

Chapter 21

Rents, Profits, and the Financial Environment of Business

21.1 Economic Rent

1) Pure economic rent is

- A) a payment to a resource owner over and above what is necessary to keep the resource in its current use.
- B) a payment to a resource owner just sufficient to keep its supply constant.
- C) the inverse of economic profit.
- D) the competitive rental rate on capital.

Answer: A

Diff: 1

Topic: 21.1 Economic Rent

Question Status: Previous Edition

2) A payment for the use of any resource over and above its opportunity cost is called

- A) accounting profit.
- B) economic profit.
- C) normal cost.
- D) economic rent.

Answer: D

Diff: 1

Topic: 21.1 Economic Rent

Question Status: Previous Edition

3) Economic rent is defined as

- A) any payment that has a contract period.
- B) a payment to an owner of a factor that is in perfectly elastic supply.
- C) a payment to an owner of a factor greater than the opportunity cost of utilizing the factor.
- D) the opportunity cost or return to a productive factor such as capital.

Answer: C

Diff: 1

Topic: 21.1 Economic Rent

Question Status: Previous Edition

4) Economic rent is a concept that can be applied

- A) only to land, as that is the only resource that is in limited supply.
- B) only to land and natural talent.
- C) to any factor of production that is fixed in supply.
- D) to any resource or factor of production that has a supply curve with a positive (upward) slope.

Answer: C

Diff: 1

Topic: 21.1 Economic Rent

AACSB: Analytic skills

Question Status: Previous Edition

- 5) Economic rent is broadly defined as
- A) a payment received by a landowner.
 - B) a payment for the use of any resource that has a fixed supply.
 - C) the return to owners of farmland.
 - D) the dividend return on a share of stock.

Answer: B

Diff: 1

Topic: 21.1 Economic Rent

Question Status: Previous Edition

- 6) Economic rent applies to
- A) land only and nothing else.
 - B) real property only.
 - C) all resources.
 - D) any resource in fixed supply.

Answer: D

Diff: 1

Topic: 21.1 Economic Rent

AACSB: Analytic skills

Question Status: Previous Edition

- 7) Economic rent is any payment
- A) received by the owner of a resource in perfectly elastic supply.
 - B) received by the owner of a resource with a supply curve that is not horizontal.
 - C) in excess of the resource's opportunity cost.
 - D) below that of a normal profit or return.

Answer: C

Diff: 2

Topic: 21.1 Economic Rent

Question Status: Previous Edition

- 8) Pure economic rent is a payment to a resource that
- A) has a high opportunity cost.
 - B) has a perfectly inelastic supply.
 - C) has a negative opportunity cost.
 - D) has a perfectly elastic demand.

Answer: B

Diff: 1

Topic: 21.1 Economic Rent

Question Status: Previous Edition

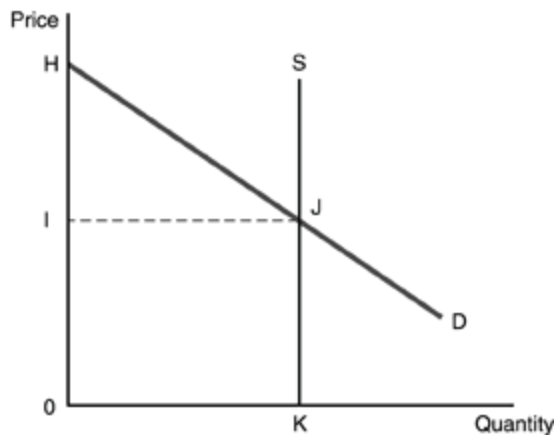
- 9) Ricardo's assumption for economic rents for land was based on
- A) the supply of land being a fixed quantity.
 - B) a shortage of land.
 - C) a surplus of land.
 - D) total government control of land.

Answer: A

Diff: 2

Topic: 21.1 Economic Rent

Question Status: Previous Edition



10) Refer to the above figure. What can we say about economic rent?

- A) Economic rent equals the area IJK0.
- B) Economic rent equals the area HJI.
- C) Economic rent equals the area HJK0.
- D) There is no economic rent represented in the figure.

Answer: A

Diff: 1

Topic: 21.1 Economic Rent

AACSB: Analytic skills

Question Status: Previous Edition

11) In analyzing land rent, David Ricardo constructed a model based on

- A) perfectly elastic demand for land.
- B) a perfectly elastic supply of land.
- C) land being available in infinite quantities.
- D) the supply of land being perfectly inelastic.

Answer: D

Diff: 2

Topic: 21.1 Economic Rent

Question Status: Previous Edition

12) A key assumption of Ricardo's economic rent concept was that

- A) all land is equally productive.
- B) land is too differentiated to be able to measure.
- C) only land in large cities matters.
- D) land is always cheap and needs development.

Answer: A

Diff: 2

Topic: 21.1 Economic Rent

Question Status: Previous Edition

- 13) The concept of economic rent is associated with the economist
A) Adam Smith. B) Karl Marx. C) David Ricardo. D) Henry George.

Answer: C

Diff: 1

Topic: 21.1 Economic Rent

Question Status: Previous Edition

- 14) According to Ricardo's explanation of land rent, what happens when the demand for land increases?
- A) The supply curve shifts to the right just enough to keep the price per acre constant.
 - B) Revenues to owners of land increase but economic rent declines.
 - C) The amount of economic rent stays constant, constrained by a perfectly inelastic supply curve.
 - D) Both revenues to owners of land and economic rent increase.

Answer: D

Diff: 2

Topic: 21.1 Economic Rent

AACSB: Analytic skills

Question Status: Previous Edition

- 15) For an individual who has special talent as an entertainer, a large proportion of his salary can be considered
- A) a fixed cost.
- B) economic rent.
- C) a payment below opportunity cost.
- D) non-taxable income.

Answer: B

Diff: 1

Topic: 21.1 Economic Rent

AACSB: Analytic skills

Question Status: Previous Edition

- 16) For an individual such as a movie star or a pop singer whose natural talents are almost impossible to duplicate,
- A) all of their earnings consist of economic rents.
 - B) none of their earnings consist of economic rents since rent applies only to land.
 - C) part of their earnings consists of economic rents.
 - D) all of their earnings consist of interest payments.

Answer: C

Diff: 2

Topic: 21.1 Economic Rent

AACSB: Analytic skills

Question Status: Previous Edition

- 17) A portion of a worker's earnings is economic rent if the worker
- A) has skills that make him more productive than an unskilled worker.
 - B) would accept a small reduction in pay without quitting.
 - C) was the last person hired at the going wage rate.
 - D) has been on the job for at least a year.

Answer: B

Diff: 2

Topic: 21.1 Economic Rent

AACSB: Analytic skills

Question Status: Previous Edition

- 18) A dedicated teacher loves being in the classroom and would teach for \$40,000 per year, but he is actually paid \$55,000 per year. This individual
- A) receives economic rent of \$20,000.
 - B) receives accounting profit of \$20,000.
 - C) has an opportunity cost of \$15,000.
 - D) receives economic rent of \$15,000.

Answer: D

Diff: 1

Topic: 21.1 Economic Rent

AACSB: Analytic skills

Question Status: Previous Edition

- 19) World-class models receive significant economic rents because
- A) their talents and abilities are in fixed supply.
 - B) there is a shortage of world-class models.
 - C) there is a surplus of world-class models.
 - D) there is no equilibrium quantity of world-class models.

Answer: A

Diff: 2

Topic: 21.1 Economic Rent

AACSB: Analytic skills

Question Status: Previous Edition

- 20) An individual would willingly give a concert for \$2,000. If she is paid \$5,000 for the concert, she is
- A) receiving \$3,000 to cover her opportunity cost.
 - B) not being paid her full opportunity cost.
 - C) receiving \$3,000 of economic rent.
 - D) certainly being paid more than warranted by the level of demand.

Answer: C

Diff: 1

Topic: 21.1 Economic Rent

AACSB: Analytic skills

Question Status: Previous Edition

- 21) Supermodel Linda Evangelista has been quoted as saying, "[I] don't wake up for less than \$10,000 a day." If Ms. Evangelista is paid \$15,000 for her next daylong photo shoot, then
- A) she is being paid \$15,000 to cover her opportunity cost.
 - B) the first \$10,000 she receives is economic rent to labor and the next \$5,000 is more economic rent.
 - C) the entire \$15,000 would be considered economic rent to labor.
 - D) she is receiving economic rent to labor equal to \$5,000.

Answer: D

Diff: 2

Topic: 21.1 Economic Rent

AACSB: Reflective thinking skills

Question Status: Previous Edition

- 22) If land is reallocated or switched from agricultural use to recreational use, then it is likely that
- A) food is not as important as recreation.
 - B) the demand for food is less today than in previous decades.
 - C) land earns a higher rent in recreational use than in agricultural use.
 - D) the demand curve for land in the agricultural industry is shifting to the right.

Answer: C

Diff: 1

Topic: 21.1 Economic Rent

AACSB: Reflective thinking skills

Question Status: Previous Edition

- 23) Suppose that Justin Timberlake sells 10,000 tickets to a concerts at \$480 each. If the equilibrium price is \$600 per ticket for a fixed supply of 10,000 tickets, what is the value of the additional economic rent that Timberlake could earn if he charged the market clearing price?
- A) \$12.00
 - B) \$1.2 million
 - C) \$3 million
 - D) \$1.8 million

Answer: B

Diff: 1

Topic: 21.1 Economic Rent

AACSB: Analytic skills

Question Status: Previous Edition

- 24) If a factor of production with a fixed supply is earning \$100 in its current use and its next best use would yield earnings of \$80, the factor is earning a pure economic rent equal to
- A) \$0.
 - B) \$20.
 - C) \$80.
 - D) \$180.

Answer: B

Diff: 1

Topic: 21.1 Economic Rent

AACSB: Analytic skills

Question Status: Previous Edition

- 25) If a rock star insists that tickets to her concert be sold for \$150 each rather than the \$450 each that could be charged as reflected by demand for those tickets, then the result will be
- A) to create an excess supply of tickets.
 - B) to eliminate \$150 worth of economic rent per ticket.
 - C) that part of the economic rent will be dissipated by scalpers, radio station owners, etc..
 - D) that the demand for tickets will decrease.

Answer: C

Diff: 1

Topic: 21.1 Economic Rent

AACSB: Analytic skills

Question Status: Previous Edition

- 26) Economic rent directs resources to
- A) the people who can use them most efficiently.
 - B) people only.
 - C) large corporations.
 - D) labor-intensive industries only.

Answer: A

Diff: 1

Topic: 21.1 Economic Rent

AACSB: Analytic skills

Question Status: Previous Edition

- 27) The Hawaiian island of Lana'i is privately owned by Castle & Cooke and for generations most of its land was used to grow pineapples. Now, many of the pineapple fields have been replaced by tourist accommodations, including a pair of world-class hotels and a top rated golf course. What would an economist say about this change in land-use patterns?
- A) While growing pineapples used the island's land more efficiently, tourism provides utility to the largest number of people.
 - B) Economic rent has allocated the island's resources to their highest valued use: tourism.
 - C) Agriculture is still the land's highest-valued and most efficient use, but tourism earns more profits for Castle & Cooke.
 - D) To find the land's economic rent, add the price per acre that land on Lana'i would be worth if used to grow pineapples to the value per acre when used for a golf course.

Answer: B

Diff: 2

Topic: 21.1 Economic Rent

AACSB: Reflective thinking skills

Question Status: Previous Edition

- 28) Economic rent is
- A) the return to owners of farmland.
 - B) the return to landlords.
 - C) a payment for the use of any resource above its opportunity cost.
 - D) a payment for land, an apartment, or a house that one does not own.

Answer: C

Diff: 1

Topic: 21.1 Economic Rent

Question Status: Previous Edition

29) The payment for the use of a resource in an amount higher than the resource's opportunity cost is

- A) a proprietorship.
- B) an irrational economic concept.
- C) economic rent.
- D) reinvestment.

Answer: C

Diff: 1

Topic: 21.1 Economic Rent

Question Status: Previous Edition

30) The payment for a factor of production that is completely inelastic in supply is

- A) opportunity cost.
- B) economic rent.
- C) discounting.
- D) limited liability.

Answer: B

Diff: 1

Topic: 21.1 Economic Rent

Question Status: Previous Edition

31) Pure economic rent involves situations where

- A) the supply curve is perfectly inelastic.
- B) the supply curve is perfectly elastic.
- C) the uses to which a resource can be used can be varied but the quality of the resource cannot be varied.
- D) the quality of a resource can be varied but the price cannot be varied.

Answer: A

Diff: 2

Topic: 21.1 Economic Rent

Question Status: Previous Edition

32) When the supply curve of a resource is vertical, then the return to the resource owner is

- A) zero.
- B) partly economic rent and partly opportunity costs.
- C) partly economic rent and partly profits.
- D) pure economic rent.

Answer: D

Diff: 1

Topic: 21.1 Economic Rent

Question Status: Previous Edition

33) The first economist to analyze economic rent was

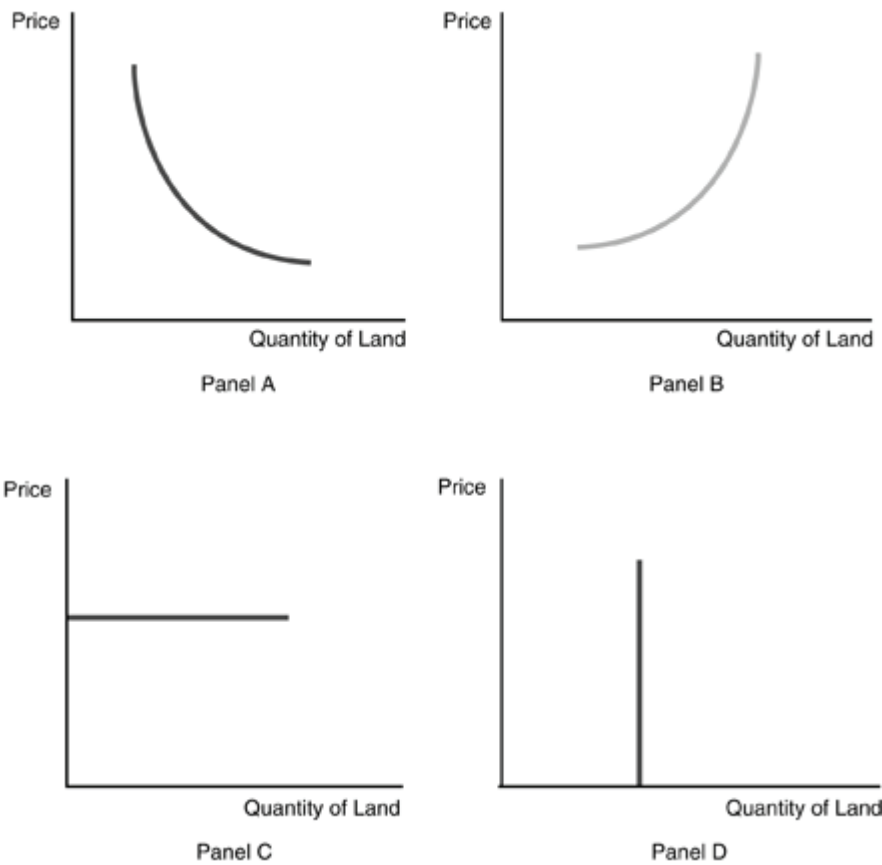
- A) Henry George.
- B) David Ricardo.
- C) Karl Marx.
- D) John Stuart Mill.

Answer: B

Diff: 1

Topic: 21.1 Economic Rent

Question Status: Previous Edition



- 34) Refer to the above figure. Which panel is consistent with Ricardo's view on the supply of land?
 A) Panel A B) Panel B C) Panel C D) Panel D

Answer: D

Diff: 2

Topic: 21.1 Economic Rent

Question Status: Previous Edition

- 35) If all the return to a resource is economic rent, we know that
 A) the price of the resource is below its opportunity cost.
 B) the price of the resource equals its opportunity cost.
 C) the price of the resource is above its opportunity cost.
 D) the resource has no opportunity cost.

Answer: C

Diff: 2

Topic: 21.1 Economic Rent

Question Status: Previous Edition

- 36) Suppose the supply of land is perfectly inelastic and landowners are receiving payments equal to \$25,000 an acre. If the government taxed the landowners' income with a tax rate of 80 percent, how much tax would the government collect?
- A) Zero, because the owner would do something else with the tax rather than pay such a high tax.
 - B) Less than \$20,000 because the owners would change their behavior so as to pay less tax.
 - C) More than \$20,000 because the combined effects of all the owners trying to change their behavior actually would generate higher returns.
 - D) \$20,000 because the use of the land doesn't depend on the price the landowners receive for the land.

Answer: D

Diff: 3

Topic: 21.1 Economic Rent

AACSB: Analytic skills

Question Status: Previous Edition

- 37) The concept of economic rent can be applied to
- A) land only.
 - B) land and natural resources only.
 - C) land, natural resources, and paintings by dead masters only.
 - D) any resource that cannot be replicated exactly.

Answer: D

Diff: 1

Topic: 21.1 Economic Rent

AACSB: Analytic skills

Question Status: Previous Edition

- 38) Rents
- A) have no useful economic purpose.
 - B) have an allocative function since they help decide to which use a resource will be put.
 - C) have a distributional function since they affect incomes, but have no allocative function since the resource is in fixed supply.
 - D) have an economic purpose only if they are taxed and provide revenue to the government.

