



# **BUSINESS-ENVIRONMENT-AND- CONCEPTS<sup>Q&As</sup>**

Certified Public Accountant (Business Environment & Concept)

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### QUESTION 1

Which of the following statements is correct if there is an increase in the resources available within an economy?

- A. More goods and services will be produced in the economy.
- B. The economy will be capable of producing more goods and services.
- C. The standard of living in the economy will rise.
- D. The technological efficiency of the economy will improve.

Correct Answer: B

Choice "b" is correct. If there is an increase in the resources available in an economy, the economy will be capable of producing more goods and services. This increase is really an increase in the long-run aggregate supply (potential GDP). On the aggregate supply and demand chart, the long-run aggregate supply line (LRAS) is the vertical line that represents the potential or equilibrium level of output. If that line shifts to the right, then the economy is capable of expanding, but it will not automatically expand just because the line shifts to the right. Choice "a" is incorrect. