Fundamentals of Corporate Finance 10th edition Brealey Test Bank

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Fundamentals of Corporate Finance, 10e **(Brealey)**
Chapter 2 Financial Markets and Institutions

1) Only small companies can go through financial markets to obtain financing.

Answer: FALSE
Difficulty: 1 Easy
Topic: Financial institution functions
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
Bloom's: Understand
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

2) The reinvestment of cash back into the firm's operations is an example of a flow of savings to investment.

Answer: TRUE
Difficulty: 1 Easy
Topic: Financial institution functions
Learning Objective: 02-01 Understand how financial markets and institutions channel savings to corporate investment.
Bloom's: Understand
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

3) Smaller businesses are especially dependent upon internally generated funds.

Answer: TRUE
Difficulty: 2 Medium
Topic: Financial institution functions
Learning Objective: 02-01 Understand how financial markets and institutions channel savings to corporate investment.
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4) An individual can save and invest in a corporation by lending money to it or by purchasing additional shares.

Answer: TRUE
Difficulty: 1 Easy
Topic: Financial institution functions
Learning Objective: 02-01 Understand how financial markets and institutions channel savings to corporate investment.
Bloom's: Understand
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

5) Previously issued securities are traded among investors in the secondary markets.

Answer: TRUE
Difficulty: 1 Easy
Topic: Primary and secondary markets
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
Bloom's: Remember
AACSB: Communication
Accessibility: Keyboard Navigation

6) Only the IPOs for large corporations are sold in primary markets.

Answer: FALSE
Difficulty: 2 Medium
Topic: Initial public offerings
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
Bloom's: Remember
AACSB: Communication
Accessibility: Keyboard Navigation

7) Hedge fund managers, unlike mutual fund managers, do not receive fund-performance-related fees.

Answer: FALSE
Difficulty: 2 Medium
Topic: Types of financial institutions
Learning Objective: 02-02 Understand the basic structure of banks, insurance companies, mutual funds, and pension funds.
Bloom's: Remember
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8) The markets for long-term debt and equity are called capital markets.

Answer: TRUE
Difficulty: 1 Easy
Topic: Capital markets
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
Bloom's: Remember
AACSB: Communication
Accessibility: Keyboard Navigation

9) The stocks of major corporations trade in many markets throughout the world on a continuous or near-continuous basis.

Answer: TRUE
Difficulty: 1 Easy
Topic: Stock trading
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
Bloom's: Remember
AACSB: Communication
Accessibility: Keyboard Navigation

10) The market for derivatives is also a source of financing for corporations.

Answer: FALSE
Difficulty: 2 Medium
Topic: Derivatives and other securities
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
Bloom's: Understand
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

11) During the Financial Crisis of 2007-2009, the U.S. government bailed out all firms in danger of failing.

Answer: FALSE
Difficulty: 2 Medium
Topic: Financial distress
Learning Objective: 02-04 Understand the main events behind the financial crisis of 2007-2009 and the subsequent eurozone crisis.
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12) In the United States, banks are the most important source of long-term financing for corporations.

Answer: FALSE
Difficulty: 2 Medium
Topic: Financial institution functions
Learning Objective: 02-02 Understand the basic structure of banks, insurance companies, mutual funds, and pension funds.
Bloom's: Understand
AACSB: Reflective Thinking
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13) A financial intermediary invests in financial assets rather than real assets.

Answer: TRUE
Difficulty: 1 Easy
Topic: Financial institutions
Learning Objective: 02-02 Understand the basic structure of banks, insurance companies, mutual funds, and pension funds.
Bloom's: Understand
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

14) Households hold directly three quarters of U.S. corporate equities.

Answer: FALSE
Difficulty: 1 Easy
Topic: Raising capital
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
Bloom's: Remember
AACSB: Communication
Accessibility: Keyboard Navigation

15) The key to the banks' ability to make illiquid loans is their ability to pool liquid deposits from thousands of depositors.

