BUSINESS-ENVIRONMENT-AND-CONCEPTS Q&As

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QUESTION 1

A parent corporation owned more than 90% of each class of the outstanding stock issued by a subsidiary corporation and decided to merge that subsidiary into itself. Under the Revised Model Business Corporation Act, which of the following actions must be taken?

A. The subsidiary corporation\\'s board of directors must pass a merger resolution.

B. The subsidiary corporation\\'s dissenting stockholders must be given an appraisal remedy.

C. The parent corporation\\'s stockholders must approve the merger.

D. The parent corporation\\'s dissenting stockholders must be given an appraisal remedy.

Correct Answer: B

Choice "b" is correct. In a short form merger (one between a parent and a subsidiary 90% of which is

owned by the parent), the subsidiary\\'s shareholders have a right to dissent and take advantage of the

appraisal remedy.

Choice "a" is incorrect. The subsidiary\\'s board is not required to take any action in a short-form merger.

Choice "c" is incorrect. The parent corporation\\'s shareholders have no right to approve or disapprove a

short-form merger.

Choice "d" is incorrect. The parent corporation\\'s shareholders have no right to dissent to a short-form

merger.

QUESTION 2

The measure most often used to compare standards of living across countries or across time is:

A. Government spending.

B. Real GDP.

C. Real consumption expenditures.

D. Real GDP per capita.

Correct Answer: D

Choice "d" is correct. Real GDP per capita is real GDP divided by population. Real GDP per capita is typically used to compare standards of living across countries or across time. By dividing real GDP by population, this measure adjusts for differences in the size of countries and for differences in population over time. Choice "a" is incorrect. Government spending is not a measure of the standard of living of a country. Choice "b" is incorrect. Countries with larger populations tend to have higher levels of real GDP. This however does not mean they have a higher standard of living. To adjust for differences in population, real GDP per capita is typically used to compare standards of living, not real GDP. Choice "c" is incorrect. Real consumption expenditures are only a part of real GDP and thus do not measure all economic activity. Furthermore, real consumption expenditures do not adjust for differences in population. It is therefore not used as a measure of the standard of living.

QUESTION 3

Managers are often engaged in decision-making. There are numerous logical steps to reach a decision. The step least likely to used by a manager for decision-making would be:

A. Obtaining information.

B. Establishment of a strategic vision.

C. Selecting alternatives.

D. Identifying alternative courses of action.

Correct Answer: B

Choice "b" is correct. Establishing a strategic vision is not normally included as part of the logical steps to reach a decision. Although decision-making techniques are incorporated as part of establishing a strategic vision and consideration of strategic issues is important, the process of deriving the vision is not considered part of the decision-making process. Choice "a" is incorrect. Obtaining information as a basis for selecting between alternatives is generally viewed as a critical part of decision-making. Choice "c" is incorrect. Selecting alternatives is a specific decision-making action that is generally included as one of the steps identified in decision-making. Choice "d" is incorrect. Identifying alternative courses of action from which to choose is a decision-making process that is generally included as one of the steps identified in decision-making.

QUESTION 4

A company with $4.8 million in credit sales per year plans to relax its credit standards, projecting that this will increase credit sales by $720,000. The company\\'s average collection period for new customers is expected to be 75 days; and the payment behavior of the existing customers is not expected to change. Variable costs are 80 percent of sales. The firm\\'s opportunity cost is 20 percent before taxes. Assuming a 360-day year, what is the company\\'s benefit (loss) on the planned change in credit terms?

A. $28,800

B. $144,000

C. $120,000

D. $126,000

Correct Answer: C

Choice "c" is correct. $120,000 benefit on the planned change in credit standards.

		Opportunity Cost	
Sales	$720,000		
Variable Costs (80%)	576,000 × 75/360 =	$120,000 =	75 Days' Costs O/S
Variable Margin	144,000		
		× 20%	Opportunity Cost Rate
Less Opportunity Cost	(24,000)	$ 24,000	
Benefit	$120,000		

This question pertains to the economic benefit associated with a change in credit terms.

The question tells us that the credit sales will increase by $720,000 if we relax our credit terms. We know variable costs are 80%, so we will earn $144,000 as a result of the expanded sales. The 20% contribution margin is equal to the 20% opportunity cost so there is no better investment of our resources for the expanded credit sales relative to its margin.

What about the variable costs, though?

We have $576,000 in variable costs that will be outstanding, pro rata, 75 days of the year. So the resources we will use to produce our sales is 75/360ths of $576,000, or $120,000 at any given time during the year. These $120,000 in resources could earn 20% annual return or $24,000. The $24,000 opportunity cost, compared to the $144,000 margin results in a $120,000 benefit in relaxing credit terms.

Choices "a", "b", and "d" are incorrect, per the above calculation/discussion.

QUESTION 5

The profitability index is a variation on which of the following capital budgeting models?

A. Internal rate of return.

B. Economic value-added.

C. Net present value.

D. Discounted payback.

Correct Answer: C

Choice "c" is correct. The profitability index is a variation on the net present value capital budgeting model. RULE: The profitability index is the ratio of the present value of net future cash inflows to the present value of the net initial investment. The profitability index is also referred to as the "excess present value index" or simply the "present value index." Companies hope that this ratio will be over 1.0, which means that the present value of the inflows is greater than the present value of the outflows.

$$\frac{\text{Present value of net future cash inflows}}{\text{Present value of net initial investment}} = \text{Profit ability index}$$

Choice "a" is incorrect. The profitability index is a companion computation to net present value, not internal rate of return, which measures percentage return.

Choice "b" is incorrect. The profitability index is a companion computation to net present value, not economic value added.

Choice "d" is incorrect. The profitability index is a companion computation to net present value, not the discounted payback method, which measures years to payback.