Introduction to Corporate Finance (Canadian) 5th edition Booth Test Bank

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CHAPTER 1

AN INTRODUCTION TO FINANCE

CHAPTER LEARNING OBJECTIVES

1.1 ***Define finance and explain what is involved in the study of finance*.**

1.2 ***List the major financial and real assets held by Canadians.***

1.3 ***Explain how money is transferred from lenders to borrowers and the role played by market and financial intermediaries*.**

1.4 ***Identify the basic types of financial instruments that are available and explain how they are traded*.**

1.5 ***Explain the importance of the global financial system and how Canada is impacted by global events such as the recent U.S. financial crisis.***

MULTIPLE CHOICE QUESTIONS

1. Finance is the study of how and under what terms
a) savings are allocated between lenders and borrowers.
b) investments are allocated between investors and brokers.
c) institutions with excess money make share purchase decisions.
d) households allocate money between spending and saving.

Answer: a

Type: Definition
Difficulty: Easy
Learning Objective: Define finance and explain what is involved in the study of finance.
Section Reference: Finance Defined
Blooms: Knowledge
AACSB: Analytic
CPA: Finance

2. A financial security is
a) a jail term for a financial manager that has committed fraud.
b) a contract that is created only when a new stock is issued to the public.
c) a financial contract created whenever funds are transferred.
d) a contract that is created only when a new bond is first sold.

Answer: c

Type: Definition
Difficulty: Easy
Learning Objective: Define finance and explain what is involved in the study of finance.
Section Reference: Finance Defined
Blooms: Knowledge
AACSB: Analytic
CPA: Finance

3. Which of the following does NOT appear as an item on Canada's balance sheet, as presented in the text?
a) non-residential structures
b) net worth or equity
c) net foreign liabilities
d) net foreign assets

Answer: c

Type: Definition
Difficulty: Medium
Learning Objective: List the major financial and real assets held by Canadians.
Section Reference: Real versus Financial Assets

Blooms: Knowledge
AACSB: Analytic
CPA: Finance

4. Human capital is
a) based on only the current skills, but not the education, of a country's citizens.
b) based on only the education, but not the current skills, of a country's citizens.
c) based on the skills and education of citizens and should be included in a country's wealth.
d) difficult to measure and should therefore not be included in a country's wealth.

Answer: c

Type: Definition
Difficulty: Easy
Learning Objective: List the major financial and real assets held by Canadians.
Section Reference: Real versus Financial Assets
Blooms: Knowledge
AACSB: Analytic
CPA: Finance

5. Which of the following items is NOT a real asset?
a) land
b) television
c) bond
d) gold mine

Answer: c

Type: Definition
Difficulty: Easy
Learning Objective: List the major financial and real assets held by Canadians.
Section Reference: Real versus Financial Assets
Blooms: Knowledge
AACSB: Analytic
CPA: Finance

6. In the following list, which item is a financial asset?
a) land
b) bond
c) building
d) inventory

Answer: b

Type: Definition
Difficulty: Easy
Learning Objective: List the major financial and real assets held by Canadians.
Section Reference: Real versus Financial Assets

Blooms: Knowledge
AACSB: Analytic
CPA: Finance

7. What is the main difference between real assets and financial assets?
a) Real assets are tangible and financial assets are intangible.
b) Real assets have known values, while the values of financial assets are not known.
c) Real assets are intangible and financial assets are tangible.
d) Real assets have unknown values, while the values of financial assets are known.

Answer: a

Type: Definition
Difficulty: Easy
Learning Objective: List the major financial and real assets held by Canadians.
Section Reference: Real versus Financial Assets
Blooms: Knowledge
AACSB: Analytic
CPA: Finance

8. If Canadian households, in aggregate, own real assets with a market value of $3.194 trillion, and also own net financial assets with a market value of $2.344 trillion, the total net assets of Canadian households have a market value of
a) $3.194 trillion
b) $5.538 trillion
c) $–0.850 trillion
d) $0.850 trillion

Answer: b

Type: Calculation
Difficulty: Easy
Learning Objective: List the major financial and real assets held by Canadians.
Section Reference: Real versus Financial Assets
Feedback: $5.538 = $3.194 + $2.344
Blooms: Application
AACSB: Analytic
CPA: Finance