Answer: B

Diff: 2

Topic: 21.1 Economic Rent

AACSB: Analytic skills

Question Status: Previous Edition

- 39) Economic rents are useful because
- A) they increase the income of the owner.
 - B) they make it easy to calculate opportunity cost.
 - C) resources will go to their most efficient use.
 - D) they increase tax revenue.

Answer: C

Diff: 1

Topic: 21.1 Economic Rent

AACSB: Analytic skills

Question Status: Previous Edition

- 40) For superstar athletes,
- A) their entire earnings are economic rent.
 - B) part of their earnings are economic rent.
 - C) none of their earnings are economic rent since rent doesn't apply to labor.
 - D) none of their earnings are economic rent since they will do some other work once they are too old to be an athlete.

Answer: B

Diff: 2

Topic: 21.1 Economic Rent

AACSB: Analytic skills

Question Status: Previous Edition

- 41) In which field would economic rents likely be greatest for the best in their field?
- A) Farming
 - B) Teaching
 - C) Hockey
 - D) Car repairing

Answer: C

Diff: 2

Topic: 21.1 Economic Rent

AACSB: Reflective thinking skills

Question Status: Previous Edition

- 42) Superstars in sports or entertainment presumably would be willing to continue working in their specific areas for lower income than they are currently earning. This implies that
- A) the large salaries serve no allocative function and only serve to make the superstars richer.
 - B) superstars are exploiting their fans by receiving such a large salary.
 - C) superstars do not respond to monetary incentives.
 - D) the high salaries are used to allocate their time but fail to bring in new sources of supply (other superstars) that are exactly like themselves.

Answer: D

Diff: 3

Topic: 21.1 Economic Rent

AACSB: Analytic skills

Question Status: Previous Edition

- 43) A popular entertainer gives a concert in a 50,000 seat stadium. To give her fans a break, she charges only \$50 a seat instead of the customary \$75 a seat. At \$75 a ticket, there would have been 50,000 tickets sold, and at \$50, there are 80,000 people who want tickets. As a consequence of the generosity of the entertainer,
- A) her fans are made better off.
 - B) a more fair system of pricing the tickets has been found.
 - C) another type of system will have to be found to allocate the tickets, making some of her fans better off and others worse off.
 - D) her fans are made worse off since there is an excess demand of 30,000 tickets.

Answer: C

Diff: 3

Topic: 21.1 Economic Rent

AACSB: Analytic skills

Question Status: Previous Edition

44) Economic rent serves

- A) a descriptive function by making some wealthier than others, but serves no allocative function.
- B) an allocative function by guiding available supplies to the most efficient use.
- C) only to make the rich richer and the poor poorer.
- D) no useful function in a modern economy.

Answer: B

Diff: 2

Topic: 21.1 Economic Rent

AACSB: Analytic skills

Question Status: Previous Edition

45) When economic rent exists,

- A) the price is equal to the opportunity cost of the resources.
- B) price is the same as the discount rate.
- C) resources are allocated inefficiently.
- D) resources are allocated efficiently.

Answer: D

Diff: 1

Topic: 21.1 Economic Rent

AACSB: Analytic skills

Question Status: Previous Edition

46) George is debating whether to concentrate on playing professional football or professional baseball. He is offered \$6 million a year to play baseball and \$7 million a year to play football. If he chooses to play football,

- A) the economic rent in his salary is \$7 million.
- B) the economic rent in his salary is \$6 million.
- C) the economic rent in his salary is \$1 million.
- D) the economic rent in his salary is \$13 million.

Answer: C

Diff: 2

Topic: 21.1 Economic Rent

AACSB: Analytic skills

Question Status: Previous Edition

47) The opportunity cost of owner-provided labor is the

- A) wage rate paid to the owner.
- B) explicit part of the wage rate paid to the owner.
- C) salary the owner could have made if she worked at her best alternative job.
- D) profit after all of the bills have been paid.

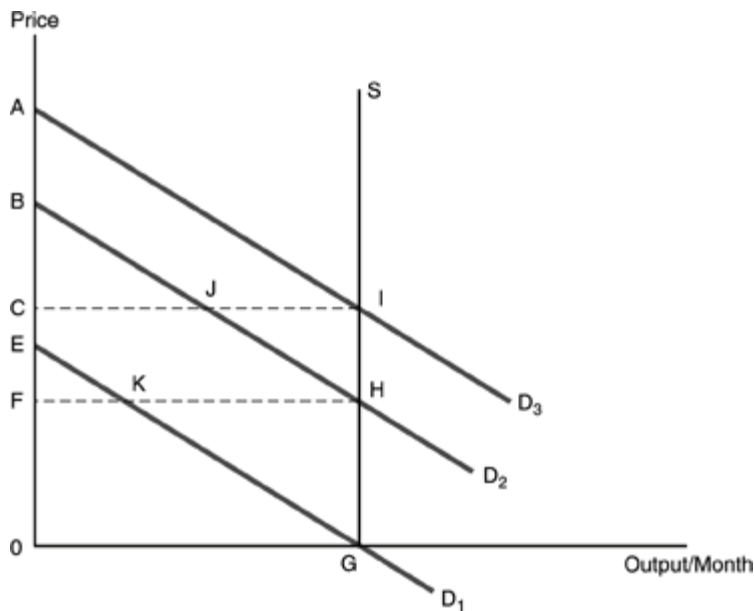
Answer: C

Diff: 1

Topic: 21.1 Economic Rent

AACSB: Analytic skills

Question Status: Previous Edition



- 51) Refer to the above figure. If demand curve D_1 is the relevant demand curve, rent is
- A) zero. B) OG. C) area FHGO. D) area KHG.

Answer: A

Diff: 2

Topic: 21.1 Economic Rent

AACSB: Analytic skills

Question Status: Previous Edition

- 52) Refer to the above figure. Suppose demand is D_2 and then increases to D_3 . Economic rent after the change is
- A) zero. B) area CIHF. C) area CIGO. D) area BJC.

Answer: C

Diff: 2

Topic: 21.1 Economic Rent

AACSB: Analytic skills

Question Status: Previous Edition

- 53) Refer to the above figure. Suppose demand is D_2 and then increases to D_3 . The change in economic rent is
- A) zero. B) area CIHF. C) area CIGO. D) area BJC.

Answer: B

Diff: 2

Topic: 21.1 Economic Rent

AACSB: Analytic skills

Question Status: New

54) Refer to the above figure. At demand curve D_2 , price equals _____ and economic rent equals _____.

A) OF; KHG

B) OF; FHGO

C) OE; EKGO

D) OE; KHG

Answer: B

Diff: 2

Topic: 21.1 Economic Rent

AACSB: Analytic skills

Question Status: Previous Edition

55) A payment to an owner of a resource in excess of its opportunity cost is known as

A) real wages.

B) economic rent.

C) financial interest.

D) accounting profits.

Answer: B

Diff: 1

Topic: 21.1 Economic Rent

Question Status: Previous Edition

56) The concept of economic rent is associated with the British economist David Ricardo (1772–1823). Ricardo analyzed economic rent for land. Which of the following is FALSE with respect to determining land rent?

A) The supply curve for land is vertical (perfectly inelastic).

B) Rent is payment for a resource above its opportunity cost.

C) Payment for a resource below its opportunity cost is rent.

D) Ricardo assumed the quantity of land in a country is fixed.

Answer: C

Diff: 1

Topic: 21.1 Economic Rent

Question Status: Previous Edition

57) A payment for a resource above the opportunity cost of the resource is

A) economic rent.

B) social rent.

C) nominal rent.

D) real rent.

Answer: A

Diff: 1

Topic: 21.1 Economic Rent

Question Status: Previous Edition

58) When a resource has a perfectly inelastic supply curve,

A) the amount of economic rent for this resource is determined by its supply.

B) the amount of economic rent for this resource is determined by demand for the resource.

C) the amount of economic rent for this resource is determined by the government.

D) there is no economic rent being earned by this resource.

Answer: B

Diff: 2

Topic: 21.1 Economic Rent

AACSB: Analytic skills

Question Status: Previous Edition

- 59) When a resource has a perfectly elastic supply curve,
- A) the amount of economic rent for the resource is determined by its supply.
 - B) the amount of economic rent for this resource is determined by demand for the resource.
 - C) there is no economic rent being earned by this resource.
 - D) the entire payment received by this resource is economic rent.

Answer: C

Diff: 3

Topic: 21.1 Economic Rent

AACSB: Analytic skills

Question Status: Previous Edition

- 60) The supply curve for land in New York City is most likely
- A) horizontal or perfectly elastic.
 - B) a downward sloping straight line.
 - C) an upward sloping straight line.
 - D) vertical or perfectly inelastic.

Answer: D

Diff: 2

Topic: 21.1 Economic Rent

AACSB: Analytic skills

Question Status: Previous Edition

- 61) If the supply curve for land was a vertical line, then any payment made for land would be considered
- A) as economic rent.
 - B) as economic lease.
 - C) as economic interest.
 - D) as an opportunity lease payment.

Answer: A

Diff: 1

Topic: 21.1 Economic Rent

Question Status: Previous Edition

- 62) The British economist most often associated with the issue of economic rent for land was
- A) John Maynard Keynes.
 - B) Jeremy Bentham.
 - C) A. W. Phillips.
 - D) David Ricardo.

Answer: D

Diff: 2

Topic: 21.1 Economic Rent

Question Status: Previous Edition

- 63) Which of the following would be most likely to receive high economic rent payments?
- A) farmer
 - B) professional baseball player
 - C) factory worker
 - D) doctor

Answer: B

Diff: 2

Topic: 21.1 Economic Rent

AACSB: Reflective thinking skills

Question Status: Previous Edition

- 64) A famous opera star made \$2 million per year. He said he would rather sell insurance if he couldn't make more than \$100,000 per year. If he is telling the truth, what's his opportunity cost as an opera star?

A) \$2.0 million B) \$100,000 C) \$1.9 million D) \$2.1 million

Answer: B

Diff: 2

Topic: 21.1 Economic Rent

AACSB: Analytic skills

Question Status: New

- 65) A famous opera star made \$2 million per year. He said he would rather sell insurance if he couldn't make more than \$100,000 per year. If he is telling the truth, how much is he being paid in economic rent?

A) \$2.0 million B) \$100,000 C) \$1.9 million D) \$2.1 million

Answer: C

Diff: 3

Topic: 21.1 Economic Rent

AACSB: Analytic skills

Question Status: Previous Edition

- 66) The term "economic rent" refers to payments

A) to owners of real estate.
B) for the use of any resource above its opportunity cost.
C) equal to the opportunity cost of the use of land.
D) for the use of housing in company owned properties.

Answer: B

Diff: 1

Topic: 21.1 Economic Rent

Question Status: Previous Edition

- 67) David Ricardo used the example of land to demonstrate the concept of rent, as the supply of land is

A) perfectly elastic. B) relatively elastic.
C) perfectly inelastic. D) negatively sloped.

Answer: C

Diff: 1

Topic: 21.1 Economic Rent

Question Status: Previous Edition

- 68) A payment for the use of an input that exceeds the opportunity cost of the input is known as

A) real interest. B) economic profit.
C) economic rent. D) economic cost.

Answer: C

Diff: 1

Topic: 21.1 Economic Rent

Question Status: Previous Edition

- 69) In the market for land, if the supply of land is perfectly inelastic, an increase in the demand for land will result in a(n)
- A) increase in the real interest rate.
 - B) increase in economic rent.
 - C) decrease in the equilibrium price.
 - D) increase in the quantity supplied of land.

Answer: B

Diff: 2

Topic: 21.1 Economic Rent

AACSB: Analytic skills

Question Status: Previous Edition

- 70) If a major league baseball player would be willing to work for \$500,000 per year and is currently being paid \$1,200,000 per year, that player is earning an annual economic rent of
- A) \$500,000.
 - B) \$1,200,000.
 - C) \$1,700,000.
 - D) \$700,000.

Answer: D

Diff: 2

Topic: 21.1 Economic Rent

AACSB: Analytic skills

Question Status: Previous Edition

- 71) If a major league baseball player would be willing to work for \$500,000 per year and is currently being paid \$1,200,000 per year, the opportunity cost of his decision to play baseball is
- A) \$500,000.
 - B) \$1,200,000.
 - C) \$1,700,000.
 - D) \$700,000.

Answer: A

Diff: 2

Topic: 21.1 Economic Rent

AACSB: Analytic skills

Question Status: New

- 72) Let us suppose that if Oprah Winfrey was not a superstar she would have been a judge making \$100,000 per year. If she makes \$63 million dollars this year, her economic rent is
- A) \$63.0 million.
 - B) \$63.1 million.
 - C) \$100,000.
 - D) \$62.9 million.

Answer: D

Diff: 2

Topic: 21.1 Economic Rent

AACSB: Analytic skills

Question Status: Previous Edition

- 73) Let us suppose that if Oprah Winfrey was not a superstar she would have been a judge making \$100,000 per year. If she makes \$63 million dollars this year, her opportunity cost is
- A) \$63.0 million.
 - B) \$63.1 million.
 - C) \$100,000.
 - D) \$62.9 million.

Answer: C

Diff: 2

Topic: 21.1 Economic Rent

AACSB: Analytic skills

Question Status: New

- 74) Suppose the supply of ocean front property in California is perfectly inelastic. Any increases in demand for this property increases the

A) economic rent. B) opportunity cost of land owners.
C) present discounted value. D) real interest rate.

Answer: A

Diff: 2

Topic: 21.1 Economic Rent

AACSB: Analytic skills

Question Status: Previous Edition

- 75) Suppose Jon Stewart of the "Daily Show" makes an annual income of \$1,000,000. If he quit his television job and went into producing he could make \$400,000 per year. Jon Stewart's annual economic rent to labor is

A) \$1,400,000. B) 1,000,000. C) \$400,000. D) \$600,000.

Answer: D

Diff: 2

Topic: 21.1 Economic Rent

AACSB: Analytic skills

Question Status: Revised

- 76) Suppose Jon Stewart of the "Daily Show" makes an annual income of \$1,000,000. If he quit his television job and went into producing he could make \$400,000 per year. Jon Stewart's opportunity cost as a producer is

A) \$1,400,000. B) 1,000,000. C) \$400,000. D) \$600,000.

Answer: B

Diff: 2

Topic: 21.1 Economic Rent

AACSB: Analytic skills

Question Status: New

- 77) Consider an NBA superstar Kobe Bryant and one of your economics professors. Who is likely to receive more economic rent in his/her job? Explain your answer.

Answer: Economic rent is a payment for the use of any resource above its opportunity cost.

Because it is harder to duplicate a highly paid NBA superstar like Kobe Bryant than an economics professor, it is more likely that the NBA superstar, who has a rather inelastic supply curve, receives more economic rent.

Diff: 2

Topic: 21.1 Economic Rent

AACSB: Reflective thinking skills

Question Status: Previous Edition

- 78) "Economic rent reflects a waste of resources." Do you agree or disagree? Explain.

Answer: Disagree. Economic rent is indeed a payment for the use of a resource above its opportunity cost. However, as determined by the demand for the resource, economic rent directs the resource to its highest-valued or most efficient use and thus is not a waste of resources.

Diff: 2

Topic: 21.1 Economic Rent

AACSB: Reflective thinking skills

Question Status: Previous Edition

21.2 Firms and Profits

- 1) The fundamental goal of a firm or a business is to
- A) produce the largest number of output units possible.
 - B) employ labor in the most socially responsible manner possible.
 - C) organize the factors of production and take risks.
 - D) earn the highest possible returns.

Answer: D

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 2) A business which is owned by two or more people is called a
- A) proprietorship.
 - B) partnership.
 - C) corporation.
 - D) none of the above.

Answer: B

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 3) Which of the following is a disadvantage of the corporate form of business organization?
- A) Limited liability
 - B) Limited financing
 - C) Double taxation
 - D) Unlimited liability

Answer: C

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 4) Which of the following is the most common form of business organization in the United States?
- A) Proprietorship
 - B) Partnership
 - C) Corporation
 - D) S-corporation

Answer: A

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 5) Economic profit can be calculated as
- A) total revenue – explicit costs.
 - B) total revenue – implicit costs.
 - C) total revenue – explicit costs – implicit costs.
 - D) total revenue – fixed costs.

Answer: C

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 6) Accounting profit can be calculated as
- A) total revenue – explicit costs.
 - B) total revenue – implicit costs.
 - C) total revenue – explicit costs – implicit costs.
 - D) total revenue – fixed costs.

Answer: A

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: New

- 7) Which of the following participants in the working of a firm are referred to as *residual claimants*?
- A) Workers
 - B) Managers
 - C) Entrepreneurs
 - D) All of the above

Answer: C

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 8) A proprietorship is
- A) difficult to form.
 - B) taxed twice—once when it pays business taxes and again when its owner pays personal income taxes.
 - C) not often found in developed economies, in which corporations have become the most common form of business organization.
 - D) risky for its owner, who is personally responsible for the firm's debts.

Answer: D

Diff: 2

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 9) The most common type of firm in the United States is the
- A) proprietorship.
 - B) partnership.
 - C) corporation.
 - D) limited partnership.

