***Financial Management, 7e* (Titman/Keown/Martin)**

**Chapter 1 Getting Started-Principles of Finance**

1.1 Finance: An Overview

1) Which of the following statements best represents what finance is about?

A) How political, social, and economic forces affect corporations

B) Maximizing profits

C) The study of how people and businesses make investment decisions and how to finance those decisions

D) Reducing risk

Answer: C

Diff: 1

AACSB: 6. Reflective thinking

Question Status: Revised

Objective: 1.1 Understand the importance of finance in your personal and professional lives and identify the three primary business decisions that financial managers make.

2) From a financial point of view, a company that decides to develop new product is making

A) a financing decision.

B) an investment decision.

C) a capital structure decision.

D) a cash flow decision.

Answer: B

Diff: 1

AACSB: 6. Reflective thinking

Question Status: New question

Objective: 1.1 Understand the importance of finance in your personal and professional lives and identify the three primary business decisions that financial managers make.

3) Working capital management refers to

A) long-term financing decisions.

B) the management of cash flows.

C) investing in product development.

D) capital structure.

Answer: B

Diff: 2

AACSB: 6. Reflective thinking

Question Status: Previous edition

Objective: 1.1 Understand the importance of finance in your personal and professional lives and identify the three primary business decisions that financial managers make.

4) Financial management skills are not just needed by finance professionals, they are also needed by

A) marketing managers.

B) accountants.

C) management information systems professionals.

D) all of the above.

Answer: D

Diff: 2

AACSB: 6. Reflective thinking

Question Status: New question

Objective: 1.1 Understand the importance of finance in your personal and professional lives and identify the three primary business decisions that financial managers make.

5) The personal decision to obtain a college degree in business is primarily a(n) \_\_\_\_\_\_\_\_ decision.

A) social

B) investment

C) ethical

D) financing

Answer: B

Diff: 2

AACSB: 6. Reflective thinking

Question Status: New question

Objective: 1.1 Understand the importance of finance in your personal and professional lives and identify the three primary business decisions that financial managers make.

6) The area of finance that deals with long-term investment decisions is known as

A) capital structure.

B) working capital management.

C) financial strategy.

D) capital budgeting.

Answer: D

Diff: 2

AACSB: 6. Reflective thinking

Question Status: New question

Objective: 1.1 Understand the importance of finance in your personal and professional lives and identify the three primary business decisions that financial managers make.

7) Capital structure refers to the financing of long-term investments.

Answer: TRUE

Diff: 1

AACSB: 6. Reflective thinking

Question Status: New question

Objective: 1.1 Understand the importance of finance in your personal and professional lives and identify the three primary business decisions that financial managers make.

8) Business financial decisions are fundamentally different from personal financial decisions.

Answer: FALSE

Diff: 1

AACSB: 6. Reflective thinking

Question Status: New question

Objective: 1.1 Understand the importance of finance in your personal and professional lives and identify the three primary business decisions that financial managers make.

9) What are the three basic questions addressed by the study of finance?

Answer: 1. What investments should the firm undertake?

2. How should the firm fund these investments?

3. How can the firm best manage cash flows in its day-to-day operations?

Diff: 2

AACSB: 6. Reflective thinking

Question Status: New question

Objective: 1.1 Understand the importance of finance in your personal and professional lives and identify the three primary business decisions that financial managers make.

1.2 Three Types of BusinessOrganisations

1) Which of the following is true concerning a sole proprietorship?

A) It has limited liability for the owner.

B) The business survives the death of the owner.

C) It has only one owner.

D) Profits are taxed at the company tax rate.

Answer: C

Diff: 2

AACSB: 6. Reflective thinking

Question Status: Previous edition

Objective: 1.2 Identify the key differences between the three major legal forms of business.

2) What is the chief disadvantage of the sole proprietorship as a form of business organisation when compared to the corporate form?

A) Sole proprietorships are subject to double taxation of profits.

B) The cost of formation.

C) Inadequate profit sharing.

