BUSINESS-ENVIRONMENT-AND-CONCEPTS^{Q&As}

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QUESTION 1

At the peak of a business cycle:

A. Output (real GDP) tends to be below the potential level of output.

B. There is likely to be an excess supply of labor and business inventories are likely to be high.

C. The overall price level is likely to be falling.

D. Capacity constraints and labor shortages are likely to put upward pressure on the overall price level.

Correct Answer: D

Choice "d" is correct. The peak of a business cycle marks the highest point of economic activity. At that

point, firms are likely to face capacity constraints and labor shortages, which will put upward pressure on

the overall price level.

Choice "a" is incorrect. Real GDP is likely to be above, not below, its potential level.

Choice "b" is incorrect. Business inventories are likely to be low, not high, and there is likely to be excess

demand for labor not an excess supply of labor.

Choice "c" is incorrect. The overall price level is likely to be rising not falling.

QUESTION 2

The treasury analyst for Garth Manufacturing has estimated the cash flows for the first half of next year (ignoring any short-term borrowings) as follows:

	Cash (millions)	
	Inflows	Outflows
January	$2	$1
February	2	4
March	2	5
April	2	3
May	4	2
June	5	3

Garth has a line of credit of up to $4 million on which it pays interest monthly at a rate of 1 percent of the amount utilized. Garth is expected to have a cash balance of $2 million on January 1 and no amount utilized on its line of credit. Assuming all cash flows occur at the end of the month, approximately how much will Garth pay in interest during the first half of the year?

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A. $61,000

B. $80,000

C. $132,000

D. $240,000

Correct Answer: A

Choice "a" is correct. First, determine the amount and timing of cash needs: Comments 1 Given 2 Computed balance, positive cash flows 3 Computed balance, negative cash flows 4 Borrow from LOC 5 Computed balance, negative cash flows + interest 6 Cumulative LOC Balance 7 Computed positive cash flows 8 Computed balance, positive cash flows - interest 9 Immediate pay down of LOC Choices "b", "c", and "d" are incorrect, per the above calculation.

	Borrow	Cash Inflows	Outflows	Balance
Beg. bal				$2,000,000 [1]
January		2,000,000	(1,000,000)	$3,000,000 [2]
February		2,000,000	(4,000,000)	$1,000,000 [2]
March		2,000,000	(5,000,000)	($2,000,000) [3]
Borrow	2,000,000			- [4]
April		2,000,000	(3,000,000)	($1,000,000) [3]
Interest paid on $2 mil			(20,000)	($1,020,000) [5]
Borrow	1,020,000			- [4]
Total debt	3,020,000			[6]
May		4,000,000	(2,000,000)	$2,000,000 [7]
Interest paid on $3.02 mil			(30,200.00)	$1,969,800 [8]
Pay LOC	(1,969,800)		(1,969,800)	- [9]
Total debt	1,050,200			[6]
June		5,000,000	(3,000,000)	$2,000,000 [7]
Interest on $1,050,200			(10,502)	$1,989,498 [8]

Total interest paid is sum of three interest payments

(20.000)

QUESTION 3

Assume that each day a company writes and receives checks totaling $10,000. If it takes five days for the checks to clear and be deducted from the company\'s account, and only four days for the deposits to clear, what is the float?

A. $10,000

B. $0

C. $(10,000)

D. $25,000

Correct Answer: A

Choice "a" is correct. $10,000. Float is the difference between the balance of checks outstanding, which have not cleared the bank and deposits made but which have not yet cleared the bank here.

$10,000/day checks drawn but not cleared × 5 days = $50,000

Less $10,000/day checks received but not cleared × 4 days = (40,000)

Positive "float" = $10,000

Choices "b", "c", and "d" are incorrect, per the above calculation.

QUESTION 4

Which of the following is not correct regarding best cost provider strategies?

A. The overall lowest cost in the industry is not a viable option in best cost strategies because the firm could not compete profit-wise with its differentiation strategy component.

B. When generic products are not acceptable to buyers, yet they still remain price sensitive to the value they are receiving for their money, the best cost strategy may work well.

C. The best cost strategy is a combination of the benefits of the cost leadership and differentiation strategies.

D. The best cost strategy strives to have the firm evaluate and change its value chain such that it can achieve the highest cost among its closest competitors with a quality differentiated product in an effort to obtain the highest profits.

Correct Answer: D

Choice "d" is correct because it is not a correct statement. The best cost strategy strives to have the firm evaluate and change its value chain such that it can achieve the lowest (not highest) cost among its closest competitors while matching them on the features desired by consumers. Choices "a", "b", and "c" are incorrect, as they are all true statements regarding best cost provider strategies.

QUESTION 5

During 1994, Deet Corp. experienced the following power outages:

Number of outages per month	Number of months
0	3
1	2
2	4
3	3
	12

Each power outage results in out-of-pocket costs of $400. For $500 per month, Deet can lease an auxiliary generator to

provide power during outages. If Deet leases an auxiliary generator in 1995, the estimated savings (or additional expenditures) for 1995 would be:

A. ($3,600)

B. ($1,200)

C. $1,600

D. $1,900

Correct Answer: C

Choice "c" is correct.

Savings:

1 outage × 2 mo	=		2
2 outage × 4 mo	=		8
3 outage × 3 mo	=		9
			19
Out-of-pocket cost		×	400
Cost to be saved			$7,600
Cost of generator ($500 × 12)			(6,000)
Estimated net savings			$1,600

Choice "a" is incorrect. The estimated savings is dependent on the number of outages and on the number of months, since there are two costs involved. Choice "b" is incorrect. The estimated savings is not the difference between the out-of-pocket costs and cost of generator, times 12 months. Choice "d" is incorrect. The cost of the generator is a monthly cost, not dependent on the number of power outages.

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