Answer: TRUE
Difficulty: 2 Medium
Topic: Financial institution functions
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
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16) From June 2001 to June 2006, house prices in the United States rose sharply.

Answer: TRUE
Difficulty: 2 Medium
Topic: Financial distress
Learning Objective: 02-04 Understand the main events behind the financial crisis of 2007-2009 and the subsequent eurozone crisis.
Bloom's: Understand
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

17) For corporate bonds, the higher the credit quality of an issuer, the higher the interest rate.

Answer: FALSE
Difficulty: 2 Medium
Topic: Bond ratings and credit risk
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
Bloom's: Understand
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

18) The cost of capital is the interest rate paid on a loan from a bank or some other financial institution.

Answer: FALSE
Difficulty: 2 Medium
Topic: Cost of capital-general
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
Bloom's: Understand
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

19) Like public companies, private companies can also use their stock price as a measure of performance.

Answer: FALSE
Difficulty: 2 Medium
Topic: Stock market prices and reporting
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
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20) The opportunity cost of capital is the expected rate of return that shareholders can obtain in the financial markets on investments with the same risk as the firm's capital investments.

Answer: TRUE
Difficulty: 2 Medium
Topic: Expected (required) return
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
Bloom's: Understand
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

21) Once Apple Computer had become a public company, it was able to raise financing from venture capital companies.

Answer: FALSE
Difficulty: 2 Medium
Topic: Raising capital
Learning Objective: 02-01 Understand how financial markets and institutions channel savings to corporate investment.
Bloom's: Understand
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

22) Insurance companies provide a mechanism for individuals to pool their risks.

Answer: TRUE
Difficulty: 2 Medium
Topic: Financial institution functions
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
Bloom's: Understand
AACSB: Reflective Thinking
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23) Financial markets and intermediaries allow investors and businesses to reduce and reallocate risk.

Answer: TRUE
Difficulty: 2 Medium
Topic: Financial institution functions
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
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24) The effects of the financial crisis of 2007-2009 were confined to the U.S. and domestic companies.

Answer: FALSE
Difficulty: 2 Medium
Topic: Financial distress
Learning Objective: 02-04 Understand the main events behind the financial crisis of 2007-2009 and the subsequent eurozone crisis.
Bloom's: Understand
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

25) The cost of capital is the minimum acceptable rate of return for capital investment.

Answer: TRUE
Difficulty: 2 Medium
Topic: Expected (required) return
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
Bloom's: Understand
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Accessibility: Keyboard Navigation

26) One root of the financial crisis of 2007-2009 was the strict money policies promoted by the U.S. Federal Reserve and other central banks after the technology bubble burst (i.e., money was relatively expensive during this time).

Answer: FALSE
Difficulty: 2 Medium
Topic: Financial distress
Learning Objective: 02-04 Understand the main events behind the financial crisis of 2007-2009 and the subsequent eurozone crisis.
Bloom's: Understand
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

27) The rates of return on investments outside the corporation set the minimum return for investment projects inside the corporation.

Answer: TRUE
Difficulty: 2 Medium
Topic: Expected (required) return
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
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28) Financing for public corporations must flow through financial markets.

Answer: FALSE
Difficulty: 2 Medium
Topic: Financial institution functions
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
Bloom's: Understand
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

29) Financing for private companies must flow through financial intermediaries such as mutual funds.

Answer: FALSE
Difficulty: 2 Medium
Topic: Financial institution functions
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
Bloom's: Understand
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

30) Most securities sold via NASDAQ are sold in the secondary market.

Answer: TRUE
Difficulty: 1 Easy
Topic: Primary and secondary markets
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
Bloom's: Remember
AACSB: Communication
Accessibility: Keyboard Navigation

31) Almost all foreign exchange trading occurs on the floors of the FOREX exchanges in New York and London.

Answer: FALSE
Difficulty: 2 Medium
Topic: Foreign exchange markets
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
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32) Exchange traded funds are tied to an index or basket of securities.

