TT TEXTBOOK TESTBANKS

Solutions Manual for Principles of Finance 1st Dahlquist

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SOLUTION MANUALS

Principles of Finance

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Chapter 1
End-of-Chapter Questions

Introduction to Finance

Multiple Choice Questions

1. Which of the following was NOT identified by your authors as one of the three main areas of financial study?

   A. business finance
   B. capital budgeting
   C. investments
   D. financial markets and institutions

Solution: B

Section 1.1 LO 1 Easy

2. What is the process of determining which long-term or fixed assets to acquire in an effort to maximize shareholder value?

   A. Business finance
   B. Capital budgeting
   C. Investments
   D. Financial markets and institutions

Solution: B

Section 1.1 LO 1 Easy

3. In an organization with each of these financial positions, which title is most likely to be associated with a job description that is less of a "hands-on" manager and that engages more in visionary and strategic planning?

   A. comptroller (or controller)
   B. treasurer
   C. vice president of finance
   D. chief financial officer (CFO)

Solution: D

Section 1.2 LO 2 Moderate

4. Which of the following statements is false?

   A. Financial planning is an important tool of for-profit organizations such as corporations and partnerships but is not important for not-for-profit enterprises such charitable organizations or governments.
   B. Good financial planning considers past, present, and pro forma income statements.
   C. Balance sheets are critical elements of the financial planning process and help demonstrate expected sources and uses of funds.
   D. Forecasting in the form of expected sales, cost of funds, and micro- and macroeconomic conditions are essential elements of financial planning.

Solution: A

Section 1.2 LO 2 Easy

5. Which of the following statements regarding data is generally NOT true?

   A. Financial data is important for internal and external analysis of business firms.
   B. Outsiders use publicly available data about firms to make investment and regulatory decisions.
   C. "Gut feelings" decision-making tends to be more consistent with value maximization.
   D. Suppliers need financial information to determine if they should supply trade credit, and customers need to know if a firm's products are reliable and appropriately priced.

Solution: C

Section 1.3 LO 1 Easy

6. Which of the following is generally NOT true about cloud data storage versus on-site data storage?

   A. Cloud data storage provides storage cost advantages.
   B. Cloud data storage causes increased energy consumption.
   C. Cloud data storage comes with specialized data protection services.
   D. Cloud data storage comes with specialized maintenance services.

Solution: B

Section 1.3 LO 3 Moderate

7. Which of the following describes United States Bureau of Labor Statistics (BLS) expectations of jobs using financial skills in the next decade?

   A. plentiful but low paying
   B. few and low paying
   C. plentiful and high paying
   D. few and high paying

Solution: C

Section 1.4 LO 1 Easy

8. Which of the following organizations would be unlikely to hire a financial analyst?

   A. Government agencies may hire financial analysts to aid in regulatory oversight and enforcement.
   B. Investment companies may hire financial analysts to produce financial reports.
   C. Corporations may hire financial analysts to develop financial forecasts.
   D. All of the above organizations are likely to hire and develop financial analysts.

Solution: D

Section 1.4 LO 2 Easy

9. The ________ market is the market for ________ securities, and the ________ is the market for ________ securities.

   A. primary; used; secondary; new
   B. primary; new; secondary; used
   C. secondary; new; primary; new
   D. secondary; used; primary; used

Solution: B

Section 1.5 LO 1 Moderate

10. ________ own the securities that they buy or sell; when they engage in a financial transaction, they are trading from their own portfolio.

    A. Dealers
    B. Brokers
    C. Advisers
    D. Comptrollers

Solution: A

Section 1.5 LO 2 Moderate

11. ________ act as facilitators in a market, and they bring together buyers and sellers for a transaction.

    A. Dealers
    B. Brokers
    C. Advisers
    D. Comptrollers

Solution: B

Section 1.5 LO 2 Moderate

12. ________ is the study of the allocation of scarce resources, ________ is devoted to the study of these decisions of allocation by small or individual entities, and ________ examines decisions taken together or in the aggregate.

    A. Macroeconomics; microeconomics; economics
    B. Microeconomics; economics; macroeconomics
    C. Economics; microeconomics; macroeconomics
    D. Economics; macroeconomics; microeconomics

Solution: C

Section 1.6 LO 2 Moderate

13. Which of the following is NOT an economy-wide macroeconomic variable used in macro-forecasting models?

    A. inflation
    B. unemployment
    C. economic growth
    D. CEO turnover

Solution: D

Section 1.6 LO 3 Moderate

14. ________ is the market for short-term, low-risk, highly liquid, homogeneous securities.

