

# Chapter 02 Testbank

*Student:* \_\_\_\_\_

1. Fisher's separation theorem shows important relationships between:
  - A. companies and the capital market.
  - B. shareholders and the capital market.
  - C. companies and shareholders.
  - D. companies, their shareholders and the capital market.
  
2. To calculate a project's net present value (NPV), the project's required rate of return is used to:
  - A. compound cash flows to their future values.
  - B. convert future cash flows to their equivalent values today.
  - C. compute the weighted average cost of capital to discount the cash flows.
  - D. convert the non-operating cash flows into operating cash flows.
  
3. The curve that displays the investment opportunities and outcomes available to the company is the:
  - A. production probability curve.
  - B. production cost curve.
  - C. production possibilities curve.
  - D. production value curve.

4. The assumed overall financial objective of a company is to:
- A. raise capital.
  - B. reduce debt.
  - C. maximise profits.
  - D. maximise the market value of its ordinary shares.
5. The curve showing a set of combinations that an individual derives equal utility from any combinations in the set is the:
- A. indifference curve.
  - B. production possibilities curve.
  - C. production frontier curve.
  - D. differential curve.
6. The line that shows the combinations of current and future consumption that an individual can achieve from a given wealth level using capital market transactions is the:
- A. capital market line.
  - B. market opportunity line.
  - C. market line.
  - D. consumption opportunity line.
7. What is the role of the capital market in Fisher's Theorem?
- A. To ensure there is no simple decision rule that will satisfy all shareholders.
  - B. To increase the market interest rate.
  - C. To allow for a transfer between current and future resources.
  - D. To provide a market for companies to employ highly skilled individuals.

8. A number of implications for investment, financing and dividend decisions can be drawn from Fisher's analysis. In terms of financing decisions Fisher's analysis states that:
- A. the nominal rate is the true interest rate.
  - B. there is a single market interest rate.
  - C. the real rate is the true interest rate.
  - D. there are multiple market interest rates.
9. Fisher's separation theorem means that a company can make investment decisions with which:
- A. no shareholders will agree.
  - B. most firms in the capital market will agree.
  - C. every shareholder will agree.
  - D. None of the given options as Fisher's analysis does not have any implications for the investment decision.
10. Pursuing a goal of maximising the market value of a company's shares is easy when:
- A. dividends are growing at a constant rate.
  - B. there is limited uncertainty.
  - C. there are limited market imperfections.
  - D. there are no market imperfections and no uncertainty.
11. When there is uncertainty, the effect on the share price due to decisions made by managers:
- A. is no longer perfectly predictable.
  - B. can only be predicted by Fisher's separation theorem.
  - C. can only be predicted by the market opportunity line.
  - D. can be predicted by Fisher's separation theorem, but only to a limited extent.

12. In Fisher's analysis of investment and consumption, the market opportunity line defines the:
- A. combination of investment opportunities for the firm to increase market share and growth opportunities.
  - B. potential new market opportunities for the firm and new product options established by appropriate research.
  - C. options for consumption by the firm relative to the investment of the shareholders who own the firm.
  - D. combinations of consumption possibilities consistent with the initial wealth of the investors in the firm.
13. A company has \$25 million in cash and the interest rate is 12%. The company has decided to invest \$20 million in assets, and the investment has a net present value of \$5 million. What is the wealth of the company's shareholders immediately after the investment plan is announced?
- A. \$30 million.
  - B. \$10 million.
  - C. \$28 million.
  - D. \$25 million.
14. In Fisher's analysis of investment and consumption, the participants include:
- A. the firm's finance director, the firm's banker and the stock exchange.
  - B. the firm's management, market analysts and the financial press.
  - C. the firm's management, the firm's owners (shareholders) and the capital market.
  - D. the firm's general manager, the firm's finance director, and the capital market.

15. Under Fisher's separation theorem, the key factor that affects the way in which financial decisions are made is that:
- A. it is critical that there are effective capital markets in place to allow firms to borrow from those lenders who choose the greater security of debt rather than equity.
  - B. regardless of an individual shareholder's preference between investment and consumption, there is an identifiable single decision for the firm that all shareholders will support.
  - C. shareholders are effectively separated from all decisions of the firm, in that they have no interest in the outcome of those decisions.
  - D. each and every shareholder's preference between investment and consumption is effectively separate in determining the activities of the firm.
16. Given a perfect capital market and perfect certainty, the firm will always undertake a project where:
- A. the future rate of return on the project is greater than the interest rate available in the capital market.
  - B. the future rate of return on the project is less than the interest rate available in the capital market.
  - C. the current rate of return on the project is less than the return available on projects undertaken by competitors.
  - D. the current rate of return on the project is greater than the opportunity cost of forgone consumption.
17. An important implication of Fisher's separation theorem is that:
- A. while the level of investment will depend on management decisions (independent of shareholders' wishes), shareholders will have a preference for given levels of dividend.
  - B. shareholders and firm management will have separate interests and directions in decisions on investment, financing and especially dividends, and these have come to be known as an agency problem.
  - C. the extent to which a firm should invest can be determined by a simple rule.
  - D. the extent of investment undertaken will determine the amount of finance to be raised, and whether that finance will be debt or equity.

18. Consider the following investment/dividend opportunities facing a company:

Project	Investment Outlay Now (\$)	Dividend Now (\$)	Dividend Later (\$)
Mini	450	400	500
Normal	550	250	625
Mega	650	150	775

Assume that the interest rate in the capital market is 12 per cent per period. Calculate the rate of return on Project Mini.

- A. 11.1%
- B. 0%
- C. 25%
- D. -20%

19. Consider the following investment/dividend opportunities facing a company:

Project	Investment Outlay Now (\$)	Dividend Now (\$)	Dividend Later (\$)
Mini	450	400	500
Normal	550	250	625
Mega	650	150	775

Assume that the interest rate in the capital market is 12 per cent per period. Calculate the rate of return on Project Normal.

- A. 14.3%
- B. 120.0%
- C. 13.6%
- D. 150.0%

20. Consider the following investment/dividend opportunities facing a company:

Project	Investment Outlay Now (\$)	Dividend Now (\$)	Dividend Later (\$)
Mini	450	400	500
Normal	550	250	625
Mega	650	150	775

Assume that the interest rate in the capital market is 12 per cent per period. Calculate the rate of return on Project Mega.

- A. 19.4%
- B. 19.2%
- C. 16.1%
- D. 23.1%

21. Consider the following investment/dividend opportunities facing a company:

Project	Investment Outlay Now (\$)	Dividend Now (\$)	Dividend Later (\$)
Mini	450	400	500
Normal	550	250	625
Mega	650	150	775

Assume that the interest rate in the capital market is 12 per cent per period. The optimal decision would be to accept:

- A. Project Mini.
- B. Project Mega.
- C. Projects Mini and Normal.
- D. Projects Normal and Mega.

22. Consider the following investment/dividend opportunities facing a company:

Project	Investment Outlay Now (\$)	Dividend Now (\$)	Dividend Later (\$)
Mini	450	400	500
Normal	550	250	625
Mega	650	150	775

Assume that the interest rate in the capital market is 12 per cent per period. Assume the company has four equal shareholders (A, B, C and D), and has chosen Project Mega for investment. Suppose Shareholder A wishes to consume \$50 now. What is her required repayment in the later period?

- A. \$12.50
- B. \$56.00
- C. \$14.00
- D. \$42.00

23. Consider the following investment/dividend opportunities facing a company:

Project	Investment Outlay Now (\$)	Dividend Now (\$)	Dividend Later (\$)
Mini	450	400	500
Normal	550	250	625
Mega	650	150	775

Assume that the interest rate in the capital market is 12 per cent per period. Also assume the company has four equal shareholders (A, B, C and D), and has chosen Project Mega for investment. What amounts will Shareholder A have to finance her consumption in the later period, after consuming \$50 in the first period?

- A. \$151.75
- B. \$181.25
- C. \$193.75
- D. \$179.75

24. Consider the following investment/dividend opportunities facing a company:

Project	Investment Outlay Now (\$)	Dividend Now (\$)	Dividend Later (\$)
Mini	450	400	500
Normal	550	250	625
Mega	650	150	775

Assume that the interest rate in the capital market is 12 per cent per period. What is the NPV of Project Mini?

- A. (\$92.86)
- B. (\$3.57)
- C. \$396.43
- D. \$4.06

25. Consider the following investment/dividend opportunities facing a company:

Project	Investment Outlay Now (\$)	Dividend Now (\$)	Dividend Later (\$)
Mini	450	400	500
Normal	550	250	625
Mega	650	150	775

Assume that the interest rate in the capital market is 12 per cent per period. What is the NPV of Project Normal?

- A. \$66.96
- B. \$75.00
- C. \$8.04
- D. \$258.04

26. Consider the following investment/dividend opportunities facing a company:

Project	Investment Outlay Now (\$)	Dividend Now (\$)	Dividend Later (\$)
Mini	450	400	500
Normal	550	250	625
Mega	650	150	775

Assume that the interest rate in the capital market is 12 per cent per period, and that the company has four equal shareholders (A, B, C and D). Also assume the company has chosen Projects Normal and Mega for investment. Suppose Shareholder B wishes to consume \$165 now. What is his required repayment in the later period?