Answer: TRUE
Difficulty: 2 Medium
Topic: Financial institution functions
Learning Objective: 02-02 Understand the basic structure of banks, insurance companies, mutual funds, and pension funds.
Bloom's: Understand
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33) Corporate financing comes ultimately from:
A) savings by households and foreign investors.
B) cash generated from the firm's operations.
C) the financial markets and intermediaries.
D) the issue of shares in the firm.

Answer: A
Difficulty: 1 Easy
Topic: Financial institution functions
Learning Objective: 02-01 Understand how financial markets and institutions channel savings to corporate investment.
Bloom's: Understand
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

34) A company can pay for its expansion in all the following ways *except*:
A) by using the earnings generated from its sale of obsolete equipment.
B) by persuading a director's mother to make a personal loan to the company.
C) by purchasing bonds in the secondary market.
D) by plowing back part of its profits.

Answer: C
Difficulty: 2 Medium
Topic: Raising capital
Learning Objective: 02-01 Understand how financial markets and institutions channel savings to corporate investment.
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35) "Reinvestment" means:
A) new investment in new operations.
B) additional investment in existing operations.
C) new investment by new shareholders.
D) the reinvestment of earnings into new projects.

Answer: D
Difficulty: 2 Medium
Topic: Raising capital
Learning Objective: 02-01 Understand how financial markets and institutions channel savings to corporate investment.
Bloom's: Remember
AACSB: Communication
Accessibility: Keyboard Navigation

36) Financing for public corporations flows through:
A) the financial markets only.
B) financial intermediaries only.
C) derivatives markets.
D) the financial markets, financial intermediaries, or both.

Answer: D
Difficulty: 1 Easy
Topic: Financial institution functions
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
Bloom's: Understand
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37) Which security is more efficient because it allows trading throughout the day and does not have managers with discretionary investment authority?
A) Bond fund
B) Exchange traded fund
C) Mutual fund
D) Stock fund

Answer: B
Difficulty: 3 Hard
Topic: Types of financial institutions
Learning Objective: 02-02 Understand the basic structure of banks, insurance companies, mutual funds, and pension funds.
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38) When corporations need to raise funds through stock issues, they rely on the:
A) primary market.
B) secondary market.
C) tertiary market.
D) centralized NASDAQ exchange.

Answer: A
Difficulty: 2 Medium
Topic: Primary and secondary markets
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
Bloom's: Remember
AACSB: Communication
Accessibility: Keyboard Navigation

39) A primary market would be utilized when:
A) investors buy or sell existing securities.
B) shares of common stock are exchanged.
C) securities are initially issued.
D) a commission must be paid on the transaction.

Answer: C
Difficulty: 1 Easy
Topic: Primary and secondary markets
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
Bloom's: Remember
AACSB: Communication
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40) The primary distinction between securities sold in the primary and secondary markets is:
A) the riskiness of the securities.
B) the price of the securities.
C) whether the securities are new or already exist.
D) the profitability of the issuing corporation.

Answer: C
Difficulty: 2 Medium
Topic: Primary and secondary markets
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
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41) The New York Stock Exchange mostly serves as what kind of financial market?
A) Foreign Exchange market
B) Over the counter market
C) Primary market
D) Secondary market

Answer: D
Difficulty: 2 Medium
Topic: Primary and secondary markets
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
Bloom's: Remember
AACSB: Communication
Accessibility: Keyboard Navigation

42) Which of the following are both a financial intermediary and a financial institution?
A) Mutual funds
B) Pension funds
C) Insurance companies
D) Hedge funds

Answer: C
Difficulty: 2 Medium
Topic: Financial institutions
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
Bloom's: Understand
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43) A share of IBM stock is purchased by an individual investor for $75 and later sold to another investor for $125. Who profits from this sale?
A) IBM
B) The first investor
C) The second investor
D) IBM and both investors