    A. The capital market
    B. The financial market
    C. The stock market
    D. The money market

Solution: D

Section 1.7 LO 1 Easy

15. ________ are short-term debt instruments issued by the federal government.

    A. Treasury bills
    B. Treasury notes
    C. Treasury bonds
    D. Federal Reserve notes

Solution: A

Section 1.7 LO 2 Moderate

16. ________ is a short-term, unsecured security issued by corporations and financial institutions to meet short-term financing needs such as inventory and receivables.

   A. A Treasury bill
   B. Commercial paper
   C. A negotiable certificate of deposit
   D. A Treasury note

Solution: B

Section 1.7 LO 2 Easy

17. ________ are US government debt instruments with maturities of 2, 3, 5, 7, or 10 years.

   A. Federal funds
   B. Federal Reserve notes
   C. Treasury notes
   D. Treasury bonds

Solution: C

Section 1.7 LO 3 Easy

18. ________ investments tend to have ________ risk and ________ expected returns.

   A. Long-term; less; smaller
   B. Long-term; greater; greater
   C. Short-term; greater; smaller
   D. Short-term; less; greater

Solution: B

Section 1.8 LO 1 Moderate

19. ________ value is what a consumer pays for a product. ________ value is what a consumer is willing to pay for a product.

   A. Market; Economic
   B. Economic; Market
   C. Book; Market
   D. Economic; Book

Solution: A

Section 1.8 LO 2 Moderate

Review Questions

1. Identify and briefly define the three areas of study in finance.

Solution:

- Business finance looks at how managers can apply financial principles to maximize the value of a firm in a risky environment.
- Investments is the study of the products and processes used to create individual and institutional portfolios with the intent of growing wealth.
- Financial markets and institutions is the study of the firms and regulatory agencies that oversee our financial system.

Section 1.1 LO 1 Moderate

2. Identify the three focal areas in *business finance.*

Solution:

- Working capital management (WCM) is the study and management of short-term assets and liabilities.
- Capital budgeting is the process of determining which long-term or fixed assets to acquire in an effort to maximize shareholder value.
- Capital structure is the process by which managers determine the optimal ways to finance the firm in general and projects more specifically in an effort to make the firm's assets more valuable and increase shareholder wealth.

Section 1.1 LO 1 Difficult

3. Define each of the following types of risk:

- inflation risk
- diversifiable risk
- non-diversifiable risk
- political risk

Solution:

- Inflation risk occurs when investors have less purchasing power from the realized cash flows from an investment due to rising prices.
- Diversifiable risk, also known as unsystematic risk, occurs when investors hold individual securities or smallish portfolios and bear risk that a more complete portfolio could eliminate.
- Non-diversifiable risk, or systematic risk, is what remains after portfolio diversification has eliminated unnecessary diversifiable risk.
- Political risk is the risk of local, state, or national governments "changing the rules" and disrupting firm cash flows.

Section 1.1 LO 3 Difficult

4. Identify three common components of good financial planning.

Solution: Students should identify at least three of the following or similar criteria.

- Income statements—past, current, and pro forma, or forward looking. The pro forma income statements should develop likely scenarios and provide sensitivity analysis of key assumptions.
- Cash flow statements are a critical part of any financial planning. Cash flow goes beyond accounting data and estimates the timing and magnitude of actual cash flows available to meet financial obligations.
- Balance sheets are critical for demonstrating the sources and uses of funds for a firm.
- Forecasting in the form of expected sales, cost of funds, and micro- and macroeconomic conditions are essential elements of financial planning.
- Financial analysis including ratio analysis, common-size financial statements, and trend statements are important aspects of financial planning. Such analysis aids in the understanding of where a firm has been, how it stacks up against the competition, and the assessment of target objectives.

Section 1.2 LO 2 Moderate

5. The Concepts in Practice feature in Section 1.3 discusses the importance of data for decision-making. List at least three of the ways the article suggests managers can use financial statements.

