

***Fundamentals of Corporate Finance 11th edition
Brealey Test Bank***

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CORRECT ANSWERS ARE LOCATED IN THE 2ND HALF OF THIS DOC.

TRUE/FALSE - Write 'T' if the statement is true and 'F' if the statement is false.

- 1) Only small companies can go through financial markets to obtain financing.
☐ true
☐ false
- 2) The reinvestment of cash back into the firm's operations is an example of a flow of savings to investment.
☐ true
☐ false
- 3) Smaller businesses are especially dependent upon internally generated funds.
☐ true
☐ false
- 4) An individual can save and invest in a corporation by lending money to it or by purchasing additional shares.
☐ true
☐ false
- 5) Previously issued securities are traded among investors in the secondary markets.
☐ true
☐ false
- 6) Only the IPOs for large corporations are sold in primary markets.
☐ true
☐ false
- 7) Hedge fund managers, unlike mutual fund managers, do not receive fund-performance-related fees.
☐ true
☐ false
- 8) The markets for long-term debt and equity are called capital markets.
☐ true
☐ false

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- 9) The stocks of major corporations trade in many markets throughout the world on a continuous or near-continuous basis.
- ☐ true
 - ☐ false
- 10) The market for derivatives is also a source of financing for corporations.
- ☐ true
 - ☐ false
- 11) During the Financial Crisis of 2007-2009, the U.S. government bailed out all firms in danger of failing.
- ☐ true
 - ☐ false
- 12) In the United States, banks are the most important source of long-term financing for corporations.
- ☐ true
 - ☐ false
- 13) A financial intermediary invests in financial assets rather than real assets.
- ☐ true
 - ☐ false
- 14) Households hold directly three quarters of U.S. corporate equities.
- ☐ true
 - ☐ false
- 15) The key to the banks' ability to make illiquid loans is their ability to pool liquid deposits from thousands of depositors.
- ☐ true
 - ☐ false
- 16) From June 2001 to June 2006, house prices in the United States rose sharply.
- ☐ true
 - ☐ false
- 17) For corporate bonds, the higher the credit quality of an issuer, the higher the interest rate.
- ☐ true
 - ☐ false

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- 18) The cost of capital is the interest rate paid on a loan from a bank or some other financial institution.
- ☐ true
 - ☐ false
- 19) Like public companies, private companies can also use their stock price as a measure of performance.
- ☐ true
 - ☐ false
- 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.
- ☐ true
 - ☐ false
- 21) Once Apple Computer had become a public company, it was able to raise financing from venture capital companies.
- ☐ true
 - ☐ false
- 22) Insurance companies provide a mechanism for individuals to pool their risks.
- ☐ true
 - ☐ false
- 23) Financial markets and intermediaries allow investors and businesses to reduce and reallocate risk.
- ☐ true
 - ☐ false
- 24) The effects of the financial crisis of 2007-2009 were confined to the U.S. and domestic companies.
- ☐ true
 - ☐ false
- 25) The cost of capital is the minimum acceptable rate of return for capital investment.
- ☐ true
 - ☐ false

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- 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).
- ☐ true
- ☐ false
- 27) The rates of return on investments outside the corporation set the minimum acceptable return for investment projects inside the corporation.
- ☐ true
- ☐ false
- 28) Financing for public corporations must flow through financial markets.
- ☐ true
- ☐ false
- 29) Financing for private companies must flow through financial intermediaries such as mutual funds.
- ☐ true
- ☐ false
- 30) Most securities sold via NASDAQ are sold in the secondary market
- ☐ true
- ☐ false
- 31) Almost all foreign exchange trading occurs on the floors of the FOREX exchanges in New York and London.
- ☐ true
- ☐ false
- 32) Exchange traded funds are tied to an index or basket of securities.
- ☐ true
- ☐ false

MULTIPLE CHOICE - Choose the one alternative that best completes the statement or answers the question.

- 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.

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- 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.
- 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.
- 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.
- 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
- 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.
- 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.

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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.
- 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
- 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
- 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
- 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
- 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.

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

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

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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.