D) Owners have unlimited liability.

Answer: D

Diff: 2

AACSB: 6. Reflective thinking

Question Status: Previous edition

Objective: 1.2 Identify the key differences between the three major legal forms of business.

3) Which of the following is NOT true for limited partnerships?

A) Limited partners can only manage the business.

B) One general partner must exist who has unlimited liability.

C) Only the name of general partners can appear in the name of the firm.

D) Limited partners may sell their interest in the company.

Answer: A

Diff: 2

AACSB: 6. Reflective thinking

Question Status: Previous edition

Objective: 1.2 Identify the key differences between the three major legal forms of business.

4) The true owners of a corporation are the

A) holders of debt issues.

B) preferred stockholders.

C) board of directors.

D) commonshareholders.

Answer: D

Diff: 1

AACSB: 6. Reflective thinking

Question Status: Previous edition

Objective: 1.2 Identify the key differences between the three major legal forms of business.

5) In terms of organisational costs, which of the following sequences are generally correct, moving from lowest to highest cost?

A) General partnership, sole proprietorship, limited partnership, corporation

B) Sole proprietorship, general partnership, limited partnership, corporation

C) Corporation, limited partnership, general partnership, sole proprietorship

D) Sole proprietorship, general partnership, corporation, limited partnership

Answer: B

Diff: 2

AACSB: 6. Reflective thinking

Question Status: Previous edition

Objective: 1.2 Identify the key differences between the three major legal forms of business.

6) Assume that you are starting a business. Further assume that the business is expected to grow very quickly and a great deal of capital will be needed soon. What type of business organisation would you choose?

A) Corporation

B) General Partnership

C) Sole proprietorship

D) Limited partnership

Answer: A

Diff: 1

AACSB: 6. Reflective thinking

Question Status: Previous edition

Objective: 1.2 Identify the key differences between the three major legal forms of business.

7) Which one of the following categories of owners enjoys limited liability?

A) limited liability company general partners

B) corporation shareholders

C) soleproprietors

D) bothA and B

Answer: B

Diff: 2

AACSB: 6. Reflective thinking

Question Status: Revised

Objective: 1.2 Identify the key differences between the three major legal forms of business.

8) Which of the following is a characteristic of a limited partnership?

A) It allows one or more partners to have limited liability.

B) It requires one or more of the partners to be a general partner to whom the privilege of limited liability does not apply.

C) It prohibits the limited partners from participating in the management of the partnership.

D) All of the above.

Answer: D

Diff: 2

AACSB: 6. Reflective thinking

Question Status: Previous edition

Objective: 1.2 Identify the key differences between the three major legal forms of business.

9) Which of the following forms of organisation blends elements of partnerships and corporations?

A) managing partnerships

B) soleproprietorships

C) limited liability companies

D) generalpartnerships

Answer: C

Diff: 2

AACSB: 6. Reflective thinking

Question Status: New question

Objective: 1.2 Identify the key differences between the three major legal forms of business.

10) Which of the following types of business forms is least risky to investors?

A) Sole proprietorship

B) Limited partnership

C) General partnership

D) A public corporation

Answer: D

Diff: 1

AACSB: 6. Reflective thinking

Question Status: Revised

Objective: 1.2 Identify the key differences between the three major legal forms of business.

11) Which forms of organisation are free of initial legal requirements?

A) Sole proprietorship

B) General partnership

C) Corporation

D) Both A and B

Answer: D

Diff: 1

AACSB: 6. Reflective thinking

Question Status: Previous edition

Objective: 1.2 Identify the key differences between the three major legal forms of business.

12) For these types of organisation, no distinction is made between business and personal assets.

A) Sole proprietorship

B) General partnership

C) Limited partnership

D) Both A and B

Answer: D

Diff: 2

AACSB: 6. Reflective thinking

Question Status: Revised

Objective: 1.2 Identify the key differences between the three major legal forms of business.

13) Which of the following is a significant disadvantage of a general partnership?

A) The cost of forming it is high.

B) Each partner is fully responsible for the liabilities incurred by the partnership.

C) There is a risk associated with the industry in which it operates.

D) Forming the business is very complex.

Answer: B

Diff: 2

AACSB: 6. Reflective thinking

Question Status: Previous edition

Objective: 1.2 Identify the key differences between the three major legal forms of business.

14) As firms grow and their capital needs increase, they are more likely to become a

A) sole proprietorship.

B) general partnership.

C) limited partnership.

D) joint venture.

E) corporation.

Answer: E

Diff: 2

AACSB: 6. Reflective thinking

Question Status: Previous edition

Objective: 1.2 Identify the key differences between the three major legal forms of business.

15) A limited partner is liable

A) for only his or her own share of the partnership's debts.

B) for his or her own share of the partnership's debts and contingently liable for the other partners shares.

C) only up to the amount invested by that partner.

D) for none of the partnership's debts.

Answer: C

Diff: 2

AACSB: 6. Reflective thinking

Question Status: Previous edition

Objective: 1.2 Identify the key differences between the three major legal forms of business.

16) A corporation is owned by

A) shareholders and partners.

B) the shareholders who hold the company's stock.

C) the Board of Directors.

D) its Chief Executive Officer.

Answer: B

Diff: 1

AACSB: 6. Reflective thinking

Question Status: New question

Objective: 1.2 Identify the key differences between the three major legal forms of business.

17) The major sources of financing for corporations are

A) partners contributions.

B) exchanges between shareholders.

C) interest and dividends.

D) debt and equity.

Answer: D

Diff: 1

AACSB: 6. Reflective thinking

Question Status: New question

Objective: 1.2 Identify the key differences between the three major legal forms of business.

18) The term,shareholder, applies to a

A) general partner.

B) creditor.

C) corporate owner.

D) proprietor.

Answer: C

Diff: 2

AACSB: 6. Reflective thinking

Question Status: New question

Objective: 1.2 Identify the key differences between the three major legal forms of business.

19) The sole proprietorship is the same as the individual for liability purposes.

Answer: TRUE

Diff: 2

AACSB: 6. Reflective thinking

Question Status: Previous edition

Objective: 1.2 Identify the key differences between the three major legal forms of business.

20) In a general partnership, all partners have unlimited liability for the actions of any one partner when that partner is conducting business for the firm.

Answer: TRUE

Diff: 2

AACSB: 6. Reflective thinking

Question Status: Previous edition

Objective: 1.2 Identify the key differences between the three major legal forms of business.

21) There is no legal distinction made between the assets of the business and the personal assets of the owners in the limited partnership.

Answer: FALSE

Diff: 2

AACSB: 6. Reflective thinking

Question Status: Previous edition

Objective: 1.2 Identify the key differences between the three major legal forms of business.

22) The owners of a corporation are liable for the corporation's obligations up to the amount of their investment.

Answer: TRUE

Diff: 1

AACSB: 6. Reflective thinking

Question Status: Previous edition

Objective: 1.2 Identify the key differences between the three major legal forms of business.

23) General partners have unrestricted transferability of ownership, while limited partners must have the consent of all partners to transfer their ownership.

Answer: FALSE

Diff: 2

AACSB: 6. Reflective thinking

Question Status: Previous edition

Objective: 1.2 Identify the key differences between the three major legal forms of business.

24) Ultimate control in a corporation is vested in the board of directors.

Answer: FALSE

Diff: 1

AACSB: 6. Reflective thinking

Question Status: Previous edition

Objective: 1.2 Identify the key differences between the three major legal forms of business.

25) The cost to create a business is usually the lowest for the sole proprietorship.

Answer: TRUE

Diff: 1

AACSB: 6. Reflective thinking

Question Status: Previous edition

Objective: 1.2 Identify the key differences between the three major legal forms of business.

26) Limited partners may actively manage the business.

Answer: FALSE

Diff: 1

AACSB: 6. Reflective thinking

Question Status: Previous edition

Objective: 1.2 Identify the key differences between the three major legal forms of business.

27) The life of a corporation is not dependent upon the status of the investors.

Answer: TRUE

Diff: 1

AACSB: 6. Reflective thinking

Question Status: Previous edition

Objective: 1.2 Identify the key differences between the three major legal forms of business.

28) A sole proprietorship is the most desirable business form in all circumstances.

Answer: FALSE

Diff: 1

AACSB: 6. Reflective thinking

Question Status: Previous edition

Objective: 1.2 Identify the key differences between the three major legal forms of business.

29) In a sole proprietorship, the owner is personally responsible without limitation for the liabilities incurred.

Answer: TRUE

Diff: 1

AACSB: 6. Reflective thinking

Question Status: Previous edition

Objective: 1.2 Identify the key differences between the three major legal forms of business.

30) In a limited partnership, at least one general partner must remain in the association; the privilege of limited liability still applies to this partner.

Answer: FALSE

Diff: 2

AACSB: 6. Reflective thinking

Question Status: Previous edition

Objective: 1.2 Identify the key differences between the three major legal forms of business.

31) In a general partnership, each partner is liable for the partnership's obligations only up to a percentage of the obligation equal to that partner's percentage of ownership of the partnership.

Answer: FALSE

Diff: 1

AACSB: 6. Reflective thinking

Question Status: Previous edition

Objective: 1.2 Identify the key differences between the three major legal forms of business.

1.3 The Goal of the Financial Manager

1) Maximisation of shareholder wealth as a goal is superior to accounting profit maximisation because

A) the former avoids an excessively short term focus.

B) theformer ensures high stock prices.

C) accounting profits are not the same as cash flows.

D) bothA and C.

Answer: D

Diff: 2

AACSB: 6. Reflective thinking

Question Status: Revised

Objective: 1.3 Understand the role of the financial manager within the firm and the goal for making financial choices.

2) Which of the following best describes the goal of the firm?

A) The maximisation of the total market value of the firm's common stock

B) Profit maximisation

C) Risk minimisation

D) None of the above

Answer: A

Diff: 1

AACSB: 6. Reflective thinking

Question Status: Previous edition

Objective: 1.3 Understand the role of the financial manager within the firm and the goal for making financial choices.

3) Profit maximisation does not adequately describe the goal of the firm because

A) profitmaximisation does not require the consideration of risk.

B) profitmaximisation ignores the timing of a project's return.

C) maximisation of dividend payout ratio is a better description of the goal of the firm.

D) A and B.

Answer: D

Diff: 2

AACSB: 6. Reflective thinking

Question Status: Previous edition

Objective: 1.3 Understand the role of the financial manager within the firm and the goal for making financial choices.

4) Which of the following goals of the firm is equivalent to the maximisation of shareholder wealth?

A) rofitmaximisation

B) iskminimisation

C) stock maximisation

D) None of the above

Answer: C

Diff: 1

AACSB: 6. Reflective thinking

Question Status: Previous edition

Objective: 1.3 Understand the role of the financial manager within the firm and the goal for making financial choices.

5) If managers are making decisions to maximise shareholder wealth, then they are primarily concerned with making decisions that should

A) positively affect short term profits at the expense of long term profits.

B) increase the market value of the firm's stock.

C) have no effect on the value of the firm's stock.

D) accomplish all of the above.

Answer: B

Diff: 2

AACSB: 6. Reflective thinking

Question Status: Previous edition

Objective: 1.3 Understand the role of the financial manager within the firm and the goal for making financial choices.

6) Profit maximisation is not an adequate goal of the firm when making financial decisions because

A) it does not necessarily reflect shareholder wealth maximisation.

B) it ignores the risk inherent in different projects that will generate the profits.

C) it ignores the timing of a project's returns.

D) all of the above are correct.

Answer: D

Diff: 2

AACSB: 6. Reflective thinking

Question Status: Previous edition

Objective: 1.3 Understand the role of the financial manager within the firm and the goal for making financial choices.

7) Which of the following goals is in the best long-term interest of stockholders?

A) profitmaximisation

B) riskminimisation

C) maximising the market value of shareholders' stock

D) maximising sales revenues

Answer: C

Diff: 2

AACSB: 6. Reflective thinking

Question Status: Previous edition

Objective: 1.3 Understand the role of the financial manager within the firm and the goal for making financial choices.

8) If managers do not pursue the goal of maximising shareholder wealth

A) they concentrate on more important matters like growing market share.

B) they can focus more on social responsibilities.

C) they are likely to lose their jobs.

D) they can focus more on long-term profitability.

Answer: C

Diff: 2

AACSB: 6. Reflective thinking

Question Status: New question

Objective: 1.3 Understand the role of the financial manager within the firm and the goal for making financial choices.

9) What does the agency problem refer to?

A) theconflictsbetween the board of directors and the employees of the firm

B) theproblemsbetween financial managers and Internal Revenue agents

C) theproblems between stockbrokers and investors

D) theconflicts of interest between the business managers and the stockholders

Answer: D

Diff: 2

AACSB: 6. Reflective thinking

Question Status: Previous edition

Objective: 1.4 Explain the five principles of finance that form the basis of financial management for both businesses and individuals.

10) Managers of corporations need to act in an ethical manner

A) because ethics violations will be punished by the law.

B) because a business must be trusted by investors, customers and the public if it is to succeed.

C) because business managers must answer to a higher authority.

D) because ethical behavior is its own justification.

Answer: B

Diff: 2

AACSB: 6. Reflective thinking

Question Status: New question

Objective: 1.3 Understand the role of the financial manager within the firm and the goal for making financial choices.

11) In regard to the agency problem, \_\_\_\_\_\_\_\_ are the principal owners of a corporation.

A) shareholders

B) managers

C) employees

D) suppliers

Answer: A

Diff: 2

AACSB: 6. Reflective thinking

Question Status: Previous edition

Objective: 1.4 Explain the five principles of finance that form the basis of financial management for both businesses and individuals.

12) Serious ethical violations by corporations including Enron led the United States to pass

A) theCorporate Law Economic Reform Program.

B) theAudit Reform and Corporate Disclosure Act.

C) the Sarbanes-Oxley Act.

D) all of the above.

Answer: C

Diff: 2

AACSB: 6. Reflective thinking

Question Status: New question

Objective: 1.3 Understand the role of the financial manager within the firm and the goal for making financial choices.

13) The goal of the firm should be the maximisation of profit.

Answer: FALSE

Diff: 1

AACSB: 6. Reflective thinking

Question Status: Previous edition

Objective: 1.3 Understand the role of the financial manager within the firm and the goal for making financial choices.

14) One of the problems associated with profit maximisation is that it ignores the timing of a project's return.

Answer: TRUE

Diff: 2

AACSB: 6. Reflective thinking

Question Status: Previous edition

Objective: 1.3 Understand the role of the financial manager within the firm and the goal for making financial choices.

15) The goal of profit maximisation is equivalent to the goal of maximisation of share value.

Answer: FALSE

Diff: 1

AACSB: 6. Reflective thinking

Question Status: Previous edition

Objective: 1.3 Understand the role of the financial manager within the firm and the goal for making financial choices.

16) The goal of profit maximisation ignores the timing of profit.

Answer: TRUE

Diff: 2

AACSB: 6. Reflective thinking

Question Status: Previous edition

Objective: 1.3 Understand the role of the financial manager within the firm and the goal for making financial choices.

17) The goal of maximising shareholder wealth inevitably conflicts with socially responsible behavior on the part of corporation.

Answer: FALSE

Diff: 2

AACSB: 6. Reflective thinking

Question Status: New question

Objective: 1.3 Understand the role of the financial manager within the firm and the goal for making financial choices.

18) The Sarbanes-Oxley Act primarily addresses insider trading.

Answer: FALSE

Diff: 2

AACSB: 6. Reflective thinking

Question Status: Previous edition

Objective: 1.3 Understand the role of the financial manager within the firm and the goal for making financial choices.

