


Pool Canvas

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Name TestBanks Chapter 7 Multiple-Choice Questions

Description Question pool for TestBanks Chapter 7 Multiple-Choice Questions

Instructions

[Modify](#)

[◀ Add Question Here](#)

Question 1 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question

In direct finance,

- Answer** ✓ savers buy securities from investors in financial markets.
 savers buy securities directly from investors.
 savers buy securities from banks.
 investors borrow directly from banks.

[◀ Add Question Here](#)

Question 2 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question

The classic “lemons” paper on adverse selection was written by

- Answer** Robert Lucas.
 John Maynard Keynes.
 ✓ George Akerlof.
 Woodrow Wilson.

[◀ Add Question Here](#)

Question 3 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question

_____ occurs when one party in a transaction has more information than the other.

- Answer** Cognitive dissonance
 ✓ Asymmetric information
 Irrational exuberance
 Contagion

[◀ Add Question Here](#)

Question 4 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question

In Akerlof’s “lemons” model, all cars are priced based on the:

- Answer** quality of the best cars.
 ✓ average quality of all cars.
 quality of the worst cars.
 market preferences about car quality.

[◀ Add Question Here](#)

Question 5 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question

In Akerlof’s “lemons” model, which of the following completes the following sentence? Because all used cars in the market are priced based on the average quality of all cars,

- I. owners of high-quality cars are not willing to sell their cars.
 II. owners of poor-quality cars want to sell their cars.
 III. buyers will only have access to high-quality cars.

- Answer** I only
 II only
 III only
 ✓ I and II

[◀ Add Question Here](#)

Question 6 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question

According to the “lemons” model, used cars will all sell for the same price because:

- Answer** ✓ of buyer ignorance.
 of seller greed.
 of buyers' access to perfect information.
 sellers are honest.

[◀ Add Question Here](#)

Question 7 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question

In the “lemons” model, because only _____ cars come to be available, the price of all used cars in the market will _____.

- Answer**
- average quality; remain in equilibrium
 - high quality; begin to bubble
 - ✓ poor quality; spiral downward
 - low mileage; remain robust

◀ [Add Question Here](#)

Question 8 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question

Firms that overissue new stocks could be accused of selling:

- Answer**
- a derivative.
 - ✓ a "lemon."
 - "junk."
 - a mutual fund.

◀ [Add Question Here](#)

Question 9 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question

When applying the "lemons" problem to stocks, buyers know that stocks are _____ and this pushes stock prices _____.

- Answer**
- ✓ overvalued; down
 - undervalued; up
 - in equilibrium; zero
 - overvalued; up

◀ [Add Question Here](#)

Question 10 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question

The "lemons" problem arises in:

- Answer**
- high-default-risk bond markets.
 - an initial public offering.
 - used car market.
 - ✓ All of the answers are correct.

◀ [Add Question Here](#)

Question 11 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question

Which of the following is *most* likely to suffer from the "lemons" problem?

- Answer** ✓
- using bonds to finance oil exploration in Uzbekistan
 - using bonds to finance oil exploration in Saudi Arabia
 - using bonds to finance improvements to a new drug
 - All of the answers are correct.

◀ [Add Question Here](#)

Question 12 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question

You have \$100 and are thinking about how you might go about saving it. You pick up the *Wall Street Journal* and see the following information:

A project that pays \$125 with a probability of 0.75, or it pays \$75.

A project that pays \$200 with a probability of 0.25, or it pays \$50.

Alternatively, you could put the \$100 in a CD account and earn \$110 at the end of the year. Which strategy would be most advantageous to you?

And, if you put it into action, how much would you take home?

- Answer** ✓
- project A; \$112.50
 - the CD; \$110
 - project B; \$162.50
 - There is not enough information provided to answer the question.

◀ [Add Question Here](#)

Question 13 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question

A project pays \$125 with a probability of 0.75 or pays \$90. What is the expected value of this project?

- Answer**
- \$93.75
 - \$98.75
 - ✓ \$116.25
 - \$161.25

◀ [Add Question Here](#)

Question 14 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question

A project's expected value of a payment is:

- Answer** ✓
- $\text{Expected payment} = \text{promised payment} \times \text{probability of project success}.$
 - $\text{Expected payment} = \text{promised payment} \div \text{probability of project success}.$
 - $\text{Expected payment} = \text{promised payment}.$
 - $\text{Expected payment} = \text{promised payment} \times (1 - \text{probability of project success}).$

◀ [Add Question Here](#)

Question 15 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question

When buyers have less information than sellers do about the quality of the product, a situation of ____ exists.

- Answer**
- asymmetric information
 - moral hazard
 - seller greed
 - None of the answers are correct.

[◀ Add Question Here](#)

Question 16 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question

Normally, the bond market is less susceptible to adverse selection than the stock market, *except*:

- Answer**
- when asymmetric information is an issue.
 - when moral hazard is high.
 - when the risk of bond default is high.
 - when the stock market is in a bubble.

[◀ Add Question Here](#)

Question 17 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question

Suppose a company is deciding whether to invest in a project. It is choosing between project A, which produces a certain \$250 revenue with certainty, and project B, which has a one-third probability of producing \$900 and a two-thirds probability that it produces nothing. What is the expected value of project B?

- Answer**
- 250
 - 900
 - 300
 - zero

[◀ Add Question Here](#)

Question 18 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question

Suppose you have \$100 and are deciding to invest in a project. Suppose that asymmetric information is not a problem. You are choosing between project A, which has a one-fifth probability of producing \$250 revenue and a four-fifths probability of producing \$150 revenue and project B, which has a one-third probability of producing \$600 and a two-thirds probability that it produces nothing. Alternatively, you could invest your \$100 in a CD and earn 20 percent after a year. Assuming that you want to maximize your return, which strategy would you prefer, and how much do you expect to take home from your investment?

- Answer**
- Project A; \$170
 - Project B; \$200
 - the CD; \$120
 - There is not enough information to answer the question.

[◀ Add Question Here](#)

Question 19 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question

Suppose that you have the same amount of information as the firms that are trying to raise funds to invest in a project. Your firm can issue a \$100 bond that promises to pay 25 percent in a year. Suppose there are two firms that are trying to raise funds to pay for a project. Firm A's project is safe and is guaranteed to produce \$130 in revenue. Firm B's project is risky and has a two-thirds probability of producing \$180 a year, and a one-third chance it produces nothing. What is the expected return on each project, and which firm will receive financing?

- Answer**
- \$125; \$120; Firm A
 - \$130; \$120; Firm A
 - \$130; \$180; Firm B
 - There is not enough information to answer the question.

[◀ Add Question Here](#)

Question 20 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question

Suppose that the two firms each have more information about their financial status than you and that two firms are trying to raise funds to invest in a project. Investors don't know which firm is risky and which firm is safe. The firm can issue a \$100 bond that promises to pay 25 percent in a year. Suppose there are two firms that are trying to raise funds to pay for a project. Firm A's project is safe and is guaranteed to produce \$130 in revenue. Firm B's project is risky and has a two-thirds probability of producing \$180 a year, and a one-third chance it produces nothing. How much must the investor receive to buy one of the bonds, and which firm will receive financing?

- Answer**
- \$130; Firm A
 - \$150; Firm B
 - \$150; neither firm will receive financing.
 - There is not enough information to answer the question.

[◀ Add Question Here](#)

Question 21 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question

The adverse selection problem arises because:

- Answer**
- of asymmetric information.
 - of symmetric information.
 - bond prices are volatile.
 - stock prices are volatile.

[◀ Add Question Here](#)

Question 22 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question

Consequences of the adverse selection problem in securities markets include:

- Answer**
- an increase in the quality of securities issued.
 - a decrease in the overall number of good-quality securities issued.
 - an increase in the average price of securities issued.
 - an increase in the volume of securities traded.

[◀ Add Question Here](#)

[Modify](#) | [Remove](#)

Question 23 **Multiple Choice** **0 points**

Question

When firms issue _____ with _____, the adverse selection problem is not always a problem.

- Answer**
- stock; low expected earnings
 - bonds; high default risk
 - stock; high expected earnings
 - bonds; very low default risk

[◀ Add Question Here](#)

[Modify](#) | [Remove](#)

Question 24 **Multiple Choice** **0 points**

Question

According to the adverse selection problem in securities markets, as good-quality securities are retrieved from the market, the price of the remaining securities _____ and buyers realize that the probability of buying a low-quality security _____.

- Answer**
- decreases; decreases
 - decreases; increases
 - increases; increases
 - increases; decreases

[◀ Add Question Here](#)

[Modify](#) | [Remove](#)

Question 25 **Multiple Choice** **0 points**

Question

The adverse selection problem helps to explain why sometimes firms issue _____ rather than _____.

- Answer**
- bonds; stocks
 - long-term bonds; short-term bonds
 - stocks; bonds
 - stocks; short-term bonds

[◀ Add Question Here](#)

[Modify](#) | [Remove](#)

Question 26 **Multiple Choice** **0 points**

Question

Security issuers have more elements to assess the quality of a security than the potential buyer of such a security. This creates a problem in securities markets known as:

- Answer**
- principal agent.
 - free-rider problem.
 - adverse selection.
 - moral hazard.

[◀ Add Question Here](#)

[Modify](#) | [Remove](#)

Question 27 **Multiple Choice** **0 points**

Question

Which of the following (is)are responsible for high health insurance premiums?

- I. irrational exuberance
- II. adverse selection
- III. moral hazard

- Answer**
- I only
 - II only
 - III only
 - II and III

[◀ Add Question Here](#)

[Modify](#) | [Remove](#)

Question 28 **Multiple Choice** **0 points**

Question

When the action of an individual affects another party who cannot observe the action, it is called:

- Answer**
- moral hazard.
 - the principal-agent problem.
 - adverse selection.
 - adaptive expectations.

[◀ Add Question Here](#)

[Modify](#) | [Remove](#)

Question 29 **Multiple Choice** **0 points**

Question

In asymmetric information, we call the party who has information about her actions the _____ and the other, imperfectly informed party, the _____.

- Answer**
- agent; principal
 - principal; trader
 - saver; investor
 - boss; employee

[◀ Add Question Here](#)