Answer: B
Difficulty: 2 Medium
Topic: Stock returns and yields
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
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44) Which of the following financial assets is *least* likely to have an active secondary market?
A) Common stock of a large public firm
B) Bank loans made to smaller firms
C) Bonds of a major, multinational corporation
D) Debt issued by the U.S. Treasury

Answer: B
Difficulty: 3 Hard
Topic: Primary and secondary markets
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
Bloom's: Apply
AACSB: Reflective Thinking
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45) When Patricia sells her General Motors common stock at the same time that Brian purchases the same amount of GM stock, GM receives:
A) the dollar value of the transaction.
B) the dollar amount of the transaction, less brokerage fees.
C) only the par value of the common stock.
D) nothing.

Answer: D
Difficulty: 2 Medium
Topic: Primary and secondary markets
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
Bloom's: Understand
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46) Which one of these is a money market security?
A) Commercial paper
B) Common stock
C) 2-year bond
D) 20-year bond

Answer: A
Difficulty: 2 Medium
Topic: Money and capital markets
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
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47) A mother in a developing country wants to borrow the equivalent of $20 to enable her to start a small restaurant run by her family. Which type of financing is she looking to obtain?
A) Public bond issue
B) IPO
C) Micro loan
D) Futures contract on a commodity

Answer: C
Difficulty: 2 Medium
Topic: Debt
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
Bloom's: Apply
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

48) Corporate debt instruments are most commonly traded:
A) on the NYSE.
B) on NASDAQ.
C) in the money market.
D) in the over-the-counter market.

Answer: D
Difficulty: 2 Medium
Topic: Primary and secondary markets
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
Bloom's: Remember
AACSB: Communication
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49) A bond differs from a share of stock in that a bond:
A) represents a claim on the firm.
B) has more risk.
C) has guaranteed returns.
D) has a maturity date.

Answer: D
Difficulty: 2 Medium
Topic: Bond features
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
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50) Short-term financing transactions commonly occur in the:
A) primary markets.
B) secondary markets.
C) capital markets.
D) money markets.

Answer: D
Difficulty: 1 Easy
Topic: Money and capital markets
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
Bloom's: Remember
AACSB: Communication
Accessibility: Keyboard Navigation

51) Long-term financing decisions commonly occur in the:
A) option markets.
B) secondary markets.
C) capital markets.
D) money markets.

Answer: C
Difficulty: 1 Easy
Topic: Money and capital markets
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
Bloom's: Remember
AACSB: Communication
Accessibility: Keyboard Navigation

52) You can buy silver in the:
A) capital markets.
B) foreign exchange markets.
C) commodities markets.
D) option markets.

Answer: C
Difficulty: 1 Easy
Topic: Money and capital markets
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
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53) Commodity and derivative markets:
A) are additional sources of financing for corporate projects.
B) enable the financial manager to adjust a firm's exposure to various business risks.
C) are always over-the-counter markets.
D) deal only in foreign currencies.

Answer: B
Difficulty: 3 Hard
Topic: Derivatives and other securities
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
Bloom's: Understand
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

54) Foreign currencies are traded:
A) only by banks in New York and London.
B) over the counter.
C) on both the NYSE and NASDAQ.
D) on the Intercontinental Exchange.

Answer: B
Difficulty: 2 Medium
Topic: Foreign exchange markets
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
Bloom's: Remember
AACSB: Communication
Accessibility: Keyboard Navigation

55) Which one of the following statements is *not* characteristic of mutual funds?
A) They are always considered to be financial institutions.
B) They raise money by selling shares to investors.
C) They pool the savings of many investors.
D) They offer professional management and portfolio diversification.

