perspective

19. 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
Ans: A

Format: True/False
Learning Objective: LO 3
Level of Difficulty: Medium
Bloomcode: Comprehension
AACSB: Analytic
IMA: Corporate Finance
AICPA: Industry/Sector Perspective

20. Equities with maturities greater than one year generally are traded in the capital market.
A) True
B) False
Ans: A

Format: True/False
Learning Objective: LO 5
Level of Difficulty: Easy
Bloomcode: Knowledge
AACSB: Analytic
IMA: Corporate Finance
AICPA: Resource Management

21. Most companies use indirect market funding from financial institutions to obtain financing.
A) True
B) False
Ans: A

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Format: True/False
Learning Objective: LO 5
Level of Difficulty: Easy
Bloomcode: Knowledge
AACSB: Analytic
IMA: Corporate Finance
AICPA: Resource Management

22. Business finance companies obtain the majority of their funds by selling equity.
A) True
B) False
Ans: B

Format: True/False
Learning Objective: LO 6
Level of Difficulty: Easy
Bloomcode: Knowledge
AACSB: Analytic
IMA: Corporate Finance
AICPA: Resource Management

23. The nominal rate of interest is the rate of interest that is adjusted for inflation.
A) True
B) False
Ans: B

Format: True/False
Learning Objective: LO 6
Level of Difficulty: Easy
Bloomcode: Knowledge
AACSB: Analytic
IMA: Corporate Finance
AICPA: Industry/Sector Perspective

24. Real rates of interest are perfectly observable in the financial markets.
A) True
B) False
Ans: B

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Format: True/False
Learning Objective: LO 6
Level of Difficulty: Medium
Bloomcode: Comprehension
AACSB: Analytic
IMA: Corporate Finance
AICPA: Resource Management

25. It is impossible for the nominal rate of interest to be less than real rate of interest.
    A) True
    B) False
    Ans: B

    Format: Multiple Choice
    Learning Objective: LO 1
    Level of Difficulty: Medium
    Bloomcode: Comprehension
    AACSB: Analytic
    IMA: Business Economics
    AICPA: Industry/Global Perspective

26. It is difficult for individuals to participate in the direct financial markets for the following reason:
    A) The direct financial markets re retail markets with a typical minimum transaction size of $1 million.
    B) The direct financial markets are wholesale markets with a typical minimum transaction size of $1 million.
    C) Major buyers and sellers of securities in indirect financial markets include commercial banks, large corporations, the federal government, hedge funds, and some wealthy individuals.
    D) Major buyers and sellers of securities in direct financial markets do not include commercial banks, large corporations, the federal government, hedge funds, and some wealthy individuals.
    Ans: B

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Format: Multiple Choice
Learning Objective: LO 1
Level of Difficulty: Easy
Bloomcode: Knowledge
AACSB: Analytic
IMA: Business Economics
AICPA: Industry/Sector Perspective

27. An economy with a large flow of funds requires:
A) a lot of gold reserves.
B) a frictionless market.
C) an efficient financial system.
D) all of the above.
Ans: C

Format: Multiple Choice
Learning Objective: LO 1
Level of Difficulty: Easy
Bloomcode: Knowledge
AACSB: Analytic
IMA: Business Economics
AICPA: Industry/Sector Perspective

28. Financial markets and financial institutions are both part of:
A) the U.S. Treasury.
B) the financial system.
C) the SEC.
D) none of the above.
Ans: B

Format: Multiple Choice
Learning Objective: LO 1
Level of Difficulty: Easy
Bloomcode: Knowledge
AACSB: Analytic
IMA: Business Economics
AICPA: Industry/Global Perspective

29. Savings by _____ in small dollar amounts is the origin of much of the money that funds business loans in an economy.
A) households
B) the U.S. government
C) small businesses
D) none of the above
Ans: A

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Format: Multiple Choice
Learning Objective: LO 1
Level of Difficulty: Easy
Bloomcode: Knowledge
AACSB: Analytic
IMA: Business Economics
AICPA: Industry/Global Perspective

