

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

- 1) If a firm lies within a country with \_\_\_\_\_ or \_\_\_\_\_ domestic capital markets, it can achieve lower global cost and greater availability of capital with a properly designed and implemented strategy to participate in international capital markets. 1) \_\_\_\_\_  
A) large; illiquid B) liquid; large  
C) liquid; segmented D) illiquid; segmented
- 2) Other things equal, a firm that must obtain its long-term debt and equity in a highly illiquid domestic securities market will probably have a: 2) \_\_\_\_\_  
A) relatively high cost of capital.  
B) relatively low cost of capital.  
C) relatively average cost of capital.  
D) cost of capital that we cannot estimate from this question.
- 3) Relatively high costs of capital are more likely to occur in: 3) \_\_\_\_\_  
A) unsegmented domestic securities markets.  
B) highly liquid domestic securities markets.  
C) highly illiquid domestic securities markets.  
D) none of the above
- 4) Reasons that firms may find themselves with relatively high costs of capital include: 4) \_\_\_\_\_  
A) The firms are too small to easily gain access to their own national securities market.  
B) The firms reside in emerging countries with undeveloped capital markets.  
C) The firms are family owned and they choose not to access public markets and lose control of the firm.  
D) all of the above
- 5) Which of the following is NOT a contributing factor to the segmentation of capital markets? 5) \_\_\_\_\_  
A) anticipated foreign exchange risk B) excessive regulatory control  
C) perceived political risk D) All of the above are contributing factors.
- 6) Which of the following is NOT a contributing factor to the segmentation of capital markets? 6) \_\_\_\_\_  
A) asymmetric availability of information B) lack of transparency  
C) insider trading D) All of the above are contributing factors.
- 7) The weighted average cost of capital (WACC) is: 7) \_\_\_\_\_  
A) equal to 13%.  
B) the required rate of return for all of a firm's capital investment projects.  
C) not applicable for use by MNE.  
D) the required rate of return for a firm's average risk projects.

- 8) The capital asset pricing model (CAPM) is an approach: 8) \_\_\_\_\_  
 A) used by marketers to determine the price of saleable product.  
 B) to determine the price of equity capital.  
 C) that can be applied only to domestic markets.  
 D) none of the above
- 9) Which of the following is NOT a key variable in the equation for the capital asset pricing model? 9) \_\_\_\_\_  
 A) the risk-free rate of interest  
 B) the marginal tax rate  
 C) the expected rate of return on the market portfolio  
 D) All are important components of the CAPM.
- 10) \_\_\_\_\_ risk is a function of the variability of expected returns of the firm's stock relative to the 10) \_\_\_\_\_  
 market index and the measure of correlation between the expected returns of the firm and the  
 market.  
 A) Total                      B) Unsystematic              C) Systematic              D) Diversifiable
- 11) Systematic risk: 11) \_\_\_\_\_  
 A) is measured with standard deviation.  
 B) is the standard deviation of a security's return.  
 C) is measured with beta.  
 D) none of the above
- 12) Which of the following is generally unnecessary in measuring the cost of debt? 12) \_\_\_\_\_  
 A) the proportions of the various classes of debt a firm proposes to use  
 B) the corporate income tax rate  
 C) a forecast of future interest rates  
 D) All of the above are necessary for measuring the cost of debt.
- 13) The after-tax cost of debt is found by: 13) \_\_\_\_\_  
 A) subtracting the corporate tax rate from the before-tax cost of debt.  
 B) multiplying the before-tax cost of debt by (1 - the corporate tax rate).  
 C) dividing the before-tax cost of debt by (1 - the corporate tax rate).  
 D) subtracting (1 - the corporate tax rate) from the before-tax cost of debt.
- 14) A firm whose equity has a beta of 1.0: 14) \_\_\_\_\_  
 A) stands little chance of surviving in the international financial market place.  
 B) has greater systematic risk than the market portfolio.  
 C) has less systematic risk than the market portfolio.  
 D) None of the above is true.