Question 30	Multiple Choice	0 points	Modify Remove
Question			
When you buy car insurance, you may begin to drive _____ because of _____.			
Answer			
	<input type="checkbox"/>	safely; adverse selection	
	<input type="checkbox"/>	safely; strong ethics	
	<input checked="" type="checkbox"/>	carelessly; moral hazard	
	<input type="checkbox"/>	carelessly; higher quality cars	
Add Question Here			
Question 31	Multiple Choice	0 points	Modify Remove
Question			
When seatbelts became mandatory by law, the number of accidents increased; this is likely due to:			
Answer			
	<input checked="" type="checkbox"/>	moral hazard.	
	<input type="checkbox"/>	adverse selection.	
	<input type="checkbox"/>	more young drivers on the road.	
	<input type="checkbox"/>	poorer road quality.	
Add Question Here			
Question 32	Multiple Choice	0 points	Modify Remove
Question			
George Mason University economist Gordon Tullock once suggested that to make people drive more safely automobile manufacturers should put a spike in the middle of the steering wheel. This is one way of getting rid of:			
Answer			
	<input type="checkbox"/>	adverse selection.	
	<input checked="" type="checkbox"/>	moral hazard.	
	<input type="checkbox"/>	bad drivers.	
	<input type="checkbox"/>	Darwinism.	
Add Question Here			
Question 33	Multiple Choice	0 points	Modify Remove
Question			
The main problem with moral hazard in the bond market is that:			
Answer			
	<input checked="" type="checkbox"/>	firms take excessive risks with their borrowed funds.	
	<input type="checkbox"/>	only risky firms will issue bonds.	
	<input type="checkbox"/>	a firm's managers may waste money on bonuses.	
	<input type="checkbox"/>	moral hazard is not a problem in the bond market.	
Add Question Here			
Question 34	Multiple Choice	0 points	Modify Remove
Question			
When the government rescues companies that are on the brink of failure, investors may become _____ concerned about _____ than if the government let these companies fail.			
Answer			
	<input type="checkbox"/>	more; adverse selection	
	<input type="checkbox"/>	less; adverse selection	
	<input type="checkbox"/>	more; moral hazard	
	<input checked="" type="checkbox"/>	less; moral hazard	
Add Question Here			
Question 35	Multiple Choice	0 points	Modify Remove
Question			
To economists, the main problem with _____ is that individuals engage in _____ behavior.			
Answer			
	<input type="checkbox"/>	adverse selection; risky	
	<input checked="" type="checkbox"/>	moral hazard; harmful	
	<input type="checkbox"/>	asymmetric information; careful	
	<input type="checkbox"/>	principal-agent; selfish	
Add Question Here			
Question 36	Multiple Choice	0 points	Modify Remove
Question			
A Ponzi scheme is characterized by:			
I. an investment whose growth is financed by high returns on its investment.			
II. an investment whose growth is financed by new clients who give money.			
III. an investment that relies on receiving funds from nonprofit institutions.			
Answer			
	<input type="checkbox"/>	I only	
	<input checked="" type="checkbox"/>	II only	
	<input type="checkbox"/>	III only	
	<input type="checkbox"/>	I, II, and III	
Add Question Here			
Question 37	Multiple Choice	0 points	Modify Remove
Question			
During the financial crisis of 2008, the Ponzi scheme led by _____ swindled its investors of about _____.			
Answer			
	<input type="checkbox"/>	Charles Ponzi; \$50 billion	
	<input type="checkbox"/>	Dennis Kozlowski; \$1 billion	
	<input checked="" type="checkbox"/>	Bernard Madoff; \$30 billion	
	<input type="checkbox"/>	Stanford Financial; \$4 billion	
Add Question Here			

Question 38	Multiple Choice	0 points	Modify Remove
Question			
Applying the principal–agent terminology to financial markets, firms are the ____ and savers are the ____.			
Answer			
		principals; agents	
	<input checked="" type="checkbox"/>	agents; principals	
		free riders; lemons	
		lemons; free riders	
Add Question Here			
Question 39	Multiple Choice	0 points	Modify Remove
Question			
Moral hazard affects the car insurance market because:			
Answer			
		insured drivers choose to behave in the best interests of the insurance company.	
		insured drivers decide to drive even more carefully after buying car insurance.	
	<input checked="" type="checkbox"/>	the insurance company cannot enforce a promise to drive carefully.	
		all car drivers choose to drive carelessly.	
Add Question Here			
Question 40	Multiple Choice	0 points	Modify Remove
Question			
The moral hazard problem in stock markets, in which _____ fear that managers will misuse their funds, makes it _____ for firms to raise funds by selling stocks.			
Answer			
		principals; easier	
	<input checked="" type="checkbox"/>	principals; harder	
		agents; harder	
		agents; easier	
Add Question Here			
Question 41	Multiple Choice	0 points	Modify Remove
Question			
The moral hazard problem is _____ severe in bond markets than in stock markets. In addition, moral hazard arises in bond markets when firms issue bonds with _____ default risk.			
Answer			
		more; low	
		more; high	
		less; low	
	<input checked="" type="checkbox"/>	less; high	
Add Question Here			
Question 42	Multiple Choice	0 points	Modify Remove
Question			
Putting your savings in a mutual fund creates moral hazard. In this case, you are the ____ and the mutual fund manager is the _____.			
Answer			
		investor; agent	
		agent; principal	
	<input checked="" type="checkbox"/>	principal; agent	
		investor; principal	
Add Question Here			
Question 43	Multiple Choice	0 points	Modify Remove
Question			
Which of the following statements about a Ponzi scheme is true?			
Answer			
		The fund manager wisely uses savers' funds.	
	<input checked="" type="checkbox"/>	The schemer sends clients false statements showing that their wealth is increasing.	
		The scheme's growth is in fact financed by the schemer's contributions.	
		The schemer's last name is always Ponzi.	
Add Question Here			
Question 44	Multiple Choice	0 points	Modify Remove
Question			
The free-rider problem arises:			
Answer			
		if labor unions are strong.	
		only when markets are perfectly competitive.	
	<input checked="" type="checkbox"/>	when people benefit from a good without paying for it.	
		when a country is expanding.	
Add Question Here			
Question 45	Multiple Choice	0 points	Modify Remove
Question			
To minimize the problem of _____ before purchasing a stock, you should _____.			
Answer			
		moral hazard; monitor the firm	
	<input checked="" type="checkbox"/>	adverse selection; gather information about the firm whose stock you are interested in	
		irrational exuberance; put all your money in savings	
		moral hazard; gather information	
Add Question Here			
Question 46	Multiple Choice	0 points	Modify Remove

Question

Because gathering information is costly, when many people buy the same stock _____ arise(s).