- A. \$65
- B. \$165
- C. \$72.80
- D. \$184.80

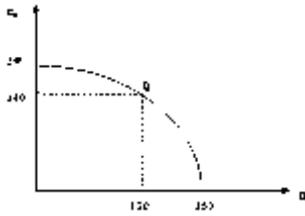
27. Consider the following investment/dividend opportunities facing a company:

Project	Investment Outlay Now (\$)	Dividend Now (\$)	Dividend Later (\$)
Mini	450	400	500
Normal	550	250	625
Mega	650	150	775

Assume that the interest rate in the capital market is 12 per cent per period. Also assume that the company has four equal shareholders (A, B, C and D). Will the shareholders support the company's decision to invest in Projects Normal and Mega instead of just Project Mega?

- A. No, only Shareholder B will support such a decision.
- B. We cannot tell, as no information has been provided with regards to the consumption choices of Shareholders C and D.
- C. Both Shareholders A and B will support this decision but we need to know the consumption choices of Shareholders C and D before being able to identify their preferences.
- D. All the shareholders will support the company's decision.

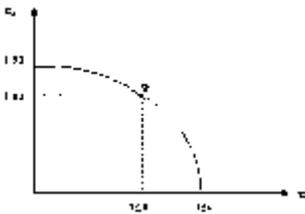
28. Consider the following production possibilities curve:



Point Q represents:

- A. an intermediate case in which a dividend of 30 units is paid at Time 1.
- B. an intermediate case in which 30 units is invested at Time 1.
- C. an intermediate case in which a dividend of 50 units is paid at Time 2.
- D. none of the given options.

29. Consider the following graph.



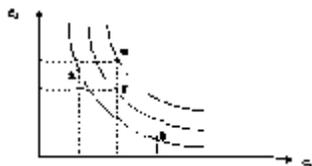
Which of the following statements is false?

- A. The Company has 150 units of resources available to it.
- B. The point (150,0) represents a dividend payment of zero units at Time 1.
- C. 190 units would be available for consumption at Time 2 if no dividend were paid at Time 1.
- D. None of the given options is false.

30. Indifference curves are normally:

- A. convex, which means they approach the horizontal axis as the level of  $C_2$  increases.
- B. concave, which means they approach the vertical axis as the level of  $C_2$  increases.
- C. convex, which means they approach the horizontal axis as the level of  $C_1$  increases.
- D. concave, which means they approach the vertical axis as the level of  $C_1$  increases.

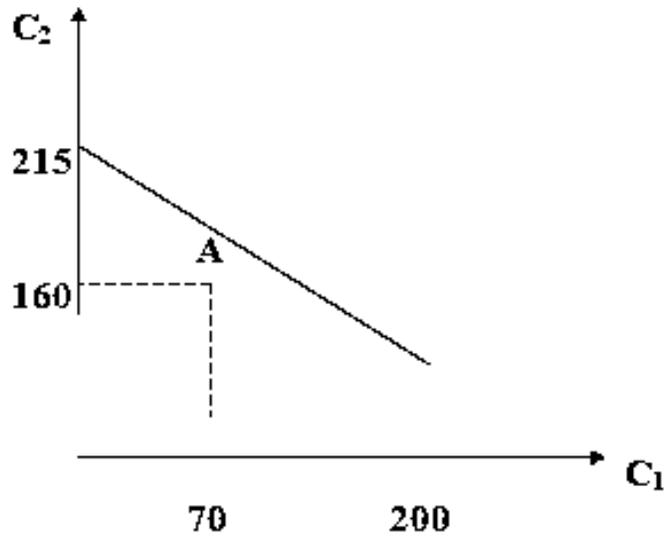
31. Consider the following set of indifference curves:



Investment Y is:

- A. preferred to Investments X and Z and is as desirable as Investment W.
- B. preferred to Investment W, but is inferior to Investments X and Z.
- C. preferred to Investments X and Z, but is inferior to Investment W.
- D. preferred to Investments X and Z, which provide an investor with equal utility, and is preferred to Investment W.

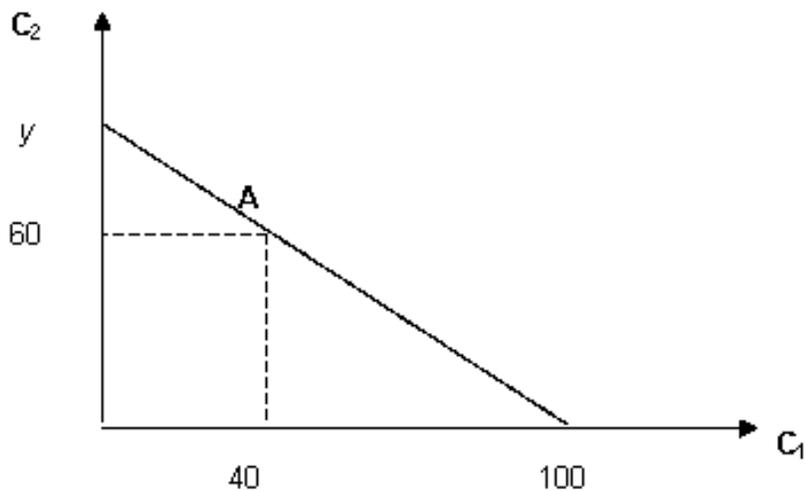
32. Consider the following graph:



What is the interest rate per period?

- A. 7.31%
- B. 7.14%
- C. 7.50%
- D. 25.00%

33. Consider the following graph:



Assume that the interest rate per period is 15 per cent. Calculate  $y$ .

- A. 115 units
- B. 106 units
- C. 92.17 units
- D. 100 units

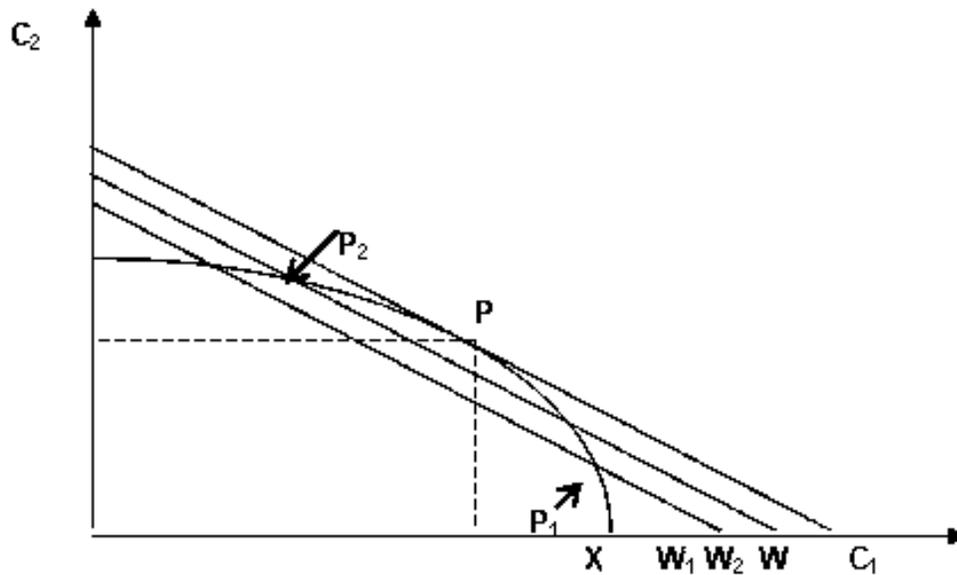
34. Which of the following correctly represents the equation of a market opportunity line?

- A.  $C_1 = [W_1(1 + i) + C_2]/(1 + i)$
- B.  $C_1(1 + i) = W_1(1 + i) + C_2$
- C.  $W_1(1 + i) - C_2 = C_1(1 + i)$
- D.  $C_2 = -W_1(1 + i) + C_1(1 + i)$

35. The slope of a market opportunity line is given by:

- A.  $-(1 + i)$
- B.  $C_1/(1 + i)$
- C.  $C_2 + C_1(1 + i)$
- D.  $-C_1/(1 + i)$

36. Suppose that a company has  $X$  units of resources and is considering three investment/dividend policies,  $P_1$ ,  $P_2$  and  $P$ . The following graph shows market opportunity lines drawn through each of these points:

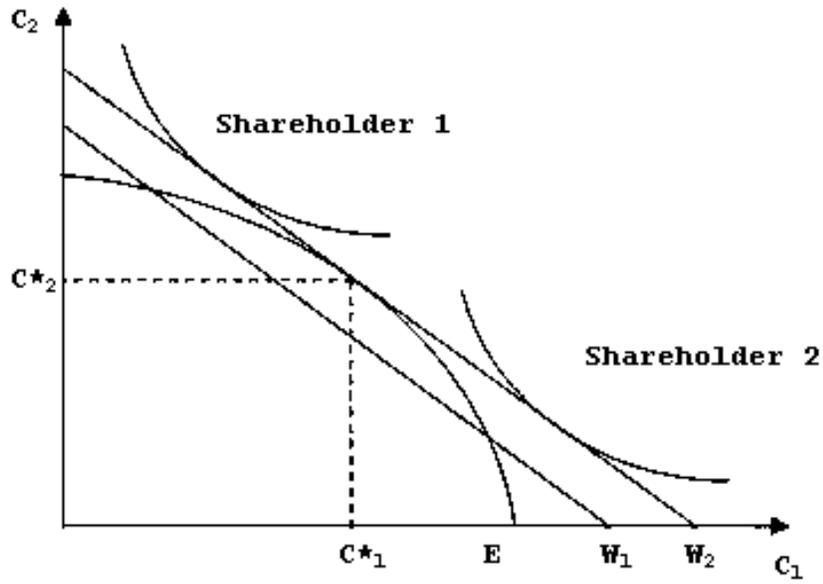


The line through  $P_1$  shows that:

- A. if policy  $P_1$  were adopted, the shareholders' wealth would decrease from  $W$  to  $W_1$ .
  - B. if policy  $P_1$  were adopted, the shareholders' wealth would increase from  $X$  to  $W_1$ .
  - C. if policy  $P_1$  were adopted, the shareholders' wealth would remain unchanged at  $W_1$ .
  - D. none of the given options.
37. Which statement is false with respect to the decision rule: accept a project if and only if  $[\text{Return at Time 2} / (1 + i) - \Delta] > 0$ ?
- A. The decision rule is completely consistent with Fisher's separation theorem.
  - B. The decision rule is the same as the net present value rule.
  - C. A company that always applies the decision rule to its investment decisions will be able to locate the optimal investment/dividend policy and will maximise the wealth of its shareholders.
  - D. None of the given options.

38. Fama (1970) outlines the sufficient conditions in order for all shareholders to agree about the exact nature of uncertainty. Which of the following statements is not one of the specified sufficient conditions?
- A. There are no transaction costs in trading securities.
  - B. All agree on the implication of current information for the future price and distributions of future prices of each security.
  - C. All information is costlessly available to all market participants.
  - D. None of the given options.
39. Fisher's separation theorem means that:
- A. a company can make an investment decision even if all shareholders do not agree.
  - B. a company should invest beyond the point where the net present value of the marginal unit of investment is zero.
  - C. a company should invest up to a point where the rate of return on the marginal unit of investment equals the market interest rate.
  - D. none of the given options is correct.
40. Which of the following statements is false?
- A. If there is only one market interest rate, then the value of the company and the wealth of its shareholders are independent of the company's capital structure.
  - B. If any one point on a market opportunity line is attainable, then all other points on the line are also attainable by borrowing or lending.
  - C. The dividend decision does not affect shareholders' wealth, provided that the company does not alter its investment decision.
  - D. None of the given options.

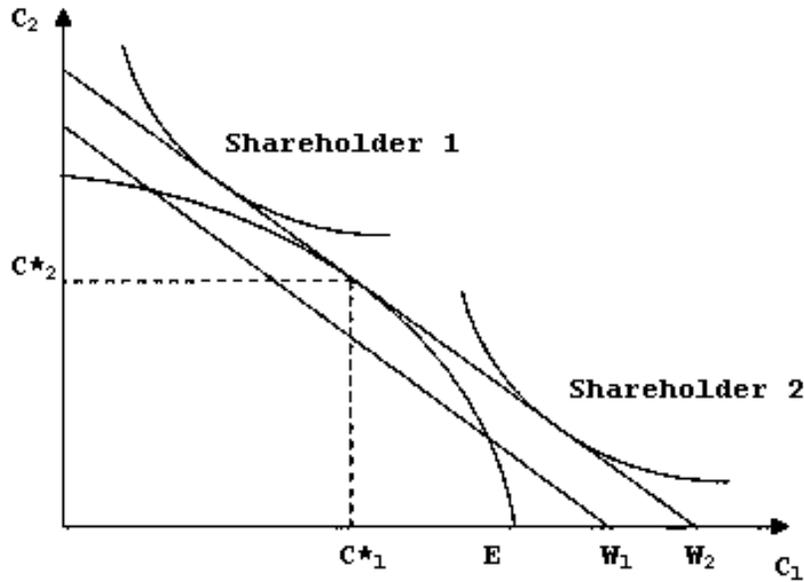
41. Consider the following diagram:



In this diagram, if the optimal policy is chosen, the company invests the amount:

- A.  $W_1 - E$
- B.  $W_1 - C^*_1$
- C.  $E - C^*_1$
- D.  $W_2 - E$

42. Consider the following diagram:



In the diagram, if the optimal policy is chosen then shareholder 2, with the lower indifference curve, will optimise her consumption by:

- A. lending in the second period and borrowing in the first period.
- B. borrowing in the first period and repaying in the second period.
- C. lending in the first period and receiving in the second period.
- D. borrowing in the first period and receiving in the second period.

43. In the absence of \_\_\_\_\_ companies are unable to make decisions about dividend policy that will please all share holders.

\_\_\_\_\_

44. A company can make optimal decisions to the benefit of all shareholders if they use the \_\_\_\_\_ rule to analyse investment proposals.

\_\_\_\_\_

45. An \_\_\_\_\_ is a curve that shows a set of combinations such that an individual derives equal utility from any combination in the set.

\_\_\_\_\_

46. Share prices change as a result of investors' reaction to \_\_\_\_\_ provided through investment, financing and dividend decisions made by the managers of a company.

\_\_\_\_\_

47. According to Fisher's Theorem, provided that the company does not alter its investment decision, the dividend decision does not affect \_\_\_\_\_.

\_\_\_\_\_

48. Fisher's separation theorem assumes markets have imperfections.

True False

49. Fisher's separation theorem has no implications for the investment decision.

True False

50. If a project costs \$700 and is expected to return \$790 to shareholders in one years time, then the rate of return on the investment is 12.86%.

True False

51. The shape of the production possibilities curve determines the combinations of current dividend, investment and future dividend that a company can achieve.

True False

52. In practice, managers are unable to predict with certainty the impact that a particular decision will have on a company's share price.

True False

53. An indifference curve represents a set of possible consumption outcomes, which yields equal utility to the individual.

True False

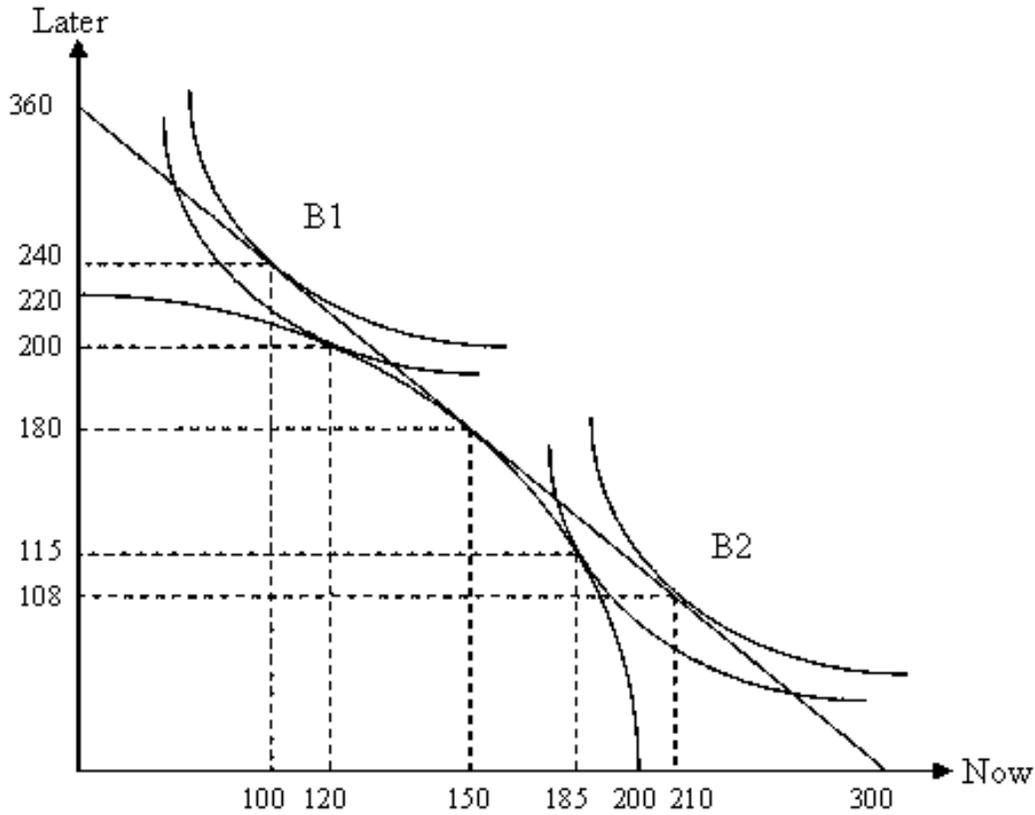
54. The market opportunity line indicates the preferences of individuals for a given level of wealth.

True False

55. Define the following terms:

- (a) The production possibilities curve
- (b) An indifference curve
- (c) The market opportunity line

56. B1 and B2 are equal shareholders in the company Banana Inc. They have each invested \$200 in the company. The following graph shows on a per shareholder basis the production possibilities curve, B1 and B2's indifference curves and the market opportunity line.



(a) What is the interest rate?