30. A financial system's primary function is funneling money from:
    A) wealthy individuals to non-wealthy individuals.
    B) lender-savers to borrower-spenders.
    C) borrower-spenders to lender-savers.
    D) the government to wealthy individuals.
    Ans: B

Format: Multiple Choice
Learning Objective: LO 1
Level of Difficulty: Easy
Bloomcode: Knowledge
AACSB: Analytic
IMA: Business Economics
AICPA: Industry/Global Perspective

31. _____ are the principal lender-savers in the economy.
    A) Households
    B) Investment banks
    C) State governments
    D) Businesses
    Ans: A

Format: Multiple Choice
Learning Objective: LO 1
Level of Difficulty: Easy
Bloomcode: Knowledge
AACSB: Analytic
IMA: Business Economics
AICPA: Industry/Sector Perspective

32. An important function of financial intermediation is:
    A) To convert financial securities with one set of characteristics into securities with another set of characteristics.
    B) To direct the money from lenders to borrowers
    C) To direct the money from borrowers to savers.
    D) For commercial banks to use consumer CD deposits to make deposits to small businesses.
    Ans: A

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Format: Multiple Choice
Learning Objective: LO 1
Level of Difficulty: Medium
Bloomcode: Comprehension
AACSB: Analytic
IMA: Corporate Finance
AICPA: Industry/Sector Perspective

33. 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) to direct the money from borrower-lenders to lender-savers.
    Ans: A

Format: Multiple Choice
Learning Objective: LO 1
Level of Difficulty: Medium
Bloomcode: Comprehension
AACSB: Analytic
IMA: Corporate Finance
AICPA: Industry/Sector Perspective

34. Direct financing occurs when:
    A) a lender-savers borrows directly from a borrower-spenders.
    B) a borrower-spenders borrows directly from a lender-savers.
    C) a lender-savers borrows from the federal government.
    D) a borrower-spenders borrows from the federal government.
    Ans: B

Format: Multiple Choice
Learning Objective: LO 2
Level of Difficulty: Easy
Bloomcode: Knowledge
AACSB: Analytic
IMA: Business Economics
AICPA: Industry/Sector Perspective

35. Which of the following is a major participant in the direct financial market?
    A) Large corporations.
    B) Wealthy individuals.
    C) Investment banks.
    D) All of the above.
    Ans: D

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Format: Multiple Choice
Learning Objective: LO 2
Level of Difficulty: Easy
Bloomcode: Knowledge
AACSB: Analytic
IMA: Business Economics
AICPA: Industry/Sector Perspective

36. The major players in the direct financial markets are:
A) investment banks.
B) money center banks.
C) regional banks.
D) both A and B.
Ans: D

Format: Multiple Choice
Learning Objective: LO 2
Level of Difficulty: Easy
Bloomcode: Knowledge
AACSB: Analytic
IMA: Business Economics
AICPA: Industry/Sector Perspective

37. What is the typical minimum denominated transaction size in the direct financial markets?
A) $10,000.
B) $100,000.
C) $1,000,000.
D) $10,000,000.
Ans: C

Format: Multiple Choice
Learning Objective: LO 2
Level of Difficulty: Easy
Bloomcode: Knowledge
AACSB: Analytic
IMA: FSA
AICPA: Legal/Regulatory Perspective

38. Which of the following is responsible for rolling back many of the rules against commercial banks offering investment banking activities?
A) The Securities Act of 1933.
B) The Securities Exchange Act of 1934.
C) The Glass-Steagall Act of 1933.
D) The Financial Services Modernization Act of 1999.
Ans: D

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Format: Multiple Choice
Learning Objective: LO 2
Level of Difficulty: Easy
Bloomcode: Knowledge
AACSB: Analytic
IMA: Corporate Finance
AICPA: Resource Management

39. Which of the following is a process by which investment bankers purchase new securities directly from the issuing company and resell them to the investors?
A) Agency marketing.
B) Underwriting.
C) Distribution.
D) Private placement.
Ans: B

Format: Multiple Choice
Learning Objective: LO 3
Level of Difficulty: Easy
Bloomcode: Knowledge
AACSB: Analytic
IMA: Business Economics
AICPA: Industry/Sector Perspective

40. Stocks that are traded in the _____ are typically those of smaller and less known firms.
A) National Stock Exchange
B) New York Stock Exchange
C) American Stock Exchange
D) over-the-counter market
Ans: D

Format: Multiple Choice
Learning Objective: LO 3
Level of Difficulty: Easy
Bloomcode: Knowledge
AACSB: Analytic
IMA: Business Economics
AICPA: Industry/Sector Perspective

41. 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 financial market.
D) none of the above.
Ans: A

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Format: Multiple Choice
Learning Objective: LO 3
Level of Difficulty: Easy
Bloomcode: Knowledge
AACSB: Analytic
IMA: Business Economics
AICPA: Industry/Sector Perspective

42. Secondary financial markets are similar to:
A) direct auction markets.
B) new-car markets.
C) used-car markets.
D) direct financial market.
Ans: C

Format: Multiple Choice
Learning Objective: LO 3
Level of Difficulty: Medium
Bloomcode: Application
AACSB: Analytic
IMA: Business Economics
AICPA: Industry/Sector Perspective

43. If you just purchased a share of IBM through a New York Stock Exchange-based transaction, you participated in:
A) a primary market transaction.
B) a secondary market transaction.
C) a futures market transaction.
D) none of the above.
Ans: B

Format: Multiple Choice
Learning Objective: LO 3
Level of Difficulty: Easy
Bloomcode: Knowledge
AACSB: Analytic
IMA: Corporate Finance
AICPA: Resource Management

44. The ease with which a security can be sold and converted into cash is called:
A) convertibility.
B) liquidity.
C) marketability.
D) none of the above.
Ans: C

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Format: Multiple Choice
Learning Objective: LO 3
Level of Difficulty: Medium
Bloomcode: Comprehension
AACSB: Analytic
IMA: Business Economics
AICPA: Industry/Sector Perspective

45. The presence of a financial market increases the marketability of a financial security by:
A) 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.
Ans: B

Format: Multiple Choice
Learning Objective: LO 3
Level of Difficulty: Easy
Bloomcode: Knowledge
AACSB: Analytic
IMA: Business Economics
AICPA: Industry/Sector Perspective

46. 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.
Ans: A

Format: Multiple Choice
Learning Objective: LO 3
Level of Difficulty: Easy
Bloomcode: Knowledge
AACSB: Analytic
IMA: Business Economics
AICPA: Industry/Sector Perspective

47. The NYSE is an example of:
A) an over-the-counter market exchange.
B) an organized exchange.
C) a commodities exchange.
D) all of the above.
Ans: B

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Format: Multiple Choice
Learning Objective: LO 3
Level of Difficulty: Medium
Bloomcode: Comprehension
AACSB: Analytic
IMA: Business Economics
AICPA: Industry/Sector Perspective

48. Which of the following markets has no central trading location?
A) A futures exchange.
B) An over-the-counter market.
C) An auction market.
D) None of the above.
Ans: B

Format: Multiple Choice
Learning Objective: LO 3
Level of Difficulty: Medium
Bloomcode: Comprehension
AACSB: Analytic
IMA: Business Economics
AICPA: Industry/Sector Perspective

49. 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 stock market.
D) none of the above.
Ans: A

Format: Multiple Choice
Learning Objective: LO 3
Level of Difficulty: Easy
Bloomcode: Knowledge
AACSB: Analytic
IMA: Business Economics
AICPA: Industry/Sector Perspective

50. Money market instruments are generally issued by:
A) firms in dire need of cash to maintain their credit rating.
B) firms of the highest credit rating.
C) firms of the lower credit ratings.
D) all of the above.
Ans: B

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Format: Multiple Choice
Learning Objective: LO 3
Level of Difficulty: Medium
Bloomcode: Comprehension
AACSB: Analytic
IMA: Business Economics
AICPA: Industry/Sector Perspective