Solution:

1. Measure the impact of business decisions such as new software, marketing plan, or product line
2. Aid in the development of budgets by creating a starting point for future expectations
3. Aid in cost cutting or the reduction of duplicate activities
4. Data-supported strategic planning and visioning
5. Consistent data and content across departments
6. Team motivation to set, meet, and exceed goals and objectives

Section 1.3 LO 3 Difficult

6. Describe the role of a financial analyst in a financial institution such as a bank or investment company.

Solution: The role of financial analyst usually includes market research, financial forecasting, modeling, cost analysis, and comparative valuations. Financial analysts gather data and produce financial reports in conjunction with multiple departments within a business or organization. In a bank, they would provide research analysis to provide support for providing loans. In an investment firm, they would evaluate the value of potential investments and aid in the purchase or sale decisions.

Section 1.4 LO 2 Moderate

7. Is a dealer or a broker more likely to be a market maker? In your answer, define the activities of a market maker.

Solution: A dealer may also be a "market maker." This means that they own large amounts of a particular security and stand ready to buy or sell at the current bid or ask price. Market makers are often brokerage firms who own large amounts of a particular security so they can quickly and efficiently execute trades for their retail and wholesale customers. By standing ready to always buy or sell, dealers increase the liquidity and efficiency of the market.

Section 1.5 LO 2 Moderate

8. How can an understanding of micro- and macroeconomic factors aid in small business decision-making?

Solution: Most small-business decisions are on the micro level. This may include decisions to hire specific individuals, borrow money from local bankers, or expand production for a specific customer. These decisions, however, are made in a macro environment where the small business owner understands the national or regional outlook for economic growth, inflation, and unemployment. For example, the national rate of unemployment may not have been much help when Bacon Signs was searching for skilled laborers who could form neon signs. However, the unemployment rate helped inform the company about the probability of demand for new businesses and the signs they would need.

Section 1.6 LO 2 Difficult

9. We measure market capitalization by multiplying the number of shares of stock outstanding by the current price per share. Go to finance.yahoo.com and determine the market capitalization of Nike, Tesla, and Walmart. Which company has the greatest market capitalization? Which company has the highest level of sales? If these are not the same companies, why do you think the company with the lower sales level has greater market capitalization?

Solution: Walmart has the highest sales, but Tesla may have greater value depending on when the student looks at current market information. Students could argue that because stock values represent market expectations, Tesla could expect to generate greater sales or a combination of increased sales and profit margin than Walmart.

Section 1.7 LO 3 Difficult

Chapter 1
Test Bank

Introduction to Finance

These questions and problems can all be solved in a classroom setting using a handheld financial calculator.

True or False Questions

1. The application of common sense is sufficient for companies to manage their financial operations.

   A. True
   B. False

Solution: B. Companies are too complex to be managed without extensive knowledge in multiple areas of finance.

Section 1.1 LO 1 Easy

2. The Financial Industry Regulatory Authority (FINRA) is a US federal institution charged with enforcement of US financial regulations.

   A. True
   B. False

Solution: B. FINRA is an independent nongovernmental organization that writes and enforces the rules governing registered brokers and broker-dealer firms in the United States.

Section 1.1 LO 3 Moderate

3. The key common feature of market brokers and dealers is that they both act as intermediaries.

   A. True
   B. False

Solution: A. Both brokers and dealers perform the function of intermediary between buyers and sellers of securities. The difference is that dealers hold inventories of securities and therefore stand ready to both buy and sell securities. This is not necessarily true of a broker.

Section 1.5 LO 2 Moderate

4. The term *broker* refers only to financial firms that buy and sell stock.

   A. True
   B. False

Solution: B. A broker is an intermediary that brings together the buyer and seller of any type of asset, including stocks, bonds, real estate, and more.

Section 1.5 LO 2 Difficult

Multiple Choice Questions

1. Business finance looks at how managers apply financial principles to maximize the value of a firm. Who benefits **most** when the value of the firm is maximized?

   A. Management
   B. Employees
   C. Shareholders
   D. Customers

Solution: C. Any interested party should benefit when a company is successful and increases its value. However, shareholders “own” the increased value, so they have the most to gain.

Section 1.1 LO 1 Moderate

2. Which of the following areas of finance is a more narrowly focused subfield of one of the other three areas?

   A. Business finance
   B. Financial markets and institutions
   C. Investments
   D. Working capital management

Solution: D. Working capital management is an important topic, but it is a subfield of business finance.