19) A reputation for unethical behavior can negatively affect the value of a company's stock.

Answer: TRUE

Diff: 1

AACSB: 6. Reflective thinking

Question Status: Previous edition

Objective: 1.3 Understand the role of the financial manager within the firm and the goal for making financial choices.

20) The agency problem arises due to the separation of ownership and control in a corporation.

Answer: TRUE

Diff: 1

AACSB: 6. Reflective thinking

Question Status: Previous edition

Objective: 1.4 Explain the five principles of finance that form the basis of financial management for both businesses and individuals.

21) Briefly discuss the incentives for financial managers to conduct their business in an ethical manner.

Answer: Extreme ethical lapses such as those evident in the HIH Insurance or OneTel scandals may break laws and result in fines or imprisonment. In less extreme cases, exposure of deceptive accounting practices or sales techniques maylead to a loss of trust. Because individuals and firms are reluctant to do business with those they mistrust, a reputation for unethical behavior may lead to increasedadversarial relations with business partners, a loss of customers, and destruction of the firm's value.

Diff: 2

AACSB: 6. Reflective thinking

Question Status: New question

Objective: 1.3 Understand the role of the financial manager within the firm and the goal for making financial choices.

1.4 The Five Basic Principles of Finance

1) Consider the following equally likely project outcomes:

 Profit

 X Y

Pessimistic prediction $ 0 $500

Expected outcome $ 500 $500

Optimistic prediction $1000 $500

A) Investors will prefer project X because it potentially offers a higher profit.

B) Investors will reject both projects because the profit is too low.

C) Investors will prefer project Y because the expected return is the same as for project X but the outcome is certain.

D) Since Projects X and Y have the same expected outcomes of $500, investors will view them as identical in value.

Answer: C

Diff: 2

AACSB: 3. Analytic thinking

Question Status: Revised

Objective: 1.4 Explain the five principles of finance that form the basis of financial management for both businesses and individuals.

2) Consider the timing of the profits of the following certain investment projects:

 Profit

 L S

Year 1 $ 0 $ 3000

Year 2 $ 3000 $ 0

A) Project S is preferred to Project L.

B) Project L is preferred to Project S.

C) Projects S and L are equally desirable.

D) A goal of profit maximisation would favor Project S only.

Answer: A

Diff: 2

AACSB: 3. Analytic thinking

Question Status: Previous edition

Objective: 1.4 Explain the five principles of finance that form the basis of financial management for both businesses and individuals.

3) In finance, we assume that investors are generally

A) neutral to risk.

B) averse to risk.

C) fond of risk.

D) none of the above.

Answer: B

Diff: 1

AACSB: 3. Analytic thinking

Question Status: Previous edition

Objective: 1.4 Explain the five principles of finance that form the basis of financial management for both businesses and individuals.

4) Consider cash flows for Projects X and Y such as:

 Project X Project Y

Year 1 $3000 $ 0

Year 2 $ 0 $3000

A rational person would prefer receiving cash flows sooner because

A) the money can be reinvested.

B) the money is nice to have around.

C) the investor may be tired of a particular investment.

D) the investor is indifferent to either proposal.

Answer: A

Diff: 2

AACSB: 3. Analytic thinking

Question Status: Previous edition

Objective: 1.4 Explain the five principles of finance that form the basis of financial management for both businesses and individuals.

5) Which of the following should be considered when assessing the financial impact of business decisions?

A) The amount of projected earnings

B) The risk-return tradeoff

C) The timing of projected earnings; i.e., when they are expected to occur

D) All of the above

Answer: D

Diff: 1

AACSB: 3. Analytic thinking

Question Status: Previous edition

Objective: 1.4 Explain the five principles of finance that form the basis of financial management for both businesses and individuals.

6) Which of the following is most likely to motivate executives to maximise shareholder wealth?