51. The term *money market* is used because:
A) firms that issue securities in this market are in dire need of cash.
B) it is a market where stocks are converted into money.
C) the instruments traded in this market are close substitutes for cash.
D) none of the above.
Ans: C

Format: Multiple Choice
Learning Objective: LO 3
Level of Difficulty: Medium
Bloomcode: Knowledge
AACSB: Analytic
IMA: Corporate Finance
AICPA: Resource Management

52. If a firm needs to adjust its liquidity position, then it would participate in:
A) the money market.
B) the bond market.
C) the stock market.
D) the auction market.
Ans: A

Format: Multiple Choice
Learning Objective: LO 3
Level of Difficulty: Easy
Bloomcode: Knowledge
AACSB: Analytic
IMA: Corporate Finance
AICPA: Resource Management

53. If a firm 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.
Ans: B

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Format: Multiple Choice
Learning Objective: LO 3
Level of Difficulty: Medium
Bloomcode: Comprehension
AACSB: Analytic
IMA: Corporate Finance
AICPA: Resource Management

54. Which of the following statements about the OTC market is true?
    A) Securities that are listed on an organized exchange are bought and sold in the OTC market.
    B) An OTC market is an organized exchange where there is a central trading location.
    C) OTC security transactions are made on the floor of an exchange by traders.
    D) Securities that are not listed on an organized exchange are bought and sold on the OTC market.
    Ans D

Format: Multiple Choice
Learning Objective: LO 3
Level of Difficulty: Medium
Bloomcode: Comprehension
AACSB: Analytic
IMA: Corporate Finance
AICPA: Resource Management

55. The most common reason that corporate firms use the futures and options markets is to:
    A) hedge risk.
    B) take risk.
    C) make deposits.
    D) none of the above.
    Ans: A

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Fundamentals of Corporate Finance 4th edition Parrino Test Bank

Format: Multiple Choice
Learning Objective: LO 4
Level of Difficulty: Medium
Bloomcode: Comprehension
AACSB: Analytic
IMA: Corporate Finance
AICPA: Industry/Sector Perspective

56. Which of the following theories states that security prices reflect all public information, but not all private information?
A) Weak-form efficiency.
B) Semistrong-form efficiency.
C) Strong-form efficiency.
D) Nominal-form efficiency.
Ans: B

Format: Multiple Choice
Learning Objective: LO 4
Level of Difficulty: Medium
Bloomcode: Comprehension
AACSB: Analytic
IMA: Corporate Finance
AICPA: Industry/Sector Perspective

57. Which of the following theories states that security prices reflect all information, whether public or private?
A) Weak-form efficiency.
B) Semistrong-form efficiency.
C) Strong-form efficiency.
D) Nominal-form efficiency.
Ans: C

Format: Multiple Choice
Learning Objective: LO 5
Level of Difficulty: Easy
Bloomcode: Knowledge
AACSB: Analytic
IMA: Corporate Finance
AICPA: Resource Management

58. If your firm obtains most of its financing 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.
Ans: B

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Format: Multiple Choice
Learning Objective: LO 5
Level of Difficulty: Medium
Bloomcode: Comprehension
AACSB: Analytic
IMA: Corporate Finance
AICPA: Resource Management

59. 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.
Ans: B

Format: Multiple Choice
Learning Objective: LO 5
Level of Difficulty: Easy
Bloomcode: Knowledge
AACSB: Analytic
IMA: Corporate Finance
AICPA: Resource Management

60. A line of credit to a corporation is like _____ to an individual.
A) a term loan
B) a bond
C) a credit card
D) a debit card
Ans: C

Format: Multiple Choice
Learning Objective: LO 5
Level of Difficulty: Medium
Bloomcode: Comprehension
AACSB: Analytic
IMA: Corporate Finance
AICPA: Resource Management

61. Which of the following is a primary investment vehicle for the funds in which life insurance companies must invest?
A) CDs.
B) Equity securities.
C) Long-term corporate bonds.
D) Both B and C.
Ans: D