Answer: A

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 10) Which of the following options is NOT a characteristic of a proprietorship?
- A) Single ownership
 - B) Unlimited liability
 - C) Double taxation
 - D) Easy to form and dissolve

Answer: C

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 11) A proprietorship is
- A) two or more individuals in business together.
 - B) a corporation that is taxed like an individual.
 - C) a business owned by one individual who makes all of the decisions.
 - D) a government-owned franchise.

Answer: C

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 12) The disadvantages of proprietorships include
- A) limited liability for the owner.
 - B) double taxation of business profits.
 - C) the fact that the proprietorship can continue even after the owner dies.
 - D) the fact that the proprietor is solely responsible for all the firm's debts.

Answer: D

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 13) By definition, a proprietorship is
- A) owned by many shareholders.
 - B) a large manufacturing concern.
 - C) owned by a single individual.
 - D) managed by a large group called the "board of directors."

Answer: C

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 14) An advantage of proprietorships is
- A) the ease with which they can be formed and dissolved.
 - B) their ability to raise large amounts of equity capital.
 - C) the fact that their profits are not taxed.
 - D) the breadth of management expertise that comes from having a board of directors.

Answer: A

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 15) One advantage of a proprietorship is that
- A) it is relatively easy to raise financial capital for a proprietorship.
 - B) a proprietorship is relatively easy to form and to dissolve.
 - C) there are limits to the possible liabilities of the owner.
 - D) depreciation rates on capital are higher.

Answer: B

Diff: 2

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 16) A proprietorship is
- A) a business with annual sales of less than \$50,000 a year.
 - B) a business owned by one individual that employs 10 or fewer workers, and has been in business less than 15 years.
 - C) a business owned by one individual who receives the profits and is legally responsible for the debts of the firm.
 - D) a form of business in which the stock of the company is closely held by members of one family.

Answer: C

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 17) The most common form of business organization, as far as the number of such firms in business, is the
- A) proprietorship.
 - B) partnership.
 - C) corporation.
 - D) S corporation.

Answer: A

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 18) One disadvantage of a partnership is
- A) limited liability.
 - B) lower monitoring costs.
 - C) difficulty raising funds.
 - D) it permits greater specialization.

Answer: C

Diff: 2

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 19) In a partnership, legal responsibility for all debts is
- A) shared by the partners.
 - B) passed to the shareholders.
 - C) paid by the principle owner.
 - D) handled by the bondholders.

Answer: A

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 20) One advantage of a partnership is
- A) lower costs.
 - B) they are easy to form.
 - C) all the profits go to the older partner.
 - D) they are double taxed.

Answer: B

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 21) In a partnership, debts accumulated by one partner
- A) are the responsibility of that partner only.
 - B) are the responsibility of the other partners as well.
 - C) are the responsibility of all the employees of the partnership, regardless of whether those employees are partners.
 - D) are the responsibility of the other partners only up to the amount each partner initially invested in the partnership.

Answer: B

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 22) Compared to a proprietorship, an advantage of a partnership is
- A) that profits are not taxed twice.
 - B) double taxation.
 - C) the ability to take advantage of greater specialization.
 - D) the limited liability of the partners.

Answer: C

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 23) Comparing proprietorships with partnerships, which is true?
- A) In both cases, profits are taxed only once.
 - B) Partnerships outnumber proprietorships 2-to-1 in the United States.
 - C) Proprietorships generally end with the death of the owner, but partnerships continue as long as at least one partner survives.
 - D) A proprietor faces unlimited liability for her firm's debts, but in a partnership each partner is only responsible for an even share of the firm's indebtedness.

Answer: A

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 24) Of the owners of the following firms, which does not have unlimited liability for the business' debts?
- A) Roy Ray's Grocery Store, Roy Ray, proprietor
 - B) The partnership of Reese and Jones, Attorneys-at-Law
 - C) The Huber Corporation
 - D) Wren's Feed and Seed Store, a proprietorship

Answer: C

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Reflective thinking skills

Question Status: Previous Edition

25) Corporations account for

- A) the largest proportion of business revenues generated in the United States.
- B) the largest amount of taxes paid to the U.S. government.
- C) the largest number of firms in the United States.
- D) the smallest amount of revenues in the United States.

Answer: A

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

26) Which of the following is NOT a characteristic of a corporation?

- A) Limited liability for shareholders
- B) Double taxation
- C) Separation of ownership problems
- D) Limited ability to raise capital funds

Answer: D

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

27) The main advantage of a corporate form of organization is that

- A) shareholders have limited liability.
- B) shareholders have unlimited liability.
- C) shareholders are not subject to double taxation.
- D) all corporate profits must be distributed as dividends.

Answer: A

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

28) In general, which form of business organization has the greatest capacity to raise large sums of financial capital?

- A) Sole proprietorships
- B) Partnerships
- C) Limited partnerships
- D) Corporations

Answer: D

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

29) The form of business organization responsible for generating the greatest portion of business revenues in the United States is the

- A) corporation.
- B) dual proprietorship.
- C) proprietorship.
- D) partnership.

Answer: A

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 30) The owners of a corporation are
- A) the employees of the firm.
 - B) the shareholders.
 - C) completely in control of the firm.
 - D) taxed only once.

Answer: B

Diff: 2

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 31) Corporations have a separation and control problem because
- A) owners and managers frequently have different incentives.
 - B) most of the profits are reinvested.
 - C) the shareholders control the firm.
 - D) taxes are paid only by the board of directors.

Answer: A

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 32) The double taxation of corporate profit in the United States refers to the fact that
- A) tax rates on partnerships are very high.
 - B) depreciation is not a deductible expense.
 - C) corporate profit is first taxed and then any dividends paid are subject to personal income tax.
 - D) proprietorships are not subject to any tax on earnings.

Answer: C

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 33) An advantage of a corporation is
- A) the ability to raise large sums of financial capital.
 - B) unlimited liability on the part of shareholders.
 - C) the fact that ownership and control are never separated.
 - D) the fact that the corporation is dissolved when one of its owners dies.

Answer: A

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 34) Limited liability is a characteristic of
- A) partnerships only.
 - B) corporations only.
 - C) partnerships and proprietorships only.
 - D) proprietorships only.

Answer: B

Diff: 2

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

35) Monitoring the performance of the people managing the firm is easiest in the case of

- A) proprietorships.
- B) partnerships.
- C) corporations.
- D) S corporations.

Answer: A

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

36) Owners may have little to do with the management of the firm in the case of

- A) partnerships.
- B) corporations.
- C) proprietorships.
- D) either corporations or proprietorships.

Answer: B

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

37) Accounting costs represent

- A) explicit costs paid by the firm.
- B) opportunity costs.
- C) both sunk and future costs.
- D) long run costs only.

Answer: A

Diff: 2

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

38) Implicit costs are measured by

- A) the value of the next-best alternative uses of inputs.
- B) actual expenses paid by a firm.
- C) total revenues minus total costs.
- D) the lowest value of all alternative uses of inputs.

Answer: A

Diff: 2

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

39) The implicit cost incurred by a firm to use its resources to produce its output is the firm's

- A) total cost.
- B) explicit cost.
- C) opportunity cost.
- D) accounting cost.

Answer: C

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

40) Which is the best example of a firm's implicit costs?

- A) Wages
- B) The opportunity cost of owner-provided labor
- C) Rent
- D) Taxes

Answer: B

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Reflective thinking skills

Question Status: Previous Edition

41) Explicit costs are

- A) the opportunity costs of all resources used by the firm.
- B) the costs associated with the resources that the firm owns.
- C) actual expenditures that a firm must make.
- D) all costs associated with the short run.

Answer: C

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

42) Implicit costs are

- A) the costs of using factors that a producer hires or rents.
- B) the opportunity costs of using factors that a producer does not buy or hire but already owns.
- C) costs that are taken into consideration by accountants.
- D) costs that are variable in the short run and fixed in the long run.

Answer: B

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

43) Economists also refer to the normal rate of return on investment as

- A) a residual cost.
- B) the opportunity cost of capital.
- C) the equity kicker.
- D) the fixed cost of entrepreneurship.

Answer: B

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

44) Another term to describe the normal rate of return on capital is the

- A) fixed cost of capital.
- B) depreciation cost of capital.
- C) opportunity cost of capital.
- D) monopoly rent.

Answer: C

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

45) The normal rate of return is the

- A) average rate of return earned in an industry at a given point in time.
- B) opportunity cost of capital.
- C) return on capital associated with zero accounting profits.
- D) the amount paid to an investor when the firm is an on-going concern.

Answer: B

Diff: 2

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

46) The opportunity cost of capital is

- A) the rate of return realized on an investment.
- B) the rate of return that could be earned by the owner's capital were it used elsewhere.
- C) the rate used to calculate a firm's tax liability.
- D) the rate of interest the government uses to calculate legal business tax penalties.

Answer: B

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

47) Which of the following is NOT a correct description of opportunity cost of capital?

- A) It is the normal rate of return on investment.
- B) It is normally included in accounting costs.
- C) It is the income sacrificed by not investing in another firm.
- D) It is an implicit cost.

Answer: B

Diff: 2

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

48) When an entrepreneur invests his own financial capital in order to start a business,

- A) the opportunity cost of capital should be included in the economic cost of doing business.
- B) the investment is treated as a fixed cost, so it should not be considered as a cost of doing business.
- C) the firm's economic profits will exceed its accounting profits.
- D) the accounting costs increase because the funds would otherwise have to be borrowed.

Answer: A

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 49) Suppose the best investment you could make with \$100,000 in cash is to purchase a government bond that pays 14 percent interest per year. If you decide to invest the money in your own business instead of buying the government bond, the opportunity cost of this financial capital is
- A) \$1,400 per year.
 - B) \$100,000 per year.
 - C) \$14,000 per year.
 - D) zero, because you already had the \$100,000.

Answer: C

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 50) Single-owner proprietorships often unintentionally exaggerate their profits because they
- A) forget their explicit losses.
 - B) look at after-tax instead of pre-tax costs.
 - C) pay their bills late and therefore incur large interest charges.
 - D) neglect to consider the opportunity cost of the owner's labor.

Answer: D

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 51) Often single-owner proprietorships seem more profitable than they really are. The reason for this is that
- A) they receive special tax benefits compared to corporations.
 - B) they use different accounting procedures.
 - C) they often fail to consider the opportunity cost of the labor provided by the owner.
 - D) they are not allowed to deduct depreciation expense.

Answer: C

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 52) If, as an entrepreneur, I am earning accounting profits of \$50,000 per year and the opportunity cost of my time is \$60,000,
- A) I am earning economic profits of \$10,000.
 - B) I am earning economic profits of \$50,000.
 - C) I should close my business.
 - D) I am in a long-run equilibrium position.

Answer: C

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 53) If, as an entrepreneur, I am earning accounting profits of \$60,000 per year and the opportunity cost of my time is \$50,000,
- A) I am earning economic profits of \$10,000.
 - B) I am earning economic profits of \$60,000.
 - C) I am earning economic losses of \$10,000.
 - D) I should close my business.

Answer: A

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: New

- 54) Economic profits equal
- A) accounting profits.
 - B) accounting profits less economic rents.
 - C) total revenue less the opportunity costs of all factors of production.
 - D) accounting profits plus the owner's labor opportunity costs.

Answer: C

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 55) If the explicit costs to a firm to produce a unit of output are \$6 and the firm sells 200,000 units of output for \$9 per unit, the accounting profit received by the producer is
- A) \$1.2 million.
 - B) \$850,000.
 - C) \$1.8 million.
 - D) \$600,000.

Answer: D

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 56) Which of the following statements is FALSE?
- A) A correct measure of a firm's economic cost includes both accounting and opportunity cost.
 - B) The accounting profit earned by a firm will always be less than its economic profit.
 - C) The major difference between accounting and economic profit is that accounting profit does not reflect the opportunity cost of using resources.
 - D) The accounting profit of a firm is its total revenue minus total explicit costs.

Answer: B

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 57) Suppose a family-owned yogurt shop has \$80,000 in total revenues, \$36,000 in rent, and \$20,000 in additional operating costs. The husband and wife work in the shop and pay no wages to themselves or others. The economic profits from the shop are
- A) \$24,000.
B) less than \$24,000.
C) more than \$24,000.
D) \$80,000.

Answer: B

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 58) Suppose that you open your own business and earn an accounting profit of \$30,000 per year. When you started your business, you left a job that paid you a \$25,000 salary annually. Also, suppose that you invested \$70,000 of your own funds to start up your business. If the normal rate of return on capital is 5 percent, your economic profit is
- A) \$5,000. B) -\$1,500. C) \$1,500. D) -\$5,000.

Answer: C

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 59) Suppose that you open your own business and earn an accounting profit of \$35,000 per year. When you started your business, you left a job that paid you a \$30,000 salary annually. Also, suppose that you invested \$70,000 of your own funds to start up your business. If the normal rate of return on capital is 10 percent, your economic profit is
- A) \$5,000. B) -\$5,000. C) \$2,000. D) -\$2,000.

Answer: D

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: New

- 60) Economic profits are equal to
- A) total revenues minus total fixed costs.
 - B) total revenues, after tax, minus cost of goods sold.
 - C) total revenues minus the implicit and explicit costs of all inputs used.
 - D) total revenues minus the opportunity cost of labor.

Answer: C

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 61) Accounting profits are total revenues minus
- A) all relevant opportunity costs.
 - B) explicit and implicit costs.
 - C) explicit costs and all other relevant opportunity costs.
 - D) explicit costs.

Answer: D

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 62) Accounting profit is equal to
- A) total revenue minus dividends and interest.
 - B) dividends paid.
 - C) total revenue minus implicit costs.
 - D) total revenue minus explicit costs.

Answer: D

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 63) In comparing accounting profit with economic profit, we generally find that
- A) accounting profit is less than economic profit.
 - B) economic profit and accounting profit are the same in the short run.
 - C) accounting profit is greater than or equal to economic profit.
 - D) economic profit exceeds accounting profit by the amount of opportunity costs.

Answer: C

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 64) In considering economic profit in a market economy, it is correct to say that
- A) there should never be any economic profit.
 - B) economic profit will only occur, even in the short run, as a result of imperfect competition.
 - C) economic profit performs an important function in allocating resources to their most highly valued uses.
 - D) economic profit tends to reduce the production efficiency of the economy, leading to wasted resources.

Answer: C

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: New

65) Economic profits are

- A) the same as accounting profits when firms do not own capital equipment.
- B) always greater than accounting profits.
- C) equal to accounting profits plus the implicit costs of the firm.
- D) whatever remains after all opportunity costs have been taken into account.

Answer: D

Diff: 2

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

66) Accounting profit will always be

- A) more than economic profit.
- B) equal to sunk costs.
- C) less than economic profit.
- D) equal to implicit costs.

Answer: A

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

67) Economic profit is always

- A) greater than accounting profit.
- B) equal to accounting profit.
- C) less than accounting profit.
- D) equally likely to be either greater or less than accounting profit.

Answer: C

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

68) Suppose your donut shop earns \$24,000 in total revenues per month with explicit costs of \$12,000 and opportunity costs of \$8,000. Your economic profit is

- A) \$16,000.
- B) \$12,000.
- C) \$4,000.
- D) zero.

Answer: C

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

69) Suppose your donut shop earns \$24,000 in total revenues per month with explicit costs of \$12,000 and opportunity costs of \$8,000. Your accounting profit is

- A) \$16,000.
- B) \$12,000.
- C) \$4,000.
- D) zero.

Answer: B

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: New

- 70) If your business earns \$10,000 in revenues, has explicit costs of \$7,000, and implicit costs of \$5,000, your economic profit is
- A) \$2,000. B) -\$2,000. C) \$5,000. D) \$3,000.

Answer: B

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 71) If your business earns \$10,000 in revenues, has explicit costs of \$7,000, and implicit costs of \$5,000, your accounting profit is
- A) \$2,000. B) -\$2,000. C) \$5,000. D) \$3,000.

Answer: D

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: New

- 72) The economy's current rate of interest is 10 percent and a firm has \$10,000 of owner-invested capital. Its total revenue is \$5000 and the firm's explicit costs are \$3500. From this we know that this firm's
- A) accounting profit is \$500. B) economic profit is \$1,500.
C) accounting profit is \$1,500. D) economic profit is \$5,000.

Answer: C

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 73) The economy's current rate of interest is 10 percent and a firm has \$10,000 of owner-invested capital. Its total revenue is \$5000 and the firm's explicit costs are \$3500. From this we know that this firm's
- A) accounting profit is \$500. B) economic profit is \$1,500.
C) accounting profit is \$11,500. D) economic profit is \$500.

Answer: D

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: New

- 74) To find economic profit from accounting profit, it is necessary to
- A) subtract dividends. B) add retained earnings.
C) subtract the opportunity cost of capital. D) add depreciation expense.

Answer: C

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

75) On a bar graph comparing a firm's economic profit with its accounting profit, it will always be true that

- A) explicit costs will be greater in the column representing accounting profit.
- B) explicit costs will be greater in the column representing economic profit.
- C) total revenue will be greater in the column depicting accounting profit.
- D) opportunity costs will be missing from the column depicting accounting profit.

Answer: D

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

76) The goal of the firm is

- A) low labor turnover.
- B) to maximize sales.
- C) to minimize costs.
- D) profit maximization.

