

**Quiz 1: Corporate Finance**

Answer all questions and show necessary work. Please be brief. This is an open books, open notes exam.

1. In the following questions, please make only one choice per question. (1/2 point each)
  - a. Faced with evidence that many companies are accumulating cash (that they have no immediate use for), you are looking for ways to improve accountability. If your objective is to make managers more accountable to stockholders, which of the following measures on cash accumulation is most like to advance that objective?
    - i. A requirement that, once the cash balance hits 10% of firm value, stockholders get a binding vote on whether the cash should be returned in dividends/buybacks.
    - ii. A requirement, for all firms, that any cash in excess of 10% of firm value be immediately reinvested (in projects or acquisitions).
    - iii. A requirement that any firm with a cash balance that exceeds 10% of firm value pay out all of its earnings as dividends.
    - iv. A cap on how much cash a firm is allowed to accumulate, at 10 percent of firm value. Excess cash has to be returned to stockholders.
    - v. A requirement, for all firms, that dividends be at least 50% of earnings.
  - b. One of the enduring conflicts in a firm is that between lenders to the firm and stockholders. Assume that you are a lender to a firm, and that the firm has a very large cash balance and investment grade rating (AA). Which of the following actions would you most prefer the firm to take with its cash?
    - i. Invest the money in good risky investments in existing businesses
    - ii. Invest the money in good risky investments in new businesses
    - iii. Hold the cash (and do nothing)
    - iv. Pay dividends to stockholders
    - v. Buy back stock
  - c. Assume that a company that pays a large dividend, suspends the dividend to reinvest the money and that the stock price goes down in reaction to the announcement. This is indicative of a market that is short term.
    - i. True
    - ii. False
  - d. There is evidence that companies delay releasing “bad” news to the market. If this the case and markets are rational, which of the following market reactions would you expect to the absence of anticipated news (earnings, dividends etc.)
    - i. The absence of news will be viewed as bad news
    - ii. The absence of news will be viewed as good news
    - iii. The absence of news will be viewed as no news

2. Minska Mines Inc. is a US corporation that derives all of its revenues in the United States. It is currently all-equity funded and has a US dollar cost of equity of 6.5%; the ten-year US T. Bond rate is 2% and the equity risk premium for the US is 6%. The company is considering expanding its existing business into Peru; the ten-year Peruvian government bond rate (in Peruvian sol) is 6.25% and the Peruvian sovereign rating (local and foreign currency) is Baa2. If the default spread for Baa2 rated countries is 1.75%, estimate the cost of equity for Minska Mines in Peruvian sol for its Peruvian operations. (The Peruvian equity index is twice as volatile as the Peruvian government bond. You can assume that the beta of the business is the same in both the US and Peru.) (3 points)



c. Now assume that Google plans to borrow \$60 billion to add to its cash balance and do the following:

- Invest \$ 70 billion in opening new Google stores, thus entering the retail business.
- Pay a special dividend of \$40 billion

Estimate the beta of Google's equity after this transaction. (The marginal tax rate is 40%) (3 points)