9. Given the following hypothetical information regarding the real and financial assets in Canada for 2022 (numbers in $ billions):

	Real Assets	Net Financial Assets
Government	677	–658
Business	2,202	–1,635
Households	3,194	2,344

What is the value of the total net assets in Canada for 2022?
a) $5,842 billion
b) $6,086 billion
c) $6,124 billion
d) $6,105 billion

Answer: c

Type: Calculation
Difficulty: Medium
Learning Objective: List the major financial and real assets held by Canadians.
Section Reference: Real versus Financial Assets
Feedback: $6,124 = $677 + $2,202 + $3,194 – $658 – $1,635 + $2,344
Blooms: Application
AACSB: Analytic
CPA: Finance

10. You are provided with the following hypothetical information regarding the real and financial assets in Canada for 2022 (numbers in $ billions):

	Real Assets	**Net Financial Assets**
Government	677	–658
Business	2,202	–1,635
Households	3,194	2,344

What is the value of the net financial assets owned by **non-residents** for 2022?
a) $901 billion
b) $51 billion
c) $2,293 billion
d) There is not enough information to answer the question.

Answer: b

Type: Calculation
Difficulty: Difficult
Learning Objective: List the major financial and real assets held by Canadians.
Section Reference: Real versus Financial Assets
Feedback: $51 billion = $2,344 – $658 – $1,635. The value of net financial assets held by non-residents is equal to the negative of the sum of the net financial assets of government, businesses, and households.
Blooms: Application
AACSB: Analytic
CPA: Finance

11. Which of the following sectors is NOT a user of savings in the economy?
a) business sector
b) household sector
c) government sector

d) banking sector

Answer: b

Type: Concept
Difficulty: Easy
Learning Objective: List the major financial and real assets held by Canadians.
Section Reference: Real versus Financial Assets
Blooms: Knowledge
AACSB: Analytic
CPA: Finance

12. In Canada, the primary provider of funds to business and government is (are)
a) international banks.
b) large Canadian banks.
c) the household sector.
d) market intermediaries.

Answer: c

Type: Definition
Difficulty: Easy
Learning Objective: Explain how money is transferred from lenders to borrowers and the role played by market and financial intermediaries.
Section Reference: The Financial System
Blooms: Knowledge
AACSB: Analytic
CPA: Finance

13. Entities that invest funds on behalf of others and change the nature of the transactions are called
a) brokers.
b) financial intermediaries.
c) dealers.
d) market intermediaries.

Answer: b

Type: Definition
Difficulty: Easy
Learning Objective: Explain how money is transferred from lenders to borrowers and the role played by market and financial intermediaries.
Section Reference: The Financial System
Blooms: Knowledge
AACSB: Analytic
CPA: Finance

14. Joe has just borrowed $5,000 from his aunt in order to make a down payment on a car. This

borrowing transaction is an example of
a) indirect intermediation.
b) direct intermediation.
c) external intermediation.
d) market transaction.

Answer: b

Type: Definition
Difficulty: Easy
Learning Objective: Explain how money is transferred from lenders to borrowers and the role played by market and financial intermediaries.
Section Reference: The Financial System
Blooms: Knowledge
AACSB: Analytic
CPA: Finance

15. An example of direct intermediation would be
a) an individual borrowing money from a bank.
b) an individual borrowing money from their mother.
c) an individual using a real estate broker to finance their home purchase.
d) a stockbroker selling securities to an individual.

Answer: b

Type: Concept
Difficulty: Easy
Learning Objective: Explain how money is transferred from lenders to borrowers and the role played by market and financial intermediaries.
Section Reference: The Financial System
Blooms: Knowledge
AACSB: Analytic
CPA: Finance

16. The three intermediation channels that transfer money from lenders to borrowers are
a) direct, indirect, and financial intermediation.
b) direct, indirect, and monetary intermediation.
c) direct, financial, and monetary intermediation.
d) indirect, financial, and monetary intermediation.