Answer: D

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

77) A basic tenet of the theory of the firm is that the firm's primary objective is to

- A) stay out of debt.
- B) produce a given level of output at a specified cost.
- C) maximize economic profits.
- D) operate for the benefit of society.

Answer: C

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

78) Economists assume that the goal of a firm is to

- A) maximize economic profits.
- B) sell as many units as possible.
- C) maximize gross revenues.
- D) be the largest firm in its industry.

Answer: A

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

79) The most commonly accepted objective for a firm is

- A) to stay in business at all cost.
- B) to maximize total revenue.
- C) to maximize economic profit.
- D) to minimize the variable cost outlay.

Answer: C

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 80) The higher are a firm's risk-corrected returns,
A) the lower are its labor costs.
B) the higher are its opportunity costs.
C) the more advantage it has in obtaining investor financing.
D) the more difficulty it will have financing its expansion plans.

Answer: C

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 81) A business organization that employs resources to produce goods and services for profit is
A) economic rent.
B) a firm.
C) inside information.
D) the opportunity cost of capital.

Answer: B

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 82) An entrepreneur is
A) the rate of return on capital.
B) a legal form of business.
C) one who takes risks and makes innovations in organizing a firm.
D) the rate of discount.

Answer: C

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 83) Which of the following is not a legal organization of a firm?
A) Corporation
B) Partnership
C) Entrepreneurship
D) Proprietorship

Answer: C

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 84) The most numerous or plentiful firms in the United States are found in this form of business
A) partnership.
B) proprietorship.
C) monopoly.
D) corporation.

Answer: B

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 85) A proprietorship is a business
- A) with annual sales below \$100,000.
 - B) in which the stock of the company is closely held by members of one family.
 - C) which produces a service rather than goods.
 - D) owned by one individual who is responsible legally for the debts of the firm.

Answer: D

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 86) By definition, a firm is
- A) a business organization that makes profits.
 - B) a business organization that utilizes resources to produce goods or services with the goal of making a profit.
 - C) a business organization that consists of more than one person.
 - D) an organization, whether private or public, that may or may not make a profit.

Answer: B

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 87) In a firm, an entrepreneur is one who
- A) decides to hire or fire.
 - B) works for the owner by running the firm.
 - C) takes the risks associated with a business firm.
 - D) represents the firm in legal proceedings.

Answer: C

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 88) If the entrepreneur is also the manager of the firm, we would expect
- A) the manager to work hard because he or she is also the residual claimant.
 - B) the manager to not work hard since there is no possibility of further advancement.
 - C) the firm to operate poorly because the specialization of labor is not adequate.
 - D) the firm to operate poorly because the entrepreneur is not as good at managing workers as a professional manager would be.

Answer: A

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 89) Out-of-pocket expenses such as wages and raw materials are
- A) direct costs.
 - B) an owner-provided capital cost.
 - C) implicit costs.
 - D) explicit costs.

Answer: D

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

90) Expenses that a firm does not have to pay out of pocket are

- A) wages of employees.
- B) taxes.
- C) implicit costs.
- D) explicit costs.

Answer: C

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

91) Which of the following is not an implicit cost?

- A) Wages
- B) Opportunity cost of using an owner's savings
- C) Owner-provided capital
- D) Owner-provided labor

Answer: A

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Reflective thinking skills

Question Status: Previous Edition

92) Which of the following is not an explicit cost?

- A) Taxes
- B) Rent
- C) Wages
- D) Opportunity cost of using an owner's savings.

Answer: D

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Reflective thinking skills

Question Status: Previous Edition

93) Juanita has just started a business and is using her personal car to deliver goods. The use of her car is an example of

- A) an explicit cost to the business.
- B) an implicit cost to the business.
- C) financial capital.
- D) interest.

Answer: B

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

94) A legal organization of a firm where the business is owned by one individual who makes the business decisions, receives all the profits, and is legally responsible for the debts of the firm is a(n)

- A) corporation.
- B) entrepreneur.
- C) proprietorship.
- D) partnership.

Answer: C

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

95) The difference between explicit costs and implicit costs

- A) is that explicit costs are opportunity costs while implicit costs are not.
- B) is that implicit costs are opportunity costs while explicit costs are not.
- C) is that explicit costs are short-run costs and implicit costs are long-run costs.
- D) is that explicit costs involve resources that are purchased and implicit costs involve resources the firm already owns.

Answer: D

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

96) Mary and Jane are partners in a business. Their business is growing but has not yet reached the point where they can afford a new delivery truck. Jane owns an old truck that she has not been using. She decides to donate it to their business for free.

- A) This transaction (donation) involves no economic cost.
- B) This transaction involves both economic cost and accounting cost.
- C) This transaction involves economic cost but no accounting cost.
- D) This transaction involves no economic cost and no accounting cost.

Answer: C

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

97) An accountant shows an invoice for a resource to the manager of the firm. They are discussing

- A) explicit costs.
- B) implicit costs.
- C) economic profits.
- D) either explicit costs or implicit costs, but we can't tell without more information.

Answer: A

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

98) Proprietorships are

- A) the most common form of business organization in the country.
- B) responsible for most of the profits in the country.
- C) generally large relative to other business organizations.
- D) easy to form but difficult to dissolve.

Answer: A

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 99) All of the following are characteristics of a proprietorship EXCEPT
- A) the business is owned by one individual.
 - B) one person is responsible for all the debts of the firm.
 - C) one person gets all of the profits.
 - D) the firm can form a corporation to protect itself against the debts.

Answer: D

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 100) Which of the following is NOT an advantage of a proprietorship?
- A) They are easy to form and dissolve.
 - B) Decision-making resides with one person—the owner.
 - C) Liability of the owner is unlimited.
 - D) Profits are only taxed once.

Answer: C

Diff: 2

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 101) Which of the following is not a disadvantage of a proprietorship?
- A) How profits are taxed
 - B) Ability to raise capital
 - C) Unlimited liability
 - D) The disposition of the firm when the owner dies

Answer: A

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 102) Unlimited liability exists when
- A) the profits of the firm are taxed once.
 - B) a firm dissolves when the owner dies.
 - C) a corporation exists.
 - D) the personal assets of the owner of a firm can be seized to pay off the firm's debts.

Answer: D

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 103) The most likely source of investment funds for a proprietorship is
- A) sales of stocks.
 - B) sales of bonds.
 - C) loans from banks.
 - D) the personal funds of the owner.

Answer: D

Diff: 2

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 104) A business owned by two or more joint owners, or partners, who share the responsibilities and the profits of the firm and are individually liable for all the debts is a(n)
- A) corporation.
 - B) entrepreneur.
 - C) proprietorship.
 - D) partnership.

Answer: D

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 105) In a partnership, debts accumulated by one partner are
- A) the responsibility of that partner only.
 - B) the responsibility of that partner plus any partners who are actively involved in running the partnership.
 - C) the responsibility of all of the other partners for the full amount of the debt.
 - D) the responsibility of all of the other partners, up to the total value of the firm.

Answer: C

Diff: 2

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 106) Which of the following is not an advantage of a partnership?
- A) Limited liability
 - B) Easy to form
 - C) Profits are subject to only personal taxation
 - D) Permits more effective specialization in occupations

Answer: A

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 107) An advantage of a partnership over a proprietorship is
- A) limited liability.
 - B) that profits are not taxed twice.
 - C) the ability to take advantage of greater specialization.
 - D) that it is easier to dissolve.

Answer: C

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 108) The owner(s) of a corporation
- A) is the entrepreneur.
 - B) are the shareholders.
 - C) are the bondholders.
 - D) is the CEO.

Answer: B

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 109) Compared to a proprietorship, a disadvantage of a partnership is
- A) that profits are taxed twice.
 - B) that it is harder to keep the firm going after the death of an owner.
 - C) unlimited liability.
 - D) that potential liability to each partner is greater.

Answer: D

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 110) Which of the following is not an advantage of a partnership?
- A) The taxation of profits
 - B) The issue of liability
 - C) The legal paperwork needed to form a partnership
 - D) Separation of partner's duties

Answer: B

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 111) In a partnership,
- A) each partner's liability is limited to their investment in the company.
 - B) profits are taxed at both the corporate rate and the personal income tax rate.
 - C) upon the death of a partner it may be necessary to sell the business.
 - D) there is a separation of ownership and management like in a corporation.

Answer: C

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 112) A difference between a proprietorship and a partnership is that
- A) a proprietorship is easy to form while a partnership is hard to form.
 - B) a proprietorship has only one owner while a partnership has only two owners.
 - C) a partnership allows for specialization while a proprietorship does not.
 - D) the profits in a proprietorship are taxed only once while in a partnership they are taxed twice.

Answer: C

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 113) A legal entity that may conduct business in its own name just as an individual does is a(n)
- A) corporation.
 - B) entrepreneur.
 - C) proprietorship.
 - D) partnership.

Answer: A

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

114) Corporations are responsible for approximately what percentage of total business revenues?

- A) 19 percent B) 50 percent C) 72 percent D) 83 percent

Answer: D

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Revised

115) The characteristic of limited liability enables corporations to

- A) avoid taxes on some of their profits. B) exist even when owners die.
C) raise large amounts of financial capital. D) start up and dissolve easily.

Answer: C

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

116) The concept of limited liability

- A) does not apply to a corporation.
B) means that the owners of a corporation have liability limited to the value of the shares in the firm.
C) means that owners of a firm are subject to double taxation.
D) limits the amount of specialization that can occur in a firm.

Answer: B

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

117) Limited liability exists when

- A) the liability of owners is limited to the value of the shares in the firm they own.
B) the liability of owners is limited to the share of the debt they personally took on.
C) partners specialize and each partner is responsible for the debts of his or her specialized area.
D) bondholders must receive their payments before stockholders can earn any money.

Answer: A

Diff: 2

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

118) Dividends are

- A) the portion of a corporation's profits that are distributed to stockholders.
B) the portion of a corporation's revenues that are distributed to bondholders.
C) bonuses given to managers of corporations, to ensure that the managers perform in the way that stockholders want.
D) taxes on the profits of corporations.

Answer: A

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

119) Which of the following statements about business organizations is TRUE?

- A) Partnerships are more common than proprietorships and are responsible for a larger percentage of business receipts.
- B) Proprietorships are more common than either partnerships or corporations but are responsible for the smallest share of total business receipts.
- C) Corporations are larger in number than either proprietorships or partnerships and also receive a larger percentage of total business receipts.
- D) Partnerships are larger than both proprietorships and corporations but are less numerous than corporations.

Answer: B

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

120) An important problem with corporations is

- A) the inability of the government to control and tax the firms.
- B) the possibility of large liabilities for the owners.
- C) the separation of ownership and control.
- D) the difficulties with raising financial capital.

Answer: C

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

121) If the death of an owner causes the firm to dissolve, the firm must have been

- A) a partnership only.
- B) a proprietorship only.
- C) a corporation only.
- D) either a proprietorship or a partnership.

Answer: D

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

122) It is likely that the owners have little to do with the day-to-day management of a firm in the case of

- A) partnerships only.
- B) proprietorships only.
- C) corporations only.
- D) partnerships and corporations.

Answer: C

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 123) The problem with the separation of ownership from control is that
- A) the owner in a proprietorship may not always act in the profit-maximizing fashion because he or she may not have the experience or expertise that professional managers have.
 - B) the managing partner of a firm may not always behave in the way that other managers would if they were the managing partners.
 - C) the managers of the firm can make decisions that reduce the wealth of the owners while not reducing their own wealth.
 - D) the owners of firms may not always know the best way to run a firm, yet they are the ones who elect the managers of the firm.

Answer: C

Diff: 3

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 124) Accounting profits are found by total revenues minus
- A) explicit costs.
 - B) explicit and implicit costs.
 - C) implicit costs.
 - D) all opportunity costs.

Answer: A

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 125) Normal rate of return is
- A) accounting profit.
 - B) an explicit cost.
 - C) economic profit.
 - D) the amount that must be paid to obtain investment in a business.

Answer: D

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 126) The amount that must be paid to an individual to get them to invest in the industry is
- A) a normal rate of return.
 - B) the explicit costs.
 - C) reinvestment.
 - D) financial capital.

Answer: A

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 127) The opportunity cost of capital is
- A) an explicit cost.
 - B) a part of economic profits.
 - C) usually unknown and must be estimated by looking at the price of capital goods.
 - D) the normal rate of return.

Answer: D

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 128) Economic profits are found by total revenues minus
- A) explicit costs.
 - B) explicit and implicit costs.
 - C) implicit costs.
 - D) all opportunity costs.

Answer: B

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 129) When economic profits are positive, accounting profits
- A) must be positive.
 - B) will be negative.
 - C) will equal zero.
 - D) could be positive, negative or zero.

Answer: A

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 130) When accounting profits are positive, economic profits
- A) must be positive.
 - B) will be negative.
 - C) will equal zero.
 - D) could be positive, negative or zero.

Answer: D

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 131) When economic profits are negative, accounting profits
- A) must be positive.
 - B) will be negative.
 - C) will equal zero.
 - D) could be positive, negative or zero.

Answer: D

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

132) When accounting profits are negative, economic profits

- A) must be positive.
- B) will be negative.
- C) will equal zero.
- D) could be positive, negative or zero.

Answer: B

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

133) When economic profits are zero, accounting profits

- A) must be positive.
- B) will be negative.
- C) will equal zero.
- D) could be positive, negative or zero.

Answer: A

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

134) What is the relationship between accounting and economic profits?

- A) Accounting profits are always larger than economic profits.
- B) Economic profits are always larger than accounting profits.
- C) There is no relationship between economic and accounting profits.
- D) Economic profits are always negative.

Answer: A

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

135) Any business wanting to attract financial capital must expect to

- A) earn a positive economic profit.
- B) keep implicit costs as close to zero as possible.
- C) pay a normal rate of return.
- D) pay a below normal rate of return in order to make a positive rate of return itself.

Answer: C

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

136) A person starts her own business. She quits her \$40,000 a year job, rents an office for \$15,000 a year, pays wages and salaries of \$50,000 a year, utilities of \$4,000 a year, and materials of \$20,000. She uses her own car for sales work rather than leasing an equivalent car for \$6000 a year. If revenues are \$140,000, her accounting profit and economic profit are respectively

- A) \$45,000 and \$11,000.
- B) \$45,000 and \$5000.
- C) \$51,000 and \$5000.
- D) \$51,000 and \$45,000.

Answer: C

Diff: 3

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 137) A person starts his own business after quitting his job in which he made \$75,000. Expenses include \$100,000 for wages and salaries, which includes a wage for the owner of \$75,000, utilities of \$5000, equipment of \$50,000, and materials of \$40,000. If revenues are \$200,000, his accounting and economic profits are respectively

A) \$80,000 and \$5000. B) -\$70,000 and -\$70,000.
C) -\$70,000 and \$5000. D) \$5000 and \$5000.

Answer: D

Diff: 3

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 138) A firm is making zero economic profits. From this, we know that

A) the firm is going to go out of business.
B) implicit costs are zero.
C) the firm is going to stay in business, but will not be able to attract new financial capital.
D) the firm will stay in business since it is covering all relevant opportunity costs.

Answer: D

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 139) The goal of the firm, according to economists, is to

A) stay in business for as long as possible.
B) sell as many units of the good it produces as possible.
C) grow as large as possible.
D) make as much economic profit as is possible.

Answer: D

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 140) A firm that is not maximizing profits

A) would never be able to operate in the United States.
B) must not be owned by stockholders.
C) may find it difficult to raise financial capital from external capital markets.
D) is likely to face legal prosecution from the Department of Commerce.

Answer: C

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 141) A disadvantage of corporations over a proprietorship or partnership is in the

A) legal liability. B) ability to raise funds.
C) taxation system. D) future of the firm when an owner dies.

Answer: C

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 142) An organization that brings together the factors of production is called
- A) an industry.
 - B) a conglomerate.
 - C) a plant.
 - D) a firm.

Answer: D

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 143) Which of the following statements regarding accounting and economic profits is FALSE?
- A) Economic profits can be zero even if accounting profits are positive.
 - B) Economic profits = total revenue – (explicit + implicit costs)
 - C) Accounting profits can be negative if economic profits are positive.
 - D) Accounting profits = total revenue – explicit costs

Answer: C

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Revised

- 144) Another term for the opportunity cost of capital is
- A) the normal interest rate.
 - B) the normal rate of return.
 - C) a normal profit.
 - D) a normal wage rate.

Answer: B

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 145) Which of the following is the formula used for computing economic profits?
- A) economic profits = total revenue – implicit costs
 - B) economic profits = total revenue – (implicit costs + explicit costs)
 - C) economic profits = total costs – total revenue
 - D) economic profits = total revenue – explicit costs

Answer: B

Diff: 2

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 146) In economics we assume that the goal of a firm is to
- A) minimize costs.
 - B) maximize revenue.
 - C) maximize economic profits.
 - D) maximize total sales.

Answer: C

Diff: 2

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 147) In analyzing the operation of a firm, an economist assumes the firm wants to
- A) maximize total sales.
 - B) maximize total revenue.
 - C) maximize total production.
 - D) maximize total profits.

Answer: D

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 148) Joanne left her last job, in which she was earning \$50,000, in order to form her own consulting business. Her revenues for the first year of consulting were \$200,000. During that year, she hired two assistants for \$25,000 each and spent \$25,000 on office equipment. In addition, she incurred \$75,000 in miscellaneous expenses. Her economic profit that first year was
- A) \$0.
 - B) \$50,000.
 - C) \$200,000.
 - D) \$75,000.

