

TEST BANK

Fundamentals of
**Financial
Management**



THIRTEENTH EDITION



BRIGHAM HOUSTON

(2-2) Financial markets **F H** **Answer: a EASY**

6. A share of common stock is not a derivative, but an option to buy the stock is a derivative because the value of the option is derived from the value of the stock.

- a. True
- b. False

(2-3) Financial institutions **F H** **Answer: a EASY**

7. Financial institutions are more diversified today than they were in the past, when federal laws kept investment banks, commercial banks, insurance companies, and similar organizations quite separate. Today the larger financial services corporations offer a variety of services, ranging from checking accounts, to insurance, to underwriting securities, to stock brokerage.

- a. True
- b. False

(2-3) Financial institutions **F H** **Answer: a EASY**

8. Hedge funds are somewhat similar to mutual funds. The primary differences are that hedge funds are less highly regulated, have more flexibility regarding what they can buy, and restrict their investors to wealthy, sophisticated individuals and institutions.

- a. True
- b. False

(2-4) Stock market **F H** **Answer: b EASY**

9. Trades on the NYSE are generally completed by having a brokerage firm acting as a "dealer" buy securities and adding them to its inventory or selling from its inventory. The Nasdaq, on the other hand, operates as an auction market, where buyers offer to buy, and sellers to sell, and the price is negotiated on the floor of the exchange.

- a. True
- b. False

(2-4) Stock market **F H** **Answer: a EASY**

10. The "over-the-counter" market received its name years ago because brokerage firms would hold inventories of stocks and then sell them by literally passing them over the counter to the buyer.

- a. True
- b. False

(2-5) Stock market transactions **F H** **Answer: a EASY**

11. If you decide to buy 100 shares of Google, you would probably do so by calling your broker and asking him or her to execute the trade for you. This would be defined as a secondary market transaction, not a primary market transaction.

- a. True
- b. False

(2-5) Stock market transactions **F H** **Answer: b EASY**

12. The term IPO stands for "individual purchase order," as when an individual (as opposed to an institution) places an order to buy a stock.
- a. True
 - b. False

(2-5) Stock market transactions **F H** **Answer: a EASY**

13. In a "Dutch auction" for new stock, individual investors place bids for shares directly. Each potential bidder indicates the price he or she is willing to pay and how many shares he or she will purchase at that price. The highest price that permits the company to sell all the shares it wants to sell is determined, and this is the "market clearing price." All bidders who specified this price or higher are allowed to purchase their shares at the market clearing price.
- a. True
 - b. False

(2-5) Closely held stock **F H** **Answer: a EASY**

14. When a corporation's shares are owned by a few individuals who are associated with the firm's management, we say that the stock is closely held.
- a. True
 - b. False

(2-5) Public company **F H** **Answer: a EASY**

15. A publicly owned corporation is a company whose shares are held by the investing public, which may include other corporations as well as institutional investors.
- a. True
 - b. False

(2-6) Stock market returns **F H** **Answer: a EASY**

16. If you wanted to know what rate of return stocks have provided in the past, you could examine data on the Dow Jones Industrial Index, the S&P 500 Index, or the Nasdaq Index.
- a. True
 - b. False

(2-6) Stock market returns **F H** **Answer: a EASY**

17. The annual rate of return on any given stock can be found as the stock's dividend for the year plus the change in the stock's price during the year, divided by its beginning-of-year price.
- a. True
 - b. False

(2-6) Stock market returns **F H** **Answer: a EASY**

18. The annual rate of return on any given stock can be found as the stock's dividend for the year plus the change in the stock's price during the year, divided by its beginning-of-year price. If you obtain such data on a large portfolio of stocks, like those in the S&P 500, find the rate of return on each stock, and then average those returns, this would give you an idea of stock market returns for the year in question.

- a. True
- b. False

(2-6) Stock market returns **F H** **Answer: a EASY**

19. Each stock's rate of return in a given year consists of a dividend yield (which might be zero) plus a capital gains yield (which could be positive, negative, or zero). Such returns are calculated for all the stocks in the S&P 500. A weighted average of those returns, using each stock's total market value, is then calculated, and that average return is often used as an indicator of the "return on the market."