A) Tying bonuses to cost reductions and meeting budget goals

B) Offering them relatively high salaries

C) Tying annual bonuses to increases in annual profits

D) Compensating them with stock options that can only be exercised after five years

Answer: D

Diff: 1

AACSB: 3. Analytic thinking

Question Status: New question

Objective: 1.4 Explain the five principles of finance that form the basis of financial management for both businesses and individuals.

7) If one security has a greater risk than another security, how will investors respond?

A) They will require a lower rate of return for the investment that has greater risk.

B) They would be indifferent regarding their expectation of rates of return for either investment.

C) They will require a higher rate of return for the investment that has greater risk.

D) None of the above.

Answer: C

Diff: 2

AACSB: 3. Analytic thinking

Question Status: Previous edition

Objective: 1.4 Explain the five principles of finance that form the basis of financial management for both businesses and individuals.

8) How could you compensate an investor for taking on a significant amount of risk?

A) Increase the expected rate of return

B) Raise more debt capital

C) Offer stock at a higher price

D) Increase sales

Answer: A

Diff: 2

AACSB: 3. Analytic thinking

Question Status: Previous edition

Objective: 1.4 Explain the five principles of finance that form the basis of financial management for both businesses and individuals.

9) If an investor had a choice of receiving $1,000 today or $1,000 in five years, which would the typical investor prefer?

A) $1,000 in five years:is better to receive money later rather than sooner.

B) $1,000 today: it will be worth more than $1,000 received in five years.

C) $1,000 in five years: it will be worth more than $1,000 received today.

D) Investors would be indifferent to when they would receive the $1,000.

E) None of the above.

Answer: B

Diff: 2

AACSB: 3. Analytic thinking

Question Status: Previous edition

Objective: 1.4 Explain the five principles of finance that form the basis of financial management for both businesses and individuals.

10) Why do investors prefer receiving cash sooner rather than later, according to finance theory?

A) Incremental profits are greater than accounting profits.

B) Money received earlier can be reinvested and returns can be increased.

C) Tax considerations are important when investing.

D) Diversification leads to increased value.

Answer: B

Diff: 2

AACSB: 3. Analytic thinking

Question Status: Previous edition

Objective: 1.4 Explain the five principles of finance that form the basis of financial management for both businesses and individuals.

11) Investors choose to invest in higher risk investments because these investments offer higher

A) expected returns.

B) inflation.

C) actual returns.

D) future consumption.

Answer: A

Diff: 2

AACSB: 3. Analytic thinking

Question Status: Previous edition

Objective: 1.4 Explain the five principles of finance that form the basis of financial management for both businesses and individuals.

12) Foregoing the earning potential of a dollar today is referred to as the

A) time value of money.

B) opportunity cost concept.

C) risk/return tradeoff.

D) creation of wealth.

Answer: B

Diff: 2

AACSB: 3. Analytic thinking

Question Status: Previous edition

Objective: 1.4 Explain the five principles of finance that form the basis of financial management for both businesses and individuals.

13) In measuring value, the focus should be on

A) cash flow.

B) accounting profits.

C) time value of money.

D) earnings per share.

Answer: A

Diff: 2

AACSB: 3. Analytic thinking

Question Status: Previous edition

Objective: 1.4 Explain the five principles of finance that form the basis of financial management for both businesses and individuals.

14) Which of the following is a characteristic of an efficient market?

A) There are small numbers of individuals.

B) Opportunities exist for investors to profit from publicly available information.

C) The market prices of securities reflect fair value of the firm.

D) Immediate responses occur for new public information.

Answer: C

Diff: 2

AACSB: 3. Analytic thinking

Question Status: Previous edition

Objective: 1.4 Explain the five principles of finance that form the basis of financial management for both businesses and individuals.

15) Which of the following factors is most important in investment decisions?

A) thechange in earnings before taxes

B) thechange in gross sales revenue

C) thechange in net income

D) thechange in cash flow

Answer: D

Diff: 2

AACSB: 3. Analytic thinking

Question Status: New question

Objective: 1.4 Explain the five principles of finance that form the basis of financial management for both businesses and individuals.