Answer: A

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 149) Joanne left her last job, in which she was earning \$50,000, in order to form her own consulting business. Her revenues for the first year of consulting were \$210,000. During that year, she hired two assistants for \$25,000 each and spent \$25,000 on office equipment. In addition, she incurred \$75,000 in miscellaneous expenses. Her accounting profit that first year was
- A) \$10,000.
 - B) \$60,000.
 - C) \$210,000.
 - D) \$50,000.

Answer: B

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: New

- 150) Accounting profits are typically
- A) greater than economic profits because accounting profits do not include explicit costs.
 - B) greater than economic profits because accounting profits do not include implicit costs.
 - C) smaller than economic profits because accounting profits do not include explicit costs.
 - D) equal to economic profits in the long run.

Answer: B

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 151) Which of the following equations is correct?
- A) $\text{accounting profit} = \text{total revenue} - (\text{explicit costs} + \text{implicit costs})$
 - B) $\text{normal profit} = \text{accounting profit} + \text{economic profit}$
 - C) $\text{economic profit} = \text{accounting profit} - \text{implicit costs}$
 - D) $\text{economic profit} = \text{accounting profit} - \text{explicit costs}$

Answer: C

Diff: 2

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

152) Suppose that during a given time period the implicit cost for a business was \$1,000 and that the explicit cost was \$5,000. Also suppose that the firm sold 1,000 units of its products at \$5 per item. We can conclude that the firm's

- A) accounting profit was \$5,000, and its economic profit was \$0.
- B) accounting and economic profits were both \$0.
- C) accounting profit was \$0, and economic profit was \$1,000.
- D) accounting profit was \$0, and economic profit was -\$1,000.

Answer: D

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

153) Suppose that during a given time period the implicit cost for a business was \$1,500 and that the explicit cost was \$6,000. Also suppose that the firm sold 1,000 units of its products at \$7 per item. We can conclude that the firm's

- A) accounting profit was \$1,000, and its economic profit was -\$500.
- B) accounting and economic profits were both \$1000.
- C) accounting profit was -\$500, and economic profit was \$1,000.
- D) accounting profit was \$1000, and economic profit was -\$1,500.

Answer: A

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: New

154) Which of the following is the formula used for computing an accounting profit?

- A) accounting profits = total revenue - implicit costs
- B) accounting profits = total revenue - (implicit + explicit costs)
- C) accounting profits = total costs - total revenue
- D) accounting profits = total revenue - explicit costs

Answer: D

Diff: 2

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

155) When a business has implicit costs,

- A) economic profits are greater than accounting profits.
- B) economic and accounting profits are the same.
- C) economic profits are less than accounting profits.
- D) economic costs are the same as accounting costs.

Answer: C

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

156) An example of an implicit cost is

- A) payment of a salary to a CEO of a company.
- B) a business using a building owned by the business owner.
- C) a payment to a resource owner.
- D) the payment of interest on a bond.

Answer: B

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Reflective thinking skills

Question Status: Previous Edition

157) If the interest rate is 10 percent and a business pays \$100,000 for a lease on a factory, the explicit costs are

- A) \$110,000.
- B) \$10,000.
- C) \$100,000.
- D) \$90,000.

Answer: C

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

158) Suppose that the implicit cost for a business was \$1,000 and the explicit cost was \$5,000 and that the firm sold 1,000 units of its products at \$6 per item. We can conclude that the firm's

- A) accounting profit was \$6,000, and its economic profit was \$0.
- B) accounting and economic profits were both \$0.
- C) accounting profit was \$1,000, and economic profit cannot be determined.
- D) accounting profit was \$1,000, and economic profit was \$0.

Answer: D

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

159) Accounting profits are

- A) total revenue minus explicit costs.
- B) total revenue minus implicit costs.
- C) total revenue minus explicit and implicit costs.
- D) total revenue minus normal costs.

Answer: A

Diff: 2

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

160) Owner-provided capital and owner-provided labor are examples of

- A) explicit costs.
- B) implicit costs.
- C) normal rate of return.
- D) accounting costs.

Answer: B

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 161) Economic profits are
- A) total revenue minus explicit costs.
 - B) total revenue minus implicit costs.
 - C) total revenue minus explicit and implicit costs.
 - D) total revenue minus accounting costs.

Answer: C

Diff: 2

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 162) Economic profit is
- A) total revenue $\times$ (explicit costs – implicit costs).
 - B) total revenue – (explicit costs – implicit costs).
 - C) total revenue + (explicit costs + implicit costs).
 - D) total revenue – (explicit costs + implicit costs).

Answer: D

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 163) The three basic legal forms of business enterprise in the United States are
- A) monopolies, enterprises, and competitors.
 - B) vertical, horizontal, and conglomerate corporations.
 - C) national, global, and multinational corporations.
 - D) proprietorships, partnerships, and corporations.

Answer: D

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 164) Which of the following is the most common form of a business organization?
- A) corporation
 - B) partnership
 - C) sole proprietorship
 - D) subchapter S corporation

Answer: C

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 165) The most common form of business organization in the United States is the
- A) proprietorship.
 - B) partnership.
 - C) corporation.
 - D) cooperative.

Answer: A

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 166) Which of the following is considered an advantage of a sole proprietorship?
- A) easy to raise large sums of capital
 - B) limited liability for owner
 - C) profit taxed only once
 - D) permits effective specialization

Answer: C

Diff: 2

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 167) An advantage of the proprietorship as a form of business organization is
- A) its limited liability.
 - B) its limited access to capital, thus reducing the possible size of debt.
 - C) that it is easy to form.
 - D) that it can sell bonds to the public.

Answer: C

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 168) A disadvantage of the proprietorship form of business organization is
- A) its limited access to capital.
 - B) its limited liability.
 - C) that it can issue only one class of stock.
 - D) that the owner must fight a lot of red tape to form the firm.

Answer: A

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 169) Numerically, the dominant type of business enterprise in the United States is
- A) the corporation.
 - B) the partnership.
 - C) the proprietorship.
 - D) the multinational corporation.

Answer: C

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 170) All of the following are advantages of organizing a business as a sole proprietorship EXCEPT
- A) ease of formation.
 - B) limited liability.
 - C) ease of decision-making.
 - D) single taxation.

Answer: B

Diff: 2

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 171) When a business is owned and operated by a single individual who receives all of the profits and is responsible for all debts, it is known as a
- A) partnership.
 - B) conglomerate.
 - C) corporation.
 - D) proprietorship.

Answer: D

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 172) Tim has a toenail clipping business that is a sole proprietorship. If he is sued for a botched pedicure,
- A) he has limited liability.
 - B) he has separation of ownership and control.
 - C) all of his personal assets are at risk.
 - D) he will be taxed doubly.

Answer: C

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Reflective thinking skills

Question Status: Previous Edition

- 173) Unlimited liability is found in
- A) proprietorships and corporations.
 - B) partnerships and corporations.
 - C) proprietorships and partnerships.
 - D) proprietorships, partnerships, and corporations.

Answer: C

Diff: 2

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 174) In a partnership of two people
- A) each person has 50 percent liability.
 - B) it is more difficult to specialize with two persons than with one.
 - C) each person has unlimited liability.
 - D) the law releases each partner from legal liabilities.

Answer: C

Diff: 3

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 175) Owners face unlimited liability in
- A) national corporations and global corporations.
 - B) partnerships and corporations.
 - C) proprietorships and corporations.
 - D) proprietorships and partnerships.

Answer: D

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 176) An advantage of the partnership form of business organization is
- A) its limited liability.
 - B) its limited access to capital, thus reducing the possible size of debt.
 - C) the ability of its owners to specialize.
 - D) that it is difficult to start up, because a lot of thought has to go into the establishment of the firm.

Answer: C

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 177) A disadvantage of the partnership form of business organization is
- A) its limited access to capital.
 - B) its limited liability.
 - C) that it can issue only one class of stock.
 - D) that the owners must fight a lot of red tape to form the firm.

Answer: A

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 178) You have received your advanced degree in biochemistry with a specialty in recombinant DNA technology. Your colleagues wish to form a partnership to research adenovirus vectors. Your legal counsel advises you on the following aspects of a partnership, yet you tell her, based on your knowledge of economics, that you think one of the following points is INCORRECT.
- A) An advantage of the partnership would be that it is relatively easy to form, almost as easy as forming a proprietorship.
 - B) The income of the partnership is treated as personal income and is subject only to personal taxation rates.
 - C) The personal assets of each partner should be safe and would not necessarily be at risk due to claims by financial institutions.
 - D) Partnerships often help reduce the costs of monitoring job performance in situations in which it is difficult to measure objectively.

Answer: C

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 179) The majority of business revenues earned in the United States are earned by
- A) proprietorships.
 - B) corporations.
 - C) partnerships.
 - D) cooperatives.

Answer: B

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

180) Which statement is FALSE considering both advantages and disadvantages of corporations as a legal business organization?

- A) Perhaps the greatest advantage of corporations is that their owners (the shareholders) enjoy limited liability—limited to the value of their shares.
- B) Legally the corporation continues to exist even if one or more owners cease to be owners.
- C) Corporations usually are not as well positioned as proprietorships and partnerships to raise large sums of financial capital.
- D) Separation of ownership and control is a disadvantage of the corporate structure; owners and managers may have different incentives.

Answer: C

Diff: 1

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

181) Which form of business organization accounts for the largest proportion of sales in the United States?

- A) the corporation
- B) the partnership
- C) the proprietorship
- D) the subchapter S partner-based proprietorship.

Answer: A

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

182) Most businesses in the United States are _____, and the type of business organization that accounts for the LEAST amount of total revenues is _____.

- | | |
|-------------------------------------|----------------------------------|
| A) proprietorships; partnerships | B) corporations; proprietorships |
| C) proprietorships; proprietorships | D) corporations; partnerships |

Answer: C

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

183) An advantage of the corporate form of business organization is

- | | |
|--|--|
| A) unlimited liability. | B) easier access to capital. |
| C) that profits are taxed only on one level. | D) government supervision of its activities. |

Answer: B

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 184) A disadvantage of the corporate form of business organization is
- A) double taxation.
 - B) limited access to capital.
 - C) that the corporation can only do business in the state where it was incorporated.
 - D) unlimited liability for shareholders.

Answer: A

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 185) You own \$10,000 in personal property, \$2,000 in Company X stocks, \$1,000 in U.S. Savings Bonds and have \$500 in your checking account. If Company X goes bankrupt, the most you could lose is
- A) \$13,500.
 - B) \$11,500.
 - C) \$2,000.
 - D) \$500.

Answer: C

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 186) When a business is considered by law to be a legal entity, it is known as a
- A) partnership.
 - B) conglomerate.
 - C) corporation.
 - D) proprietorship.

Answer: C

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 187) All of the following are advantages of a corporation EXCEPT
- A) double taxation.
 - B) limited liability.
 - C) ability to raise large sums of financial capital.
 - D) unlimited life.

Answer: A

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 188) The greatest advantage of a corporation is
- A) ease of setting up the business.
 - B) the double taxation of dividends.
 - C) separation of ownership and control of the business.
 - D) limited liability.

Answer: D

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 189) Corrina was working as a waitress in an Italian restaurant making an annual income of \$25,000 per year when she decided to start up her own catering business. Corrina used \$10,000 of her savings that was earning 5 percent annual interest to establish her business. After the first year she made an accounting profit of \$20,000. Her economic profit was

A) -\$5,550. B) -\$5,000. C) \$20,000. D) \$25,000.

Answer: A

Diff: 3

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 190) A normal rate of return on investment is equal to
- A) accounting profit minus economic profit.
 - B) the opportunity cost of capital plus any other implicit costs.
 - C) accounting profit plus economic profit.
 - D) total revenue plus total accounting profit

Answer: B

Diff: 3

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 191) What is a normal rate of return?

Answer: A normal rate of return is the amount that must be paid an investor to induce investment in a business. It is the opportunity cost of capital.

Diff: 1

Topic: 21.2 Firms and Profits

Question Status: Previous Edition

- 192) Discuss the advantages and disadvantages of proprietorships.

Answer: Proprietorships are easy to form and to dissolve. Furthermore, all the decisions are made by the proprietor, so decisions can be made quickly. The profits are taxed only once, which is not the case for corporations. However, there are also disadvantages. The biggest disadvantage is unlimited liability: the owner is personally responsible for all the debts of the firm, and could lose assets that are not part of the firm. This often makes it difficult to raise financial capital. Finally, the firm ends with the death of the owner, creating uncertainty for employees and creditors.

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 193) Why are there so many more proprietorships than corporations, yet corporations account for so much more of the sales of business firms in the country?

Answer: Proprietorships are easy to form and can be run by an individual, so there can be many of them, especially in businesses in which large size is not necessary for success. However, large-scale business will usually be done by corporations because of the advantages corporations have in raising financial capital.

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 194) What is the difference between accounting profits and economic profits? Which of the two concepts is more appropriate for explaining decisions made by entrepreneurs? Explain.

Answer: The difference between accounting profits and economic profits is implicit costs, which represent the opportunity costs of factors of production that are owned, such as labor and capital. Opportunity cost is the highest value of alternatives to a firm's inputs. Economic profits take such implicit costs into consideration and so is a more appropriate for explaining the behavior of entrepreneurs.

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 195) Why is limited liability so important when firms try to raise large amounts of financial capital? How is this advantage of a corporation tied to a disadvantage of a corporation?

Answer: Limited liability is important in raising large funds because the owners (stockholders) know that the total liability they have connected with the firm is limited to the investment they made in buying the shares of stock. It is easier to get people to buy a portion of the firm when their liability is limited. But, this large group of owners also means that the diverse ownership may make it difficult to monitor the performance of the management team.

Diff: 3

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 196) For which type of organization is unlimited liability likely to be the greater problem—proprietorships or partnerships? Why?

Answer: Unlimited liability probably poses more problems for partnerships because each partner is liable for debts incurred by the firm, even if those debts are incurred by the other partner. A proprietor knows all the debts he or she has taken on, but a partner could be in the dark on some occasions.

Diff: 3

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

- 197) Amber has opened a coffee shop for many years on a piece of land that she has also owned. She has also made accounting profits from the coffee shop. This year, rents in the area rose considerably, and Amber responded by deciding to sell the land and the coffee shop to an apartment builder. How can you explain Amber's decision to sell her business?

Answer: Even though Amber has been making accounting profits, her decision to sell her business was based on the opportunity cost of the land, which obviously had risen to the point that she made a negative economic profit on her coffee shop business.

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Reflective thinking skills

Question Status: Previous Edition

- 198) "Economic profits are less than or at most equal to accounting profits." Do you agree or disagree? Explain.

Answer: Agree. Economic profits are accounting profits less implicit costs, or the opportunity costs of inputs. Since the opportunity costs of capital and labor inputs are never negative, economic profits are less than or at most equal to accounting profits.

Diff: 2

Topic: 21.2 Firms and Profits

AACSB: Analytic skills

Question Status: Previous Edition

21.3 Interest

- 1) Interest is paid to
- A) all holders of stock.
 - B) individuals who own gold.
 - C) owners of capital.
 - D) borrowers of funds.

Answer: C

Diff: 2

Topic: 21.3 Interest

Question Status: Previous Edition

- 2) Which of the following is correct?
- A) real interest rate = nominal interest rate – anticipated inflation rate
 - B) real interest rate = nominal interest rate + anticipated inflation rate
 - C) real interest rate = nominal interest rate * anticipated inflation rate
 - D) real interest rate = nominal interest rate / anticipated inflation rate

Answer: A

Diff: 2

Topic: 21.3 Interest

Question Status: Previous Edition

- 3) Interest can be defined as
- A) the amount of funds loaned to a creditor.
 - B) the participation of a shareholder in the operations of a firm.
 - C) the return paid to owners of capital.
 - D) the return above opportunity cost paid to owners of a firm.

Answer: C

Diff: 1

Topic: 21.3 Interest

Question Status: Previous Edition

- 4) In economic terms, interest is the payment for
- A) current command over resources.
 - B) producers' goods.
 - C) stocks.
 - D) both consumer and capital goods.

Answer: A

Diff: 1

Topic: 21.3 Interest

Question Status: Previous Edition

- 5) Which of the following characteristics is NOT likely to increase the interest on a loan?
- A) A high-risk proposal
 - B) A non-creditworthy borrower
 - C) A short-term loan
 - D) A larger dollar loan

Answer: C

Diff: 1

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

- 6) In most cases, the higher is the quality of the collateral for a loan is,
- A) the higher is the interest rate.
 - B) the lower is the interest rate.
 - C) the riskier is the loan.
 - D) the greater is the handling charge for the loan.

Answer: B

Diff: 1

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

- 7) Creditors require collateral in many cases, because
- A) it helps offset the risks of lending the funds.
 - B) the borrower is a low risk.
 - C) the loan is small.
 - D) none of the above.

Answer: A

Diff: 2

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

- 8) Because handling charges are relatively fixed, the interest rate on a loan generally
- A) increases with the size of the loan.
 - B) decreases with the size of the loan.
 - C) is constant regardless of the size of the loan.
 - D) is unrelated to the size of the loan.

