Overview of Equity and Intro to Company and Industry Analysis

Test ID: 7697445

Question #1 of 73

Question ID: 415309

An aggressive price reduction to gain market share is *most likely* to be associated with a:

- ✗ **A) service differentiation strategy.**
- ✓ **B)** cost leadership strategy.
- ✗ **C)** product differentiation strategy.

Explanation

Michael Porter identified two competitive strategies: cost leadership and product or service differentiation. A firm that uses a cost leadership or low-cost strategy seeks to have low production costs that will enable it to offer lower prices than its competitors to protect or gain market share. A product or service differentiation strategy seeks to gain a price premium for its products by making them distinctive to the consumer.

Question #2 of 73

Question ID: 415255

Participating preference shares *most likely*:

- ✗ **A) can be exchanged for common stock at a ratio determined at issuance.**
- ✓ **B)** receive extra dividends if firm profits exceed a predetermined threshold.
- ✗ **C)** give the shareholder the right to sell the shares back to the firm at a specific price.

Explanation

Participating preference shares receive extra dividends if firm profits exceed a predetermined threshold. Convertible preference shares can be exchanged for common stock at a conversion ratio determined at issuance. Putable common shares give the shareholder the right to sell the shares back to the firm at a specific price.

Question #3 of 73

Question ID: 415261

Private equity securities *most likely*:

- ✓ **A) are illiquid and do not have quoted prices.**
- ✗ **B)** are issued to individual investors.
- ✗ **C)** trade in over-the-counter dealer markets.

Explanation

Private equity securities are illiquid and do not trade in public securities markets. Holders of private equity must negotiate with other investors to sell the securities. Private equity securities are typically issued to qualified institutional investors.

Question #4 of 73

Question ID: 415288

Which of the following types of industries is typically characterized by stable performance during both expansions and contractions of the business cycle?

✓ **A) Defensive.**
✗ **B)** Cyclical.
✗ **C)** Growth.

Explanation

A defensive industry is typically characterized by stable performance during both expansions and contractions of the business cycle.

Question #5 of 73

Question ID: 415281

During the contraction phase of the business cycle, how will an active portfolio manager using an industry rotation strategy treat stocks of companies in a cyclical industry?

✗ **A) Maintain the target weight of the industry.**
✗ **B)** Overweight the industry.
✓ **C)** Underweight the industry.

Explanation

A cyclical industry is one that is expected to outperform during an expansion and underperform in a contraction. The industry rotation strategy for a cyclical industry is to overweight during an expansion and underweight during a contraction.

Question #6 of 73

Question ID: 415275

The difference between a firm's balance sheet assets and liabilities is equal to the firm's:

✗ **A) market value of equity.**
✓ **B)** book value of equity.
✗ **C)** intrinsic value of equity.

Explanation

Book value of equity is equal to balance sheet assets minus liabilities.

Question #7 of 73

Question ID: 434381

Which of the following statements about book value of equity is *most accurate*?

✗ **A) Increases in retained earnings decrease book value.**
✗ **B)** Book value of equity reflects the market's perception of the firm's prospects.
✓ **C)** The primary goal of firm management is to increase the book value of the firm's equity.

Explanation

Increasing book value is the primary goal of firm management. Increases in retained earnings increase book value. The market value of equity reflects investor perception of the firm's future value.

Question #8 of 73

Question ID: 415310

A firm that pursues a differentiation strategy is *most likely* to emphasize:

- ✗ **A)** **operating efficiency.**
- ✓ **B)** market research.
- ✗ **C)** gains in market share.

Explanation

A firm that follows a product or service differentiation strategy needs to emphasize market research to identify needs for which customers are willing to pay a premium. Market share and operating efficiency are more of a focus for firms that pursue a low-cost strategy.

Question #9 of 73

Question ID: 415264

A security that represents an equity share in a foreign firm and for which the voting rights are retained by the depository bank, is a(n):

- ✗ **A)** **American depository share.**
- ✗ **B)** global registered share.
- ✓ **C)** unsponsored depository receipt.

Explanation

In an unsponsored DR, the depository bank retains the voting rights of the equity shares of the foreign firm. In a sponsored DR, the investor in the DR has the voting rights. For an American depository receipt, an American depository share is the underlying security that trades in the issuing firm's domestic market. A global registered share is an equity security that trades in the local currencies on stock exchanges around the world.

Question #10 of 73

Question ID: 415273

Equity securities are *least likely* issued to finance:

- ✓ **A)** **inventories.**
- ✗ **B)** research and development.
- ✗ **C)** equipment.