Answer: a

Type: Definition
Difficulty: Easy
Learning Objective: Explain how money is transferred from lenders to borrowers and the role played by market and financial intermediaries.
Section Reference: The Financial System
Blooms: Knowledge
AACSB: Analytic

CPA: Finance

17. Although Canadian banks are involved in almost all areas of the financial system, which of the following is their core activity?
a) stock market investment activity
b) retirement planning
c) wealth management
d) taking deposits and lending funds

Answer: d

Type: Definition
Difficulty: Easy
Learning Objective: Explain how money is transferred from lenders to borrowers and the role played by market and financial intermediaries.
Section Reference: The Financial System
Blooms: Knowledge
AACSB: Analytic
CPA: Finance

18. Which of the following is NOT a financial intermediary?
a) chartered banks
b) insurance companies
c) pension funds
d) mutual funds

Answer: d

Type: Definition
Difficulty: Easy
Learning Objective: Explain how money is transferred from lenders to borrowers and the role played by market and financial intermediaries.
Section Reference: The Financial System
Blooms: Knowledge
AACSB: Analytic
CPA: Finance

19. Which of the following is NOT one of the main functions performed by mutual funds?
a) pooling sums of money to make investments
b) paying out premiums to their clients
c) providing professional management expertise
d) acting as a “pass-through” for individuals to invest in the equity and debt markets

Answer: b

Type: Concept
Difficulty: Medium

Learning Objective: Explain how money is transferred from lenders to borrowers and the role played by market and financial intermediaries.
Section Reference: The Financial System
Blooms: Knowledge
AACSB: Analytic
CPA: Finance

20. As of 2018 what was the major proportion of Canadian households' financial assets?
a) stocks and bonds
b) deposits
c) foreign investment
d) claims on retirement and insurance funds

Answer: d

Type: Concept
Difficulty: Easy
Learning Objective: List the major financial and real assets held by Canadians.
Section Reference: Real versus Financial Assets
Blooms: Knowledge
AACSB: Analytic
CPA: Finance

21. Two examples of marketable assets include
a) savings accounts and demand deposits held at financial institutions.
b) provincial and federal savings bonds.
c) demand deposits and provincial savings bonds.
d) equity securities and T-bills.

Answer: d

Type: Definition
Difficulty: Easy
Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.
Section Reference: Financial Instruments and Markets
Blooms: Knowledge
AACSB: Analytic
CPA: Finance

22. Since March 2000 the Montreal Exchange (ME) has functioned as Canada's national market for
a) hedge funds.
b) publicly traded stocks.
c) derivatives.
d) T-bills.

Answer: c

Type: Definition
Difficulty: Easy
Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.
Section Reference: Financial Instruments and Markets
Blooms: Knowledge
AACSB: Analytic
CPA: Finance

23. Financial markets are usually classified by the type and maturity of the financial assets traded. The two main classifications are as follows:
a) bond market and money market.
b) money market and capital market.
c) bond market and foreign-exchange market.
d) commodity market and capital market.

Answer: b

Type: Definition
Difficulty: Easy
Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.
Section Reference: Financial Instruments and Markets
Blooms: Knowledge
AACSB: Analytic
CPA: Finance

24. Of the following list, who are the dominant players in the money market?
I. individuals
II. corporations
III. governments
a) I and II
b) I and III
c) II and III
d) I, II, and III

Answer: c

Type: Definition
Difficulty: Easy
Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.
Section Reference: Financial Instruments and Markets
Blooms: Knowledge
AACSB: Analytic
CPA: Finance

25. All common shares are comprised of which two components?
a) ownership and voting rights
b) ownership and dividend rights
c) voting and dividend rights
d) dividend and yield rights

Answer: a

Type: Concept
Difficulty: Easy
Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.
Section Reference: Financial Instruments and Markets
Blooms: Knowledge
AACSB: Analytic
CPA: Finance

26. Though they are classified as equity, why are preferred shares also similar to debt?
a) Both carry the same interest rate.
b) Dividends on preferred shares must be paid out before any common share dividends.
c) The voting structures for preferred shares and debt are equivalent.
d) Preferred shares have similar maturity structures to debt.

Answer: b

Type: Concept
Difficulty: Difficult
Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.
Section Reference: Financial Instruments and Markets
Blooms: Knowledge
AACSB: Analytic
CPA: Finance

27. Which of the following is NOT a component of debt securities?
a) maturity
b) repayment
c) dividends
d) interest payments

Answer: c

Type: Definition
Difficulty: Easy
Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.
Section Reference: Financial Instruments and Markets
Blooms: Knowledge
AACSB: Analytic

CPA: Finance

28. An example of a non-marketable financial asset is a
a) demand deposit.
b) T-bill.
c) commercial paper.
d) common share.