- Answer**
- the free-rider problem
 - irrational exuberance
 - adverse selection
 - pecuniary externalities

[◀ Add Question Here](#)

Question 47 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question

If a large number of savers want to buy a certain stock, they should each contribute to the cost of _____, however, they likely won't. This is called _____.

- Answer**
- gathering information; the free-rider problem
 - hiring a trader; the asymmetric information problem
 - vetting the firm; moral hazard
 - paying trader fees; imperfect competition

[◀ Add Question Here](#)

Question 48 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question

In securities markets, we can see evidence for the free-rider problem because:

- Answer**
- every saver pays for a portion of the costs of gathering information.
 - individual savers can observe others' actions and do the same.
 - stock prices are correctly valued.
 - information is costless.

[◀ Add Question Here](#)

Question 49 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question

To reduce information asymmetries, individual savers should examine a firm's:

- I. past earnings.
- II. future projects.
- III. managers.

- Answer**
- I, II, and III
 - I and II
 - II only
 - III only

[◀ Add Question Here](#)

Question 50 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question

To reduce adverse selection when selecting a stock or bond to buy, individual savers should examine a firm's:

- I. past earnings.
- II. future projects.
- III. managers.

- Answer**
- I only
 - II only
 - III only
 - I, II, and III

[◀ Add Question Here](#)

Question 51 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question

To reduce moral hazard after buying a stock or bond, individual savers should examine a firm's:

- I. past earnings.
- II. future projects.
- III. managers.

- Answer**
- I only
 - II only
 - II and III
 - III only

[◀ Add Question Here](#)

Question 52 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question

To reduce moral hazard after buying a stock or bond, individual savers should:

- I. monitor the firm's projects.
- II. visit the firm's offices.
- III. monitor the firm's expenditures.

- Answer**
- I
 - II
 - III
 - All of the answers are correct.

[◀ Add Question Here](#)

Question 53 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question

To reduce moral hazard after buying a stock or bond, individual savers should monitor the firm's:

- I. projects.
- II. future projects.
- III. expenditures.

Answer

- I and III
- I only
- II only
- III only

[◀ Add Question Here](#)

[Modify](#) [Remove](#)

Question 54

Multiple Choice**0 points****Question**

Which of the following are information-gathering firms in financial markets?

Answer

- commercial banks
- credit unions
- investment banks
- insurance companies

[◀ Add Question Here](#)

[Modify](#) [Remove](#)

Question 55

Multiple Choice**0 points****Question**

Which of the following are information-gathering firms in financial markets?

Answer

- insurance companies
- private equity firms
- commercial banks
- None of the answers are correct.

[◀ Add Question Here](#)

[Modify](#) [Remove](#)

Question 56

Multiple Choice**0 points****Question**

The firms Moody's and Standard & Poor's are examples of a(n):

Answer

- bond-rating agency.
- investment bank.
- umbrella corporation.
- financial market.

[◀ Add Question Here](#)

[Modify](#) [Remove](#)

Question 57

Multiple Choice**0 points****Question**

To reduce information asymmetries in financial market, we can use:

Answer

- boards of directors.
- bond-rating agencies.
- investment banks.
- All of the answers are correct.

[◀ Add Question Here](#)

[Modify](#) [Remove](#)

Question 58

Multiple Choice**0 points****Question**

A firm's board of directors are elected by its _____ and are charged with reducing _____.

Answer

- employees; production costs
- chief financial officer; fraud
- shareholders; moral hazard
- chief operating officer; adverse selection

[◀ Add Question Here](#)

[Modify](#) [Remove](#)

Question 59

Multiple Choice**0 points****Question**

A board of directors that takes directions from a firm's managers is called a _____ board.

Answer

- puppet
- captive
- fraudulent
- marionette

[◀ Add Question Here](#)

[Modify](#) [Remove](#)

Question 60

Multiple Choice**0 points****Question**

One of the problems associated with the manufacturing conglomerate Tyco in the early 2000s was:

Answer

- its CEO was also chairman of the board of directors.
- it used hedge funds to finance its capital investment.
- it borrowed heavily from its employee pension fund.
- it borrowed directly from the Federal Reserve.

[◀ Add Question Here](#)

[Modify](#) [Remove](#)

Question 61

Multiple Choice**0 points**

Question

When the board of directors is "captive," the problem of _____ arises.

- Answer**
- moral hazard
 - profit minimization
 - free-riding
 - corporate raiding

[◀ Add Question Here](#)

[Modify](#) | [Remove](#)

Question 62 **Multiple Choice** **0 points**

Question

Ineffective boards of directors can be replaced by:

- Answer**
- private equity firms.
 - shareholder revolts.
 - shareholder elections.
 - shareholder elections and revolts.

[◀ Add Question Here](#)

[Modify](#) | [Remove](#)

Question 63 **Multiple Choice** **0 points**

Question

An famous shareholder revolt recently occurred at:

- Answer**
- IBM.
 - Home Depot.
 - Enron.
 - Microsoft.