Answer: A
Difficulty: 2 Medium
Topic: Types of financial institutions
Learning Objective: 02-02 Understand the basic structure of banks, insurance companies, mutual funds, and pension funds.
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56) In which of the following financial markets is an investor *least* likely to interact with a public corporation?
A) Bond market
B) Foreign exchange market
C) Primary market
D) Secondary market

Answer: B
Difficulty: 2 Medium
Topic: Financial institutions
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
Bloom's: Understand
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

57) Which one of these correctly applies to mutual funds?
A) Mutual funds are a costly means of achieving portfolio diversification.
B) Funds are required to limit their annual fees and expenses to less than 1 percent of the portfolio value.
C) You can generally buy additional shares in the fund at any time.
D) Shareholders sell their shares to other shareholders.

Answer: C
Difficulty: 2 Medium
Topic: Types of financial institutions
Learning Objective: 02-02 Understand the basic structure of banks, insurance companies, mutual funds, and pension funds.
Bloom's: Understand
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58) "Balanced" mutual funds:
A) invest in both stocks and bonds.
B) spread their investments equally over a specified geographic area.
C) spread their investments equally over various industries.
D) charge a management fee that is proportionate to the investment return.

Answer: A
Difficulty: 2 Medium
Topic: Types of financial institutions
Learning Objective: 02-02 Understand the basic structure of banks, insurance companies, mutual funds, and pension funds.
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59) Who was responsible for the financial crisis of 2007-2009?
A) The U.S. Federal Reserve, for its policy of easy money
B) The U.S. government, for pushing banks to expand credit for low-income housing
C) Bankers, who aggressively promoted and resold subprime mortgages
D) The U.S. Federal Reserve, the U.S. government, rating agencies, and bankers

Answer: D
Difficulty: 2 Medium
Topic: Financial distress
Learning Objective: 02-04 Understand the main events behind the financial crisis of 2007-2009 and the subsequent eurozone crisis.
Bloom's: Understand
AACSB: Reflective Thinking
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60) Which one of the following funds provides a tax advantage to individual investors?
A) Balanced funds
B) Pension funds
C) Bond funds
D) Funds that invest in foreign countries

Answer: B
Difficulty: 2 Medium
Topic: Types of financial institutions
Learning Objective: 02-02 Understand the basic structure of banks, insurance companies, mutual funds, and pension funds.
Bloom's: Remember
AACSB: Communication
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61) A financial institution:
A) is a kind of financial intermediary.
B) simply pools and invests savings.
C) raises financing by selling shares.
D) invests primarily in commodities.

Answer: A
Difficulty: 3 Hard
Topic: Financial institutions
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
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62) Which type of financial institution generally does not accept deposits but does underwrite stock offerings?
A) Insurance company
B) Mutual fund
C) Commercial bank
D) Investment bank

Answer: D
Difficulty: 2 Medium
Topic: Types of financial institutions
Learning Objective: 02-02 Understand the basic structure of banks, insurance companies, mutual funds, and pension funds.
Bloom's: Understand
AACSB: Reflective Thinking
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63) Which one of the following financial intermediaries has shown the greatest preference for investing in *long-term* financial assets?
A) Commercial banks
B) Insurance companies
C) Finance companies
D) Savings banks

Answer: B
Difficulty: 2 Medium
Topic: Financial institution functions
Learning Objective: 02-02 Understand the basic structure of banks, insurance companies, mutual funds, and pension funds.
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64) Which one of these may provide a financial return to some investors while not providing any financial return to other investors?
A) Mutual funds
B) Pension funds
C) Insurance companies
D) Hedge fund

Answer: C
Difficulty: 1 Easy
Topic: Types of financial institutions
Learning Objective: 02-02 Understand the basic structure of banks, insurance companies, mutual funds, and pension funds.
Bloom's: Understand
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

65) Insurance companies can usually cover the claims of policyholders because:
A) the incidence of claims normally averages out across all policyholders.
B) they issue a very limited number of policies.
C) they are fully insured by the U.S. government.
D) their stockholders will cover any cash shortfalls encountered by the company.