(b) How much is invested by the company at the optimal point?

(c) Assuming that the company invests at the optimal point, complete the following table (where applicable) for shareholder B1.

	Now	Later
Dividend	150	
Borrow/Repay		
Lend/Receive		
Consumption		

(d) Assuming that the company invests at the optimal point, complete the following table (where applicable) for B2.

	Now	Later
Dividend	150	
Borrow/Repay		
Lend/Receive		
Consumption		

57. The AlphaBeta company is considering several investment opportunities. The interest rate for both borrowing and lending is 15 per cent per period and the investment/dividend opportunities are given in the following table:

Project	Investment Outlay Now (\$)	Dividend Now (\$)	Dividend Later (\$)
AOne	1250	750	1350
BTwo	1500	500	1650
CThree	2000	0	2500

- What is the net present value of each project?
- Based on the NPV rule which project(s) should the company invest in?
- What is the IRR of project AOne?
- The company has 2 equal shareholders, Alpha and Beta, and invests in the project CThree. Alpha would prefer to consume \$500 today. What can she do? How much will she be able to consume later?

# Chapter 02 Testbank Key

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- A. companies and the capital market.
- B. shareholders and the capital market.
- C. companies and shareholders.
- D.** companies, their shareholders and the capital market.

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*Blooms: Knowledge*

*Difficulty: Medium*

*EQUIS: Apply knowledge*

*Graduate Attributes: Problem-solving*

*Learning Objective: 02-01 Explain how a company's managers can, in principle, make financial decisions that will be supported by all shareholders*

*Section: 2.1 Introduction*

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- A. compound cash flows to their future values.
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3. The curve that displays the investment opportunities and outcomes available to the company is the:

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*Section: 2.3 Fisher's Separation Theorem: a formal approach*

4. The assumed overall financial objective of a company is to:

- A. raise capital.
- B. reduce debt.
- C. maximise profits.
- D.** maximise the market value of its ordinary shares.

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5. The curve showing a set of combinations that an individual derives equal utility from any combinations in the set is the:

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6. The line that shows the combinations of current and future consumption that an individual can achieve from a given wealth level using capital market transactions is the:

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7. What is the role of the capital market in Fisher's Theorem?
- A. To ensure there is no simple decision rule that will satisfy all shareholders.
  - B. To increase the market interest rate.
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- A. the nominal rate is the true interest rate.
  - B.** there is a single market interest rate.
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- A. no shareholders will agree.
- B. most firms in the capital market will agree.
- C.** every shareholder will agree.
- D. None of the given options as Fisher's analysis does not have any implications for the investment decision.

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- B. there is limited uncertainty.
- C. there are limited market imperfections.
- D.** there are no market imperfections and no uncertainty.

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*Section: 2.4 Investors' reaction to managers' decisions*

11. When there is uncertainty, the effect on the share price due to decisions made by managers:

- A. is no longer perfectly predictable.
- B. can only be predicted by Fisher's separation theorem.
- C. can only be predicted by the market opportunity line.
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*EQUIS: Apply knowledge*

*Graduate Attributes: Problem-solving*

*Learning Objective: 02-02 Explain how the existence of a capital market makes it possible for the company to make decisions acceptable to all shareholders*

*Section: 2.4 Investors' reaction to managers' decisions*

12. In Fisher's analysis of investment and consumption, the market opportunity line defines the:

- A. combination of investment opportunities for the firm to increase market share and growth opportunities.
- B. potential new market opportunities for the firm and new product options established by appropriate research.
- C. options for consumption by the firm relative to the investment of the shareholders who own the firm.
- D. combinations of consumption possibilities consistent with the initial wealth of the investors in the firm.

*AACSB: Analytic*

*Blooms: Knowledge*

*Difficulty: Medium*

*EQUIS: Apply knowledge*

*Graduate Attributes: Problem-solving*

*Learning Objective: 02-02 Explain how the existence of a capital market makes it possible for the company to make decisions acceptable to all shareholders*

*Section: 2.3 Fisher's Separation Theorem: a formal approach*

13. A company has \$25 million in cash and the interest rate is 12%. The company has decided to invest \$20 million in assets, and the investment has a net present value of \$5 million. What is the wealth of the company's shareholders immediately after the investment plan is announced?

- A. \$30 million.
- B. \$10 million.
- C. \$28 million.
- D. \$25 million.

*AACSB: Analytic*

*Blooms: Application*

*Difficulty: Hard*

*EQUIS: Analyse*

*Graduate Attributes: Problem-solving*

*Learning Objective: 02-03 Identify a company's optimal investment/dividend policy under conditions of certainty*

*Section: 2.3 Fisher's Separation Theorem: a formal approach*

14. In Fisher's analysis of investment and consumption, the participants include:

- A. the firm's finance director, the firm's banker and the stock exchange.
- B. the firm's management, market analysts and the financial press.
- C. the firm's management, the firm's owners (shareholders) and the capital market.
- D. the firm's general manager, the firm's finance director, and the capital market.

*AACSB: Analytic*

*Blooms: Knowledge*

*Difficulty: Medium*

*EQUIS: Apply knowledge*

*Graduate Attributes: Problem-solving*

*Learning Objective: 02-01 Explain how a company's managers can, in principle, make financial decisions that will be supported by all shareholders*

*Section: 2.1 Introduction*

15. Under Fisher's separation theorem, the key factor that affects the way in which financial decisions are made is that:

- A. it is critical that there are effective capital markets in place to allow firms to borrow from those lenders who choose the greater security of debt rather than equity.
- B.** regardless of an individual shareholder's preference between investment and consumption, there is an identifiable single decision for the firm that all shareholders will support.
- C. shareholders are effectively separated from all decisions of the firm, in that they have no interest in the outcome of those decisions.
- D. each and every shareholder's preference between investment and consumption is effectively separate in determining the activities of the firm.

*AACSB: Analytic*

*Blooms: Knowledge*

*Difficulty: Medium*

*EQUIS: Apply knowledge*

*Graduate Attributes: Problem-solving*

*Learning Objective: 02-02 Explain how the existence of a capital market makes it possible for the company to make decisions acceptable to all shareholders*

*Section: 2.2 Fisher's Separation Theorem: a simplified example*

16. Given a perfect capital market and perfect certainty, the firm will always undertake a project where:

- A.** the future rate of return on the project is greater than the interest rate available in the capital market.
- B. the future rate of return on the project is less than the interest rate available in the capital market.
- C. the current rate of return on the project is less than the return available on projects undertaken by competitors.
- D. the current rate of return on the project is greater than the opportunity cost of forgone consumption.

*AACSB: Analytic*

*Blooms: Knowledge*

*Difficulty: Medium*

*Graduate Attributes: Problem-solving*

*Learning Objective: 02-03 Identify a company's optimal investment/dividend policy under conditions of certainty*

*Section: 2.3 Fisher's Separation Theorem: a formal approach*

17. An important implication of Fisher's separation theorem is that:
- A. while the level of investment will depend on management decisions (independent of shareholders' wishes), shareholders will have a preference for given levels of dividend.
  - B. shareholders and firm management will have separate interests and directions in decisions on investment, financing and especially dividends, and these have come to be known as an agency problem.
  - C.** the extent to which a firm should invest can be determined by a simple rule.
  - D. the extent of investment undertaken will determine the amount of finance to be raised, and whether that finance will be debt or equity.

*AACSB: Analytic*

*Blooms: Knowledge*

*Difficulty: Medium*

*EQUIS: Apply knowledge*

*Graduate Attributes: Problem-solving*

*Learning Objective: 02-01 Explain how a company's managers can, in principle, make financial decisions that will be supported by all shareholders*

*Section: 2.3 Fisher's Separation Theorem: a formal approach*

18. Consider the following investment/dividend opportunities facing a company:

Project	Investment Outlay Now (\$)	Dividend Now (\$)	Dividend Later (\$)
Mini	450	400	500
Normal	550	250	625
Mega	650	150	775

Assume that the interest rate in the capital market is 12 per cent per period. Calculate the rate of return on Project Mini.

- A.** 11.1%
- B. 0%
- C. 25%
- D. -20%

*AACSB: Analytic*

*Blooms: Application*

*Difficulty: Medium*

*EQUIS: Apply knowledge*

*Graduate Attributes: Problem-solving*

19. Consider the following investment/dividend opportunities facing a company:

Project	Investment Outlay Now (\$)	Dividend Now (\$)	Dividend Later (\$)
Mini	450	400	500
Normal	550	250	625
Mega	650	150	775

Assume that the interest rate in the capital market is 12 per cent per period. Calculate the rate of return on Project Normal.

- A. 14.3%
- B. 120.0%
- C. 13.6%
- D. 150.0%

AACSB: Analytic

Blooms: Application

Difficulty: Medium

EQUIS: Apply knowledge

Graduate Attributes: Problem-solving

20. Consider the following investment/dividend opportunities facing a company:

Project	Investment Outlay Now (\$)	Dividend Now (\$)	Dividend Later (\$)
Mini	450	400	500
Normal	550	250	625
Mega	650	150	775

Assume that the interest rate in the capital market is 12 per cent per period. Calculate the rate of return on Project Mega.

