MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

1) American businesses get their external funds primarily from

A) other loans.
B) stock issues.
C) bonds and commercial paper issues.
D) bank loans.

2) Which of the following statements concerning external sources of financing for nonfinancial businesses in the United States are true?

A) Stocks and bonds, combined, supply less than one–half of the external funds.
B) Financial intermediaries such as banks are the most important source of external funds.
C) Bonds are a far more important source of finance than are stocks.
D) All of the above.
E) Only A and B of the above.

3) Regulation of the financial system

A) occurs only in the United States.
B) protects the wealth of owners of financial institutions.
C) protects the jobs of employees of financial institutions.
D) ensures the stability of the financial system.
E) does all of the above.

4) Collateral is

A) a prevalent feature of debt contracts for business.
B) is property that is pledged to the lender if a borrower cannot make his or her debt payments.
C) a prevalent feature of debt contracts for households.
D) all of the above.
E) only A and C of the above.

5) Collateralized debt is also know as

A) unrestricted debt.
B) restricted debt.
C) secured debt.
D) unsecured debt.
E) promissory debt.

6) Financial intermediaries provide their customers with

A) greater liquidity.
B) increased diversification and reduced risk.
C) reduced transactions costs.
D) all of the above.

7) The reduction in transactions costs per dollar of investment as the size of transactions increases is

A) discounting.
B) economies of trade.
C) economies of scale.
D) diversification.
E) both A and B of the above.

8) A borrower who takes out a loan usually has better information about the potential returns and risk of the investment projects he plans to undertake than does the lender. This inequality of information is called

A) noncollateralized risk.
B) moral hazard.
C) adverse selection.
D) asymmetric information.

9) The "lemons problem" is a term used to describe the

A) free–rider problem.
B) principal–agent problem.
C) adverse selection problem.
D) moral hazard problem.
E) both A and B of the above.

10) Government regulations require publicly traded firms to provide information, reducing

A) the need for diversification.
B) the adverse selection problem.
C) transactions costs.
D) all of the above.
E) both A and C of the above.

11) The concept of adverse selection helps to explain

A) why financial markets are among the most heavily regulated sectors of the economy.
B) why collateral is an important feature of debt contracts.
C) why only large, well–established corporations have access to securities markets.
D) all of the above.
E) only A and B of the above.

12) The principal–agent problem arises because

A) principals have incentives to free–ride off the monitoring expenditures of other principals.
B) agents have more information about their activities than do the principals.
C) monitoring agents' activities is costly.
D) of all of the above.
E) of only A and B of the above.

13) Equity contracts account for a small fraction of external funds raised by American businesses because

A) costly state verification makes the equity contract less desirable than the debt contract.
B) of the greater scope for moral hazard problems under equity contracts, as compared to debt contracts.
C) equity contracts do not permit borrowing firms to raise additional funds by issuing debt.
D) of all of the above.
E) of both A and B of the above.

14) A debt contract is incentive compatible

A) if the borrower has the incentive to behave in the way that the lender expects and desires, since doing otherwise jeopardizes the borrower's net worth in the business.

B) if the borrower's net worth is sufficiently high so that the lender's risk of moral hazard is significantly reduced.

C) if the debt contract is treated like an equity.

D) if both A and B of the above occur.

15) In a bank panic

A) the source of contagion is the free-rider problem.

B) the source of contagion is the too-big-to-fail problem.

C) the source of contagion is the asymmetric information problem.

D) the source of contagion is the transactions cost problem.

E) the source of contagion is a regulatory problem.

Answer Key
Testname: CHAPTER 8 PQ.TST

1) D
2) D
3) D
4) D
5) C
6) D
7) C
8) D
9) C
10) B
11) D
12) D
13) E
14) D
15) C