Explanation

Equity securities are typically issued to finance a firm's long-lived assets, such as equipment, and long-term projects such as research and development.

Question #11 of 73

Question ID: 415274

Pearl River Heavy Industries shows the following information in its financial statements:

Total Assets	HK$146,000,000
Total Liabilities	HK$87,000,000
Net Income	HK$27,000,000
Price per Share	HK$312
Shares Outstanding	200,000

The equity securities of Pearl River have a:

✗ **A)** **book value of HK$62,400,000.**

✓ **B)** book value of HK$59,000,000.

✗ **C)** market value of HK$146,000,000.

Explanation

Book value = Total assets − total liabilities = 146,000,000 − 87,000,000 = HK$59,000,000
Market value of equity = Market price per share × shares outstanding = HK$312 × 200,000 = HK$62,400,000

Question #12 of 73

Question ID: 415267

Preference shares will have the *most* risk for the investor if the shares are:

✓ **A)** **callable and non-cumulative.**

✗ **B)** callable and cumulative.

✗ **C)** non-callable and non-cumulative.

Explanation

Preference shares (preferred stock) has more risk for the investor if they are non-cumulative than if they are cumulative, because with cumulative preference shares the firm must pay the holder any omitted dividends before it can pay any dividends to common shareholders. Callable shares have more risk for the investor than non-callable shares because the call option limits their potential for price appreciation.

Question #13 of 73

Question ID: 415268

Other things equal, which of the following types of stock has the *most* risk from the investor's perspective?

✗ **A)** **Callable preferred share.**

✓ **B)** Callable common share.

✗ **C)** Putable common share.

Explanation

Callable shares have more risk than putable shares because the issuer can exercise the call option (which limits the investor's potential gains) while the investor can exercise the put option (which limits the investor's potential losses, assuming the firm is able to meet its obligation). Preferred shares have less risk for the investor than common shares because preferred shares have a higher priority claim on the firm's assets in the event of liquidation, and because preferred dividends typically must be paid before common dividends may be paid.

Question #14 of 73

Question ID: 415305

In which of the following industries are technological factors *least likely* a significant influence?

- ✗ **A)** **Oil services.**
- ✓ **B)** Confections.
- ✗ **C)** Pharmaceuticals.

Explanation

Technological influences are relatively important in the pharmaceuticals and oil services industries, but they are generally not a significant influence in the confections industry.

Question #15 of 73

Question ID: 415282

Commercial industry classification systems such as the Global Industry Classification Standard (GICS) typically classify firms according to their:

- ✗ **A)** **correlations of historical returns.**
- ✗ **B)** sensitivity to business cycles.
- ✓ **C)** principal business activities.

Explanation

Commercial providers of industry classification systems such as the GICS classify firms according to principal business activity, such as Consumer Staples, Financial Services, or Health Care.

Question #16 of 73

Question ID: 415307

Changes in population size and average age that affect industry growth and profitability are *best* described as:

- ✗ **A)** **social influences.**
- ✗ **B)** macroeconomic influences.
- ✓ **C)** demographic influences.

Explanation

Among the external influences that affect industries, "demographic factors" refers to those that are related to the size and composition of the population.

Question #17 of 73

Question ID: 434379

Which of the following statements about the role of equities in financing a company's assets is *most accurate*?

✓ **A) Equity capital is typically used for the purchase of long-term assets and expansion into new areas.**

✗ **B)** Management can directly increase the market value of equity by increasing net income.

✗ **C)** The book value and market value of equities is usually the same.

Explanation

Equity capital is used for the purchase of long-term assets, equipment, research and development and expansion into new businesses or geographic areas. Book value and market value of equities are almost always valued differently. Management can only indirectly affect the market value of equity.

Question #18 of 73

Question ID: 415293

The industry experience curve illustrates the relationship between:

✗ **A) company age and profitability.**

✓ **B)** cumulative output and cost per unit.

✗ **C)** productivity and average years of employment.

Explanation

The industry experience curve shows cost per unit relative to cumulative output. Cost per unit typically decreases over time due to higher utilization rates for fixed capital, improvements in the efficiency of labor, and better product design and manufacturing methods.

Question #19 of 73

Question ID: 415258

Cheryl Brower and Todd Sutter each own 100 shares of Hills Company stock. In a recent proxy vote, Brower had 100 votes but Sutter had 10 votes. The *most likely* reason for this difference in voting rights is that:

✓ **A) Brower and Sutter own different classes of stock.**

✗ **B)** Brower is a director of Hills Company.

✗ **C)** Hills Company uses a statutory voting method.