- A. 19.4%
- B. 19.2%**
- C. 16.1%
- D. 23.1%

*AACSB: Analytic*

*Blooms: Application*

*Difficulty: Medium*

*EQUIS: Apply knowledge*

*Graduate Attributes: Problem-solving*

*Learning Objective: 02-01 Explain how a company's managers can, in principle, make financial decisions that will be supported by all shareholders*

*Section: 2.2 Fisher's Separation Theorem: a simplified example*

21. Consider the following investment/dividend opportunities facing a company:

Project	Investment Outlay Now (\$)	Dividend Now (\$)	Dividend Later (\$)
Mini	450	400	500
Normal	550	250	625
Mega	650	150	775

Assume that the interest rate in the capital market is 12 per cent per period. The optimal decision would be to accept:

- A. Project Mini.
- B. Project Mega.
- C. Projects Mini and Normal.
- D. Projects Normal and Mega.

*AACSB: Analytic*

*Blooms: Application*

*Difficulty: Hard*

*EQUIS: Apply knowledge*

*Graduate Attributes: Problem-solving*

*Learning Objective: 02-01 Explain how a company's managers can, in principle, make financial decisions that will be supported by all shareholders*

*Section: 2.2 Fisher's Separation Theorem: a simplified example*

22. Consider the following investment/dividend opportunities facing a company:

Project	Investment Outlay Now (\$)	Dividend Now (\$)	Dividend Later (\$)
Mini	450	400	500
Normal	550	250	625
Mega	650	150	775

Assume that the interest rate in the capital market is 12 per cent per period. Assume the company has four equal shareholders (A, B, C and D), and has chosen Project Mega for investment. Suppose Shareholder A wishes to consume \$50 now. What is her required repayment in the later period?

- A. \$12.50
- B. \$56.00
- C. \$14.00**
- D. \$42.00

*AACSB: Analytic*

*Blooms: Application*

*Difficulty: Hard*

*EQUIS: Apply knowledge*

*Graduate Attributes: Problem-solving*

*Learning Objective: 02-02 Explain how the existence of a capital market makes it possible for the company to make decisions acceptable to all shareholders*

*Section: 2.3 Fisher's Separation Theorem: a formal approach*

23. Consider the following investment/dividend opportunities facing a company:

Project	Investment Outlay Now (\$)	Dividend Now (\$)	Dividend Later (\$)
Mini	450	400	500
Normal	550	250	625
Mega	650	150	775

Assume that the interest rate in the capital market is 12 per cent per period. Also assume the company has four equal shareholders (A, B, C and D), and has chosen Project Mega for investment. What amounts will Shareholder A have to finance her consumption in the later period, after consuming \$50 in the first period?

- A. \$151.75
- B. \$181.25
- C. \$193.75
- D.** \$179.75

*AACSB: Analytic*

*Blooms: Application*

*Difficulty: Hard*

*EQUIS: Apply knowledge*

*Graduate Attributes: Problem-solving*

*Learning Objective: 02-02 Explain how the existence of a capital market makes it possible for the company to make decisions acceptable to all shareholders*

*Section: 2.3 Fisher's Separation Theorem: a formal approach*

24. Consider the following investment/dividend opportunities facing a company:

Project	Investment Outlay Now (\$)	Dividend Now (\$)	Dividend Later (\$)
Mini	450	400	500
Normal	550	250	625
Mega	650	150	775

Assume that the interest rate in the capital market is 12 per cent per period. What is the NPV of Project Mini?

- A. (\$92.86)
- B. (\$3.57)**
- C. \$396.43
- D. \$4.06

*AACSB: Analytic*

*Blooms: Application*

*Difficulty: Hard*

*EQUIS: Apply knowledge*

*Graduate Attributes: Problem-solving*

*Learning Objective: 02-01 Explain how a company's managers can, in principle, make financial decisions that will be supported by all shareholders*

*Section: 2.2 Fisher's Separation Theorem: a simplified example*

25. Consider the following investment/dividend opportunities facing a company:

Project	Investment Outlay Now (\$)	Dividend Now (\$)	Dividend Later (\$)
Mini	450	400	500
Normal	550	250	625
Mega	650	150	775

Assume that the interest rate in the capital market is 12 per cent per period. What is the NPV of Project Normal?

- A. \$66.96
- B. \$75.00
- C. \$8.04**
- D. \$258.04

*AACSB: Analytic*

Blooms: Application

Difficulty: Hara

EQUIS: Apply knowledge

Graduate Attributes: Problem-solving

Learning Objective: 02-01 Explain how a company's managers can, in principle, make financial decisions that will be supported by all shareholders

Section: 2.2 Fisher's Separation Theorem: a simplified example

26. Consider the following investment/dividend opportunities facing a company:

Project	Investment Outlay Now (\$)	Dividend Now (\$)	Dividend Later (\$)
Mini	450	400	500
Normal	550	250	625
Mega	650	150	775

Assume that the interest rate in the capital market is 12 per cent per period, and that the company has four equal shareholders (A, B, C and D). Also assume the company has chosen Projects Normal and Mega for investment.

Suppose Shareholder B wishes to consume \$165 now. What is his required repayment in the later period?

- A. \$65
- B. \$165
- C. \$72.80
- D. \$184.80

AACSB: Analytic

Blooms: Application

Difficulty: Hara

EQUIS: Apply knowledge

Graduate Attributes: Problem-solving

Learning Objective: 02-02 Explain how the existence of a capital market makes it possible for the company to make decisions acceptable to all shareholders

Section: 2.3 Fisher's Separation Theorem: a formal approach

27. Consider the following investment/dividend opportunities facing a company:

Project	Investment Outlay Now (\$)	Dividend Now (\$)	Dividend Later (\$)
Mini	450	400	500
Normal	550	250	625
Mega	650	150	775

Assume that the interest rate in the capital market is 12 per cent per period. Also assume that the company has four equal shareholders (A, B, C and D). Will the shareholders support the company's decision to invest in Projects Normal and Mega instead of just Project Mega?

- A. No, only Shareholder B will support such a decision.
- B. We cannot tell, as no information has been provided with regards to the consumption choices of Shareholders C and D.
- C. Both Shareholders A and B will support this decision but we need to know the consumption choices of Shareholders C and D before being able to identify their preferences.
- D. All the shareholders will support the company's decision.

*AACSB: Analytic*

*Blooms: Application*

*Difficulty: Medium*

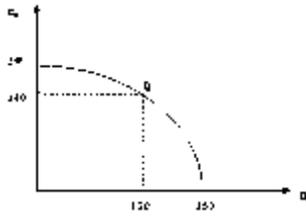
*EQUIS: Apply knowledge*

*Graduate Attributes: Problem-solving*

*Learning Objective: 02-01 Explain how a company's managers can, in principle, make financial decisions that will be supported by all shareholders*

*Section: 2.3 Fisher's Separation Theorem: a formal approach*

28. Consider the following production possibilities curve:



Point Q represents:

- A. an intermediate case in which a dividend of 30 units is paid at Time 1.
- B.** an intermediate case in which 30 units is invested at Time 1.
- C. an intermediate case in which a dividend of 50 units is paid at Time 2.
- D. none of the given options.

*AACSB: Analytic*

*Blooms: Application*

*Difficulty: Medium*

*EQUIS: Apply knowledge*

*Graduate Attributes: Problem-solving*

*Learning Objective: 02-03 Identify a company's optimal investment/dividend policy under conditions of certainty*

*Section: 2.3 Fisher's Separation Theorem: a formal approach*

29. Consider the following graph.



Which of the following statements is false?

- A. The Company has 150 units of resources available to it.
- B.** The point (150,0) represents a dividend payment of zero units at Time 1.
- C. 190 units would be available for consumption at Time 2 if no dividend were paid at Time 1.
- D. None of the given options is false.

*AACSB: Analytic*

*Blooms: Analysis*

*Difficulty: Medium*

*EQUIS: Analyse*

*Graduate Attributes: Problem-solving*

*Learning Objective: 02-02 Explain how the existence of a capital market makes it possible for the company to make decisions acceptable to all shareholders*

*Section: 2.3 Fisher's Separation Theorem: a formal approach*

30. Indifference curves are normally:

- A. convex, which means they approach the horizontal axis as the level of  $C_2$  increases.
- B. concave, which means they approach the vertical axis as the level of  $C_2$  increases.
- C. convex, which means they approach the horizontal axis as the level of  $C_1$  increases.
- D. concave, which means they approach the vertical axis as the level of  $C_1$  increases.

*AACSB: Analytic*

*Blooms: Application*

*Difficulty: Easy*

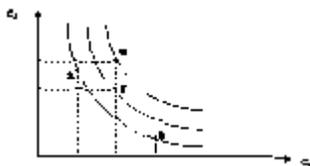
*EQUIS: Apply knowledge*

*Graduate Attributes: Problem-solving*

*Learning Objective: 02-02 Explain how the existence of a capital market makes it possible for the company to make decisions acceptable to all shareholders*

*Section: 2.3 Fisher's Separation Theorem: a formal approach*

31. Consider the following set of indifference curves:



Investment Y is:

- A. preferred to Investments X and Z and is as desirable as Investment W.
- B. preferred to Investment W, but is inferior to Investments X and Z.
- C.** preferred to Investments X and Z, but is inferior to Investment W.
- D. preferred to Investments X and Z, which provide an investor with equal utility, and is preferred to Investment W.