Answer: a

Type: Definition
Difficulty: Easy
Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.
Section Reference: Financial Instruments and Markets
Blooms: Knowledge
AACSB: Analytic
CPA: Finance

29. How do governments obtain the majority of their short- and long-term financing?
a) T-bills and Canada Savings Bonds
b) T-bills, traditional bonds, and Canada Savings Bonds
c) T-bills, equity, and traditional bonds
d) traditional bonds and Canada Savings Bonds

Answer: b

Type: Concept
Difficulty: Easy
Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.
Section Reference: Financial Instruments and Markets
Blooms: Knowledge
AACSB: Analytic
CPA: Finance

30. Which of the following is NOT an example of a capital market security?
a) bond
b) debenture
c) common equity
d) T-bill

Answer: d

Type: Definition
Difficulty: Easy
Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.

Section Reference: Financial Instruments and Markets
Blooms: Knowledge
AACSB: Analytic
CPA: Finance

31. Which of the following is an existing stock exchange in Canada?
a) Toronto Stock Exchange (TSX)
b) Montreal Exchange (ME)
c) Vancouver Stock Exchange (VSE)
d) Winnipeg Stock Exchange (WSE)

Answer: a

Type: Definition
Difficulty: Medium
Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.
Section Reference: Financial Instruments and Markets
Blooms: Knowledge
AACSB: Analytic
CPA: Finance

32. Which of the following was NOT one of the major objectives in the restructuring of the Canadian stock exchanges in 1999 and 2000?
a) to create a Canadian market for NASDAQ-listed companies
b) to combine all futures and options trading on one exchange
c) to make the TSX the official exchange for the trading of Canadian senior stocks
d) to create a single national exchange for trading in junior company stocks

Answer: a

Type: Concept
Difficulty: Medium
Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.
Section Reference: Financial Instruments and Markets
Blooms: Knowledge
AACSB: Analytic
CPA: Finance

33. A market where transactions are made directly between large institutions and wealthy individuals that bypass brokers and dealers is an example of
a) the primary market.
b) the secondary market.
c) the third market.
d) the fourth market.

Answer: d

Type: Definition
Difficulty: Easy
Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.
Section Reference: Financial Instruments and Markets
Blooms: Knowledge
AACSB: Analytic
CPA: Finance

34. The main difference between exchanges and dealer/OTC markets is
a) exchanges are a part of the primary market, while dealer and OTC markets are part of the secondary market.
b) transactions in dealer markets are conducted entirely by humans, not electronically.
c) exchanges have a physical location while dealer and OTC markets do not.
d) All of the above are differences between exchanges and dealer markets.

Answer: c

Type: Concept
Difficulty: Easy
Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.
Section Reference: Financial Instruments and Markets
Blooms: Knowledge
AACSB: Analytic
CPA: Finance

35. The exchange that acts as the Canadian national derivatives market and conducts all options and futures trading is called the
a) Montreal Exchange (ME).
b) Winnipeg Commodity Exchange.
c) TSX Venture.
d) Alpha Exchange.

Answer: a

Type: Definition
Difficulty: Easy
Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.
Section Reference: Financial Instruments and Markets
Blooms: Knowledge
AACSB: Analytic
CPA: Finance

36. Which is the only province where trades in unlisted securities need to be reported?
a) British Columbia

b) Quebec
c) Alberta
d) Ontario

Answer: d

Type: Definition
Difficulty: Easy
Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.
Section Reference: Financial Instruments and Markets
Blooms: Knowledge
AACSB: Analytic
CPA: Finance

37. Which one of the following is NOT a function of brokers?
a) Manage money for clients.
b) Make the market work.
c) Charge a fee for their services.
d) Assist with the transaction process.