Answer: B

Diff: 1

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

- 9) People basically borrow in order to
- A) go into debt.
 - B) have more funds.
 - C) have interest payments.
 - D) have current consumption rather than waiting to consume in the future.

Answer: D

Diff: 1

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

- 10) Interest rates are positive because
- A) people prefer future consumption over current consumption.
 - B) people prefer current consumption over future consumption.
 - C) usury laws require rates to be very high.
 - D) banks are not competitive.

Answer: B

Diff: 1

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

- 11) The greater is the risk of non-repayment of a loan, the
- A) higher is the expected rate of interest.
 - B) longer is the expected time to repay the loan.
 - C) lower is the handling charges for the loan.
 - D) lower is the expected rate of interest.

Answer: A

Diff: 1

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

- 12) Which combination of circumstances will most likely raise the rate of interest for a loan the most?
- A) Low handling charges and low risk
 - B) Low handling charges and a long length of time for repayment
 - C) High risk and low handling charges
 - D) High risk and a long length of time for repayment

Answer: D

Diff: 1

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

- 13) Under which one of the following situations would you be better off?
- A) You have \$10,000 in your savings account paying 5 percent per year and unanticipated inflation is 8 percent per year.
 - B) You have paid \$500 for a \$1,000 U.S. savings bond that matures in 10 years and unanticipated inflation is 10 percent per year.
 - C) You lend a friend \$1,000 at 6 percent to be repaid in one year and unanticipated inflation is 7 percent during the year.
 - D) You borrowed \$2,500 at 7 percent to pay for this year's college expenses and unanticipated inflation is 12 percent during the year.

Answer: D

Diff: 2

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Revised

- 14) Suppose that you borrow \$5,000 from the bank to purchase some land and you agree to pay 9 percent interest on the loan. If the loan must be repaid in 12 months and the inflation rate is 13 percent during the year, then
- A) you will repay the bank with dollars with more purchasing power than you initially borrowed.
 - B) you will repay the bank with fewer dollars than the bank initially loaned you.
 - C) you will repay the bank with dollars with less purchasing power than it initially loaned you.
 - D) the bank will receive fewer dollars, because of inflation, than it had initially expected to receive.

Answer: C

Diff: 2

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Revised

- 15) If the rate of inflation is zero, prices are expected to remain stable, and the nominal rate of interest is 5 percent, then the
- A) real rate of interest is equal to the nominal rate.
 - B) real rate of interest is less than the nominal rate.
 - C) nominal rate is greater than the real rate of interest.
 - D) investment demand schedule will shift upward.

Answer: A

Diff: 2

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

- 16) When the anticipated rate of inflation declines, the real rate of interest
- A) increases.
 - B) decreases.
 - C) is not affected.
 - D) increases exponentially.

Answer: A

Diff: 1

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

- 17) The real rate of interest will approximately be equal to
- A) the nominal interest rate plus the expected rate of inflation.
 - B) the stated rate of interest in a high-inflation economy.
 - C) the nominal interest rate minus the expected rate of change in the price level.
 - D) the stated rate minus the opportunity cost of capital.

Answer: C

Diff: 1

Topic: 21.3 Interest

Question Status: Previous Edition

- 18) The nominal rate of interest is
- A) the same as the price level.
 - B) the real rate of interest minus the previous year's change in the price level.
 - C) the interest rate actually paid by the borrower.
 - D) lower than the real rate in a period of inflation.

Answer: C

Diff: 1

Topic: 21.3 Interest

Question Status: Previous Edition

- 19) The real rate of interest is
- A) the nominal interest rate minus the anticipated rate of inflation.
 - B) the interest rate actually paid explicitly by the borrower.
 - C) the interest rate received by the lender minus the handling charges of the loan.
 - D) the average rate of interest over the last 20 years.

Answer: A

Diff: 1

Topic: 21.3 Interest

Question Status: Previous Edition

- 20) In an inflationary atmosphere that everyone anticipates will persist, lenders will
- A) desire a lower nominal interest rate to increase the real rate.
 - B) desire a higher nominal interest rate to protect against the inflation.
 - C) tend to see the real rate of interest increase, particularly if the inflation is unforeseen.
 - D) have the real rate of interest guaranteed by the Federal Reserve Board.

Answer: B

Diff: 1

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

- 21) When the anticipated rate of inflation is 5 percent and the real rate of interest is 4 percent, the nominal rate of interest is
- A) 1 percent.
 - B) 4 percent.
 - C) 5 percent.
 - D) 9 percent.

Answer: D

Diff: 1

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

- 22) Suppose that the nominal rate of interest is holding steady at 8 percent even as the anticipated rate of inflation rises. What is happening to the real rate of interest?
- A) It is unchanged.
 - B) It is increasing.
 - C) It is decreasing.
 - D) It equals the nominal interest rate.

Answer: C

Diff: 2

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

- 23) One role of the interest rate is to
- A) allocate capital to its most efficient uses.
 - B) redistribute income from the wealthy to the poor.
 - C) reduce the rate of inflation by encouraging government borrowing.
 - D) discourage saving and encourage current consumption.

Answer: A

Diff: 1

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

- 24) A star basketball player signs a contract that newspaper reports indicate is worth \$10 million. The player receives \$2 million upon signing, and \$2 million every year for four years. The contract is worth
- A) less than \$10 million since the present value of \$2 million received one or more years from now is less than \$2 million.
 - B) more than \$10 million since the present value of \$2 million received one or more years from now is more than \$2 million.
 - C) \$10 million as reported in the press.
 - D) some amount around \$10 million. To determine whether it is more or less than \$10 million we need to know whether the interest the player can earn is more or less than the market rate of interest.

Answer: A

Diff: 2

Topic: 21.3 Interest

AACSB: Reflective thinking skills

Question Status: Previous Edition

- 25) If the interest rate is 5 percent per year and you borrow \$100 for one year, at the end of the year you must pay back
- A) \$95.
 - B) \$100.
 - C) \$105.
 - D) \$5.

Answer: C

Diff: 1

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

- 26) If the interest rate is 5 percent per year and you borrow \$100 for two years, at the end of the second year you must pay back

A) \$90.70. B) \$10.25. C) \$105. D) \$110.25.

Answer: D

Diff: 1

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: New

- 27) Given a discount rate of 10 percent, the present value of receiving \$10,000 two years in the future is

A) \$12,000. B) \$8,000. C) \$8,264.46. D) \$12,100.

Answer: C

Diff: 1

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

- 28) What is the future value of \$1,000 in three years if the rate of discount is equal to 5 percent?

A) \$1,150.00 B) \$1,005.00 C) \$1,157.63 D) \$863.84

Answer: C

Diff: 1

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

- 29) Suppose that you borrow \$10,000 for one year, and at the end of the year, you must repay \$10,450. The interest rate is

A) 14.5 percent. B) 8.0 percent. C) 4.5 percent. D) 2.7 percent.

Answer: C

Diff: 2

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

- 30) Suppose that you borrow \$10,000 for one year, and at the end of the year, you must repay \$10,450. Also, during that year inflation was 2.5%. The **real** interest rate is

A) 12.0 percent. B) 7.0 percent. C) 4.5 percent. D) 2.0 percent.

Answer: D

Diff: 2

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: New

- 31) Suppose that you borrow \$10,000 for two years, and at the end of the second year, you must repay \$11,664. The interest rate is
- A) 16.7 percent. B) 8.0 percent. C) 7.0 percent. D) 9.0 percent.

Answer: B

Diff: 2

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: New

- 32) Assuming a market interest rate of 6 percent per year, what is the present value of \$5,000 payable at the end of three years?
- A) \$4,717 B) \$4,450 C) \$4,198 D) \$4,317

Answer: C

Diff: 2

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Revised

- 33) The rate of discount is best described as the rate of
- A) return on physical capital after the cost of capital has been removed.
B) return on financial assets after an inflation adjustment has been made.
C) interest used to derive the present values of future sums.
D) return on financial capital that has not been adjusted for inflation.

Answer: C

Diff: 1

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

- 34) The interest rate used to bring future sums back to present value is
- A) always negative. B) zero when there is no inflation.
C) the rate of discount. D) the prime rate.

Answer: C

Diff: 1

Topic: 21.3 Interest

Question Status: Previous Edition

- 35) When the rate of interest is 10 percent, the present value of \$100 payable in two years is approximately
- A) \$65. B) \$83. C) \$100. D) \$117.

Answer: B

Diff: 2

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

36) Present value is

- A) the value of a future amount expressed in today's dollars.
- B) the value of a dollar received a year from now, expressed in terms of its future value.
- C) the inverse of the interest rate.
- D) the nominal value instead of the real value of something.

Answer: A

Diff: 1

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

37) The present value of \$110 to be received one year from now

- A) is \$110.
- B) is \$100.
- C) is \$121.
- D) depends on the rate of discount.

Answer: D

Diff: 2

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

38) If the present value of \$110 to be received one year from now is \$100, what will \$100 be worth two years from now?

- A) \$110
- B) \$121
- C) \$100
- D) Can't say since we don't know what the interest rate is

Answer: B

Diff: 3

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

39) Financial capital is

- A) the collection of stock and bond exchanges around the country.
- B) funds used to purchase capital goods.
- C) the foreign exchange market.
- D) assets of financial institutions.

Answer: B

Diff: 1

Topic: 21.3 Interest

Question Status: Previous Edition

40) The funds used to purchase capital goods are called

- A) investment.
- B) savings.
- C) financial capital.
- D) dividends and interest.

Answer: C

Diff: 1

Topic: 21.3 Interest

Question Status: Previous Edition

41) In economics, interest refers to all of the following EXCEPT

- A) the payment for current rather than future command over resources.
- B) the cost of obtaining credit.
- C) the return paid to owners of financial institutions.
- D) the return paid to the owners of capital.

Answer: C

Diff: 1

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

42) Businesses go to credit markets in order to

- A) obtain capital.
- B) obtain financial assets that can be used to buy capital.
- C) obtain capital so they can earn rents.
- D) channel their savings into investments.

Answer: B

Diff: 2

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

43) The payment for current rather than future command over resources is

- A) an implicit cost.
- B) an implicit benefit.
- C) interest.
- D) opportunity cost.

Answer: C

Diff: 1

Topic: 21.3 Interest

Question Status: Previous Edition

44) Interest rates are higher the

- A) shorter the duration of the loan.
- B) greater the risk.
- C) larger the amount of the loan, holding other things constant.
- D) lower the inflation rate.

Answer: B

Diff: 1

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

45) Larger loans, other things constant, have lower interest rates because

- A) only large, financially sound corporations obtain such loans.
- B) large loans always have collateral.
- C) large loans are always for short time periods.
- D) the fixed costs associated with the handling charges as a percent of the total loan are less.

Answer: D

Diff: 2

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

46) Businesses demand funds because

- A) they prefer earlier consumption to later consumption.
- B) they have deficits to cover.
- C) they prefer to purchase capital goods in the current year.
- D) they make investments that they believe will increase productivity and profitability.

Answer: D

Diff: 1

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

47) The real rate of interest is

- A) equal to the nominal rate of interest less the anticipated rate of inflation.
- B) equal to the nominal rate of interest plus the anticipated rate of inflation.
- C) found by taking the nominal rate of interest and dividing it by the actual rate of inflation.
- D) found by taking the nominal rate of interest and adding the actual rate of inflation.

Answer: A

Diff: 1

Topic: 21.3 Interest

Question Status: Previous Edition

48) The nominal rate of interest is

- A) the rate observed in the market that includes an inflation premium.
- B) not the rate observed in the market.
- C) not adjusted for inflation.
- D) expressed in dollars from the chosen base year.

Answer: A

Diff: 1

Topic: 21.3 Interest

Question Status: Previous Edition

49) If the nominal interest rate is high and rising, a possible cause is

- A) increased lending activity.
- B) a rising inflation rate.
- C) a falling real interest rates.
- D) increased government borrowing.

Answer: B

Diff: 2

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

50) The real rate of interest is 4% and the anticipated rate of inflation is 1%. What is the nominal rate of interest?

- A) 1%
- B) 3%
- C) 4%
- D) 5%

Answer: D

Diff: 2

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

- 51) The real rate of interest is 5% and the anticipated rate of inflation is 2%. What is the nominal rate of interest?

A) 7% B) 5% C) 3% D) 2%

Answer: A

Diff: 2

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

- 52) The nominal rate of interest is 4% and the anticipated rate of inflation is 1%. What is the real rate of interest?

A) 1% B) 3% C) 4% D) 5%

Answer: B

Diff: 1

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

- 53) The nominal rate of interest is 6% and the anticipated rate of inflation is 2%. What is the real rate of interest?

A) 8% B) 6% C) 4% D) 2%

Answer: C

Diff: 2

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

- 54) Interest rates perform the function of

A) signaling information about the inflation rate.
B) allocating funds, but only in the consumer sector.
C) allocating funds, which determines the allocation of physical capital.
D) rewarding those who save but has no direct allocative role.

Answer: C

Diff: 2

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

- 55) Suppose the auto industry has several investment projects with an expected rate of return of 15 percent, the aluminum industry has projects with an expected return of over 20 percent, the publishing industry projects with an expected return of 10 percent, the steel industry has projects with an expected return of 7 percent and the rubber industry projects with an expected return of 5 percent. The current market rate of interest is 7 percent. A reduction in the supply of funds causes interest rates to rise to 11 percent. The effect is to
- A) cause the firms in the steel and publishing industries to cancel their projects, which would have been funded at the old interest rate.
 - B) cause the firms in the steel and the rubber industries to go ahead with their projects.
 - C) force the firms in the automobile industry and the publishing industry to rely on funding their projects through other means.
 - D) make the projects of the aluminum industry and the steel industry unprofitable; the firms in these industries will not borrow the funds or make the investments.

Answer: A

Diff: 2

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

- 56) When interest rates allocate capital,
- A) many worthwhile projects fail to get funded and society is worse off.
 - B) investment projects of firms tend to get funded while valuable social investments funded by the government tend not to get funded.
 - C) only investment projects are funded for which the expected benefits of the projects equal or exceed the opportunity cost of the projects.
 - D) there is an under investment in capital and overspending on durable consumer goods.

Answer: C

Diff: 3

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

- 57) The value of a future amount expressed in today's dollars is
- A) the interest rate.
 - B) present value.
 - C) the discount rate.
 - D) the inflation rate.

Answer: B

Diff: 1

Topic: 21.3 Interest

Question Status: Previous Edition

- 58) The most that someone would pay today to receive a certain sum at some point in the future is known as
- A) the interest rate.
 - B) present value.
 - C) future value.
 - D) economic profit.

Answer: B

Diff: 1

Topic: 21.3 Interest

Question Status: Previous Edition

- 59) What is the present value of \$100 one year from now at an interest rate of 5%?
A) \$5 B) \$95.24 C) \$100 D) \$105

Answer: B

Diff: 2

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

- 60) What is the present value of \$100 one-year from now at an interest rate of 6%?
A) \$160 B) \$106 C) \$94.34 D) \$6

Answer: C

Diff: 2

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

- 61) What is the present value of \$100 two years from now at an interest rate of 5%?
A) \$105 B) \$95.24 C) \$90.70 D) \$5

Answer: C

Diff: 3

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

- 62) What is the present value of \$100 two years from now at an interest rate of 6%?
A) \$6 B) \$89 C) \$94.34 D) \$106

Answer: B

Diff: 3

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

- 63) What is the present value of \$100 three years from now at an interest rate of 5%?
A) \$85 B) \$115.76 C) \$90.70 D) \$86.38

Answer: D

Diff: 3

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: New

- 64) What is the present value of \$100 three years from now at an interest rate of 6%?
A) \$83.96 B) \$82 C) \$94.34 D) \$119.10

Answer: A

Diff: 3

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: New

- 65) The present value of \$100 to be received one year from now
- A) is \$100.
 - B) is \$110.
 - C) is \$90.
 - D) cannot be determined without knowing the interest rate.

Answer: D

Diff: 2

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

- 66) If the annual interest rate remains unchanged over the next two years, and the present value of \$120 to be received one year from now is \$100, what will \$100 be worth two years from now?
- A) \$120
 - B) \$140
 - C) \$144
 - D) Uncertain. We need to know the interest rate.

Answer: C

Diff: 3

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

- 67) The general form for discounting is
- A) $PV = A_t * (1 + i)^t$.
 - B) $PV = A_t / (1 + i)^t$.
 - C) $PV = (1 + i)^t / A_t$.
 - D) $PV = 1 / (1 + i)^t$.

Answer: B

Diff: 2

Topic: 21.3 Interest

Question Status: Previous Edition

- 68) A firm is considering three projects. Each costs \$1 million now. Project A will yield \$400,000 a year for three years, beginning one year from now. Project B will yield \$1.25 million three years from now, and Project C will yield \$600,000 for two years, beginning two years from now. If the interest rate is 8 percent, which of these projects should the firm undertake?
- A) Project A.
 - B) Project B.
 - C) Project C.
 - D) None of these.

Answer: A

Diff: 3

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

69) The present value of a sum to be received in the future is greater

- A) the greater the interest rate.
- B) the less the time period before receiving the sum.
- C) the greater the inflation rate.
- D) the greater the discount rate.

Answer: B

Diff: 2

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

70) A firm is considering an investment that will cost \$2 million today and \$2 million a year from now. It will generate revenues of \$1 million a year for five years, beginning two years from now. If the interest rate is 10 percent, the firm should

- A) not make the investment because the present value of the net revenues is less than the present value of the investment spending.
- B) not make the investment because the present value of the net revenues is less than \$4 million.
- C) make the investment because the present value of the net revenues is greater than the present value of the investment.
- D) make the investment because the project will generate a net profit of \$1 million.

Answer: A

Diff: 3

Topic: 21.3 Interest

AACSB: Reflective thinking skills

Question Status: Previous Edition

71) The greater the interest rate,

- A) the greater the present value of a sum to be received a year in the future.
- B) the greater the opportunity cost of another dollar of current consumption.
- C) the more a dollar invested today will be worth a year from now.
- D) the lower the discount rate.

Answer: B

Diff: 2

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

72) A star basketball player signs a contract that newspaper reports say is worth \$20 million. The player receives \$5 million on signing, and \$5 million a year for three years. The contract is worth

- A) \$20 million as reported in the papers.
- B) less than \$20 million since the present value of \$5 million received one or more years from now is less than \$5 million.
- C) more than \$20 million because the present value of \$5 million received one or more years from now is more than \$5 million.
- D) either more or less than \$20 million, depending on the value of the discount rate.

Answer: B

Diff: 2

Topic: 21.3 Interest

AACSB: Reflective thinking skills

Question Status: Previous Edition

- 73) The difference between the nominal rate of interest and the real rate of interest is
- A) handling charges.
 - B) government regulatory charges.
 - C) administrative overhead charges.
 - D) the anticipated rate of inflation.

Answer: D

Diff: 2

Topic: 21.3 Interest

Question Status: Previous Edition

- 74) Assuming a market rate of interest equal to 7 percent, what is the present value of \$200 to be received one year from today?

A) \$123 B) \$156 C) \$187 D) \$210

Answer: C

Diff: 3

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

- 75) Assuming a market rate of interest equal to 7 percent and anticipated inflation is 2 percent, what is the **real** (adjusted for inflation) present value of \$200 to be received one year from today?

A) \$190 B) \$214 C) \$187 D) \$210

Answer: A

Diff: 3

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: New

- 76) How much money would you have to put into a savings account today to be worth \$500 three years from now at a market rate of interest equal to 8 percent?

A) \$397 B) \$351 C) \$420 D) \$459

Answer: A

Diff: 3

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

- 77) If the bank advertises 6 percent annual interest rate on a one-year certificate of deposit and you anticipate the rate of inflation to rise to 3 percent during the year, then the real rate of interest on the certificate of deposit is

A) 9 percent. B) 6 percent. C) 3 percent. D) 2 percent.

Answer: C

Diff: 2

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

- 78) The rate of interest that you pay on a home loan depends upon all of the following EXCEPT
- A) the supply of houses in the real estate market.
 - B) the length of the loan.
 - C) your credit rating.
 - D) handling charges or loan fees.

Answer: A

Diff: 2

Topic: 21.3 Interest

Question Status: Previous Edition

- 79) What is the present value of \$104.25 that you could receive one year from now, given that the rate of interest is 4.25 percent?
- A) \$108.50
 - B) \$0.00
 - C) \$4.25
 - D) \$100.00

Answer: D

Diff: 1

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

- 80) What is the **real** (adjusted for inflation) present value of \$104.25 that you could receive one year from now, given that the rate of interest is 4.25 percent and the anticipated rate of inflation is 1 percent?
- A) \$99.05
 - B) \$100.97
 - C) \$107.64
 - D) \$100.00

Answer: B

Diff: 3

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: New

- 81) The higher the expected rate of inflation,
- A) the lower is the nominal rate of interest.
 - B) the higher is the real rate of interest.
 - C) the higher is the nominal rate of interest.
 - D) the higher the real and nominal rates of interest.

Answer: C

Diff: 1

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

- 82) The greater the risk of nonrepayment of a loan, other things being equal
- A) the longer is the repayment term.
 - B) the lower is the charged loan fees.
 - C) the higher is the rate of interest.
 - D) the smaller is the amount of collateral that is used.

Answer: C

Diff: 1

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

83) Present value is

- A) unrelated to the rate of interest.
- B) lower the longer the time horizon.
- C) not expressed in today's dollars.
- D) opposite the time value of money.

Answer: B

Diff: 1

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

84) The real interest rate is the

- A) nominal interest rate plus the anticipated interest rate.
- B) nominal interest rate minus the anticipated interest rate.
- C) nominal interest rate plus the anticipated inflation rate.
- D) nominal interest rate minus the anticipated inflation rate.

Answer: D

Diff: 1

Topic: 21.3 Interest

Question Status: Previous Edition

85) If the interest rate is 10 percent per year, and you have \$100,000 now, which of the following is closest to what your \$100,000 will be worth in one year?

- A) \$105,000
- B) \$110,000
- C) \$100,000
- D) \$102,000

Answer: B

Diff: 2

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

86) The ABC Corporation earned a real rate return of 4.5 percent on an investment. In the economy, the nominal rate of interest was 6 percent and the rate of inflation was 3 percent. We can conclude that

- A) the investment was unprofitable.
- B) the investment was profitable.
- C) the real rate of interest was 9 percent.
- D) the real rate of interest was 1.5 percent.

Answer: B

Diff: 2

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

87) Last year, the nominal interest rate was less than the anticipated rate of inflation.

- A) This means that not enough loans were made by banks.
- B) This means that the real interest rate was negative.
- C) This means that the real interest rate was very high.
- D) This scenario is not possible.

Answer: B

Diff: 1

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

- 88) If the interest rate is 10 percent per year, and you have \$100,000 now, which of the following is closest to what your \$100,000 will be worth in three years?

A) \$155,000 B) \$115,000 C) \$120,000 D) \$133,000

Answer: D

Diff: 3

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

- 89) If the interest rate is 10 percent per year, and you have \$100,000 now, which of the following is closest to what your \$100,000 will be worth in four years?

A) \$175,000 B) \$125,000 C) \$146,000 D) \$190,000

Answer: C

Diff: 3

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

- 90) Suppose someone offered to give you \$1,000,000 five years in the future and the anticipated interest rate is 5 percent. The present value of this offer would be worth approximately

A) \$784,000. B) \$500,000. C) \$1,050,000. D) \$286,000

Answer: A

Diff: 3

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

- 91) What are the two meanings of interest in economics?

Answer: Interest refers to the price paid by debtors to creditors for the use of funds and refers to the market return earned by capital as a factor of production.

Diff: 1

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

- 92) Do people make decisions on the basis of the nominal interest rate or the real interest rate? What is the relationship between the two interest rates?

Answer: People make their decisions on the basis of the real interest rate since decisions are always made on the basis of relative and not absolute prices. The nominal interest rate equals the real interest rate plus the anticipated rate of inflation.

Diff: 2

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

93) How is inflation related to interest rates?

Answer: People base their decisions on borrowing, lending, and investing on the basis of the real interest rate. If there is anticipated inflation, the nominal rate of interest will equal the real rate of interest plus the anticipated inflation rate. So, interest rates vary directly with anticipated inflation. Unanticipated inflation leads to a real interest rate different from what people thought, and the decisions people made turn out to be mistaken.

Diff: 2

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Revised

94) What is the main purpose of an interest payment? What major factors affect interest rates?

Answer: Interest is the price paid by debtors to creditors for the use of loanable funds or financial capital. It represents the cost of obtaining credit and it compensates the creditors for their loss of current command over resources. Interest rates are affected by such factors as the length of loan, risk of nonrepayment of the loan and handling changes.

Diff: 1

Topic: 21.3 Interest

AACSB: Analytic skills

Question Status: Previous Edition

95) You have won the lottery. There are two payment options for you. The first option is a lump sum payment of \$10 million that you will receive immediately. The second option is an annual payment of \$1 million for each of the next 12 years. Assume there is no inflation. How would you make a decision between the two options?

Answer: You need to compare the present values of the two payment options and select the option with the higher present value. The present value of the lump sum payment is \$10 million, but the total present value of the scheduled payments depends on the interest rate that you would use to discount the future payments back to present value.

Diff: 2

Topic: 21.3 Interest

AACSB: Reflective thinking skills

Question Status: Previous Edition

21.4 Corporate Financing Methods

1) A shareholder in a corporation

- A) may not sell his or her share of ownership in the business without the business dissolving.
- B) can earn interest, but not dividends, from the profits of the business.
- C) is a part owner of the business.
- D) is personally liable for the debts of the corporation.

Answer: C

Diff: 1

Topic: 21.4 Corporate Financing Methods

AACSB: Analytic skills

Question Status: Previous Edition

- 2) The part of corporate profits that is paid to the shareholders of a corporation is
- A) retained earnings.
 - B) shareholders.
 - C) dividends.
 - D) business revenue.

Answer: C

Diff: 1

Topic: 21.4 Corporate Financing Methods

Question Status: Previous Edition

- 3) Each of the following is a source of financial capital for a corporation EXCEPT
- A) issuing new stock.
 - B) reinvestment of profit or retained earnings.
 - C) issuing bonds or borrowing funds from a bank.
 - D) dividends.

Answer: D

Diff: 1

Topic: 21.4 Corporate Financing Methods

Question Status: Previous Edition

- 4) Corporations are able to raise large amounts of financial capital because
- A) of the tax breaks corporations are given relative to partnerships or proprietorships.
 - B) of the elimination of the problem of separation of ownership and control.
 - C) of limited liability and the treatment of a corporation as an individual entity.
 - D) of their greater ability to monitor the performance of decision makers.

Answer: C

Diff: 3

Topic: 21.4 Corporate Financing Methods

AACSB: Analytic skills

Question Status: Previous Edition

- 5) In which of the following ways can a corporation raise new funds for investment?
- I. Issuing new shares of stock
 - II. Having existing stock resold between two owners
- A) I only B) II only C) Both I and II D) Neither I nor II

Answer: A

Diff: 1

Topic: 21.4 Corporate Financing Methods

Question Status: Previous Edition

- 6) A difference between a share of stock in a corporation and a corporate bond is that
- A) the share of stock is a legal claim while the bond is not.
 - B) the bond owner has voting rights within the corporation whereas the stockholder does not.
 - C) the bond owner is entitled to receive a fixed annual coupon payment plus a lump-sum payment at the bond's maturity date, whereas the stockholder is entitled to a share of future profits.
 - D) stocks are issued in return for funds that are lent to the corporation.

Answer: C

Diff: 1

Topic: 21.4 Corporate Financing Methods

AACSB: Analytic skills

Question Status: Previous Edition

- 7) The owners of preferred stock
- A) receive preferential treatment in the payment of dividends.
 - B) have the same voting rights as owners of common stock.
 - C) are the original owners of the corporation.
 - D) have the same rights as bondholders.

Answer: A

Diff: 1

Topic: 21.4 Corporate Financing Methods

AACSB: Analytic skills

Question Status: Previous Edition

- 8) When a firm uses profits to purchase new capital equipment, it is engaging in
- A) tax evasion.
 - B) balance sheet accounting.
 - C) reinvestment.
 - D) the most risky way the firm can obtain investment funds.

Answer: C

Diff: 1

Topic: 21.4 Corporate Financing Methods

AACSB: Analytic skills

Question Status: Previous Edition

- 9) A share of stock in a corporation is
- A) a guarantee to a fixed amount of income from the corporation.
 - B) a legal claim to a lump-sum payment at a specified point of time in the future.
 - C) a legal claim to a dividend, regardless of the corporation's ability to pay its interest payments.
 - D) a legal claim to a share of the company's future profits.

Answer: D

Diff: 1

Topic: 21.4 Corporate Financing Methods

Question Status: Previous Edition

- 10) The person least likely to receive a payment from a corporation in a year of losses is the
- A) bank that loaned money to the corporation.
 - B) bondholder.
 - C) preferred stockholder.
 - D) common stockholder.

Answer: D

Diff: 2

Topic: 21.4 Corporate Financing Methods

AACSB: Analytic skills

Question Status: Previous Edition

- 11) If profits are reinvested in the corporation, then
- A) payments made to bondholders will be less.
 - B) there are fewer funds available to distribute to stockholders.
 - C) the company will sell more bonds in order to pay dividends to stockholders.
 - D) the high profits indicate that common stockholders will get larger dividends than normal.

Answer: B

Diff: 1

Topic: 21.4 Corporate Financing Methods

AACSB: Analytic skills

Question Status: Previous Edition

- 12) If you want a say in the management of a corporation, you should buy
- A) common stock.
 - B) preferred stock.
 - C) bonds.
 - D) either bonds or preferred stock.

Answer: A

Diff: 2

Topic: 21.4 Corporate Financing Methods

AACSB: Analytic skills

Question Status: Previous Edition

- 13) A legal claim against a firm that usually entitles the owner of the claim to receive a fixed annual coupon payment, plus a lump-sum payment at some future date, is known as
- A) a bond.
 - B) a share of common stock.
 - C) a share of preferred stock.
 - D) a reinvestment coupon.

Answer: A

Diff: 1

Topic: 21.4 Corporate Financing Methods

Question Status: Previous Edition

- 14) An investor who owns preferred stock has
- A) regular voting rights.
 - B) preferential treatment in the payment of dividends.
 - C) the same rights as a bond holder.
 - D) unlimited liability for the debts of the firm.

Answer: B

Diff: 1

Topic: 21.4 Corporate Financing Methods

AACSB: Analytic skills

Question Status: Previous Edition

- 15) Bond coupon payments represent
- A) dividends paid to owners.
 - B) interest on the amount borrowed.
 - C) capital gains for tax purposes.
 - D) payments to preferred shareholders.

Answer: B

Diff: 1

Topic: 21.4 Corporate Financing Methods

Question Status: Previous Edition

16) Which of the following modern methods of financing a corporation was not available to corporations four hundred years ago?

- A) Selling stock.
- B) Selling bonds.
- C) Reinvestment.
- D) All of these methods were used then as well as now.

Answer: D

Diff: 1

Topic: 21.4 Corporate Financing Methods

Question Status: Previous Edition

17) A legal claim to a part of a corporation's future profits is called

- A) a bond.
- B) a share of stock.
- C) a dividend.
- D) a financial debt.

Answer: B

Diff: 1

Topic: 21.4 Corporate Financing Methods

Question Status: Previous Edition

18) Which legal claim comes with voting rights?

- A) Common stock
- B) Preferred stock
- C) Bond
- D) Reinvestment

Answer: A

Diff: 1

Topic: 21.4 Corporate Financing Methods

AACSB: Analytic skills

Question Status: Previous Edition

19) Which legal claim has a fixed annual coupon payment?

- A) Common stock
- B) Preferred stock
- C) Bond
- D) Reinvestment

Answer: C

Diff: 1

Topic: 21.4 Corporate Financing Methods

AACSB: Analytic skills

Question Status: Previous Edition

20) Which legal claim comes with the most preferential treatment in the payment of dividends?

- A) Common stock
- B) Preferred stock
- C) Bond
- D) Reinvestment

Answer: B

Diff: 1

Topic: 21.4 Corporate Financing Methods

AACSB: Analytic skills

Question Status: Previous Edition

21) Which of the following is not a principal method of financing today?

- A) Common stock
- B) Bond
- C) Reinvestment
- D) The entrepreneur's wealth

Answer: D

Diff: 1

Topic: 21.4 Corporate Financing Methods

Question Status: Previous Edition

- 22) A bond is
- A) a legal claim to a part of a corporation's future profits that includes voting rights.
 - B) a legal claim to a part of a corporation's future profits that does not include voting rights.
 - C) a legal claim against a firm, providing a fixed annual coupon payment and a lump-sum payment at maturity.
 - D) a nonlegal promise to provide an annual payment to the holder when the corporation makes profits.

Answer: C

Diff: 1

Topic: 21.4 Corporate Financing Methods

Question Status: Previous Edition

- 23) The most important source of financial capital for firms today is
- A) sale of bonds.
 - B) sale of new issues of stock.
 - C) trade of previously issued stock.
 - D) reinvestment of profits.

Answer: D

Diff: 2

Topic: 21.4 Corporate Financing Methods

AACSB: Analytic skills

Question Status: Previous Edition

- 24) The person most likely to receive a payment from a corporation in a year of losses is the
- A) bondholder.
 - B) common stockholder.
 - C) preferred stockholder.
 - D) investment banker.

Answer: A

Diff: 2

Topic: 21.4 Corporate Financing Methods

AACSB: Analytic skills

Question Status: Previous Edition

- 25) The more profits are reinvested into the firm, the
- A) less there is available to distribute to bondholders.
 - B) less there is available to distribute to stockholders.
 - C) more the firm will be able to raise in sales of new issues to stock.
 - D) more bonds the firm will sell in order to pay their required dividends to preferred stockholders.

Answer: B

Diff: 3

Topic: 21.4 Corporate Financing Methods

AACSB: Analytic skills

Question Status: Previous Edition

- 26) A person who is willing to bear more risk will buy
- A) common stock.
 - B) preferred stock.
 - C) bonds.
 - D) government bonds.

Answer: A

Diff: 2

Topic: 21.4 Corporate Financing Methods

AACSB: Analytic skills

Question Status: Previous Edition

- 27) The three primary sources of corporate funds are
- A) banks, friends, and family.
 - B) government, other corporations, and the central bank.
 - C) investment banks, brokerages, and insurance companies.
 - D) stocks, bonds, and reinvestment of profits.