Explanation

Companies may issue classes of stock (e.g., Class A and Class B shares) that differ in aspects such as voting rights, dividends, or priority of claims in liquidation.

Question #20 of 73

Question ID: 415263

Liquidity of private equity is *most likely*:

✗ **A) greater than liquidity of public equity.**

✓ **B)** less than liquidity of public equity.

✗ **C)** about equal to liquidity of public equity.

Explanation

Private equity securities are not registered to be traded in a public market, and therefore are less liquid that public equity.

Question #21 of 73

Question ID: 415286

A firm's earnings are *most likely* to be cyclical if:

- ✗ **A)** **the firm operates in a growth industry.**
- ✓ **B)** the firm produces luxury items.
- ✗ **C)** most of the firm's costs depend on its level of output.

Explanation

Producers of luxury items tend to have cyclical earnings because consumers typically decrease their purchases of these items during economic recessions. The earnings of firms with high percentages of variable costs are not as likely to be cyclical as those of firms with high percentages of fixed costs (i.e., high operating leverage). A growth industry has demand that is strong enough that earnings remain relatively unaffected by the business cycle.

Question #22 of 73

Question ID: 415290

When constructing a peer group of firms, an analyst should *least* appropriately consider the firms':

- ✓ **A)** **business cycle sensitivity.**
- ✗ **B)** cost structures.
- ✗ **C)** industry classification.

Explanation

A peer group should consist of firms that are alike in their principal lines of business, along with other similarities such as cost structures and access to capital. Firms can be similar in business cycle sensitivity but dissimilar in terms of their business activities (e.g., a firm in the home building industry and a firm in the heavy equipment manufacturing industry).

Question #23 of 73

Question ID: 415266

A basket of listed depository receipts (BLDR) is *best* described as a(n):

- ✗ **A)** **special purpose vehicle for issuing depository receipts in multiple countries.**
- ✓ **B)** exchange traded fund of depository receipts.
- ✗ **C)** index of global depository receipts that trade on a specific exchange.

Explanation

A basket of listed depository receipts (BLDR) is an exchange traded fund that represents a portfolio of depository receipts.

Question #24 of 73

Question ID: 415291

For relative valuation, a peer group is *best* described as companies:

- ✗ **A) in a similar sector or industry classification.**
- ✗ **B)** at a similar stage of the industry life cycle.
- ✓ **C)** with similar business activities and competitive factors.

Explanation

An analyst should form peer groups of companies that have similar business activities, drivers of demand and costs, and access to capital. Companies in the same industry or sector and companies at the same stage of the industry life cycle are not necessarily comparable for equity valuation purposes.

Question #25 of 73

Question ID: 415270

In a period when U.S. equity prices are increasing and the U.S. dollar is depreciating, which of the following investors in U.S. equities is *most likely* to earn the highest return in the investor's local currency?

- ✗ **A) Non-U.S. investor who reinvests dividends.**
- ✓ **B)** U.S. investor who reinvests dividends.
- ✗ **C)** Non-U.S. investor who does not reinvest dividends.

Explanation

Sources of return on equity securities include price appreciation or depreciation, dividend income, and foreign exchange gains or losses for investors outside the country. In an increasing equity market, reinvesting dividends is likely to increase returns compared to not reinvesting dividends. If the currency is depreciating, investors from outside the country will experience foreign exchange losses that decrease their returns.

Question #26 of 73

Question ID: 434377

Compared to publicly traded firms, privately held firms have which of the following characteristics?

- ✗ **A) Higher reporting costs.**
- ✓ **B)** More limited financial disclosure.
- ✗ **C)** Less ability to focus on long-term prospects.

Explanation

Private firms have fewer financial disclosure requirements, and therefore lower reporting costs, because they are not listed on an exchange. Private firms generally have greater ability to focus on long-term results because they do not experience pressure from public shareholders.

Question #27 of 73

Question ID: 415295

The competitive forces identified by Michael Porter include:

- ✗ **A) threat of substitute products and rivalry among suppliers.**
- ✗ **B)** bargaining power of existing competitors and threat of new entrants.

✓ **C)** rivalry among existing competitors and bargaining power of buyers.

Explanation

Porter's five competitive forces are: (1) rivalry among existing competitors; (2) threat of new entrants; (3) threat of substitute products; (4) bargaining power of buyers; (5) bargaining power of suppliers.

Question #28 of 73

Question ID: 415280

Industry analysis is *most likely* to provide an analyst with insight about a company's:

✗ **A) financial performance.**

✗ **B)** competitive strategy.

✓ **C)** pricing power.

Explanation

Industry analysis provides a framework for an analyst to understand a firm in relation to its competitive environment, which determines how much pricing power a firm has. Competitive strategy and financial performance are aspects of company analysis.

Question #29 of 73

Question ID: 415301

Which of the following statements about the industry life cycle is *most* accurate?

✗ **A) Industry growth rates are highest in the embryonic stage.**

✗ **B)** The mature stage is followed by a shakeout stage and a decline stage.

✓ **C)** The growth stage is typically characterized by decreasing prices.

Explanation

Prices tend to decrease in the growth stage as firms begin to realize economies of scale in production. The stages of the industry life cycle, in order, are embryonic, growth, shakeout, mature, and decline. Industry growth is slow during the embryonic stage as firms develop products and attempt to gain customer acceptance.

Question #30 of 73

Question ID: 415278

Which of the following changes would *most likely* cause a firm's return on equity to increase?

✗ **A) Net income increases by 5% and average book value of equity increases by 10%.**

✓ **B)** Net income decreases by 5% and average book value of equity decreases by 10%.

✗ **C)** Net income increases by 5% and average book value of equity increases by 5%.

Explanation

Return on equity is net income divided by average book value of equity. If the book value of equity decreases relatively more than net income decreases, return on equity will increase. This illustrates that an increase in ROE is not necessarily positive for the firm. An analyst must examine the reasons for changes in ROE.

Question #31 of 73

Question ID: 415283

Auto manufacturers and home builders would *most likely* be grouped together in an industry classification system based on:

✗ **A) dividend yields.**

✓ **B)** sensitivity to business cycles.

✗ **C)** type of business activity.

Explanation

Auto manufacturing and home building are both cyclical industries. An industry classification system based on business cycle sensitivity would be the most likely to group firms from these industries together.

Question #32 of 73

Question ID: 415306

Which of the following industries is likely to be most sensitive to the business cycle?

✓ **A) Automobile.**

✗ **B)** Pharmaceutical.

✗ **C)** Confectionery.

Explanation

The automobile industry is cyclical because demand for new autos fluctuates with the business cycle. The confectionery industry tends to be non-cyclical and defensive because demand for candy tends to be stable through the business cycle. The pharmaceutical industry is non-cyclical because demand for medicines is independent of the business cycle.

Question #33 of 73

Question ID: 415257

With which of the following types of equity shares does the investor typically have the greatest voting power?

✗ **A) Participating preference shares.**

✓ **B)** Common shares.

✗ **C)** Unsponsored depository receipts.

Explanation

While common shares have voting rights, preference shares typically do not. With unsponsored depository receipts, the depository bank retains the right to vote the shares.

Question #34 of 73

Question ID: 415308

Technological changes are *most likely* to result in which of the following effects? Evolving technology is likely to result in changes in:

✗ **A) the relative demand for various products only.**

✗ **B)** educational curriculum only.

✓ **C)** educational curriculum and the relative demand for various products.

Explanation

If technological changes result in changes in the set of skills required of workers, this is likely to lead to changes in educational curriculum (and possibly delivery). Such changes often result in the production and demand for new or different products.

Question #35 of 73

Question ID: 415294

Economic profits are *most likely* to be earned by firms in an industry that is characterized by:

✗ **A) low threat of substitute products and high rivalry among existing competitors.**

✗ **B)** high bargaining power of suppliers and low threat of new entrants.

✓ **C)** high barriers to entry and low bargaining power of buyers.

Explanation

High barriers to entry (low threat of new entrants) and low bargaining power of suppliers both increase the potential for economic profits within an industry. The five forces that shape industry competition are rivalry among existing competitors, threat of new entrants, threat of substitute products, bargaining power of buyers, and bargaining power of suppliers. The stronger any of these forces are within an industry, the less potential that industry has to generate (or continue to earn) economic profits.

Question #36 of 73

Question ID: 434388

Which of the following statements about switching costs is *most accurate*?

✗ **A) Low switching costs contribute to market share stability.**

✓ **B)** Switching costs include the time needed to learn to use a competitor's product.

✗ **C)** Switching costs tend to be lower for specialized products.

Explanation

Switching costs include the time and expense of learning to use a competitor's product and tend to be higher for specialized or differentiated products. High switching costs contribute to market share stability and pricing power.

Question #37 of 73

Question ID: 434384

The experience curve, which illustrates the cost per unit relative to output:

✗ **A) slopes upward.**

✗ **B)** slopes upward in the early years and downward in the later years.

✓ **C)** slopes downward.

Explanation

The experience curve, which shows the cost per unit relative to output, slopes downward because of increases in productivity and economies of scale, especially in industries with high fixed costs.