Section 1.1 LO 1 Moderate

3. Financial regulations in the United States were significantly expanded and improved beginning in the 1930s. What was the primary motivation for this regulatory reform and improvement?

   A. To make financial investing more profitable
   B. To make markets safer and increase investor confidence
   C. To increase tax receipts for the US government
   D. To increase unemployment during the Great Depression

Solution: B. Mostly unregulated markets were a factor in the stock market crash of 1929. To help rebuild investor confidence and provide safer markets, more and better regulations were adopted.

Section 1.1 LO 3 Moderate

4. The concepts of risk and return are fundamental to finance and are seen in many applications. The relationship between risk and return is ________.

   A. direct and positive
   B. inverse
   C. neutral
   D. uncorrelated

Solution: A. Overwhelming empirical evidence shows that risk and return are positively correlated. In other words, to earn a higher rate of return, an investor would need to take on more risk.

Section 1.1 LO 3 Moderate

5. Corporate budgets are important because they provide what to companies?

   A. Established objectives for the upcoming period
   B. Financial statements to submit to regulators
   C. A tax-planning tool
   D. Share price targets

Solution: A. A budget provides a roadmap for a business to establish corporate objectives and compare outcome to those objectives.

Section 1.2 LO 2 Moderate

6. Company managers use financial data extensively to make ongoing business decisions within the firm. Which of the following are external users of a company's data?

   A. Strategic planning staff
   B. Department managers
   C. Suppliers
   D. Internal auditors

Solution: C. Although suppliers rely on data about their corporate customers, they are external to the firm.

Section 1.3 LO 2 Moderate

7. Which type of financial data do companies generally not provide to the public?

   A. Balance sheets
   B. Income statements
   C. Staff salaries
   D. Statements of cash flows

Solution: C. Salary information is confidential to a company, except for limited compensation information about the most senior executives.

Section 1.3 LO 5 Easy

8. According to the US Bureau of Labor Statistics, the finance field is expected to ________ over the next 10 years.

   A. grow and diversify
   B. grow but narrow in opportunities
   C. contract but diversify
   D. contract and narrow in opportunities

Solution: A. Data provided by US Bureau of Labor Statistics' *Occupation Outlook Handbook* predicts that the finance field will grow and diversify over the next decade.

Section 1.4 LO 1 Moderate

9. A financial analyst holds an essential position within a corporate or financial firm. Of the many skills that are needed in this position, which of the following is typically **most** important?

   A. Quantitative and analytical skills
   B. Communication skills
   C. Adaptability
   D. Ability to focus on tasks

Solution: A. All of these attributes are important to varying degrees, but to get the job done, quantitative and analytical skills are the most critical.

Section 1.4 LO 2 Moderate

10. As a financial analyst advances to the role of financial manager, what key attribute is needed in their new role that was not previously required?

   A. Comprehensive strategic thinking skills
   B. Highly specific financial skills
   C. Strong grasp of financial fundamentals
   D. Technical capabilities

Solution: A. As an analyst moves up to the higher position of financial manager, more higher-order skills and abilities are needed. Strategic thinking is a higher-order ability.

Section 1.4 LO 3 Moderate

11. The US Bureau of Labor Statistics predicts that the finance industry will experience a future job market characterized by what?

   A. More jobs at lower salaries
   B. More jobs at higher salaries
   C. Fewer jobs at lower salaries
   D. Fewer jobs at higher salaries

Solution: B. The BLS reports a favorable job market in terms of more and better-paying jobs that will build on the already premium prospects in the finance industry.

Section 1.4 LO4 Moderate

12. When a company's security is sold in the secondary market, which entity receives the proceeds of the sale?

    A. The company
    B. The exchange where the security was traded
    C. The securities seller
    D. The bank syndicate

Solution: C. Once a security is initially sold in the primary market, the proceeds from any subsequent sales go to the securities seller.

Section 1.5 LO 1 Moderate

13. It is said that an effective and efficient secondary market is essential to having a functioning primary market. Why might this be true?

    A. The secondary market allows investors to liquidate their assets.
    B. The primary market can be inefficient.
    C. Individual investors cannot access the primary market.
    D. The secondary market provides an accurate pricing mechanism.

Solution: A. Without a functioning secondary market, investors would not be confident that the liquidity of the financial market would allow them to sell securities when desired. In other words, investors need to know they can trade in and out of positions with little or no restrictions.

