

## **Finance Tutorial Questions**

### **Tutorial 2- Introduction**

**1. Maximising profits is a more appropriate goal for a financial manager than maximising shareholder wealth. True or false?**

False. Maximising shareholder wealth is a financial manager's goal. Maximising profits ignores cash flow, timing & risk

**2. Buying shares on the ASX is a primary market transaction. True or false?**

False, it is a secondary market transaction. A primary one is where investors buy shares directly from the issuing company

**3. Primary market transactions are helped by good secondary markets. True or false?**

True. An active secondary market is essential as it provides liquidity, which is important to investors. Securities purchased in the primary market are more attractive to investors if the secondary market is liquid.

**4. Which is more important & why- the investment decision or the financing decision? Which part of the balance sheet does each decision affect? Give to examples**

The INVESTMENT DECISION is more important. This is because it determines the real assets that a business controls, which in turn determines the cash flows a business generates. The investment decision determines the composition of assets controlled by the firm. The financing decision is concerned with debt (liabilities) and owner's equity.

**5. Suppose a firm has had negative cash flow for each of the past 3 years but positive NP. Does this indicate a problem? What is CF is positive & NP is negative?**

Yes. Continued negative cash flow means the firm is a major problem because more cash is going out than coming in. The firm may be insolvent. Positive profit may be artificial.

**6. What is the primary disadvantage of the corporate form of organisation? What are 2 advantages?**

Cost & complexity of establishing. Agency problem. Some advantages include: limited liability, ease of transferability, ability to raise capital, and unlimited life.

**7. Suppose you own shares in a company. The current price per share is \$25. Another company has just announced it wants to buy your company & will pay \$35 per share. Your company's management immediately begins fighting off this hostile bid. Is management acting in shareholder's best interest? Why/ why not?**

If management believes the firm is worth more than \$35 per share, then they should fight the offer.

If management cannot increase the value of the firm beyond the bid price, and no other higher bids come in, then management is not acting in the interests of the shareholders by fighting the offer. Since current managers often lose their jobs when the company is acquired, poorly monitored managers have an incentive to fight takeovers.

### **Tutorial 3**

#### **1. Explain the difference between an APR (or nominal rate) & an effective rate**

The APR is a rate compounded more frequently than annually. The effective rate (EFF) is a rate compounded annually.

#### **2. In 2001, a mechanized toy robot from the television series Lost in Space sold for \$750. This represented a 13.86 percent annual return. For this to be true, what must the robot have sold for new in 1965?**

$$\begin{aligned}PV &= FV(1 + i)^{-n} \\&= 750(1 + 0.1386)^{-36} \\&= \$7.01\end{aligned}$$

#### **3. You invested \$17,000 in a superannuation fund in 2006. If you withdraw \$18,000 from the fund in 2009, how much will be in the fund in 2013? Assume the fund earns a constant return of 7.6% pa.**

1. Find value of \$17,000 investment in 2009

$$\begin{aligned}FV &= 17,000(1.076)^3 \\&= 21,178.04\end{aligned}$$

2. Determine balance in 2009

$$\begin{aligned}\text{Balance in 2009} &= \$21,178.04 - \$18,000 \\&= \$3,178.04\end{aligned}$$

3. Find accumulated value in 2013

$$\begin{aligned}FV &= 3,178.04(1.076)^4 \\&= \$4,259.99\end{aligned}$$

#### **8. If today is Year 0, what is the future value of the following cash flows five years from now? What is the future value 10 years from now? Assume a discount rate of 10.2 percent per year.**

Year	Cash Flow
2	\$30,000
3	45,000
5	75,000

Future value five years from now:

Amount	Future value
30000	$30000(1 + 0.102)^3 = 40,148.20$
45000	$45000(1 + 0.102)^2 = 54,648.18$
75000	75000
TOTAL	\$169,796.38

$$\begin{aligned}\text{Future value ten years from now} &= 169796.38(1 + 0.102)^5 \\&= \$275,953.81\end{aligned}$$