Answer: A
Difficulty: 2 Medium
Topic: Types of financial institutions
Learning Objective: 02-02 Understand the basic structure of banks, insurance companies, mutual funds, and pension funds.
Bloom's: Understand
AACSB: Reflective Thinking
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66) Which of the following is *not* typically considered a function of financial intermediaries?
A) Providing a payment mechanism
B) Investing in real assets
C) Accumulating funds from smaller investors
D) Spreading, or pooling risk among individuals

Answer: B
Difficulty: 2 Medium
Topic: Financial institution functions
Learning Objective: 02-02 Understand the basic structure of banks, insurance companies, mutual funds, and pension funds.
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67) U.S. bonds and other debt securities are mostly held by:
A) institutional investors.
B) households.
C) foreign investors.
D) state and local governments.

Answer: A
Difficulty: 2 Medium
Topic: Raising capital
Learning Objective: 02-02 Understand the basic structure of banks, insurance companies, mutual funds, and pension funds.
Bloom's: Remember
AACSB: Communication
Accessibility: Keyboard Navigation

68) Approximately what percentage of U.S. corporate equities are held by households?
A) 20%
B) 40%
C) 60%
D) 80%

Answer: B
Difficulty: 2 Medium
Topic: Raising capital
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
Bloom's: Remember
AACSB: Communication
Accessibility: Keyboard Navigation

69) Which of the following are major holders of corporate bonds?
A) households.
B) banks.
C) insurance companies.
D) New York Stock Exchange.

Answer: C
Difficulty: 2 Medium
Topic: Raising capital
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
Bloom's: Remember
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70) Which of the following is not a function of financial markets?
A) allow individuals to diversify their risk.
B) provide convenient ways to make large payments.
C) allow individuals to purchase a range of goods online.
D) provide funds to companies that wish to expand.

Answer: C
Difficulty: 2 Medium
Topic: Financial institution functions
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
Bloom's: Apply
AACSB: Thinking
Accessibility: Keyboard Navigation

71) Which one of these transports income forward in time?
A) Retirement savings
B) Car loan
C) Bank line of credit
D) Credit card purchase

Answer: A
Difficulty: 2 Medium
Topic: Financial institution functions
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
Bloom's: Apply
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

72) Which one of these assists in shifting an individual's consumption forward in time?
A) A bank line of credit
B) A bank savings account
C) A life insurance policy
D) A retirement savings plan

Answer: A
Difficulty: 2 Medium
Topic: Financial institution functions
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
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73) One reason suggesting that banks may be better than individuals at matching lenders to borrowers is that banks:
A) can shift loan risk to their deposit customers.
B) are motivated by the potential for profit.
C) do not have any income tax liability.
D) have information to evaluate creditworthiness.

Answer: D
Difficulty: 2 Medium
Topic: Financial institution functions
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
Bloom's: Understand
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

74) Which one of the following is *least* liquid?
A) Foreign currency
B) U.S. Treasury bonds
C) Real estate
D) Bank deposit

Answer: C
Difficulty: 2 Medium
Topic: Financial institution functions
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
Bloom's: Understand
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75) Financial markets and intermediaries:
A) channel savings to real investment.
B) increase risks for businesses.
C) generally reduce the liquidity of securities.
D) prevent the transportation of cash across time.

Answer: A
Difficulty: 1 Easy
Topic: Financial institution functions
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
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76) Which of the following functions does *not* require financial markets?
A) Retention of cash by corporations
B) Provision of liquidity
C) Risk reduction by investment in diversified portfolios
D) Provision of pricing information

Answer: A
Difficulty: 3 Hard
Topic: Financial institution functions
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
Bloom's: Understand
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77) Liquidity is important to a mutual fund primarily because:
A) a fund that is less liquid will attract more investors.
B) the fund's shareholders may want to redeem their shares at any time.
C) new investors may invest in the fund at any time.
D) the fund requires cash to pay its taxes.