*AACSB: Analytic*

*Blooms: Application*

*Difficulty: Easy*

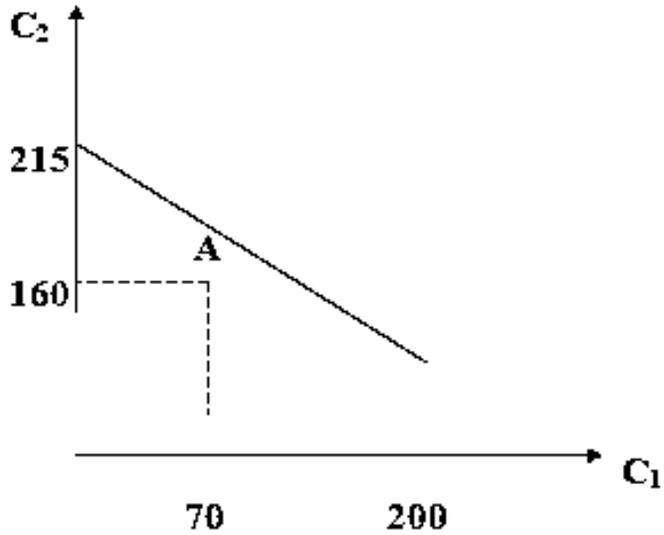
*EQUIS: Analyse*

*Graduate Attributes: Problem-solving*

*Learning Objective: 02-02 Explain how the existence of a capital market makes it possible for the company to make decisions acceptable to all shareholders*

*Section: 2.3 Fisher's Separation Theorem: a formal approach*

32. Consider the following graph:



What is the interest rate per period?

- A. 7.31%
- B. 7.14%**
- C. 7.50%
- D. 25.00%

*AACSB: Analytic*

*Blooms: Application*

*Difficulty: Medium*

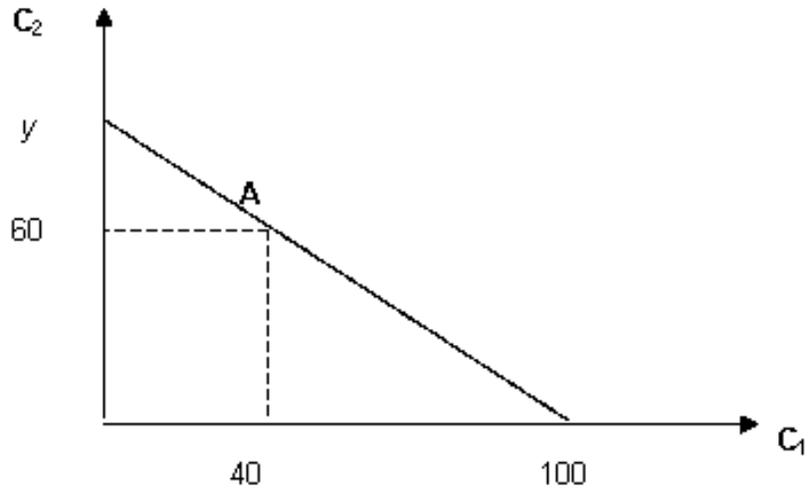
*EQUIS: Apply knowledge*

*Graduate Attributes: Problem-solving*

*Learning Objective: 02-02 Explain how the existence of a capital market makes it possible for the company to make decisions acceptable to all shareholders*

*Section: 2.3 Fisher's Separation Theorem: a formal approach*

33. Consider the following graph:



Assume that the interest rate per period is 15 per cent. Calculate  $y$ .

- A. 115 units
- B. 106 units**
- C. 92.17 units
- D. 100 units

*AACSB: Analytic*

*Blooms: Application*

*Difficulty: Medium*

*EQUIS: Apply knowledge*

*Graduate Attributes: Problem-solving*

*Learning Objective: 02-02 Explain how the existence of a capital market makes it possible for the company to make decisions acceptable to all shareholders*

*Section: 2.3 Fisher's Separation Theorem: a formal approach*

34. Which of the following correctly represents the equation of a market opportunity line?

A.  $C_1 = [W_1(1 + i) + C_2]/(1 + i)$

B.  $C_1(1 + i) = W_1(1 + i) + C_2$

**C.**  $W_1(1 + i) - C_2 = C_1(1 + i)$

D.  $C_2 = -W_1(1 + i) + C_1(1 + i)$

*AACSB: Analytic*

*Blooms: Knowledge*

*Difficulty: Easy*

*EQUIS: Apply knowledge*

*Graduate Attributes: Problem-solving*

*Learning Objective: 02-02 Explain how the existence of a capital market makes it possible for the company to make decisions acceptable to all shareholders*

*Section: 2.3 Fisher's Separation Theorem: a formal approach*

35. The slope of a market opportunity line is given by:

**A.**  $-(1 + i)$

B.  $C_1/(1 + i)$

C.  $C_2 + C_1(1 + i)$

D.  $-C_1/(1 + i)$

*AACSB: Analytic*

*Blooms: Knowledge*

*Difficulty: Easy*

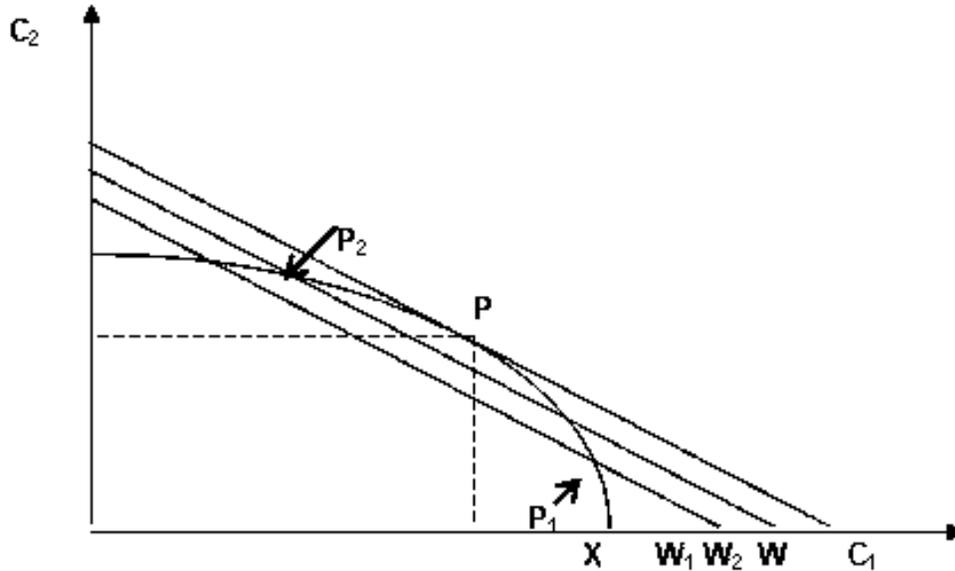
*EQUIS: Apply knowledge*

*Graduate Attributes: Problem-solving*

*Learning Objective: 02-02 Explain how the existence of a capital market makes it possible for the company to make decisions acceptable to all shareholders*

*Section: 2.3 Fisher's Separation Theorem: a formal approach*

36. Suppose that a company has  $X$  units of resources and is considering three investment/dividend policies,  $P_1$ ,  $P_2$  and  $P$ . The following graph shows market opportunity lines drawn through each of these points:



The line through  $P_1$  shows that:

- A. if policy  $P_1$  were adopted, the shareholders' wealth would decrease from  $W$  to  $W_1$ .
- B.** if policy  $P_1$  were adopted, the shareholders' wealth would increase from  $X$  to  $W_1$ .
- C. if policy  $P_1$  were adopted, the shareholders' wealth would remain unchanged at  $W_1$ .
- D. none of the given options.

*AACSB: Analytic*

*Blooms: Application*

*Difficulty: Medium*

*EQUIS: Apply knowledge*

*Graduate Attributes: Problem-solving*

*Learning Objective: 02-02 Explain how the existence of a capital market makes it possible for the company to make decisions acceptable to all shareholders*

*Section: 2.3 Fisher's Separation Theorem: a formal approach*

37. Which statement is false with respect to the decision rule: accept a project if and only if  $[\text{Return at Time 2} / (1 + i) - \Delta] > 0$ ?
- A. The decision rule is completely consistent with Fisher's separation theorem.
  - B. The decision rule is the same as the net present value rule.
  - C. A company that always applies the decision rule to its investment decisions will be able to locate the optimal investment/dividend policy and will maximise the wealth of its shareholders.
  - D.** None of the given options.

*AACSB: Analytic*

*Blooms: Knowledge*

*Difficulty: Medium*

*EQUIS: Apply knowledge*

*Graduate Attributes: Problem-solving*

*Learning Objective: 02-02 Explain how the existence of a capital market makes it possible for the company to make decisions acceptable to all shareholders*

*Section: 2.3 Fisher's Separation Theorem: a formal approach*

38. Fama (1970) outlines the sufficient conditions in order for all shareholders to agree about the exact nature of uncertainty. Which of the following statements is not one of the specified sufficient conditions?
- A. There are no transaction costs in trading securities.
  - B.** All agree on the implication of current information for the future price and distributions of future prices of each security.
  - C. All information is costlessly available to all market participants.
  - D. None of the given options.