[◀ Add Question Here](#)

[Modify](#) | [Remove](#)

Question 64 **Multiple Choice** **0 points**

Question

According to a study by economists at Harvard and the University of Chicago, stock market activity is highest with _____ legal systems.

- Answer**
- English
 - German
 - French
 - Russian

[◀ Add Question Here](#)

[Modify](#) | [Remove](#)

Question 65 **Multiple Choice** **0 points**

Question

A private equity firm is a financial institution that:

- Answer**
- operates like a commercial bank.
 - owns large shares in private companies.
 - is used to trade stocks and bonds.
 - conducts open-market operations.

[◀ Add Question Here](#)

[Modify](#) | [Remove](#)

Question 66 **Multiple Choice** **0 points**

Question

The most important type of private equity firm are:

- Answer**
- venture capital firms.
 - takeover firms.
 - investment banks.
 - venture capital and takeover firms.

[◀ Add Question Here](#)

[Modify](#) | [Remove](#)

Question 67 **Multiple Choice** **0 points**

Question

A takeover firm:

- Answer**
- issues stocks to new potential shareholders.
 - buys shares in a growing company.
 - buys entire companies.
 - sells stocks that are overvalued.

[◀ Add Question Here](#)

[Modify](#) | [Remove](#)

Question 68 **Multiple Choice** **0 points**

Question

Hostile takeovers reduce _____ because if a company is poorly managed, there is an incentive to _____.

- Answer**
- moral hazard; change things
 - adverse selection; split the firm's stock
 - free-riding; pay for better information
 - adverse selection; reduce externalities

[◀ Add Question Here](#)

[Modify](#) | [Remove](#)

Question 69 **Multiple Choice** **0 points**

Question

In a hostile takeover, a firm can offer a price for company stock that is _____ than the value _____ approves.

- Answer**
- equal to market value but less; management
 - less than market value and less; shareholders
 - ✓ greater than market value but less; management
 - equal to market value but more; management

◀ [Add Question Here](#)

Question 70 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question
_____ firms reduce _____ by gathering information on new firms.

- Answer** ✓
- Venture capital; adverse selection
 - Takeover; moral hazard
 - Commercial banking; free-riding
 - Security exchange monitoring; bad management

◀ [Add Question Here](#)

Question 71 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question
Placing officers of a _____ firm on the board of directors of a new firm can reduce the problem of _____.

- Answer**
- takeover; adverse selection
 - ✓ venture capital; moral hazard
 - banking; free riding
 - security exchange; adverse selection

◀ [Add Question Here](#)

Question 72 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question
The free-rider problem causes _____ because people benefit from a good _____.

- Answer**
- a moral hazard; without knowing about it
 - ✓ a market failure; without paying for it
 - efficient markets; without paying for it
 - adverse selection; while paying for it

◀ [Add Question Here](#)

Question 73 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question
The main ratings agencies, Moody's, Standard & Poor's, and Fitch, receive fees from companies for:

- Answer**
- giving good ratings to their financial outlook.
 - rating corporate stock.
 - ✓ rating corporate bonds.
 - rating sovereign debt.

◀ [Add Question Here](#)

Question 74 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question
In the aftermath of the 2007–2009 financial crisis, the rating agencies were criticized for:

- Answer** ✓
- giving triple A ratings to securities that were riskier than the ratings suggested.
 - paying corporations for the right to rate their securities.
 - predicting that the housing bubble would burst.
 - giving their opinions about their ratings.

◀ [Add Question Here](#)

Question 75 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question
The rating agencies argue that their opinions are:

- Answer**
- priced fairly in the market.
 - ✓ protected by the First Amendment.
 - divided into accurate risk categories, e.g., triple A.
 - designed to be used only by sophisticated investors.

◀ [Add Question Here](#)

Question 76 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question
The financial crisis of 2007–2009 led Congress to enact legislation known as the _____ designed to _____ executive pay.

- Answer**
- Financial Crisis Inquiry Commission; examine
 - Troubled Asset Relief Program; restrict
 - ✓ Dodd-Frank Act; allow shareholders a vote regarding
 - Economic Recovery Board; protect

◀ [Add Question Here](#)

Question 77 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question
Methods to reduce information asymmetries include using:

- Answer**
- information-gathering firms.
 - boards of directors of publicly traded companies.
 - private equity firms.

✓ All of these are methods.

[Add Question Here](#)

[Modify](#) [Remove](#)

Question 78 **Multiple Choice** **0 points**

Question

When conflicts of interest arise in the bond-rating industry,

Answer

- ✓ bond-rating firms issue low ratings to bad-quality securities.
- ✓ savers can potentially lose a lot of money.
- the quality of securities traded in securities markets increases.
- savers benefit from these conflicts of interest.

[Add Question Here](#)

[Modify](#) [Remove](#)

Question 79 **Multiple Choice** **0 points**

Question

According to empirical research, in countries where stockholders' rights are strong, firms issue ____ stock than in countries where stockholders' rights are weak. Researchers conclude that strong stockholders' rights ____ moral hazard in stock markets.

Answer

- more; increase
- less; reduce
- ✓ more; reduce
- less; increase

[Add Question Here](#)

[Modify](#) [Remove](#)

Question 80 **Multiple Choice** **0 points**

Question

_____ firms buy an entire company, make it profitable, and then resell it after a few years.

Answer

- Speculative
- ✓ Takeover
- Predatory
- Venture capital

[Add Question Here](#)

[Modify](#) [Remove](#)

Question 81 **Multiple Choice** **0 points**

Question

_____ firms buy ownership shares (i.e., a substantial share) in a new company, which is used to finance the company's expansion.