- a. True
- b. False

(2-6) Stock market returns **F H** **Answer: b EASY**

20. Each stock's rate of return in a given year consists of a dividend yield (which might be zero) plus a capital gains yield (which could be positive, negative, or zero). Such returns are calculated for all the stocks in the S&P 500. A simple average of those returns (which gives equal weight to each company in the S&P 500) is then calculated. That average is called the "return on the S&P Index," and it is often used as an indicator of the "return on the market."

- a. True
- b. False

Multiple Choice: Conceptual

(2-1) Capital allocation **F H** **Answer: a EASY**

21. You recently sold 100 shares of Microsoft stock to your brother at a family reunion. At the reunion your brother gave you a check for the stock and you gave your brother the stock certificates. Which of the following best describes this transaction?

- a. This is an example of a direct transfer of capital.
- b. This is an example of a primary market transaction.
- c. This is an example of an exchange of physical assets.
- d. This is an example of a money market transaction.
- e. This is an example of a derivative market transaction.

(2-2) Financial markets

F H

Answer: c EASY

22. Which of the following statements is CORRECT?

- a. The NYSE does not exist as a physical location. Rather it represents a loose collection of dealers who trade stock electronically.
- b. An example of a primary market transaction would be your uncle transferring 100 shares of Walmart stock to you as a birthday gift.
- c. Capital market instruments include both long-term debt and common stocks.
- d. If your uncle in New York sold 100 shares of Microsoft through his broker to an investor in Los Angeles, this would be a primary market transaction.
- e. While the two frequently perform similar functions, investment banks generally specialize in lending money, whereas commercial banks generally help companies raise large blocks of capital from investors.

(2-2) Financial markets

F H

Answer: c EASY

23. Which of the following is a primary market transaction?

- a. You sell 200 shares of IBM stock on the NYSE through your broker.
- b. You buy 200 shares of IBM stock from your brother. The trade is not made through a broker--you just give him cash and he gives you the stock.
- c. IBM issues 2,000,000 shares of new stock and sells them to the public through an investment banker.
- d. One financial institution buys 200,000 shares of IBM stock from another institution. An investment banker arranges the transaction.
- e. IBM sells 2,000,000 shares of treasury stock to its employees when they exercise options that were granted in prior years.

(2-2) Capital market instruments

F H

Answer: b EASY

24. Which of the following is an example of a capital market instrument?

- a. Commercial paper.
- b. Preferred stock.
- c. U.S. Treasury bills.
- d. Banker's acceptances.
- e. Money market mutual funds.

(2-2) Money markets

F H

Answer: e EASY

25. Money markets are markets for

- a. Foreign currencies.
- b. Consumer automobile loans.
- c. Common stocks.
- d. Long-term bonds.
- e. Short-term debt securities such as Treasury bills and commercial paper.

(2-4) Financial markets **F H** **Answer: a EASY**

30. Which of the following statements is CORRECT?

- a. The New York Stock Exchange is an auction market, and it has a physical location.
- b. Home mortgage loans are traded in the money market.
- c. If an investor sells shares of stock through a broker, then it would be a primary market transaction.
- d. Capital markets deal only with common stocks and other equity securities.
- e. While the distinctions are blurring, investment banks generally specialize in lending money, whereas commercial banks generally help companies raise capital from other parties.

(2-5) IPOs **F H** **Answer: c EASY**

31. Which of the following statements is CORRECT?

- a. The term "IPO" stands for Introductory Price Offered, and it is the price at which shares of a new company are offered to the public.
- b. IPO prices are generally established by the market, and buyers of the new stock must pay the price that prevails at the close of trading on the day the stock is offered to the public.
- c. In a "Dutch auction," investors who want to buy shares in an IPO submit bids indicating how many shares they want to buy and the price they are willing to pay. The company determines how many shares it wants to sell. The highest price that enables the company to sell the desired number of shares is the price that all buyers must pay.
- d. It is possible that the price set in an IPO is so high that investors will refuse to buy the number of shares that the company wants to sell. In this situation, the IPO is said to be oversubscribed.
- e. It is possible that the price set in an IPO is so low that investors will want to buy more shares than the company wants to sell. In that case, the company will have to issue more shares than it wants to sell.

