

Session 1: Post Class tests

1. Which of the following decisions is a corporate finance decision?
 - a. An acquisition of another company
 - b. A change in pricing strategy
 - c. An accounting revaluation of assets on the balance sheet (with no tax implications)
 - d. A decision to carry less inventory (even if it means lost sales)
 - e. Adding a child care center for employee's children
 - f. All of the above
 - g. None of the above
2. Corporate finance is built around the "financial" balance sheet, where assets are categorized into assets in place and growth assets. Assume that you are investing in a company that derives its value primarily from growth assets. Given the description of growth assets as the value of investments that you expect the firm to make in the future, which of the following would you expect to see in terms of the rest of corporate finance?
 - a. The firm is funded with a lot of debt and pays little out to its stockholders
 - b. The firm is funded with primarily equity and pays out large amounts to its stockholders
 - c. The firm is funded with primarily equity and pays little out to its stockholders
 - d. The firm is funded with a lot of debt and pays out large amounts to its stockholders.
3. In the big picture of corporate finance, the first big piece is the investment decision. Which of the following best characterizes that decision?
 - a. Firms should take investments that make them more profitable
 - b. Firms should take investments that generate the most cash flows
 - c. Firms should take investments that earn the highest returns
 - d. Firms should take investments that earn returns greater than the risk free rate
 - e. Firms should take investments that earn returns greater than the risk adjusted hurdle rate
4. In the big picture of corporate finance, the financing principle lays out how firms should approach raising debt. If you follow that principle, which of the following is your best choice to borrow?
 - a. Debt with the lowest interest rate attached to it
 - b. The longest term debt that you can get
 - c. The shortest term debt that you can get
 - d. Debt in the your local currency
 - e. Debt in the same currency that your cash flows are in
5. In the big picture of corporate finance, the dividend principle states that firms should return as much cash as they can to their owners. If firms followed this principle, which of the following would you expect to observe?
 - a. Firms will pay out all of their earnings as dividends/stock buybacks

- b. Firms will not pay out any of their earnings to stockholders
- c. Firms that have high earnings and low growth potential will return more cash to stockholders.
- d. Firms that have high earnings and high growth potential will return more cash to stockholders.
- e. None of the above

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1. F. All of the listed are corporate finance decisions, since they all require financial resources. The one that comes closest to not making it is the accounting reevaluation because it really is cosmetic. The only reason I include it is because you have to pay the accountants to do this cosmetic restatement.
2. **c. That the firm is funded with primarily equity and pays little out to its stockholders.** If you are a firm that derives your value from growth assets, you cannot afford debt (since you don't have much in existing assets & cash flows) and you need all your cash to go back into the firm to generate future growth (and thus cannot return cash to stockholders).
3. **e. Firms should take investments that earn returns greater than the risk adjusted hurdle rate.** It is not enough that the investments are profitable & increase growth or that they earn more than the risk free rate. The projects earning the highest returns may not be good enough, if they are very risky.
4. e. Debt in the same currency that your cash flows are in. Using the cheapest debt, the longest term debt or the shortest term debt may not make sense if the debt is not matched up to the cash flows on the assets. Mismatching debt to assets increases default risk.
5. c. Firms that have high earnings and low growth potential will return more cash to stockholders. It is a combination of having lots of earnings (cash flows) and not that much to invest those cash flows in that creates the opportunity to return more cash.