Section 1.5 LO 1 Difficult

14. The key difference between a broker and a dealer is that the dealer is a "market maker," meaning they are able to give a "two-way price." As a market maker, the dealer is what?

    A. Sometimes ready to buy a security
    B. Always ready to sell a security
    C. Able to advise on whether to buy or sell a security
    D. Able to give tax advice to the customer

Solution: B. A dealer is able to provide either side of a trade—that is, to buy from the seller or sell to the buyer. This requires the dealer to hold inventory of the security.

Section 1.5 LO 2 Difficult

15. Which US federal agency is responsible for regulatory oversight and enforcement of publicly traded securities?

    A. Federal Deposit Insurance Corporation (FDIC)
    B. Financial Industry Regulatory Authority (FINRA)
    C. Securities and Exchange Commission (SEC)
    D. New York Stock Exchange (NYSE)

Solution: C. The SEC is responsible for regulatory oversight and enforcement of publicly traded securities. The FDIC is a federal agency that insures bank deposits. FINRA is a private industry self-regulator. The NYSE is a private business.

Section 1.5 LO 2 Moderate

16. Financial intermediaries are essential players in functioning financial markets. Of the many roles that financial intermediaries play, which one has occasionally caused harm to financial markets rather than benefiting them?

    A. Bringing together depositors and borrowers
    B. Creating exotic derivative securities
    C. Providing liquidity to the securities market
    D. Helping ensure that securities are “correctly” priced

Solution: B. Financial innovation has existed throughout the lifetime of the industry. Normally, this innovation brings benefits to the industry, but when misused, innovations can cause harm. For example, the securitizing of assets, especially mortgages, existed for many years. Only after the mortgage securitization industry grew to excess did calamity strike, in 2007–2009.

Section 1.5 LO 2 Difficult

17. Microeconomics studies the resource allocation decisions of ________.

    A. individual businesses, persons, or organizations
    B. national governments
    C. financial institutions
    D. small companies

Solution: A. Resource allocation is a key process of the economy, and microeconomics encompasses the study of how all participants in an economy make those decisions.

Section 1.6 LO 1 Easy

18. Macroeconomics is important to businesses because it helps them ________.

A. better understand the overall context of the economy
B. better understand how prices are set in the market
C. more accurately predict future interest rates
D. more accurately determine their costs

Solution: A. While microeconomics is concerned with economic decision-making among specific actors within the economy, macroeconomics addresses large economy-wide issues, such as growth and inflation.

Section 1.6 LO 3 Moderate

19. The market for short-term, low-risk, highly liquid securities is called the ________.

A. capital market
B. equity market
C. debt market
D. money market

Solution: D. There are a number of money market instruments, but they all share the characteristics of being short term, low risk, and highly liquid. By contrast, the capital, equity, and debt markets trade in longer-term, riskier securities.

Section 1.7 LO 1 Moderate

20. What money market instrument is commonly used by high-quality corporations to raise funds over very short periods of time?

A. Commercial paper
B. Treasury bills
C. Federal funds
D. Certificates of deposit

Solution: A. The key phrase is *high-quality corporations*. All four are money market instruments, but commercial paper is used only by the highest-quality corporate borrowers.

Section 1.7 LO 2 Difficult

21. What is the key difference between money market instruments and capital market instruments?

A. Their credit rating
B. The use of their proceeds
C. Their maturity
D. Their collateral

Solution: C. Money market instruments are short-term instruments, while capital markets trade in medium- to long-term instruments.

Section 1.7 LO 3 Difficult

22. Which of the following is an attractive characteristic of municipal securities (munis) for investors?

    A. Their interest is not taxable for federal return purposes, and sometimes for state and local returns too.
    B. They are less risky than federally issued securities.
    C. They normally offer higher returns than stock investments.
    D. They can be customized for individual investors.

Solution: A. The preferred tax status of munis makes them especially attractive instruments, particularly for investors with higher tax rates.

Section 1.7 LO 3 Moderate

23. Which of the following characteristics would an investor place a greater priority on for a short-term investment than for a long-term investment?

    A. Length of the investment period
    B. Liquidity of the investment
    C. How often the investment rate compounds
    D. Tax considerations

Solution: B. If the investor had a short time horizon, the liquidity of the investment, or the ability to sell it quickly, would take on greater importance.

Section 1.8 LO 1 Difficult