Question #38 of 73

Question ID: 434382

Commercial index providers typically classify companies by:

- ✗ **A) sensitivity to business cycles.**
- ✗ **B)** statistical grouping.
- ✓ **C)** principal business activity.

Explanation

Commercial providers such as Standard and Poor's and MSCI Barra classify companies according to their principal business activity and the products and services they provide.

Question #39 of 73

Question ID: 415276

For a non-dividend paying firm, an increase in net income must increase:

- ✗ **A) both book value and market value of equity.**
- ✓ **B)** book value of equity.
- ✗ **C)** market value of equity.

Explanation

Book value of equity is the company's assets minus its liabilities. For a non-dividend paying firm, positive net income will increase the book value of equity. An increase in book value of equity may or may not increase the market value of equity. An increase in net income that does not meet investors' prior expectations may decrease the market value of equity.

Question #40 of 73

Question ID: 415272

The primary reason for a firm to issue equity securities is to:

- ✓ **A) acquire the assets necessary to carry out its operations.**
- ✗ **B)** improve its solvency ratios.
- ✗ **C)** increase publicity for the firm's products.

Explanation

While issuing equity securities can improve a company's solvency ratios and increase the firm's visibility with the public, the primary reason to issue equity is to raise the capital needed to acquire operating assets.

Question #41 of 73

Question ID: 434385

Industries with undifferentiated products and high exit costs *most likely* have:

- ✗ **A) low rivalry among competitors and low profit margins.**
- ✗ **B)** high rivalry among competitors and high profit margins.

✓ **C)** high rivalry among competitors and low profit margins.

Explanation

Industries with undifferentiated products have high rivalry with their competitors. Companies with high exit costs try to operate at full capacity to cover fixed costs and typically have low profit margins.

Question #42 of 73

Question ID: 415292

A manager tells a research analyst, "A thorough industry analysis should use more than one approach to estimate industry variables," and "An analyst should not compare his valuations to those of other analysts." Which of these two statements is (are) CORRECT?

✗ **A) Both of these statements are accurate.**

✗ **B)** Neither of these statements is accurate.

✓ **C)** Only one of these statements is accurate.

Explanation

The first statement is accurate. When analyzing an industry, an analyst should use different approaches and scenarios when estimating industry variables. The second statement is inaccurate. Comparing one's own forecasts with those of other analysts can be useful for confirming the soundness of the analysis and for identifying industries that are potentially overvalued or undervalued by the consensus view.

Question #43 of 73

Question ID: 415279

When analyzing an industry characterized by increasing book values of equity, return on equity for a period is *most* appropriately calculated based on:

✗ **A) beginning book value.**

✓ **B)** average book value.

✗ **C)** ending book value.

Explanation

When book values are not stable, analysts should calculate ROE based on the average book value for the period. When book values are more stable, beginning book value is appropriate.

Question #44 of 73

Question ID: 415265

Global depository receipts are *most likely* issued:

✗ **A) in the United States and denominated in U.S. dollars.**

✗ **B)** outside the issuer's home country and denominated in the exchange's home currency.

✓ **C)** outside the issuer's home country and denominated in U.S. dollars.

Explanation

Global depository receipts are issued outside the U.S. and the issuer's home country and are most often denominated in U.S.

dollars. Depository receipts issued in the United States and denominated in U.S. dollars are called American depository receipts. Global registered shares are denominated in the home currencies of the exchanges on which they trade.

Question #45 of 73

Question ID: 415252

Two seats on a board of directors are to be elected. A voting system in which the owner of 100 shares may cast 100 votes in each of the board elections is a:

- ✗ **A)** **cumulative voting system.**
- ✗ **B)** proportional voting system.
- ✓ **C)** statutory voting system.

Explanation

In a statutory voting system, a shareholder can vote in each separate board election based on the number of shares she owns. Under cumulative voting, the shareholder may choose to cast her total number of votes (200 in this example) for a candidate in one of the elections.

Question #46 of 73

Question ID: 415284

Food, beverage, and utility companies are examples of:

- ✗ **A)** **cyclical industries.**
- ✓ **B)** defensive industries.
- ✗ **C)** declining industries.

Explanation

Food, beverage, and utility companies provide basic necessities of life and are considered to be defensive industries. In a recession, the demand for their products will not fall as much as for some of the other industry groups.

Question #47 of 73

Question ID: 415299

Which of the following conditions is *most likely* to indicate that barriers to entry into an industry are low?