*AACSB: Analytic*

*Blooms: Knowledge*

*Difficulty: Easy*

*EQUIS: Apply knowledge*

*Graduate Attributes: Problem-solving*

*Learning Objective: 02-01 Explain how a company's managers can, in principle, make financial decisions that will be supported by all shareholders*

*Section: 2.4 Investors' reaction to managers' decisions*

39. Fisher's separation theorem means that:

- A. a company can make an investment decision even if all shareholders do not agree.
- B. a company should invest beyond the point where the net present value of the marginal unit of investment is zero.
- C. a company should invest up to a point where the rate of return on the marginal unit of investment equals the market interest rate.
- D. none of the given options is correct.

*AACSB: Analytic*

*Blooms: Knowledge*

*Difficulty: Easy*

*EQUIS: Apply knowledge*

*Graduate Attributes: Problem-solving*

*Learning Objective: 02-01 Explain how a company's managers can, in principle, make financial decisions that will be supported by all shareholders*

*Section: 2.2 Fisher's Separation Theorem: a simplified example*

40. Which of the following statements is false?

- A. If there is only one market interest rate, then the value of the company and the wealth of its shareholders are independent of the company's capital structure.
- B. If any one point on a market opportunity line is attainable, then all other points on the line are also attainable by borrowing or lending.
- C. The dividend decision does not affect shareholders' wealth, provided that the company does not alter its investment decision.
- D. None of the given options.

*AACSB: Analytic*

*Blooms: Knowledge*

*Difficulty: Easy*

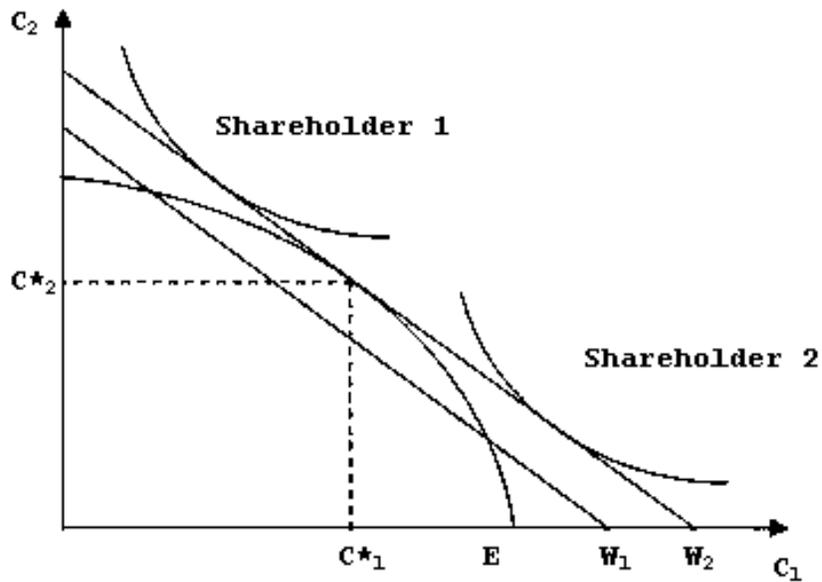
*EQUIS: Apply knowledge*

*Graduate Attributes: Problem-solving*

*Learning Objective: 02-01 Explain how a company's managers can, in principle, make financial decisions that will be supported by all shareholders*

*Section: 2.1 Introduction*

41. Consider the following diagram:



In this diagram, if the optimal policy is chosen, the company invests the amount:

- A.  $W_1 - E$
- B.  $W_1 - C^*_1$
- C.  $E - C^*_1$**
- D.  $W_2 - E$

*AACSB: Analytic*

*Blooms: Application*

*Difficulty: Medium*

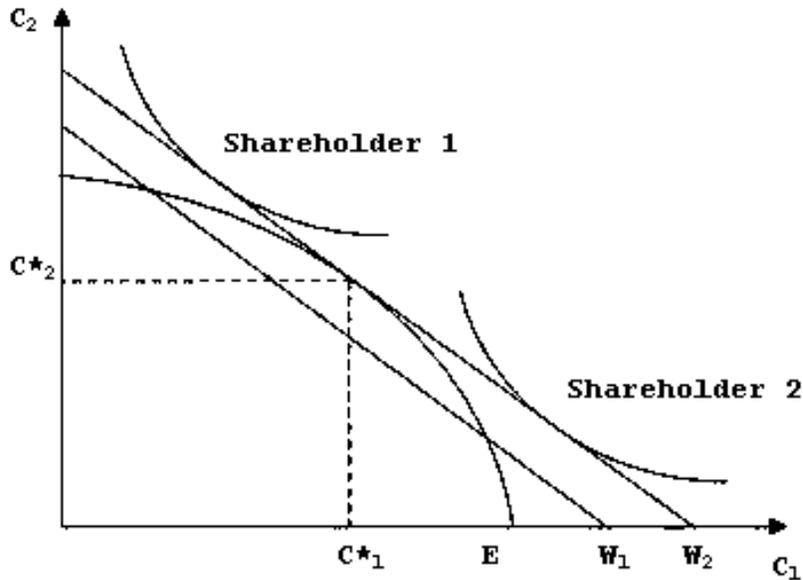
*EQUIS: Apply knowledge*

*Graduate Attributes: Problem-solving*

*Learning Objective: 02-02 Explain how the existence of a capital market makes it possible for the company to make decisions acceptable to all shareholders*

*Section: 2.3 Fisher's Separation Theorem: a formal approach*

42. Consider the following diagram:



In the diagram, if the optimal policy is chosen then shareholder 2, with the lower indifference curve, will optimise her consumption by:

- A. lending in the second period and borrowing in the first period.
- B.** borrowing in the first period and repaying in the second period.
- C. lending in the first period and receiving in the second period.
- D. borrowing in the first period and receiving in the second period.

*AACSB: Analytic*

*Blooms: Application*

*Difficulty: Medium*

*EQUIS: Apply knowledge*

*Graduate Attributes: Problem-solving*

*Learning Objective: 02-02 Explain how the existence of a capital market makes it possible for the company to make decisions acceptable to all shareholders*

*Section: 2.3 Fisher's Separation Theorem: a formal approach*

43. In the absence of \_\_\_\_\_ companies are unable to make decisions about dividend policy that will please all share holders.

**capital markets**

*AACSB: Analytic*

*Blooms: Knowledge*

*Difficulty: Easy*

*EQUIS: Apply knowledge*

*Graduate Attributes: Problem-solving*

*Learning Objective: 02-02 Explain how the existence of a capital market makes it possible for the company to make decisions acceptable to all shareholders*

*Section: 2.2 Fisher's Separation Theorem: a simplified example*

44. A company can make optimal decisions to the benefit of all shareholders if they use the \_\_\_\_\_ rule to analyse investment proposals.

**net present value**

*AACSB: Analytic*

*Blooms: Knowledge*

*Difficulty: Easy*

*EQUIS: Apply knowledge*

*Graduate Attributes: Problem-solving*

*Learning Objective: 02-01 Explain how a company's managers can, in principle, make financial decisions that will be supported by all shareholders*

*Section: 2.2 Fisher's Separation Theorem: a simplified example*

45. An \_\_\_\_\_ is a curve that shows a set of combinations such that an individual derives equal utility from any combination in the set.

**indifference curve**

*AACSB: Analytic*

*Blooms: Knowledge*

*Difficulty: Easy*

*EQUIS: Apply knowledge*

*Graduate Attributes: Problem-solving*

*Learning Objective: 02-02 Explain how the existence of a capital market makes it possible for the company to make decisions acceptable to all shareholders*

*Section: 2.3 Fisher's Separation Theorem: a formal approach*

46. Share prices change as a result of investors' reaction to \_\_\_\_\_ provided through investment, financing and dividend decisions made by the managers of a company.

**information**

*AACSB: Analytic*

*Blooms: Knowledge*

*Difficulty: Medium*

*EQUIS: Apply knowledge*

*Graduate Attributes: Problem-solving*

*Learning Objective: 02-01 Explain how a company's managers can, in principle, make financial decisions that will be supported by all shareholders*

*Section: 2.4 Investors' reaction to managers' decisions*

47. According to Fisher's Theorem, provided that the company does not alter its investment decision, the dividend decision does not affect \_\_\_\_\_.

**shareholders wealth**

*Blooms: Knowledge*

*Difficulty: Medium*

*EQUIS: Apply knowledge*

*Graduate Attributes: Problem-solving*

*Learning Objective: 02-01 Explain how a company's managers can, in principle, make financial decisions that will be supported by all shareholders*

*Section: 2.4 Investors' reaction to managers' decisions*

48. Fisher's separation theorem assumes markets have imperfections.

**FALSE**

*AACSB: Analytic*

*Blooms: Knowledge*

*Difficulty: Medium*

*EQUIS: Apply knowledge*

*Graduate Attributes: Problem-solving*

*Learning Objective: 02-01 Explain how a company's managers can, in principle, make financial decisions that will be supported by all shareholders*

*Section: 2.3 Fisher's Separation Theorem: a formal approach*

49. Fisher's separation theorem has no implications for the investment decision.

**FALSE**

*AACSB: Analytic*

*Blooms: Knowledge*

*Difficulty: Easy*

*EQUIS: Apply knowledge*

*Graduate Attributes: Problem-solving*

*Learning Objective: 02-01 Explain how a company's managers can, in principle, make financial decisions that will be supported by all shareholders*

*Section: 2.3 Fisher's Separation Theorem: a formal approach*

50. If a project costs \$700 and is expected to return \$790 to shareholders in one year's time, then the rate of return on the investment is 12.86%.