Answer: a

Type: Concept
Difficulty: Easy
Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.
Section Reference: Financial Instruments and Markets
Blooms: Knowledge
AACSB: Analytic
CPA: Finance

38. Which of the following was NOT a reason for the credit crunch of 2008–09?
a) mistrust between financial intermediaries
b) illiquidity of debt markets
c) the arrest of Bernard Madoff
d) bankruptcy of one of the leading financial institutions

Answer: c

Type: Concept
Difficulty: Easy
Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.
Section Reference: Financial Instruments and Markets
Blooms: Knowledge
AACSB: Analytic
CPA: Finance

39. Who are the biggest borrowers and lenders in Canada, respectively?
a) government and households
b) government and banks
c) banks and mutual funds
d) Crown corporations and banks

Answer: a

Type: Concept
Difficulty: Easy
Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.
Section Reference: Financial Instruments and Markets
Blooms: Knowledge
AACSB: Analytic
CPA: Finance

40. Why can't the Canadian government issue equity?
a) because assets belong to all Canadians
b) it is not listed in the financial markets
c) it has too much debt
d) because expenditures exceed revenues

Answer: a

Type: Concept
Difficulty: Medium
Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.
Section Reference: Financial Instruments and Markets
Blooms: Knowledge
AACSB: Analytic
CPA: Finance

41. If the stock of a listed firm decreases by 50 percent, what does it mean to the shareholders?
a) Their ownership of the firm will decrease by 50 percent.
b) Total value of their holdings decreases by 50 percent.
c) The debt of the firm decreases by 50 percent.
d) nothing

Answer: b

Type: Concept
Difficulty: Medium
Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.
Section Reference: Financial Instruments and Markets
Blooms: Knowledge

AACSB: Analytic
CPA: Finance

42. The consolidation of U.S. and global stock markets has
a) been increasing recently, as shown by the merger of the NYSE and Euronext.
b) been decreasing recently, as shown by the decrease in multi-listed stocks.
c) led to lower risk in investments because markets have become less interdependent.
d) led to increased reliance on human interactions in securities trading.

Answer: a

Type: Concept
Difficulty: Medium
Learning Objective: Explain the importance of the global financial system and how Canada is impacted by global events such as the recent U.S. financial crisis.
Section Reference: The Global Financial Community
Blooms: Knowledge
AACSB: Analytic
CPA: Finance

43. The two sectors that are normally regarded as the lowest risk in the financial market are
a) T-bills and loans extended to “PIIGS” countries.
b) demand deposits and loans to countries that have taken austerity measures.
c) household mortgages and government debt.
d) government debt and foreign company borrowings.

Answer: c

Type: Definition
Difficulty: Easy
Learning Objective: Explain the importance of the global financial system and how Canada is impacted by global events such as the recent U.S. financial crisis.
Section Reference: The Global Financial Community
Blooms: Knowledge
AACSB: Analytic
CPA: Finance

44. Which of the following is NOT a benefit of global financial markets?
a) They represent important sources of funds for borrowers.
b) They provide diversification benefits to Canadian investors.
c) Canadian companies can list their shares in different markets.
d) The value of Canadian shares becomes more stable.

Answer: d

Type: Concept
Difficulty: Easy

Learning Objective: Explain the importance of the global financial system and how Canada is impacted by global events such as the recent U.S. financial crisis.
Section Reference: The Global Financial Community
Blooms: Knowledge
AACSB: Analytic
CPA: Finance

45. Which is the world's largest and most famous stock market?
a) New York Stock Exchange (NYSE)
b) Toronto Stock Exchange (TSX)
c) Tokyo Stock Exchange (TSE)
d) London Stock Exchange (LSE)

Answer: a

Type: Definition
Difficulty: Easy
Learning Objective: Explain the importance of the global financial system and how Canada is impacted by global events such as the recent U.S. financial crisis.
Section Reference: The Global Financial Community
Blooms: Knowledge
AACSB: Analytic
CPA: Finance

46. The spread of the financial crisis in the autumn of 2008 was NOT increased by
a) linkages between global financial markets.
b) the cross listing of firms in different markets.
c) the consolidation of the global financial system.
d) excessive debt of the government.