- ✗ **A)** **The industry has significant economies of scale.**
- ✗ **B)** Market shares have been stable over the last two business cycles.
- ✓ **C)** Investment capital is available at low cost.

Explanation

Readily available capital tends to make entry into an industry easier. If an industry is composed of the same firms over a long period of time, barriers to entry are likely high. Economies of scale are a barrier to entry because existing firms are likely to be producing at a lower cost per unit than a new competitor can achieve.

Question #48 of 73

Question ID: 415302

Declining prices that result from the development of substitute products are *most likely* to characterize an industry in the:

- ✗ **A) shakeout stage.**
- ✗ **B)** mature stage.
- ✓ **C)** decline stage.

Explanation

The decline stage of the industry life cycle is often characterized by declining prices as substitute products or global competition emerge, or as a result of decreasing demand due to societal changes.

Question #49 of 73

Question ID: 434380

The book value of equity is equal to a firm's assets:

- ✗ **A) plus its accumulated other comprehensive income.**
- ✓ **B)** minus its liabilities.
- ✗ **C)** plus its retained earnings.

Explanation

The book value of equity is the balance sheet value of a firm's assets minus its liabilities.

Question #50 of 73

Question ID: 434389

Factors affecting industry growth that are related to the composition and age distribution of the population are *best* described as:

- ✗ **A) social influences.**
- ✓ **B)** demographic factors.
- ✗ **C)** macroeconomic factors.

Explanation

Demographic factors include age distribution and population size, as well as other changes in the composition of the population.

Question #51 of 73

Question ID: 415298

Market share stability within an industry is *least likely* to result from a high level of:

- ✓ **A) product innovation.**
- ✗ **B)** switching costs.
- ✗ **C)** barriers to entry.

Explanation

Frequent introductions of new products and innovations tend to make firms' market shares within an industry less stable. High barriers to entry into the industry and high switching costs for customers to change to a competing product both contribute to market share stability.

Question #52 of 73

Question ID: 415260

Compared to a publicly traded firm, a private equity firm is *most likely* to:

- ✗ **A) exhibit stronger corporate governance.**
- ✓ **B)** disclose less information about its financial performance.
- ✗ **C)** be more concerned with short-term results.

Explanation

Private equity firms are not held to the same financial reporting requirements as publicly traded firms. Less public scrutiny and limited financial disclosure may lead to weaker corporate governance. However, with less pressure from public shareholders, a private equity firm is typically more able to focus on long-term performance.

Question #53 of 73

Question ID: 415256

Johnson Company shuts down and is liquidated. Bob Smith owns 100 common shares of Johnson, but has a lower priority of claims than Al Jones, who also owns 100 common shares. Smith *most likely* owns:

- ✗ **A) non-participating shares.**
- ✗ **B)** non-cumulative shares.
- ✓ **C)** Class B shares.

Explanation

Some firms have different classes of common stock (e.g., Class A and Class B shares). These classes may be distinguished by factors such as voting rights and priority in the event of liquidation. Participating and non-participating, cumulative and non-cumulative refer to characteristics of preferred stock.

Question #54 of 73

Question ID: 434383

Stages of an industry life cycle in chronological order are:

- ✗ **A) embryonic, growth, mature, shakeout, and decline.**
- ✗ **B)** growth, shakeout, mature, decline, and embryonic.
- ✓ **C)** embryonic, growth, shakeout, mature, and decline.

Explanation

Embryonic, growth, shakeout, mature, and decline are the life-cycle stages of an industry.

Question #55 of 73

Question ID: 415271

Compared to preferred stock, common stock is *most likely* to:

- ✓ **A) provide a higher average return.**
- ✗ **B)** pay more frequent dividends.

✗ **C)** exhibit a lower standard deviation of returns.

Explanation

Common stock is more risky than preferred stock and is expected to provide higher average returns. Preferred stock promises fixed periodic dividends. Common stock can be dividend-paying or non-dividend paying and the dividends are at management's discretion.

Question #56 of 73

Question ID: 434386

Factors that increase competition in an industry *most likely* include:

✓ **A) low barriers to entry, low concentration, and high unused capacity.**

✗ **B)** high barriers to entry, low concentration, and low unused capacity.

✗ **C)** low barriers to entry, high concentration, and high unused capacity.

Explanation

Low barriers to entry increase competition as more firms can enter the business. Industries that are fragmented and have unused capacity tend to be highly competitive as they fight for market share and attempt to utilize excess manufacturing resources.

Question #57 of 73

Question ID: 415259

Two investors, Craig Tower and Erin Gray, own 100 shares each of the same company. Tower receives a quarterly dividend while Gray does not. This is *most likely* because Tower:

✓ **A) owns a different class of stock than Gray.**

✗ **B)** owns common shares while Gray owns preferred shares.