**TRUE**

*AACSB: Analytic*

*Blooms: Knowledge*

*Difficulty: Hard*

*EQUIS: Apply knowledge*

*Graduate Attributes: Problem-solving*

*Learning Objective: 02-03 Identify a company's optimal investment/dividend policy under conditions of certainty*

*Section: 2.2 Fisher's Separation Theorem: a simplified example*

51. The shape of the production possibilities curve determines the combinations of current dividend, investment and future dividend that a company can achieve.

**TRUE**

*AACSB: Analytic*

*Blooms: Knowledge*

*Difficulty: Hard*

*EQUIS: Apply knowledge*

*Graduate Attributes: Problem-solving*

*Learning Objective: 02-01 Explain how a company's managers can, in principle, make financial decisions that will be supported by all shareholders*

*Section: 2.3 Fisher's Separation Theorem: a formal approach*

52. In practice, managers are unable to predict with certainty the impact that a particular decision will have on a company's share price.

**TRUE**

*AACSB: Analytic*

*Blooms: Knowledge*

*Difficulty: Medium*

*EQUIS: Apply knowledge*

*Graduate Attributes: Problem-solving*

*Learning Objective: 02-03 Identify a company's optimal investment/dividend policy under conditions of certainty*

*Section: 2.4 Investors' reaction to managers' decisions*

53. An indifference curve represents a set of possible consumption outcomes, which yields equal utility to the individual.

**TRUE**

*AACSB: Analytic*

*Blooms: Knowledge*

*Difficulty: Medium*

*Graduate Attributes: Problem-solving*

*Learning Objective: 02-02 Explain how the existence of a capital market makes it possible for the company to make decisions acceptable to all shareholders*

*Section: 2.3 Fisher's Separation Theorem: a formal approach*

54. The market opportunity line indicates the preferences of individuals for a given level of wealth.

**FALSE**

*AACSB: Analytic*

*Blooms: Knowledge*

*Difficulty: Medium*

*EQUIS: Apply knowledge*

*Graduate Attributes: Problem-solving*

*Learning Objective: 02-02 Explain how the existence of a capital market makes it possible for the company to make decisions acceptable to all shareholders*

*Section: 2.3 Fisher's Separation Theorem: a formal approach*

55. Define the following terms:
- (a) The production possibilities curve
  - (b) An indifference curve
  - (c) The market opportunity line

*AACSB: Analytic*

*Blooms: Knowledge*

*Difficulty: Easy*

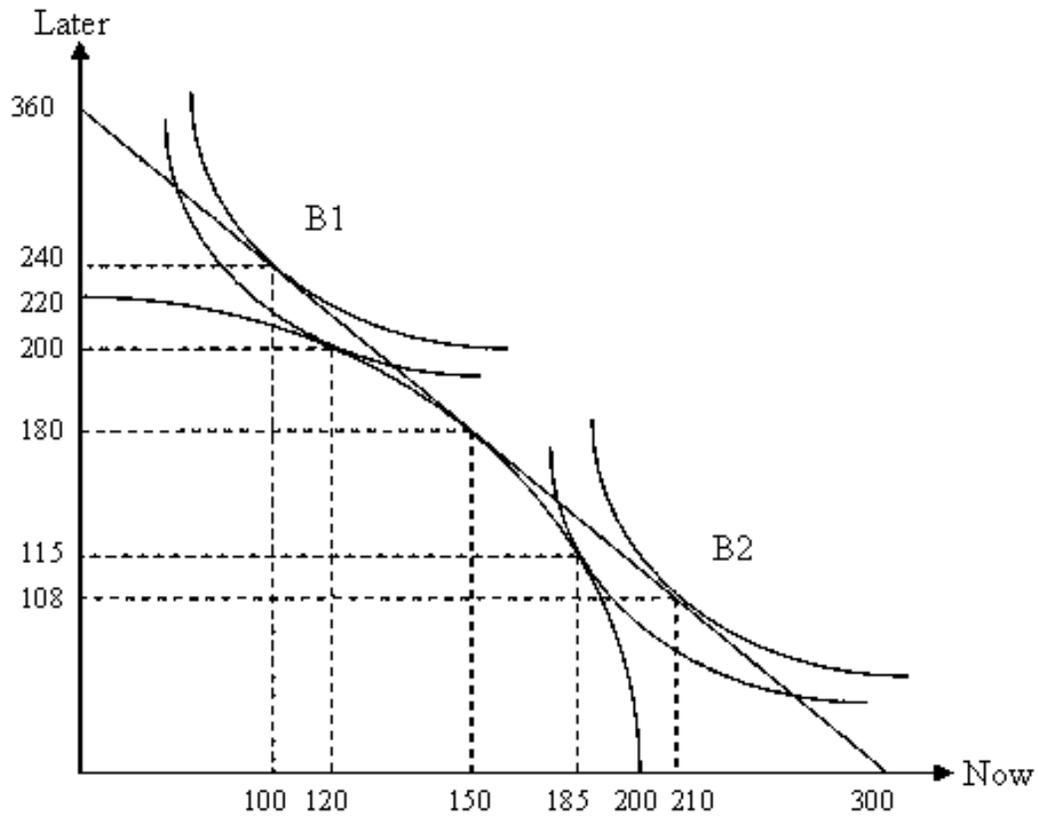
*EQUIS: Apply knowledge*

*Graduate Attributes: Problem-solving*

*Learning Objective: 02-02 Explain how the existence of a capital market makes it possible for the company to make decisions acceptable to all shareholders*

*Section: 2.3 Fisher's Separation Theorem: a formal approach*

56. B1 and B2 are equal shareholders in the company Banana Inc. They have each invested \$200 in the company. The following graph shows on a per shareholder basis the production possibilities curve, B1 and B2's indifference curves and the market opportunity line.



- (a) What is the interest rate?  
 (b) How much is invested by the company at the optimal point?  
 (c) Assuming that the company invests at the optimal point, complete the following table (where applicable) for shareholder B1.

	Now	Later
Dividend	150	
Borrow/Repay		
Lend/Receive		
Consumption		

- (d) Assuming that the company invests at the optimal point, complete the following table (where applicable) for B2.

	Now	Later
Dividend	150	
Borrow/Repay		
Lend/Receive		
Consumption		

*AACSB: Analytic*

*Blooms: Application*

*Difficulty: Medium*

*EQUIS: Apply knowledge*

*Graduate Attributes: Problem-solving*

*Learning Objective: 02-02 Explain how the existence of a capital market makes it possible for the company to make decisions acceptable to all shareholders*

*Section: 2.3 Fisher's Separation Theorem: a formal approach*

57. The AlphaBeta company is considering several investment opportunities. The interest rate for both borrowing and lending is 15 per cent per period and the investment/dividend opportunities are given in the following table:

Project	Investment Outlay Now (\$)	Dividend Now (\$)	Dividend Later (\$)
AOne	1250	750	1350
BTwo	1500	500	1650
CThree	2000	0	2500

- What is the net present value of each project?
- Based on the NPV rule which project(s) should the company invest in?
- What is the IRR of project AOne?
- The company has 2 equal shareholders, Alpha and Beta, and invests in the project CThree. Alpha would prefer to consume \$500 today. What can she do? How much will she be able to consume later?

*AACSB: Analytic*

*Blooms: Application*

*Difficulty: Medium*

*EQUIS: Apply knowledge*

*Graduate Attributes: Problem-solving*

*Learning Objective: 02-03 Identify a company's optimal investment/dividend policy under conditions of certainty*

*Section: 2.2 Fisher's Separation Theorem: a simplified example*



# Chapter 02 Testbank Summary

<u>Category</u>	<u># of Questions</u>
AACSB: Analytic	56
Blooms: Analysis	1
Blooms: Application	21
Blooms: Knowledge	35
Difficulty: Easy	18
Difficulty: Hard	9
Difficulty: Medium	30
EQUIS: Analyse	3
EQUIS: Apply knowledge	52
Graduate Attributes: Problem-solving	57
Learning Objective: 02-01 Explain how a company's managers can, in principle, make financial decisions that will be supported by all shareholders	23
Learning Objective: 02-02 Explain how the existence of a capital market makes it possible for the company to make decisions acceptable to all shareholders	28
Learning Objective: 02-03 Identify a company's optimal investment/dividend policy under conditions of certainty	6
Section: 2.1 Introduction	3
Section: 2.2 Fisher's Separation Theorem: a simplified example	14
Section: 2.3 Fisher's Separation Theorem: a formal approach	34
Section: 2.4 Investors' reaction to managers' decisions	6