CORPORATE ISSUERS MOCK TEST

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1. The CFO of Axis Manufacturing is evaluating the introduction of a new product. The costs of a recently completed marketing study for the new product and the possible increase in the sales of a related product made by Axis are best described (respectively) as:
(A) opportunity cost; externality.
(B) externality; cannibalization.
(C) sunk cost; externality.

2. Which of the following examples best represents a flexibility option?
(A) In three years, a company can invest $500 million to increase the size of its project by 40%.
(B) In two years, a company can cease operating a factory if the present value of production is negative.
(C) In one year, a company can increase the price of its product by up to 30% if demand rises.

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4. A firm is reviewing an investment opportunity that requires an initial cash outlay of $336,875 and promises to return the following irregular payments: Year 1: $100,000 Year 2: $82,000 Year 3: $76,000 Year 4: $111,000 Year 5: $142,000 If the required rate of return for the firm is 8%, what is the net present value of the investment?
(A) $64,582.
(B) $99,860.
(C) $86,133.

5. A company with a moderate approach to working capital management would most likely fund:
   (A) Permanent current assets using long-term funds, and fund seasonal current assets using short-term funds.
   (B) Both permanent and seasonal current assets using short-term funds.
   (C) Permanent current assets using short-term funds, and fund seasonal current assets using long-term funds.

6. While conducting market research, an analyst observes that significant amounts of a company's sales are prepaid, while inventory levels are generally very low. The analyst should most appropriately conclude that the company has a:
   (A) low cash conversion cycle.
   (B) high cash conversion cycle.
   (C) high days of inventory on hand.

7. If the days of inventory on hand, days sales outstanding, and days payable outstanding all doubled, a positive cash conversion cycle (CCC) would:
   (A) increase by a factor of less than 2.
   (B) double.
   (C) remain unchanged.

8. The cash conversion cycle (CCC) would most likely decrease if:
   (A) days sales outstanding increased.
   (B) days payable outstanding decreased.
   (C) days of inventory on hand decreased.

9. The quick ratio is considered a more conservative measure of liquidity than the current ratio because the quick ratio excludes:
   (A) inventories.
   (B) marketable securities.
   (C) accounts receivable.

10. Which of the following scenarios is most consistent with an aggressive approach to working capital management?
(A) A company finances working capital using short-term funds.
(B) A company finances working capital using long-term funds.
(C) A company finances working capital using equity instead of debt.

11. According to the static trade-off theory the amount of debt used by a company should decrease as the company's
(A) corporate tax rate increases.
(B) new debt financing is always preferable to new equity financing.
(C) there is an optimal proportion of debt that will maximize the value of the firm.

12. A firm is planning a $25 million expansion project. The project will be financed with $10 million in debt and $15 million in equity stock (equal to the company's current capital structure). The before-tax required return on debt is 10% and 15% for equity. If the company's tax rate is 35%, what cost of capital should the firm use to determine the project's net present value?
(A) 9.6%.
(B) 12.5%.
(C) 11.6%.

13. A financial services company requires all new hires in senior management positions to sign noncompete agreements. The costs associated with these noncompete agreements are an example of:
(A) monitoring costs, a component of pecking order theory.
(B) bonding costs, a component of the net agency costs of equity.
(C) bonding costs, a component of pecking order theory.

14. Under the assumptions of Modigliani and Miller's Proposition I, the value of a firm:
(A) is not affected by its capital structure.
(B) increases as the use of debt financing rises.
(C) decreases as the use of equity financing rises.

15. Under the static tradeoff theory, the optimal capital structure of a firm is at the point where the:
   (A) value of an unlevered firm is at its maximum.
   (B) Difference between the value of a levered firm and unlevered firm is at its maximum.
   (C) cost of financial distress is at its minimum.

16. The conclusion of Modigliani and Miller's capital structure model with taxes is that:
   (A) There is a trade-off between tax savings on debt increased risk of bankruptcy.
   (B) Capital structure decisions do not affect the value of a firm.
   (C) Firms should be financed with all debt.

17. Which of the following statements regarding Modigliani and Miller's Proposition II with taxes is most accurate?
   (A) The value of the firm is maximized at the point where the WACC is minimized.
   (B) Companies should use a 50% equity/50% debt capital structure to maximize value.
   (C) The tax shield provided by debt causes the WACC to increase as leverage increases.

18. Smith Company's board of directors assigns responsibilities to several committees. The committee that is most likely to be responsible for establishing the chief executive officer's compensation package is Smith's:
   (A) remuneration committee.
   (B) risk committee.
   (C) governance committee.

19. Risks that may arise from ineffective corporate governance least likely include:
   (A) Reduced default risk.
   (B) Less effective decision making.
   (C) Weaker financial performance.

20. Responsibilities of a board of directors' nominations committee are least likely to include:
   (A) Evaluating the independence of directors.
   (B) Recruiting qualified members to the board.
   (C) Selecting an external auditor for the company.

21. The interests of community groups affected by a company's operations are most likely to be considered in corporate governance under:
    (A) Special interest theory.
    (B) Shareholder theory.
    (C) Stakeholder theory.

22. Increasing a company's risk exposure in an effort to increase its growth rate is most likely to be favored by:
    (A) Owners but not lenders.
    (B) Neither lenders nor owners.
    (C) Both lenders and owners.

23. Which of the following payments are contractual obligations of a corporation?
    (A) Interest, principal, and preferred stock dividend payments.
    (B) Interest and principal payments.
    (C) Interest and common stock dividend payments.

24. Under which business structure are profits potentially subject to double taxation?
    (A) General partnership.
    (B) Limited partnership.
    (C) Corporation.

25. A corporation that wishes to raise equity capital and have its shares publicly traded is most likely to engage in:
    (A) a management buyout.
    (B) a direct listing on an exchange.
    (C) an initial public offering.

26. Government regulators typically require periodic disclosure of a company's financial performance for:
    (A) listed companies only.
    (B) private companies only.
    (C) both private and listed companies.

27. Debrin Company uses a tiered pricing strategy. Debrin is most likely to:
    (A) Charge higher prices during peak times of day.
    (B) Offer a discount for buying a large number of units.
    (C) Set a temporarily low price until it builds market share and scales up production.

28. To generate more sales on slow days, a hair salon will be offering its services at a 50% discount on Sundays and Mondays, but it will increase its prices by 20% on Fridays and Saturdays. Which pricing model best describes the company's strategy?
    (A) Dynamic pricing.
    (B) Razors-and-blades.
    (C) Tiered pricing.

29. Pro-X Cycle (Pro-X) is a bicycle manufacturer specializing in custom bicycles. The company sells all bikes for $1,200, but it offers high-margin packages like custom paint and premium tires and brakes ranging between $1,000 and $2,000. The pricing model that best reflects Pro-X's strategy is:
    (A) hidden revenue.
    (B) bundling.
    (C) add-on pricing.

30. Binder Company describes itself as a direct sales business. In terms of its business model, this refers to Binder's:
    (A) channel strategy.
    (B) pricing strategy.
    (C) product or service.