✗ **C)** purchased his shares after Gray purchased her shares.

Explanation

Different classes of common stocks can have different features with respect to dividends, stock splits, voting power and seniority if the firm's assets are liquidated. If Gray owns preferred shares, she would be more likely to receive a dividend than Tower's common shares. If Gray had purchased shares before an ex-dividend date and Tower purchased the same class of shares after that ex-dividend date, Gray would receive a dividend that Tower did not.

Question #58 of 73

Question ID: 415287

Starr Company is an asset management firm. Thomas Company is a manufacturer of apparel. Assuming these firms are representative of their industry groups, how are they *best* classified with regard to their sensitivity to the business cycle?

	Starr	Thomas
✗ **A)**	**Non-cyclical**	**Non-cyclical**
✗ **B)**	Cyclical	Non-cyclical

✓ **C)** Cyclical Cyclical

Explanation

Asset management firms are classified in the financial services industry group. Apparel manufacturers are classified in the consumer discretionary industry group. Financial services and consumer discretionary are cyclical industry groups.

Question #59 of 73

Question ID: 434376

Securities that can be sold back to the issuing firm at a specific price are *best* described as:

✗ **A) callable.**

✓ **B)** putable.

✗ **C)** convertible.

Explanation

Putable securities give the investor the right to sell the securities back to the firm at a predetermined price. Callable securities give the issuer the right to buy the securities back at a predetermined price. Convertible securities give the investor the right to exchange the securities for a predetermined number of the firm's common shares.

Question #60 of 73

Question ID: 415269

Other things equal, preference shares have the *most* risk for the investor when they are:

✗ **A) putable and cumulative.**

✓ **B)** callable and non-cumulative.

✗ **C)** non-callable and non-cumulative.

Explanation

Callable shares have more risk than otherwise equivalent non-callable shares. Putable shares have less risk than otherwise equivalent non-putable shares. Cumulative preference shares have less risk than otherwise equivalent non-cumulative preference shares.

Question #61 of 73

Question ID: 415296

The threat of substitute products is *most likely* to be low for a firm that:

✗ **A) operates in a fragmented market with little unused capacity.**

✓ **B)** produces a differentiated product with high switching costs.

✗ **C)** produces a commodity product in an industry with significant unused capacity.

Explanation

The threat of competition from substitute products is likely to be low for a firm that produces a differentiated product with high switching costs. Unused capacity and low industry concentration (a fragmented market) tend to intensify rivalry among industry competitors but are not directly related to the threat of substitute products.

Question #62 of 73

Question ID: 415277

A firm's cost of equity capital is *least* accurately described as the:

✓ **A)** **ratio of the firm's net income to its average book value.**

✗ **B)** expected total return on the firm's equity shares in equilibrium.

✗ **C)** minimum rate of return investors require to invest in the firm's equity securities.

Explanation

The ratio of the firm's net income to its average book value is the firm's return on equity, which can be greater than, equal to, or less than the firm's cost of equity. Cost of equity for a firm can be defined as the expected equilibrium total return in the market on its equity shares, or as minimum rate of return that investors require as compensation for the risk of the firm's equity securities.

Question #63 of 73

Question ID: 415303

Wallace Kidwell is classifying an industry as to its life-cycle stage. Kidwell notes that the industry's growth is stable and largely limited to replacement demand and overall population increases. The companies that comprise the industry have achieved efficient cost structures and strong brand loyalty. This level of brand loyalty has resulted in very few price wars. Kidwell will *most likely* classify the industry life cycle stage as being:

✗ **A)** **Shakeout.**

✓ **B)** Mature.

✗ **C)** Decline.

Explanation

The mature stage exhibits little or no growth, industry consolidation, and high barriers to entry. Kidwell has noted that the industry is growing, but slowly (replacement demand and population gains). Furthermore, the firms have efficient cost structures and strong brand loyalty; both of which are high barriers to entry.

The decline stage exhibits negative growth, excess capacity, and high competition. Kidwell has observed positive, slow growth and a lack of price wars. Both of these observations are contrary to what would be expected in the decline stage.

The shakeout stage exhibits slowing growth, intense competition, and declining profitability. Kidwell has observed that growth is stable, the firms have achieved efficient cost structures, and price wars are uncommon. Hence, growth is not slowing, competition must not be intense because there are price wars (these occur when competition is intense), and profitability is likely stable given the efficient cost structures.