Answer: D

Diff: 1

Topic: 21.4 Corporate Financing Methods

Question Status: New

- 28) If you own 500 shares of preferred stock, how many regular votes would you get to cast at the next stockholders meeting?
- A) 500
 - B) 250
 - C) 1
 - D) 0

Answer: D

Diff: 2

Topic: 21.4 Corporate Financing Methods

AACSB: Analytic skills

Question Status: Previous Edition

- 29) When the Dutch East India Company was founded in 1602, it raised financial capital by issuing notes of indebtedness called
- A) stocks.
 - B) bonds.
 - C) funds.
 - D) notes.

Answer: B

Diff: 1

Topic: 21.4 Corporate Financing Methods

Question Status: Previous Edition

- 30) When Patricia sells her General Motors common stock at the same time that Brian purchases the same amount of General Motors stock from another party, General Motors receives
- A) the dollar value of the transaction.
 - B) only the par value of the common stock.
 - C) nothing.
 - D) the dollar amount of the transaction, less brokerage fees.

Answer: C

Diff: 1

Topic: 21.4 Corporate Financing Methods

AACSB: Analytic skills

Question Status: Previous Edition

- 31) Stocks are
- A) promises to repay loans.
 - B) a liability of a proprietorship.
 - C) a liability of a corporation.
 - D) shares of ownership in a corporation.

Answer: D

Diff: 1

Topic: 21.4 Corporate Financing Methods

Question Status: Revised

32) Bonds are

- A) promises to repay loans.
- B) promissory notes issued by partnerships.
- C) promissory notes issued by proprietorships.
- D) shares of ownership in a corporation.

Answer: A

Diff: 1

Topic: 21.4 Corporate Financing Methods

Question Status: Previous Edition

33) When a person buys stock in a company, that person is buying _____, but when a person buys a bond in a company, that person is _____ the company.

- A) ownership; borrowing funds from
- B) ownership; lending funds to
- C) debt; lending funds to
- D) debt; borrowing funds from

Answer: B

Diff: 2

Topic: 21.4 Corporate Financing Methods

AACSB: Analytic skills

Question Status: Previous Edition

34) A legal claim to a percentage of a company's future profits and assets is known as a

- A) share of stock.
- B) bond.
- C) dividend.
- D) random walk.

Answer: A

Diff: 1

Topic: 21.4 Corporate Financing Methods

Question Status: Previous Edition

35) A long-term loan that is given to a firm is known as a

- A) share of stock.
- B) bond.
- C) dividend.
- D) random walk.

Answer: B

Diff: 1

Topic: 21.4 Corporate Financing Methods

Question Status: Previous Edition

36) When a corporation uses profits to pay for the purchase of new capital equipment, this is known as

- A) reinvestment.
- B) a coupon payment.
- C) dividend.
- D) collusion.

Answer: A

Diff: 1

Topic: 21.4 Corporate Financing Methods

Question Status: Previous Edition

37) If a corporation fails, the first recipients of funds that may remain are

- A) preferred stockholders.
- B) common stockholders.
- C) bond holders.
- D) no one.

Answer: C

Diff: 2

Topic: 21.4 Corporate Financing Methods

AACSB: Analytic skills

Question Status: Previous Edition

- 38) If a corporation fails, the last recipients of funds that may remain are
- A) preferred stockholders.
 - B) common stockholders.
 - C) bond holders.
 - D) government tax collectors.

Answer: B

Diff: 2

Topic: 21.4 Corporate Financing Methods

AACSB: Analytic skills

Question Status: New

- 39) Suppose you own \$15,000 of personal property, \$5,000 of stock in ABC Corporation, a \$1,000 certificate of deposit, and \$10,000 of government bonds. If ABC goes bankrupt, the most you could lose is
- A) \$31,000.
 - B) \$26,000.
 - C) \$15,000.
 - D) \$5,000.

Answer: D

Diff: 2

Topic: 21.4 Corporate Financing Methods

AACSB: Analytic skills

Question Status: Previous Edition

- 40) A company raises funds by selling 5 million shares of common stock to 5,000 shareholders and \$1 million bonds to 1,000 bondholders. The number of individuals who vote for the company's board of directors is
- A) 6,000.
 - B) 5,000.
 - C) 1,000.
 - D) 5,000,000.

Answer: B

Diff: 2

Topic: 21.4 Corporate Financing Methods

AACSB: Analytic skills

Question Status: Previous Edition

- 41) A legal claim entitling the owner of the claim to fixed annual payments and a lump-sum payment is called a(n)
- A) equity share.
 - B) bond.
 - C) stock.
 - D) debit.

Answer: B

Diff: 1

Topic: 21.4 Corporate Financing Methods

Question Status: Revised

- 42) If you want to vote for the management of the corporation, you should buy
- A) common stock.
 - B) preferred stock.
 - C) bonds.
 - D) either common stock or preferred stock.

Answer: A

Diff: 1

Topic: 21.4 Corporate Financing Methods

AACSB: Analytic skills

Question Status: Revised

- 43) Suppose a firm wanted to go out of business. The firm sells all its assets and pays off everything it owes to creditors. The stockholders would receive

A) nothing.
B) their annual dividend payment.
C) one half of the funds; the other half of the funds goes to bondholders.
D) the rest of the funds, after everyone who has a claim against the firm is paid.

Answer: D

Diff: 2

Topic: 21.4 Corporate Financing Methods

AACSB: Analytic skills

Question Status: Revised

- 44) Describe and explain the three principle methods of financing used by corporations.

Answer: Corporations raise funds by selling stocks, selling bonds, and reinvesting profits. A share of stock is a form of ownership in the firm and entitles the owner to a share of future profits. A person who buys a bond from a firm is lending the firm money. Finally, if the firm earns profits, it can use some of them for investment rather than pay them all out to stockholders as dividends.

Diff: 1

Topic: 21.4 Corporate Financing Methods

AACSB: Analytic skills

Question Status: Previous Edition

- 45) What would happen if a corporation goes out of business?

Answer: The assets of the corporation would be sold and the bondholders would receive the funds due them. Any funds left over would be divided among the shareholders. Firms must pay their obligations to bondholders before stockholders get money.

Diff: 1

Topic: 21.4 Corporate Financing Methods

AACSB: Analytic skills

Question Status: Previous Edition

- 46) Which method of corporate finance is used the most? Why?

Answer: Reinvestment accounts for about 75 percent of new financial capital for corporations. Smaller corporations may find it difficult to find people willing to buy shares of stock, and the existing owners may not want other owners involved in electing directors. Smaller firms may also have a difficult time getting people to lend to them. So, they have to rely on reinvesting profits.

Diff: 3

Topic: 21.4 Corporate Financing Methods

AACSB: Analytic skills

Question Status: Previous Edition

- 47) Suppose that you decide to purchase either stocks or bonds of a particular corporation and you also prefer to receive some returns from the securities every year. Which should you buy – stocks or bonds? Why?

Answer: You should buy bonds because you would receive coupons payments each year from holding the bonds whether the corporation makes profits or not while there is no guarantee for any payment for holding stocks.

Diff: 2

Topic: 21.4 Corporate Financing Methods

AACSB: Analytic skills

Question Status: Previous Edition

21.5 The Markets for Stocks and Bonds

- 1) According to the random walk theory,
- A) today's stock price will be related to yesterday's stock price.
 - B) successive prices of a stock are independent of each other.
 - C) stock prices can easily be predicted for as much as 52 weeks into the future.
 - D) stock prices rise and fall in predictable cycles that correspond with the overall business cycle.

Answer: B

Diff: 1

Topic: 21.5 The Markets for Stocks and Bonds

AACSB: Analytic skills

Question Status: Previous Edition

- 2) The random walk theory says that
- A) stock prices follow a trend for varying periods of time.
 - B) successive stock prices increase more than they decrease.
 - C) successive stock prices are dependent on the weighted average of the previous week's prices.
 - D) successive stock prices are independent of each other.

Answer: D

Diff: 2

Topic: 21.5 The Markets for Stocks and Bonds

AACSB: Analytic skills

Question Status: Previous Edition

- 3) Which of the following statements about "inside information" is FALSE?
- A) It is information that is not available to the general public.
 - B) It is illegal to knowingly use inside information when trading stocks.
 - C) Profits can be made using inside information.
 - D) The government never imposes fines or other penalties for abuse of inside information.

Answer: D

Diff: 1

Topic: 21.5 The Markets for Stocks and Bonds

AACSB: Analytic skills

Question Status: Previous Edition

- 4) The idea that any public information you will be able to find will prove of little value to you when buying and selling stocks, because that information is so quickly incorporated into the trading prices of stocks, is known as the

A) theory of efficient markets. B) theory of fundamental analysis.
C) principle of context. D) over-the-counter hypothesis.

Answer: A

Diff: 1

Topic: 21.5 The Markets for Stocks and Bonds

Question Status: Previous Edition

- 5) The yield percentage of a stock is calculated as

A) the corporation's net worth divided by the number of shareholders.
B) the book value of the stock divided by the number of shareholders.
C) the stock dividend divided by the price of the stock.
D) the expected appreciation of the stock.

Answer: C

Diff: 1

Topic: 21.5 The Markets for Stocks and Bonds

Question Status: Previous Edition

- 6) The PE ratio for a stock is

A) the predicted earnings per share of the stock divided by its current yield.
B) the current yield of the stock.
C) the price of the stock divided by its earnings per share.
D) the predicted volatility of the stock.

Answer: C

Diff: 1

Topic: 21.5 The Markets for Stocks and Bonds

Question Status: Previous Edition

- 7) A stock that has a price of \$20 per share, earnings per share of \$2.00, and a dividend of \$1.50 will have

A) a PE ratio of 20/1.50. B) a yield of 7.5 percent.
C) a yield of 12 percent. D) a PE ratio of 1.333.

Answer: B

Diff: 1

Topic: 21.5 The Markets for Stocks and Bonds

AACSB: Analytic skills

Question Status: Previous Edition

- 8) The most prestigious stock market in the world is the

A) New York Stock Exchange. B) Chicago Mercantile Exchange.
C) London Stock Exchange. D) Tokyo Stock Exchange.

Answer: A

Diff: 1

Topic: 21.5 The Markets for Stocks and Bonds

Question Status: Previous Edition

- 9) Stock markets for securities are important because
- A) they are where corporations raise financial capital.
 - B) they are where proprietorships and partnerships raise financial capital.
 - C) they permit individuals to transfer their savings directly into investment spending.
 - D) they make the stocks and bonds more valuable.

Answer: A

Diff: 1

Topic: 21.5 The Markets for Stocks and Bonds

Question Status: Previous Edition

- 10) Exchanges of stocks take place
- A) in New York City only.
 - B) in the principle financial city of each country, such as New York City for the United States and London for England.
 - C) in a decentralized fashion around the world.
 - D) in centralized physical locations known as stock exchanges and online through Internet brokers.

Answer: D

Diff: 2

Topic: 21.5 The Markets for Stocks and Bonds

Question Status: Previous Edition

- 11) According to the random walk theory,
- A) the probability that a stock's price will increase tomorrow is greater if it increased today.
 - B) the probability that a stock's price will increase tomorrow is greater if it decreased today.
 - C) the best forecast of tomorrow's price is today's price.
 - D) the best forecast of tomorrow's price is found by determining the trend for the last five trading days.

Answer: C

Diff: 2

Topic: 21.5 The Markets for Stocks and Bonds

AACSB: Analytic skills

Question Status: Previous Edition

- 12) The theory that there is no predictable trends in securities prices is the
- A) opportunity cost of capital.
 - B) random walk theory.
 - C) capital reinvestment.
 - D) present value.

Answer: B

Diff: 1

Topic: 21.5 The Markets for Stocks and Bonds

Question Status: Previous Edition

- 13) Which of the following is a TRUE statement about stock markets?
- A) Economists can make above-average profits in the stock market because of their specialized knowledge of economics.
 - B) It is always better to buy growth stocks than the older and more stable blue-chip stocks.
 - C) The stock market on average over time is random and totally unrelated to the performance of the economy.
 - D) It is illegal for a friend of a corporate executive to make large profits in the stock market by using his inside information.

Answer: D

Diff: 3

Topic: 21.5 The Markets for Stocks and Bonds

AACSB: Analytic skills

Question Status: Revised

- 14) Information that is not available to the general public about what is happening in a corporation is
- A) opportunity benefit.
 - B) limited liability.
 - C) economic rent.
 - D) inside information.

Answer: D

Diff: 1

Topic: 21.5 The Markets for Stocks and Bonds

Question Status: Previous Edition

- 15) Inside information
- A) applies to proprietorships only.
 - B) applies to proprietorships and partnerships only.
 - C) applies to corporations only.
 - D) applies to all forms of business.

Answer: C

Diff: 1

Topic: 21.5 The Markets for Stocks and Bonds

Question Status: Previous Edition

- 16) "Stocks and bonds" are collectively known as
- A) securities.
 - B) equities.
 - C) real property.
 - D) shares.

Answer: A

Diff: 1

Topic: 21.5 The Markets for Stocks and Bonds

Question Status: New

- 17) The theory that there is no way to "get rich quick" in securities due to a lack of predictable trends is
- A) no-win theory.
 - B) market trend analysis.
 - C) random walk theory.
 - D) trading.

Answer: C

Diff: 2

Topic: 21.5 The Markets for Stocks and Bonds

AACSB: Analytic skills

Question Status: Previous Edition

- 18) Which of the following statements about stock market brokers and dealers is TRUE?
- A) Brokers earn commissions from trading stocks but dealers try to profit from trading stocks.
 - B) Brokers try to profit from trading stocks but dealers earn commissions from trading stocks.
 - C) Both brokers and dealers earn commissions from trading stocks.
 - D) Both brokers and dealers try to profit from trading stocks.

Answer: A

Diff: 1

Topic: 21.5 The Markets for Stocks and Bonds

Question Status: Previous Edition

- 19) Efficient markets theory suggests that purchasing the published reports of financial analysts
- A) is likely to increase one's returns by an average of 5 percent.
 - B) is likely to increase one's returns by an average of about 3 to 5 percent.
 - C) is not likely to increase financial returns.
 - D) will increase financial returns in the first year but not in following years.

Answer: C

Diff: 3

Topic: 21.5 The Markets for Stocks and Bonds

AACSB: Analytic skills

Question Status: Previous Edition

- 20) The theory that there are no predictable trends in securities prices that can be used to "get rich quick" is the
- A) dartboard theory.
 - B) random walk theory.
 - C) Wall Street theory.
 - D) inefficient market hypothesis.

Answer: B

Diff: 1

Topic: 21.5 The Markets for Stocks and Bonds

AACSB: Analytic skills

Question Status: Previous Edition

- 21) "Inside information" is the use of information
- A) by those who read the companies' annual reports.
 - B) by those who write the companies' annual reports.
 - C) by stockbrokers at the largest brokerage firms.
 - D) that is not available to the public.

Answer: D

Diff: 1

Topic: 21.5 The Markets for Stocks and Bonds

Question Status: Previous Edition

- 22) According to efficient market theory, which of the following can best predict the stock price of a particular company tomorrow?

A) a finance professor who knows a lot of investment theory
 B) a stock trader who has traded stocks for more than 10 years
 C) that company's employee who has inside information about the company
 D) none of the above: Everyone has an equal chance of predicting future stock prices

Answer: C

Diff: 2

Topic: 21.5 The Markets for Stocks and Bonds

AACSB: Analytic skills

Question Status: New

- 23) The price of the stock divided by the profits per share of stock is known as the

A) price-earnings ratio.
 B) dividend.
 C) yield in percent per year.
 D) number of shares traded during the day.

Answer: A

Diff: 2

Topic: 21.5 The Markets for Stocks and Bonds

Question Status: Previous Edition

- 24) The stock market showed a PE for BluarCo equal to 17. What does PE mean?

A) price-earnings ratio
 B) profit-earnings ratio
 C) perfect-earnings ratio
 D) price-equity ratio

Answer: A

Diff: 2

Topic: 21.5 The Markets for Stocks and Bonds

Question Status: Previous Edition

- 25) What is the random walk theory?

Answer: The random walk theory is the theory that prices of stocks move independently in securities markets and, hence, that there are no predictable trends that can be used to make riskless profits. The theory assumes that information about companies and stocks quickly are processed by the market and reflected in changed prices. This process happens so fast that no one can generate riskless profits.

Diff: 1

Topic: 21.5 The Markets for Stocks and Bonds

AACSB: Analytic skills

Question Status: Previous Edition

- 26) If the random walk theory is correct, then is there any way to "beat the market"?

Answer: If the random walk theory is correct, then no one can use publicly available information to predict the magnitude or direction of a stock price change. However, if you have inside information that is not available to the public, then you can still "beat the market." Inside information is about what is happening in a corporation that is not available to the public.

Diff: 2

Topic: 21.5 The Markets for Stocks and Bonds

AACSB: Reflective thinking skills

Question Status: Previous Edition

27) How can one "beat the market?"

Answer: Most economists feel the only way one can beat the market is to have inside information, which is information about what is happening in a corporation that is not available to the general public.

Diff: 1

Topic: 21.5 The Markets for Stocks and Bonds

AACSB: Reflective thinking skills

Question Status: Previous Edition