Answer

- Speculative
- Takeover
- Predatory
- ✓ Venture capital

[Add Question Here](#)

[Modify](#) [Remove](#)

Question 82 **Multiple Choice** **0 points**

Question

Boards of directors are meant to reduce information asymmetries by controlling managers. Which of the following statements about boards of directors is true?

Answer

- Boards of directors do not have enough power to monitor managers.
- Members of the board of directors do not receive fees for their services.
- ✓ Boards of directors are not always effective in solving information asymmetries.
- Boards of directors effectively solve asymmetric information problems.

[Add Question Here](#)

[Modify](#) [Remove](#)

Question 83 **Multiple Choice** **0 points**

Question

In the United States, financial markets are primarily regulated by:

Answer ✓ the Securities and Exchange Commission.

- Congress.
- the Board of Governors of the Federal Reserve.
- the Treasury Secretary.

[Add Question Here](#)

[Modify](#) [Remove](#)

Question 84 **Multiple Choice** **0 points**

Question

One of the Securities and Exchange Commission's main goals is to:

Answer

- underwrite IPOs.
- ensure maximum returns to shareholders.
- set short-term interest rates.
- ✓ reduce information asymmetries.

[Add Question Here](#)

[Modify](#) [Remove](#)

Question 85 **Multiple Choice** **0 points**

Question

Because a large part of Enron's managers' pay was _____, there was an incentive to _____.

Answer

- cash; not pay taxes
- ✓ in stock options; lie about losses
- in dividend payments; lower profit expectations
- in kind; to produce a lot of output

Question 86	Multiple Choice	0 points	Add Question Here
	Question		
	_____ was the founder and CEO of WorldCom and was convicted of fraud in 2005.		
	Answer	<input checked="" type="checkbox"/> Bernard Ebbers <input type="checkbox"/> Jeffrey Skilling <input type="checkbox"/> Dennis Kozlowski <input type="checkbox"/> G.W. Bush	Modify Remove
			Add Question Here
Question 87	Multiple Choice	0 points	Modify Remove
	Question		
	The _____ strengthens the requirements for information disclosure by corporations.		
	Answer	<input type="checkbox"/> Akerlof Act <input type="checkbox"/> Napoleonic Code <input checked="" type="checkbox"/> Sarbanes-Oxley Act <input type="checkbox"/> Sherman Act	
			Add Question Here
Question 88	Multiple Choice	0 points	Modify Remove
	Question		
	Critics of the Sarbanes-Oxley Act argue that:		
	Answer	<input type="checkbox"/> it is not far-reaching enough. <input checked="" type="checkbox"/> it increases bureaucracy and costs. <input type="checkbox"/> it doesn't have enough "teeth." <input type="checkbox"/> its penalties for noncompliance are too small.	
			Add Question Here
Question 89	Multiple Choice	0 points	Modify Remove
	Question		
	The Sarbanes-Oxley Act created _____ to monitor accounting auditors' performance.		
	Answer	<input checked="" type="checkbox"/> the Accounting Oversight Board <input type="checkbox"/> the Securities and Exchange Commission <input type="checkbox"/> the firm Arthur Anderson <input type="checkbox"/> Moody's	
			Add Question Here
Question 90	Multiple Choice	0 points	Modify Remove
	Question		
	If you are using information that is not available to the public to make financial transactions, you are:		
	Answer	<input type="checkbox"/> trading "lemons." <input type="checkbox"/> committing fraud. <input checked="" type="checkbox"/> committing insider trading. <input type="checkbox"/> None of the answers are correct.	
			Add Question Here
Question 91	Multiple Choice	0 points	Modify Remove
	Question		
	Barry Saffer was an employee of _____ who was found guilty of insider trading.		
	Answer	<input checked="" type="checkbox"/> Manugistics Group <input type="checkbox"/> Tyco <input type="checkbox"/> Home Depot <input type="checkbox"/> Enron	
			Add Question Here
Question 92	Multiple Choice	0 points	Modify Remove
	Question		
	Famous entrepreneur and "lifestyle adviser" _____ was found guilty of _____.		
	Answer	<input type="checkbox"/> Oprah Winfrey; offshore investments <input checked="" type="checkbox"/> Martha Stewart; insider trading <input type="checkbox"/> Rosie O'Donnell; tax evasion <input type="checkbox"/> Phil Donahue; under-reporting profits	
			Add Question Here
Question 93	Multiple Choice	0 points	Modify Remove
	Question		
	In November 2009, the SEC announced charges in a case involving Raj Rajaratnam, the manager of the Galleon hedge fund. The SEC alleges that Rajaratnam:		
	Answer	<input type="checkbox"/> conspired to defraud investors. <input type="checkbox"/> was engaged in a Ponzi scheme. <input type="checkbox"/> violated corporate ethics rules. <input checked="" type="checkbox"/> profited from information that was not publicly available.	
			Add Question Here
Question 94	Multiple Choice	0 points	Modify Remove

Question

Which of the following statements about the SEC is true?

- Answer**
- The SEC makes sure no firm that issues securities loses money.
 - ✓ The SEC requires that firms that issue securities disclose information to buyers of their securities.
 - The SEC is part of the Federal Reserve System.
 - The SEC cannot monitor the behavior of firms that issue securities.

◀ [Add Question Here](#)

[Modify](#) [Remove](#)

Question 95 **Multiple Choice** **0 points**

Question

Which of the following statements about the Sarbanes-Oxley Act is true?