- 15) The difference between the expected (or required) return for the market portfolio and the risk-free rate of return is referred to as: 15) \_\_\_\_\_  
 A) the market risk premium. B) the arithmetic mean.  
 C) the geometric mean. D) beta.
- 16) In general the geometric mean will be \_\_\_\_\_ the arithmetic mean for a series of returns. 16) \_\_\_\_\_  
 A) equal to B) less than  
 C) greater than or equal to D) greater than
- 17) The beginning share price for a security over a three-year period was \$50. Subsequent year-end prices were \$62, \$58 and \$64. The arithmetic average annual rate of return and the geometric average annual rate of return for this stock was: 17) \_\_\_\_\_  
 A) 9.30% and 8.58% respectively. B) 9.30% and 6.37% respectively.  
 C) 9.30% and 7.03% respectively. D) 9.30% and 7.89% respectively.
- 18) If a company fails to accurately predict its cost of equity, then: 18) \_\_\_\_\_  
 A) the firm may not be using the proper interest rate to estimate NPV.  
 B) the firm's wacc will also be inaccurate.  
 C) the firm may incorrectly accept or reject projects based on decisions made using the cost of capital computed with an incorrect cost of equity.  
 D) All of the above are true.
- 19) Which of the following statements is NOT true regarding beta? 19) \_\_\_\_\_  
 A) *Beta* will have a value of equal to 1.0 if the firm's returns are of equal volatility to the market.  
 B) *Beta* will have a value of greater than 1.0 if the firm's returns are more volatile than the market.  
 C) *Beta* will have a value of less than 1.0 if the firm's returns are less volatile than the market.  
 D) All of the statements above are true.
- 20) Which of the following will NOT affect a firm's beta? 20) \_\_\_\_\_  
 A) the choice of the risk-free security  
 B) the choice of the market portfolio against which to compare the variability of a firm's returns  
 C) the choice of the time period used to calculate the firm's beta  
 D) None of the above, because each of them affects the calculation of a firm's beta.

**TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.**

- 21) A national securities market is segmented if the required rate of return on securities in that market differs from comparable securities traded in other, unsegmented markets. 21) \_\_\_\_\_
- 22) Other things equal, an increase in the firm's tax rate will increase the WACC for a firm that has both debt and equity financing. 22) \_\_\_\_\_

- 23) If a firm's expected returns are more volatile than the expected return for the market portfolio, it will have a beta less than 1.0. 23) \_\_\_\_\_
- 24) The WACC is usually used as the risk-adjusted required rate of return for new projects that are of the same average risk as the firm's existing projects. 24) \_\_\_\_\_
- 25) One of the elegant beauties of international equity markets is that over the last 100 or so years, the average market risk premium is almost identical across major industrial countries. 25) \_\_\_\_\_
- 26) Firms acquire debt in either the form of loans from commercial banks, or by selling new common stock. 26) \_\_\_\_\_
- 27) When estimating an average corporate after-tax cost of capital, the component cost of equity is multiplied by  $(1-t)$  to allow for the tax-deductibility of dividend payments. 27) \_\_\_\_\_
- 28) *International CAPM* (ICAPM) assumes that there is a global market in which the firm's equity trades, and estimates of the firm's *beta*, and the market risk premium, must then reflect this global portfolio. 28) \_\_\_\_\_
- 29) Use of the *International CAPM* (ICAPM) assures that the WACC will be lower than if a purely domestic market portfolio had been used in the estimation of the cost of equity. 29) \_\_\_\_\_
- 30) A *global portfolio* is an index of all the securities in the world, whereas a *world portfolio* represents those securities actually available to an investor. 30) \_\_\_\_\_
- 31) The CAPM has now become very widely accepted in global business as the preferred method of calculating the cost of equity for a firm. As a result of this, there is now *little debate* over what numerical values should be used in its application. 31) \_\_\_\_\_
- 32) The geometric mean will, in all but a few extreme circumstances, yield a *larger* return than the arithmetic mean return. 32) \_\_\_\_\_

**ESSAY. Write your answer in the space provided or on a separate sheet of paper.**

- 33) What are the components of the weighted average cost of capital (WACC) and how do they differ for an MNE compared to a purely domestic firm?

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

- 34) The primary goal of both domestic and international portfolio managers is: 34) \_\_\_\_\_
- A) to maximize their WACC.
- B) to minimize the number of unique securities held in their portfolio.
- C) to maximize return for a given level of risk, or to minimize risk for a given level of return.
- D) all of the above

- 35) Which of the following is NOT a portfolio diversification technique used by portfolio managers? 35) \_\_\_\_\_  
 A) diversify by the size of capitalization of the securities held  
 B) diversify by country  
 C) diversify by type of security  
 D) All of the above are diversification techniques.
- 36) If all capital markets are fully integrated, securities of comparable expected return and risk should 36) \_\_\_\_\_  
 have the same required rate of return in each national market after adjusting for:  
 A) time of day and language requirements. B) political risk and time lags.  
 C) foreign exchange risk and the spot rate. D) foreign exchange risk and political risk.
- 37) Capital market segmentation is a financial market imperfection caused mainly by: 37) \_\_\_\_\_  
 A) institutional practices. B) government constraints.  
 C) investor perceptions. D) all of the above
- 38) Capital market imperfections leading to financial market segmentation include: 38) \_\_\_\_\_  
 A) foreign exchange risks.  
 B) high securities transaction costs.  
 C) asymmetric information between domestic and foreign-based investors.  
 D) all of the above
- 39) Capital market imperfections leading to financial market segmentation include: 39) \_\_\_\_\_  
 A) political risks. B) regulatory barriers.  
 C) corporate governance differences. D) all of the above
- 40) The authors refer to companies that have access to a \_\_\_\_\_ as MNEs, and firms without such 40) \_\_\_\_\_  
 access are identified as \_\_\_\_\_.  
 A) world financial markets; antiquated.  
 B) large domestic capital market; geographically challenged.  
 C) global cost and availability of capital; domestic firms.  
 D) none of the above
- 41) The MNE can \_\_\_\_\_ its \_\_\_\_\_ by gaining access to markets that are more liquid and/or less 41) \_\_\_\_\_  
 segmented than its own.  
 A) increase; MCC. B) maintain; MRR.  
 C) decrease; MCC. D) none of the above

**TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.**

- 42) Internationally diversified portfolios often have a lower rate of return and almost always have a 42) \_\_\_\_\_  
 higher level of portfolio risk than their domestic counterparts.
- 43) Empirical tests of market efficiency fail to show that most major national markets are reasonably 43) \_\_\_\_\_  
 efficient.



- 51) The optimal capital budget: 51) \_\_\_\_\_  
 A) is an illusion found only in international finance textbooks.  
 B) occurs where the marginal cost of capital equals the marginal rate of return of the opportunity set of projects.  
 C) is typically larger for purely domestic firms than for MNEs.  
 D) none of the above
- 52) Empirical studies indicate that MNEs have higher costs of capital than purely domestic firms. This could be due to higher levels of: 52) \_\_\_\_\_  
 A) agency costs. B) political risk.  
 C) exchange rate risk. D) all of the above
- 53) Despite the theoretical elegance of this hypothesis, empirical studies have come to the opposite conclusion. Despite the favorable effect of international diversification of cash flows, bankruptcy risk was only about the same for MNEs as for domestic firms. However, MNEs faced higher costs for each of the following EXCEPT: 53) \_\_\_\_\_  
 A) political risk.  
 B) asymmetric information.  
 C) agency costs.  
 D) In fact, each of these costs were higher for the MNE than for the domestic firm.

**TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.**

- 54) Because of the international diversification of cash flows, the risk of bankruptcy for MNEs is significantly lower than that for purely domestic firms. 54) \_\_\_\_\_
- 55) The opportunity set of projects is typically smaller for MNEs than for purely domestic firms because international markets are typically specialized niches. 55) \_\_\_\_\_
- 56) Surprisingly, empirical studies find that MNEs have a higher level of systematic risk than their domestic counterparts. 56) \_\_\_\_\_

**ESSAY. Write your answer in the space provided or on a separate sheet of paper.**

- 57) What do theory and empirical evidence say about capital structure and the cost of capital for MNEs versus their domestic counterparts?

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- 58) Empirical studies indicate that WACC for an MNE is higher than for their domestic competitors. Reasons cited for this increased cost include all of the following EXCEPT: 58) \_\_\_\_\_  
 A) political risk.  
 B) foreign exchange risk.  
 C) agency costs.  
 D) All of the above are cited as reasons for an MNE's increased WACC.

## Answer Key

Testname: UNTITLED4

- 1) D
- 2) A
- 3) C
- 4) D
- 5) D
- 6) D
- 7) D
- 8) B
- 9) B
- 10) C
- 11) C
- 12) D
- 13) B
- 14) D
- 15) A
- 16) B
- 17) A
- 18) D
- 19) D
- 20) A
- 21) TRUE
- 22) FALSE
- 23) FALSE
- 24) TRUE
- 25) FALSE
- 26) FALSE
- 27) FALSE
- 28) TRUE
- 29) FALSE
- 30) FALSE
- 31) FALSE
- 32) FALSE
- 33) The WACC considers the proportion or weight of assets financed with debt and the proportion financed with equity. It also looks at the costs of debt and equity financing and the firm's corporate tax rate. The difficulty of such a computation is compounded for an MNE because there are several additional sources of debt financing with different required rates of return and tax rates for an MNE than for a domestic firm. Also, equity may be sourced in several different markets and subject to several different regulations of several different countries. Adding regulatory oversight, multiple sourcing locations, and differing investor expectations may significantly complicate the process of determining an MNE's cost of capital.
- 34) C
- 35) D
- 36) D
- 37) D



Answer Key

Testname: UNTITLED4

38) D

39) D

40) C

41) C

42) FALSE

43) FALSE

44) TRUE

45) TRUE

46) TRUE

47) A

48) A

49) D

50) C

51) B

52) D

53) D

54) FALSE

55) FALSE

56) TRUE

57) In theory, MNEs should be able to support greater amounts of debt due to reduced variability of cash flows brought about by diversification across countries. And, because of this reduced risk borne by MNEs, they should also have a lower cost of capital. However, empirical research finds that domestic firms tend to use greater amounts of short and intermediate debt than do MNEs and that the cost of capital is greater for MNEs due to increased agency costs, political risk, exchange rate risk, and asymmetric information.

58) D