Answer: B
Difficulty: 3 Hard
Topic: Financial institution functions
Learning Objective: 02-02 Understand the basic structure of banks, insurance companies, mutual funds, and pension funds.
Bloom's: Understand
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

78) Which one of the following is the biggest provider of payment mechanisms?
A) Hedge funds
B) Banks
C) Mutual funds
D) Insurance companies

Answer: B
Difficulty: 2 Medium
Topic: Financial institution functions
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
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79) Which of the following actions does *not* help reduce risk?
A) Extending the service warranty for your notebook
B) Converting your money market account to a mutual fund account
C) Contracting to sell your farm produce to the neighborhood grocery
D) Buying Japanese yen now when you plan to study in Japan next year

Answer: B
Difficulty: 2 Medium
Topic: Financial institution functions
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
Bloom's: Apply
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

80) Insurance companies primarily reduce an individual's risk by:
A) transporting that risk forward in time.
B) providing payment services.
C) spreading that risk across many individuals.
D) providing low-interest-rate loans.

Answer: C
Difficulty: 2 Medium
Topic: Financial institution functions
Learning Objective: 02-02 Understand the basic structure of banks, insurance companies, mutual funds, and pension funds.
Bloom's: Understand
AACSB: Reflective Thinking
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81) Which of the following information is *not* provided by the financial markets?
A) The price of six ounces of gold
B) The cost of borrowing $500,000 for 5 years
C) Microsoft's earnings in 2013
D) The cost of one million yen in U.S. dollars

Answer: C
Difficulty: 2 Medium
Topic: Financial institution functions
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
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82) A capital investment that generates a 10% rate of return is worthwhile if:
A) corporate bonds of similar risk offer 8% rates of return.
B) corporate bonds of similar risk offer 11% rates of return.
C) top-quality corporate bonds offer 10% rates of return.
D) the expected rate of return on the stock market is 12%.

Answer: A
Difficulty: 1 Easy
Topic: Expected (required) return
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
Bloom's: Apply
AACSB: Reflective Thinking
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83) The cost of capital:
A) is the expected rate of return on a capital investment.
B) is an opportunity cost determined by the risk-free rate of return.
C) is the interest rate that the firm pays on a loan from a bank or insurance company.
D) for risky investments is normally higher than the firm's borrowing rate.

Answer: D
Difficulty: 3 Hard
Topic: Cost of capital-general
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
Bloom's: Understand
AACSB: Reflective Thinking
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84) Excess cash held by a firm should be:
A) reinvested by the firm in projects offering the highest rate of return.
B) reinvested by the firm in projects offering rates of return higher than the cost of capital.
C) reinvested by the firm in the financial markets.
D) distributed to bondholders in the form of extra coupon payments.

Answer: B
Difficulty: 2 Medium
Topic: Goal of financial management
Learning Objective: 02-01 Understand how financial markets and institutions channel savings to corporate investment.
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85) One contributing factor to the 2007-2009 financial crisis was the structuring of mortgage loans with:
A) high initial payments, offset by significantly lower payments later.
B) low initial payments, offset by significantly higher payments later.
C) high initial payments, offset by high payments later.
D) very short maturities.

Answer: B
Difficulty: 2 Medium
Topic: Financial distress
Learning Objective: 02-04 Understand the main events behind the financial crisis of 2007-2009 and the subsequent eurozone crisis.
Bloom's: Understand
AACSB: Reflective Thinking
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86) The opportunity cost of capital:
A) is the interest rate that the firm pays on a loan from a financial institution.
B) is the maximum acceptable rate of return on a project.
C) is the minimum acceptable rate of return on a project.
D) is always less than 10%.

Answer: C
Difficulty: 2 Medium
Topic: Expected (required) return
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
Bloom's: Remember
AACSB: Communication
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87) During the Financial Crisis of 2007-2009, the U.S. government bailed out all of the following firms *except:*
A) AIG.
B) Fannie Mae.
C) Lehman Brothers.
D) Freddie Mac.