- Answer**
- It allows corporations to conduct their own audits.
 - It is clear to all individuals that it is the best way to reduce asymmetric information problems.
 - ✓ It established the Accounting Oversight Board, to monitor the performance of corporations' auditors.'
 - It increased the incentives for conflicts of interests in the investment banking industry.

◀ [Add Question Here](#)

[Modify](#) [Remove](#)

Question 96 **Multiple Choice** **0 points**

Question

Which of the following statements about insider trading is true?

- Answer**
- Insider trading encourages the flow of funds from savers to investors.
 - Insider trading reduces asymmetric information problems.
 - ✓ Insider trading is prohibited by the SEC.
 - Insider trading is a legal activity.

◀ [Add Question Here](#)

[Modify](#) [Remove](#)

Question 97 **Multiple Choice** **0 points**

Question

SEC efforts are mainly aimed at:

- Answer**
- reducing insider trading.
 - increasing the flow of information in financial markets.
 - protecting corporations from a decrease in the price of their securities.
 - ✓ reducing insider trading and increasing the flow of information in financial markets.

◀ [Add Question Here](#)

[Modify](#) [Remove](#)

Question 98 **Multiple Choice** **0 points**

Question

Suppose you work for a corporation that is about to make an announcement that will surely increase its stock price. If you know about this before everyone else and you decide to buy stock in this corporation, you will be guilty of:

- Answer**
- asymmetric trading.
 - informed trading.
 - outsider trading.
 - ✓ insider trading.

◀ [Add Question Here](#)

[Modify](#) [Remove](#)

Question 99 **Multiple Choice** **0 points**

Question

Because of asymmetric information problems, financial markets represent the typical case of a(n):

- Answer**
- market imperfection.
 - ✓ market failure.
 - inefficient market.
 - imperfect market.

◀ [Add Question Here](#)

[Modify](#) [Remove](#)

Question 100 **Multiple Choice** **0 points**

Question

Banks mitigate adverse selection by:

- Answer**
- requiring borrowers to have collateral.
 - ✓ screening potential borrowers.
 - charging high interest rates.
 - requiring borrowers to open a checking account.

◀ [Add Question Here](#)

[Modify](#) [Remove](#)

Question 101 **Multiple Choice** **0 points**

Question

Banks mitigate moral hazard by:

- Answer**
- ✓ requiring borrowers to have collateral.
 - screening potential borrowers.
 - charging high interest rates.
 - requiring borrowers to open a checking account.

◀ [Add Question Here](#)

[Modify](#) [Remove](#)

Question 102 **Multiple Choice** **0 points**

Question

Banks are careful at screening potential borrowers because they are:

- Answer**
- concerned about bank runs.
 - lending savers' deposits.
 - under the scrutiny of the Federal Government.
 - ✓ the sole recipient of the benefits of loans.

◀ [Add Question Here](#)

Question 103 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question

Because of _____, banks prefer to develop _____ with customers.

- Answer**
- moral hazard; short-term relationships
 - ✓ adverse selection; long-term relationships
 - fraud; a polite relationship
 - insider trading; friendships

◀ [Add Question Here](#)

Question 104 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question

To encourage long-term relationships with good borrowers, banks often offer:

- Answer**
- ✓ a line of credit.
 - interest rates below the federal funds rate.
 - a free checking account.
 - no collateral loans.

◀ [Add Question Here](#)

Question 105 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question

By requiring collateral when making a loan, a bank:

- I. reduces the probability of default.
- II. can charge a very low interest rate.
- III. reduces its loss if a borrower defaults.

- Answer**
- I only
 - II only
 - III only
 - ✓ I and III

◀ [Add Question Here](#)

Question 106 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question

Net worth is the:

- Answer**
- ✓ difference between a firm's assets and debts.
 - difference between returns to assets and interest paid on debt.
 - value of an individual's assets.
 - value of a bank's loans.

◀ [Add Question Here](#)

Question 107 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question

To minimize moral hazard, many banks require:

- Answer**
- collateral.
 - covenants in a loan contract.
 - compensating balances.
 - ✓ All of the answers are correct.

◀ [Add Question Here](#)

Question 108 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question

Which of the following are examples of home loan covenants?

- I. fire insurance
- II. flood insurance
- III. car insurance

- Answer**
- I only
 - II only
 - III only
 - ✓ I and II

◀ [Add Question Here](#)

Question 109 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question

The interest rate offered by banks to their highest quality borrowers is called the:

- Answer**
- discount rate.
 - federal funds rate.
 - ✓ prime rate.
 - None of the answers are correct.

◀ [Add Question Here](#)