(2-4) Financial markets **F H** **Answer: d EASY/MEDIUM**

32. Which of the following statements is CORRECT?

- a. The most important difference between spot markets versus futures markets is the maturity of the instruments that are traded. Spot market transactions involve securities that have maturities of less than one year whereas futures markets transactions involve securities with maturities greater than one year.
- b. Capital market transactions involve only preferred stock or common stock.
- c. If General Electric were to issue new stock this year, this would be considered a secondary market transaction since the company already has stock outstanding.
- d. Both Nasdaq dealers and "specialists" on the NYSE hold inventories of stocks.
- e. Money market transactions do not involve securities denominated in currencies other than the U.S. dollar.

33. Which of the following statements is NOT CORRECT?

- a. When a corporation's shares are owned by a few individuals, we say that the firm is "closely, or privately, held."
- b. "Going public" establishes a firm's true intrinsic value and ensures that a liquid market will always exist for the firm's shares.
- c. The stock of publicly owned companies must generally be registered with and reported to a regulatory agency such as the SEC.
- d. When stock in a closely held corporation is offered to the public for the first time, the transaction is called "going public, or an IPO," and the market for such stock is called the new issue or IPO market.
- e. It is possible for a firm to go public and yet not raise any additional new capital for the firm itself.

CHAPTER 2

ANSWERS AND SOLUTIONS

1.	(2-1) Financial intermediaries	F H	Answer: a EASY
2.	(2-2) Financial markets	F H	Answer: b EASY
3.	(2-2) Financial markets	F H	Answer: b EASY
4.	(2-2) Financial markets	F H	Answer: b EASY
5.	(2-2) Financial markets	F H	Answer: b EASY
6.	(2-2) Financial markets	F H	Answer: a EASY
7.	(2-3) Financial institutions	F H	Answer: a EASY
8.	(2-3) Financial institutions	F H	Answer: a EASY
9.	(2-4) Stock market	F H	Answer: b EASY
10.	(2-4) Stock market	F H	Answer: a EASY
11.	(2-5) Stock market transactions	F H	Answer: a EASY
12.	(2-5) Stock market transactions	F H	Answer: b EASY
13.	(2-5) Stock market transactions	F H	Answer: a EASY
14.	(2-5) Closely held stock	F H	Answer: a EASY
15.	(2-5) Public company	F H	Answer: a EASY
16.	(2-6) Stock market returns	F H	Answer: a EASY
17.	(2-6) Stock market returns	F H	Answer: a EASY
18.	(2-6) Stock market returns	F H	Answer: a EASY
19.	(2-6) Stock market returns	F H	Answer: a EASY
20.	(2-6) Stock market returns	F H	Answer: b EASY
21.	(2-1) Capital allocation	F H	Answer: a EASY
22.	(2-2) Financial markets	F H	Answer: c EASY
23.	(2-2) Financial markets	F H	Answer: c EASY
24.	(2-2) Capital market instruments	F H	Answer: b EASY
25.	(2-2) Money markets	F H	Answer: e EASY
26.	(2-2) Fin. mkt. transactions	F H	Answer: e EASY

27.	(2-2) Fin. mkt. transactions	F H	Answer: c EASY
28.	(2-3) Hedge funds	F H	Answer: e EASY
29.	(2-4) Fin. mkts. & institutions	F H	Answer: b EASY
30.	(2-4) Financial markets	F H	Answer: a EASY
31.	(2-5) IPOs	F H	Answer: c EASY
32.	(2-4) Financial markets	F H	Answer: d EASY/MEDIUM
33.	(2-5) Ownership and going public	F H	Answer: b MEDIUM/HARD