Answer: d

Type: Concept
Difficulty: Medium
Learning Objective: Explain the importance of the global financial system and how Canada is impacted by global events such as the recent U.S. financial crisis.
Section Reference: The Global Financial Community
Blooms: Knowledge
AACSB: Analytic
CPA: Finance

PRACTICE PROBLEMS

47. How do financial intermediaries help those with “too much money today” and those with “not enough money today”?

Answer: Financial markets provide these surplus- and deficit-spending units with a way to improve their respective situations. Deficit-spending units do not have to postpone profitable investments today, and surplus-spending units can hold financial securities that generate a return. More importantly, financial markets provide a framework that facilitates the “meeting” of these two parties. Financial markets accelerate, simplify, and reduce the cost of contact between borrowers and lenders.

Type: Concept
Difficulty: Medium
Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.
Section Reference: Financial Instruments and Markets
Blooms: Comprehension
AACSB: Reflective Thinking
CPA: Finance

48. What are the differences between the primary markets and the secondary markets?

Answer: The primary market is where a borrower issues new securities and exchanges these securities for cash from investors. The proceeds of the sale of securities in the primary market go to the issuing entity.
In secondary markets, investors trade previously issued securities with other investors. Securities may trade repeatedly in the secondary markets, however the original issuers will be unaffected in the sense that they will not receive any additional cash from these transactions. The secondary markets are a key factor in the success of the primary market, for without the option or ability to be able to trade securities in the secondary market, investors would not be a quick to invest their dollars.

Type: Concept
Difficulty: Medium
Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.
Section Reference: Financial Instruments and Markets
Blooms: Comprehension
AACSB: Reflective Thinking
CPA: Finance

49. Why is the secondary market important?

Answer: The secondary market is where investors trade previously issued securities. It is important because it provides liquidity to investors. If an efficient secondary market did not exist, investors would be very reluctant to hold securities with longer maturities. If they are not willing to buy these securities, then securities in the primary market will become more difficult to sell. Hence, the secondary market is necessary for the proper functioning of the primary market.

Type: Definition
Difficulty: Medium
Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.
Section Reference: Financial Instruments and Markets
Blooms: Comprehension
AACSB: Reflective Thinking
CPA: Finance

50. What is an over-the-counter market? Do all bonds in Canada trade over-the-counter?

Answer: "Over-the-counter" means a large network of dealers make markets in both debt and equity securities. The market doesn't have a physical location and instead consists of a network of dealers who trade with each other via telephone or computer networks. Investors can buy and sell with their brokers who then trade with other dealers.
The majority of bonds in Canada trade over-the-counter, although some bonds trade on stock exchanges such as the Toronto Stock Exchange (convertible bonds only).

Type: Concept
Difficulty: Easy
Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.
Section Reference: Financial Instruments and Markets
Blooms: Knowledge
AACSB: Analytic
CPA: Finance

51. Explain what an auction market is and how it works.

Answer: Stock exchanges are auction markets. Brokers act on behalf of their clients and arrange to match buyers and sellers through an auction system. Trading takes place either on the floor of an exchange or by computer link. For their services, brokers charge a commission that is a percentage of the value of the transaction.

Type: Definition
Difficulty: Easy
Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.
Section Reference: Financial Instruments and Markets
Blooms: Knowledge
AACSB: Analytic
CPA: Finance

52. Define and describe the difference between the third and fourth markets.

Answer: The third market is an OTC market for the trading of securities that are listed on organized exchanges. The fourth market refers to transactions made directly between large institutions and/or wealthy individuals, thereby bypassing brokers and dealers. The third market involves extremely large transactions and is used primarily to avoid exchange commission fees. The fourth market involves relatively smaller trades and is used to avoid information leaks regarding who is trading which stock(s).

Type: Definition
Difficulty: Easy
Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.
Section Reference: Financial Instruments and Markets
Blooms: Knowledge
AACSB: Analytic
CPA: Finance

53. Explain why primary markets are the key to the wealth creation process.

Answer: In a primary market, new securities are issued. In these transactions, a financial obligation in the form of new debt or new equity is created in exchange for capital. Without the primary market, governments and companies would be unable to raise money. A primary market that is regulated, reliable, and accessible is highly important to a well-functioning economy, where those entities with saved capital can be matched with those entities that are seeking capital.

Type: Concept
Difficulty: Medium
Learning Objective: Identify the basic types of financial instruments that are available and explain how they are traded.
Section Reference: Financial Instruments and Markets
Blooms: Comprehension
AACSB: Reflective Thinking
CPA: Finance

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