Answer: C
Difficulty: 2 Medium
Topic: Financial distress
Learning Objective: 02-04 Understand the main events behind the financial crisis of 2007-2009 and the subsequent eurozone crisis.
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88) If Apple Computer Inc. is used as the model, then new firms should expect to raise capital in which one of these orders? Start with the first money raised.
A) Owners, venture capitalists, suppliers, public investors
B) Owners, suppliers, venture capitalists, public investors
C) Venture capitalists, owners, public investors, suppliers
D) Owners, public investors, venture capitalists, suppliers

Answer: B
Difficulty: 2 Medium
Topic: Raising capital
Learning Objective: 02-02 Understand the basic structure of banks, insurance companies, mutual funds, and pension funds.
Bloom's: Apply
AACSB: Reflective Thinking
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89) Which one of these parties *cannot* invest in a hedge fund?
A) Small retail investors
B) Pension funds
C) Insurance companies
D) Wealthy individuals

Answer: A
Difficulty: 1 Easy
Topic: Hedging
Learning Objective: 02-01 Understand how financial markets and institutions channel savings to corporate investment.
Bloom's: Understand
AACSB: Reflective Thinking
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90) Which one of these enterprises generally acts as an underwriter for an initial public offering?
A) Commercial bank
B) Government
C) Investment bank
D) Insurance company

Answer: C
Difficulty: 1 Easy
Topic: Underwriting
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
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91) Which of these institutions are not major investors in U.S. equities?
A) mutual funds
B) banks
C) pension funds
D) hedge funds

Answer: B
Difficulty: 2 Medium
Topic: Raising capital
Learning Objective: 02-01 Understand how financial markets and institutions channel savings to corporate investment.
Bloom's: Remember
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92) Firms can often determine the price of any commodities they use in their production process by consulting the price quotes provided by:
A) their investment bank.
B) the New York Mercantile Exchange.
C) the New York Stock Exchange.
D) the Standard & Poor's market indexes.

Answer: B
Difficulty: 2 Medium
Topic: Financial institution functions
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
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93) How is the relationship between a bond's credit rating and its interest rate best defined?
A) Inverse relationship
B) Direct relationship
C) Unrelated
D) Logarithmic

Answer: A
Difficulty: 2 Medium
Topic: Bond ratings and credit risk
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
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94) The financial crisis of 2007-2009 contributed to the largest sovereign default in history by which one of these countries?
A) Italy
B) Portugal
C) Ireland
D) Greece

Answer: D
Difficulty: 2 Medium
Topic: Financial distress
Learning Objective: 02-04 Understand the main events behind the financial crisis of 2007-2009 and the subsequent eurozone crisis.
Bloom's: Apply
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95) Which one of these was a contributing factor to the need for many foreign banks to seek aid from their governments as a result of the financial crisis of 2007-2009?
A) Decrease in their exchange rates
B) Investments in U.S. subprime mortgages
C) Interest rate spikes
D) Currency controls

Answer: B
Difficulty: 2 Medium
Topic: Financial distress
Learning Objective: 02-04 Understand the main events behind the financial crisis of 2007-2009 and the subsequent eurozone crisis.
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96) Which one of these was a major cause of the deep recession and severe unemployment throughout much of Europe that followed the financial crisis of 2007-2009?
A) Government actions to raise interest rates
B) Investor speculation
C) Risk-adverse investor attitudes
D) Government actions to lower government debt

Answer: D
Difficulty: 2 Medium
Topic: Financial distress
Learning Objective: 02-04 Understand the main events behind the financial crisis of 2007-2009 and the subsequent eurozone crisis.
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97) Which one of these is generally a key difference between U.S. and foreign commercial banks?
A) Pooling and investing savings
B) Accepting investor deposits
C) Providing debt financing to corporations
D) Making equity investments in corporations

Answer: D
Difficulty: 2 Medium
Topic: Financial institution functions
Learning Objective: 02-03 Explain the functions of financial markets and institutions.
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