16) Investors prefer $1 today versus $1 in the future due to

A) time value of money.

B) response to incentives.

C) the need for immediate gratification.

D) A and B.

Answer: A

Diff: 2

AACSB: 3. Analytic thinking

Question Status: Revised

Objective: 1.4 Explain the five principles of finance that form the basis of financial management for both businesses and individuals.

17) The price of Netflix stock dropped sharply after customers responded negatively to a change in pricing policies. The change in stock price illustrates which principle?

A) Market prices reflect information.

B) Individuals respond to incentives.

C) Cash flows are the source of value.

D) The time-value of money.

Answer: A

Diff: 2

AACSB: 3. Analytic thinking

Question Status: New question

Objective: 1.4 Explain the five principles of finance that form the basis of financial management for both businesses and individuals.

18) For the risk-return principle implies that the more risky a given course of action, the higher the expected return must be.

Answer: TRUE

Diff: 2

AACSB: 3. Analytic thinking

Question Status: Revised

Objective: 1.4 Explain the five principles of finance that form the basis of financial management for both businesses and individuals.

19) The financial manager should examine available risk-return trade-offs and make his decision based upon the greatest expected return.

Answer: FALSE

Diff: 2

AACSB: 3. Analytic thinking

Question Status: Previous edition

Objective: 1.4 Explain the five principles of finance that form the basis of financial management for both businesses and individuals.

20) Only a few financial decisions involve some sort of risk-return tradeoff.

Answer: FALSE

Diff: 1

AACSB: 3. Analytic thinking

Question Status: Previous edition

Objective: 1.4 Explain the five principles of finance that form the basis of financial management for both businesses and individuals.

21) In efficient markets, price adjustments to new information are gradual.

Answer: FALSE

Diff: 2

AACSB: 3. Analytic thinking

Question Status: Revised

Objective: 1.4 Explain the five principles of finance that form the basis of financial management for both businesses and individuals.

22) Rewarding executives for increasing quarterly earnings will motivate them to act in the long-term best interests of shareholders.

Answer: FALSE

Diff: 1

AACSB: 3. Analytic thinking

Question Status: New question

Objective: 1.4 Explain the five principles of finance that form the basis of financial management for both businesses and individuals.

23) In an efficient market, prices will quickly adjust to new information.

Answer: TRUE

Diff: 2

AACSB: 3. Analytic thinking

Question Status: Previous edition

Objective: 1.4 Explain the five principles of finance that form the basis of financial management for both businesses and individuals.

24) Briefly discuss why financial decision makers must focus on incremental cash flows when evaluating new projects.

Answer: Incremental cash flows describe the total cash effect on the company, looking at the difference between total cash flow to the company with the cash flow, and without the cash flow. The company can then value these cash flows and see if the company is worth more with the project or without the project.

Diff: 3

AACSB: 3. Analytic thinking

Question Status: Previous edition

Objective: 1.4 Explain the five principles of finance that form the basis of financial management for both businesses and individuals.

25) Discuss the risk/return tradeoff and how it relates to finance.

Answer: As people are risk averse, they need a higher return as the risk gets higher. This means that investors will need a higher return on bonds that they do not consider to be as safe as other bonds, and they will need a higher return on stock when the company in question's stock seems to be riskier than the stock of other companies.

Diff: 2

AACSB: 3. Analytic thinking

Question Status: Previous edition

Objective: 1.4 Explain the five principles of finance that form the basis of financial management for both businesses and individuals.

26) Why do you think many companies compensate executives with options based on long-term increases in the value of the company's stock?

Answer: Tying executive compensation to long-term increases in the stock price makes sense because they are supposed to be working to maximize shareholder wealth. Stock-based compensation plans imply that decisions made to benefit shareholders will also benefit themselves.

Diff: 2

AACSB: 3. Analytic thinking

Question Status: New question

Objective: 1.4 Explain the five principles of finance that form the basis of financial management for both businesses and individuals.