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Format: Multiple Choice
Learning Objective: LO 5
Level of Difficulty: Easy
Bloomcode: Knowledge
AACSB: Analytic
IMA: Corporate Finance
AICPA: Industry/Sector Perspective

62. Casualty 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.
    Ans: B

Format: Multiple Choice
Learning Objective: LO 5
Level of Difficulty: Medium
Bloomcode: Knowledge
AACSB: Analytic
IMA: Corporate Finance
AICPA: Industry/Sector Perspective

63. Which of the following is least likely to be included in a pension fund's investment portfolio?
    A) Commercial paper.
    B) Long-term corporate bonds.
    C) Stocks.
    D) Government securities.
    Ans: A

Format: Multiple Choice
Learning Objective: LO 5
Level of Difficulty: Easy
Bloomcode: Knowledge
AACSB: Analytic
IMA: Corporate Finance
AICPA: Resource Management

64. A mutual fund is an example of:
    A) a line of credit.
    B) an endowment fund.
    C) an investment fund.
    D) a pension fund.
    Ans: C

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Format: Multiple Choice
Learning Objective: LO 5
Level of Difficulty: Medium
Bloomcode: Comprehension
AACSB: Analytic
IMA: Business Economics
AICPA: Industry/Sector Perspective

65. Large firms are most likely to use money markets for the following reason:
A) To finance long term investments
B) To adjust their liquidity position.
C) To make long term investments.
D) To buy commercial paper at lower interest rates than it could sell through a bank
Ans: B

Format: Multiple Choice
Learning Objective: LO 5
Level of Difficulty: Medium
Bloomcode: Comprehension
AACSB: Analytic
IMA: Business Economics
AICPA: Industry/Sector Perspective

66. If a small business chooses not to borrow funds from a commercial bank, then what will probably be its next best alternative?
A) An insurance company.
B) A pension.
C) An investment fund.
D) A business finance company.
Ans: D

Format: Multiple Choice
Learning Objective: LO 6
Level of Difficulty: Easy
Bloomcode: Knowledge
AACSB: Analytic
IMA: Corporate Finance
AICPA: Resource Management

67. The cost of borrowing money is called:
A) inflation.
B) return.
C) interest.
D) all of the above.
Ans: C

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Format: Multiple Choice
Learning Objective: LO 6
Level of Difficulty: Medium
Bloomcode: Comprehension
AACSB: Analytic
IMA: Corporate Finance
AICPA: Resource Management

68. Which of the following statements best describes the relationship between interest rates andthe business cycle?
    A) Typically, the Fed tightens credit to stimulate the economy, which puts further downward pressure on interest rates.
    B) Interest rates tend rise during economic expansion and decline during recessions.
    C) During an expansion, there is downward pressure on interest rates as businesses begin to grow and borrow more money.
    D) During a recession, the demand for goods and services is lower, businesses borrow more, and as a result the economy slows down and the interest rates decline.
    Ans: B

Format: Multiple Choice
Learning Objective: LO 6
Level of Difficulty: Medium
Bloomcode: Comprehension
AACSB: Analytic
IMA: Corporate Finance
AICPA: Resource Management

69. The nominal rate of interest is comprised of:
    A) the real rate of interest.
    B) compensation for inflation.
    C) a commodity cross-index return.
    D) both A and B .
    Ans: D

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Format: Multiple Choice
Learning Objective: LO 6
Level of Difficulty: Medium
Bloomcode: Comprehension
AACSB: Analytic
IMA: Corporate Finance
AICPA: Resource Management

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.
Ans: B

Format: Multiple Choice
Learning Objective: LO 6
Level of Difficulty: Medium
Bloomcode: Application
AACSB: Reflective Thinking
IMA: Corporate Finance
AICPA: Resource Management

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
Ans: A

Format: Multiple Choice
Learning Objective: LO 6
Level of Difficulty: Medium
Bloomcode: Application
AACSB: Analytic
IMA: Corporate Finance
AICPA: Resource Management