59) Who was responsible for the financial crisis of 2007-2009?

- A) The U.S. Federal Reserve, only, for its policy of easy money
- B) The U.S. government, only, for pushing banks to expand credit for low-income housing
- C) Bankers, only; they aggressively promoted and resold subprime mortgages
- D) The U.S. Federal Reserve, the U.S. government, rating agencies, and bankers

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

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.

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

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

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- 64) Which one of these may provide a financial return to some investors (based on contingency) while not providing any financial return to other investors?
- A) Mutual funds
 - B) Pension funds
 - C) Insurance companies
 - D) Hedge fund
- 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.
- 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
- 67) U.S. bonds and other debt securities are mostly held by:
- A) institutional investors. TBEXAM.COM
 - B) households.
 - C) foreign investors.
 - D) state and local governments.
- 68) Approximately what percentage of U.S. corporate equities are held by households?
- A) 28%
 - B) 38%
 - C) 48%
 - D) 68%
- 69) Which of the following are major holders of corporate bonds?
- A) Households
 - B) Banks
 - C) Insurance companies
 - D) New York Stock Exchange

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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
- 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
- 72) 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
- 73) One reason suggesting that banks may be better than individuals at matching lenders to borrowers is that banks: TBEXAM.COM
- 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.
- 74) Which one of the following is *least* liquid?
- A) Foreign currency
 - B) U.S. Treasury bonds
 - C) Real estate
 - D) Bank deposit
- 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.

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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
- 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.
- 78) Which one of the following is the biggest provider of payment mechanisms?
- A) Hedge funds
 - B) Banks
 - C) Mutual funds
 - D) Insurance companies
- 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 when you know the yen value will be increasing
- 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.
- 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 2030
 - D) The cost of one million yen in U.S. dollars

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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%.
- 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.
- 84) Excess cash held by a firm should be:
- A) reinvested by the firm in projects offering the highest rate of return, regardless of risk.
 - 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.
- 85) One contributing factor to the 2007-2009 financial crisis was the structuring of mortgage loans with:
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- 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.
- 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%.
- 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.

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- 88) If Apple Computer Incorporated 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
- 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
- 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
- 91) Which of these institutions are not major investors in U.S. equities?
- A) Mutual funds
 - B) Banks
 - C) Pension funds
 - D) Hedge funds
- 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.
- 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

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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
- 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
- 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

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Answer Key

Test name: Chapter 02

- 1) FALSE
- 2) TRUE
- 3) TRUE
- 4) TRUE
- 5) TRUE
- 6) FALSE
- 7) FALSE
- 8) TRUE
- 9) TRUE
- 10) FALSE
- 11) FALSE
- 12) FALSE
- 13) TRUE
- 14) FALSE
- 15) TRUE
- 16) TRUE
- 17) FALSE
- 18) FALSE
- 19) FALSE
- 20) TRUE
- 21) FALSE
- 22) TRUE
- 23) TRUE
- 24) FALSE
- 25) TRUE
- 26) FALSE
- 27) TRUE
- 28) FALSE
- 29) FALSE
- 30) TRUE
- 31) FALSE
- 32) TRUE
- 33) A
- 34) C
- 35) D
- 36) D
- 37) B

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- 38) A
- 39) C
- 40) C
- 41) D
- 42) C
- 43) B
- 44) B
- 45) D
- 46) A
- 47) C
- 48) D
- 49) D
- 50) D
- 51) C
- 52) C
- 53) B
- 54) B
- 55) A
- 56) B
- 57) C
- 58) A
- 59) D
- 60) B
- 61) A
- 62) D
- 63) B
- 64) C
- 65) A
- 66) B
- 67) A
- 68) B
- 69) C
- 70) C
- 71) A
- 72) D
- 73) D
- 74) C
- 75) A
- 76) A
- 77) B

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- 78) B
- 79) B
- 80) C
- 81) C
- 82) A
- 83) D
- 84) B
- 85) B
- 86) C
- 87) C
- 88) B
- 89) A
- 90) C
- 91) B
- 92) B
- 93) A
- 94) D
- 95) B
- 96) D

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