Quiz 1 — Answers and explanations

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Correct answers are **bolded** and underlined. A short explanation follows each question.

1. Where would you find a company's official SEC-filed annual report (Form 10-K)?

   A. CNBC
   B. SEC EDGAR
   C. An earnings press release
   D. An AI summary

   Why: EDGAR is the SEC's filing database, where you can retrieve the company's filed Form 10-K rather than a summary.

2. Which feature helps corporations raise large amounts of capital?

   A. Every shareholder manages daily operations.
   B. The business must close when its founder leaves.
   C. They can pool investment from many shareholders.
   D. They cannot borrow money.

   Why: Selling shares allows a corporation to combine capital from many investors to finance large investments.

3. Why can separating ownership from management create an agency problem?

   A. Managers may pursue interests that differ from the owners' interests.
   B. Owners and managers must disagree about every decision.
   C. Managers are unable to own company shares.
   D. Shareholders make every operating decision themselves.

   Why: Managers control decisions but may prefer outcomes that benefit themselves rather than the owners.

4. A CEO wants an acquisition mainly to increase her status, even though she expects it to reduce shareholder value. This illustrates:

   A. Effective board oversight.
   B. Alignment of owner and manager interests.
   C. Evidence that all acquisitions are bad.
   D. Empire building.

   Why: Pursuing a larger firm for personal status at the expense of shareholder value is empire building.

5. Why might a board pay a CEO partly in company stock?

   A. To guarantee that every decision succeeds.
   B. To link part of the CEO's wealth to shareholder value.
   C. To eliminate the need for oversight.
   D. To prevent shareholders from benefiting when the firm succeeds.

   Why: Stock compensation makes part of the CEO's wealth depend on share value, helping align incentives without eliminating every conflict.

6. A bonus based only on this year's earnings can encourage managers to:

   A. Always choose the best long-term investment.
   B. Ignore the performance measure used for their bonus.
   C. Cut valuable long-term investment to improve this year's earnings.
   D. Eliminate every conflict with shareholders.

   Why: An earnings-only bonus can reward cutting worthwhile investment today even when that harms long-term value.

7. In the Friedman position discussed in class, managers' primary objective is to:

   A. Create shareholder value within the rules of society.
   B. Maximize the number of employees regardless of cost.
   C. Make the company as large as possible.
   D. Maximize managers' personal benefits.

   Why: The Friedman position discussed in class emphasizes serving shareholders while operating within society's rules.

8. Among firms you are comparing, one has the fastest revenue growth over the last two years. Is that enough to conclude it is the best investment?

   A. Yes; the fastest growth guarantees the highest investment return.
   B. Yes; growing firms have no investment risk.
   C. No; only last year's net income matters.
   D. No; you also need to consider the investment's price and risk.

   Why: Growth alone does not establish a good investment; the price paid and the risks also affect its attractiveness.

9. What challenge arises when managers try to serve multiple stakeholder groups?

   A. All stakeholder interests are always identical.
   B. Competing interests require a way to prioritize tradeoffs.
   C. Employees cannot affect business results.
   D. Managers no longer need to make decisions.

   Why: Stakeholders can have conflicting goals, so managers need a way to choose among tradeoffs and be accountable.

10. An AI-generated company report gives a revenue number without a source. What is the best next step?

    A. Accept it because the report looks professional.
    B. Ask the AI to sound more confident.
    C. Check the underlying source, reporting period and units.
    D. Assume it must be this year's revenue.

    Why: Checking the original source, reporting period and units helps establish whether the revenue figure is accurate and comparable.