72. If inflation is anticipated to be 6 percent during the next year, while the real rate of interest for a one-year loan is 5 percent, then what should the nominal rate of interest be for a risk-free one-year loan?
A) 6%
B) 11%
C) 5%
D) 12%
Ans: B

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Format: Multiple Choice
Learning Objective: LO 6
Level of Difficulty: Easy
Bloomcode: Knowledge
AACSB: Analytic
IMA: Corporate Finance
AICPA: Industry/Sector Perspective

73. If inflation is anticipated to be 5 percent during the next year, while the real rate of interest for a one-year loan is 5 percent, then what should the nominal rate of interest be for a risk-free one-year loan?
A) 5 percent.
B) 10 percent.
C) 15 percent.
D) 25 percent.
Ans: B

Format: Multiple Choice
Learning Objective: LO 6
Level of Difficulty: Easy
Bloomcode: Knowledge
AACSB: Analytic
IMA: Corporate Finance
AICPA: Industry/Sector Perspective

74. The general level of interest rates tends to follow:
A) deflation.
B) the business cycle.
C) the default cycle.
D) all of the above.
Ans: B

Format: Multiple Choice
Learning Objective: LO 6
Level of Difficulty: Easy
Bloomcode: Knowledge
AACSB: Analytic
IMA: Business Economics
AICPA: Industry/Sector Perspective

75. 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 cost of money to decrease.
Ans: A

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Format: Multiple Choice
Learning Objective: LO 6
Level of Difficulty: Easy
Bloomcode: Knowledge
AACSB: Analytic
IMA: Business Economics
AICPA: Industry/Global Perspective

76. In the United States, the real rate of interest has historically been around:
A) 1 percent.
B) 3 percent.
C) 5 percent.
D) 7 percent.
Ans: B

Format: Multiple Choice
Learning Objective: LO 6
Level of Difficulty: Medium
Bloomcode: Analysis
AACSB: Analytic
IMA: Corporate Finance
AICPA: Resource Management

77. You loaned $100 to a friend for one year at a nominal rate of interest of 3 percent. Inflation during that year was 2 percent. How much did the purchasing power of your money change (an increase is positive and a decrease is negative)?
A) increased by 1 percent.
B) decreased by 1 percent.
C) increased by 5 percent.
D) decreased by 5 percent.
Ans: A

Format: Multiple Choice
Learning Objective: LO 6
Level of Difficulty: Medium
Bloomcode: Analysis
AACSB: Analytic
IMA: Corporate Finance
AICPA: Resource Management

78. You loaned $100 to a friend for one year at a nominal rate of interest of 5 percent. Inflation during that year was 8 percent. How much did the purchasing power of your money change (an increase is positive and a decrease is negative)?
A) increase by approximately 3 percent.
B) decrease by approximately 3 percent.
C) increase by approximately 13 percent.
D) decrease by approximately 13 percent.
Ans: B

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Format: Multiple Choice
Learning Objective: LO 6
Level of Difficulty: Medium
Bloomcode: Analysis
AACSB: Analytic
IMA: Corporate Finance
AICPA: Resource Management

79. 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 cost of money to remain unchanged.
Ans: B

Format: Multiple Choice
Learning Objective: LO 6
Level of Difficulty: Easy
Bloomcode: Knowledge
AACSB: Analytic
IMA: Corporate Finance
AICPA: Industry/Sector Perspective

80. Which of the following terms relates to the process in which a firm sells common stock to the public for the very first time?
A) an underwriting
B) an initial public offering
C) a financial intermediation
D) an origination
Ans: B

Format: Essay
Level of Difficulty: Medium
Bloomcode: Comprehension
AACSB: Analytic
IMA: Business Economics
AICPA: Industry/Sector Perspective
Learning Objective: LO 3

81. Explain why secondary markets are so important to businesses that need to raise capital?
Ans: Secondary markets provide liquidity to the buyers of securities. They facilitate the sale of securities because they enable investors to buy and sell securities as frequently as they want. Secondary markets are important to corporations because investors are willing to pay higher prices for securities in primary markets if the securities have active secondary markets. This lowers the cost of capital for the corporations that issue securities.

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