- Question 110 **Multiple Choice** **0 points** [Modify](#) [Remove](#)
- Question**
Financial markets responded to the subprime crisis in the mid-2000s by _____ because of concern over the rising potential of loan default.
- Answer**
- credit rationing
 - charging higher interest rates
 - banks loaning only to their best customers.
 - ✓ All of the answers are correct.
- ◀ [Add Question Here](#)
- Question 111 **Multiple Choice** **0 points** [Modify](#) [Remove](#)
- Question**
Which of the following are among the “Five Cs” of business lending?
I. capacity
II. collateral
III. character
- Answer**
- I only
 - II only
 - III only
 - ✓ I, II, and III
- ◀ [Add Question Here](#)
- Question 112 **Multiple Choice** **0 points** [Modify](#) [Remove](#)
- Question**
Which of the following are among the “Five Ps” of business lending?
- Answer**
- profit
 - production
 - preferred
 - ✓ There is no such thing as the “Five Ps” of business lending.
- ◀ [Add Question Here](#)
- Question 113 **Multiple Choice** **0 points** [Modify](#) [Remove](#)
- Question**
Screening for home mortgages relies most heavily on:
- Answer**
- debt–income ratio.
 - collateral.
 - credit scores.
 - ✓ All of the answers are correct.
- ◀ [Add Question Here](#)
- Question 114 **Multiple Choice** **0 points** [Modify](#) [Remove](#)
- Question**
In a home mortgage, the house serves as:
- Answer**
- ✓ collateral.
 - bank capital.
 - a bank's real asset.
 - a down payment.
- ◀ [Add Question Here](#)
- Question 115 **Multiple Choice** **0 points** [Modify](#) [Remove](#)
- Question**
Banks' methods to reduce asymmetric information problems include:
- Answer**
- information gathering.
 - including restrictive covenants in loan contracts.
 - requiring collateral before making a loan.
 - ✓ All of the methods are used.
- ◀ [Add Question Here](#)
- Question 116 **Multiple Choice** **0 points** [Modify](#) [Remove](#)
- Question**
Banks reduce the adverse selection problem by:
- Answer**
- charging higher interest rates for loans.
 - ✓ developing expertise in screening potential borrowers.
 - making only short-term loans.
 - rationing loans based on the age of potential borrowers.
- ◀ [Add Question Here](#)
- Question 117 **Multiple Choice** **0 points** [Modify](#) [Remove](#)
- Question**
Banks' strategies to reduce default risk when making loans include:
- Answer**
- charging high real interest rates to secure a high return.
 - ✓ requiring the borrower to pledge an asset as collateral.
 - making sure the borrower's net worth is negative.
 - making sure the borrower is unemployed.
- ◀ [Add Question Here](#)
- Question 118 **Multiple Choice** **0 points** [Modify](#) [Remove](#)

Question

Suppose you take out a loan to buy a small plane for your aerial sightseeing company and you pledge the plane as collateral. When the bank requires that the plane cannot be used in acrobatic competitions, it is effectively including a _____ in the loan contract.

- Answer**
- negative covenant
 - negative collateral
 - positive covenant
 - positive collateral

[◀ Add Question Here](#)

Question 119 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question

Banks' strategies designed to solve moral hazard problems include:

- Answer**
- setting net worth requirements.
 - including restrictive covenants.
 - monitoring borrowers' activities.
 - All of these are strategies.

[◀ Add Question Here](#)

Question 120 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question

Which of the following include traditional mortgage loan conditions?

- Answer** The borrower makes a constant monthly payment for 15 or 30 years.
- The mortgage loan covers 50 percent of the price of a house.
 - The home is never used as collateral for the loan.
 - The borrower makes only one payment when the loan matures.

[◀ Add Question Here](#)

Question 121 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question

Transaction costs are defined as:

- Answer**
- the cost of transporting goods and services for exchange.
 - the costs in time and money of exchange.
 - the time spent determining a market price.
 - effort required to produce a good or service.

[◀ Add Question Here](#)

Question 122 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question

When a small firm borrows from a commercial bank instead of an investment bank, it reduces its:

- Answer**
- transaction costs.
 - collateral.
 - interest rate.
 - default risk.

[◀ Add Question Here](#)

Question 123 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question

Banks can offer small firms smaller transaction costs because of:

- Answer**
- lower default risk.
 - constant returns to scale.
 - economies of scale.
 - higher rates of return.

[◀ Add Question Here](#)

Question 124 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question

Transaction costs are lowest for:

- Answer** a line of credit.
- mortgage loans.
 - microloans.
 - loans to long-time bank customers.

[◀ Add Question Here](#)

Question 125 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question

Reasons why indirect finance is so important include:

- Answer** the fact that banks provide liquidity to depositors.
- the fact that banks increase transaction costs for savers.
 - the fact that banks increase transaction costs for investors.
 - the persistent increase in the cost of stocks.

[◀ Add Question Here](#)

Question 126 **Multiple Choice** **0 points**

[Modify](#) [Remove](#)

Question

Banks typically have standardized contracts for the most common loans (e.g., car loans), which significantly decrease the cost of making these loans. The concept of spreading such costs over many loans is known as:

- Answer**
- transactions costs.
 - free-rider transactions.
 - ✓ economies of scale.
 - constant returns to scale.

◀ [Add Question Here](#)

Question 127 **Multiple Choice**

0 points

[Modify](#) [Remove](#)

Question

Mutual funds shares are _____ liquid assets than checking accounts. In addition, mutual funds usually _____ minimum balances.

- Answer**
- more; do not require
 - less; do not require
 - more; require
 - ✓ less; require

◀ [Add Question Here](#)

Question 128 **Multiple Choice**

0 points

[Modify](#) [Remove](#)

Question

Commercial (i.e., not “investment”) banks reduce costs to investors by:

- Answer**
- charging firms for issuing bonds.
 - ✓ establishing credit lines with a customer firm.
 - establishing only short-term relationships with their customer firms.
 - making business with big corporations only.

◀ [Add Question Here](#)

Question 129 **Multiple Choice**

0 points

[Modify](#) [Remove](#)

Question

Which of the following statements about banks and transactions costs is true?

- Answer**
- Banks usually increase transaction costs for small investors.
 - Small investors usually raise funds by issuing bonds or stock to get funds.
 - ✓ Small savers resort to banks because of the benefit of liquidity and the low cost of acquiring assets.
 - Banks increase transaction costs by exploiting economies of scale.

◀ [Add Question Here](#)

OK