Question #64 of 73

Question ID: 415254

Dividends on non-participating preference shares are typically:

✗ **A)** **lower than the dividends on common shares.**

✓ **B)** a fixed percentage of par value.

✗ **C)** a contractual obligation of the company.

Explanation

Similar to the interest payments on a debt security, dividends on non-participating preference shares (preferred stock) are typically fixed. Unlike the interest payments on a debt security, the company is not contractually obligated to pay preferred dividends. Preferred dividends are typically higher than a firm's common dividends.

Question #65 of 73

Question ID: 415262

Hodges Fund provides mezzanine stage financing to private companies. In which type of private equity investing is Hodges Fund most likely involved?

- ✓ **A) Venture capital.**
- ✗ **B)** Leveraged buyout.
- ✗ **C)** Private investment in public equity.

Explanation

Venture capital providers invest in firms that are early in their life cycles. Stages of venture capital financing include seed stage, early stage, and mezzanine financing. In a leveraged buyout, an investor purchases all of a public firm's equity, taking the firm private. In a private investment in public equity (PIPE), an investor purchases private equity issued by a public firm.

Question #66 of 73

Question ID: 415300

Pricing power for the firms in an industry is *most likely* to result from low:

- ✗ **A) industry concentration.**
- ✓ **B)** levels of capacity.
- ✗ **C)** barriers to entry.

Explanation

Low capacity is associated with pricing power because it increases the likelihood that supply in the short run will be less than demand at current prices. Low barriers to entry and low industry concentration (a fragmented market) typically suggest firms have little pricing power.

Question #67 of 73

Question ID: 415285

Which of the following industries is *most likely* to be classified as non-cyclical?

- ✗ **A) Autos.**
- ✓ **B)** Utilities.
- ✗ **C)** Housing.

Explanation

Non-cyclical industries are those for which demand is not highly sensitive to business cycles, such as utilities, health care, and food and beverages. Housing and autos are examples of cyclical industries.

Question #68 of 73

Question ID: 415289

Which of the following types of industries is typically characterized by above-normal expansion in sales and profits independent of the business cycle?

✓ **A) Growth.**

✗ **B)** Counter-cyclical.

✗ **C)** Defensive.

Explanation

A growth industry is typically characterized by above-normal expansion in sales and profits independent of the business cycle.

Question #69 of 73

Question ID: 415253

An equity security that requires the firm to pay any scheduled dividends that have been missed, before paying any dividends to common equity holders, is a:

✗ **A) convertible preference share.**

✓ **B)** cumulative preference share.

✗ **C)** participating preference share.

Explanation

Cumulative preference shares (cumulative preferred stock) must receive any dividends in arrears before the firm may pay any dividends to common shareholders.

Question #70 of 73

Question ID: 415297

A firm is *most likely* to have pricing power if:

✗ **A) costs to exit the industry are high.**

✓ **B)** its product is differentiated.

✗ **C)** its market share is high.

Explanation

Firms offering products that are differentiated in terms of quality and features are more likely to have pricing power than firms that produce undifferentiated (commodity-like) products. High market share does not necessarily imply pricing power; for example, if four firms each have 25% market share, none of them are likely to have significant pricing power. High exit costs can create overcapacity in an industry and result in a high degree of price competition as firms try to maintain production volume during a period of reduced demand.

Question #71 of 73

Question ID: 434378

Common equity share types ranked from least risky to most risky are:

✓ **A) putable, option-free, callable.**

✗ **B)** option-free, putable, callable.

✗ **C)** callable, putable, option-free.

Explanation

Putable shares are the least risky because the investor can sell the shares back to the issuer at a predetermined price. Callable shares are the most risky because the issuer can buy the securities back at a predetermined price, which limits the upside for the investor.

Question #72 of 73

Question ID: 415304

Which of the following industries is *most likely* to operate in a fragmented market?

✓ **A) Oil services.**

✗ **B)** Confections.

✗ **C)** Pharmaceuticals.

Explanation

Most areas of the oil services industry are characterized by many small competitors. The confections and pharmaceutical industries each have a small number of very large firms.

Question #73 of 73

Question ID: 434387

A firm is *most likely* to have pricing power if it operates in an industry characterized by:

✗ **A) low concentration, overcapacity, and high market share stability.**

✗ **B)** high concentration, undercapacity, and low market share stability.

✓ **C)** high concentration, undercapacity, and high market share stability.

Explanation

Firms in highly concentrated industries are more likely to have pricing power than firms in fragmented industries. Firms in industries with tight capacity constraints are more likely to have pricing power than firms in industries with excess capacity. High market share stability is indicative of pricing power because competition is likely less intensive.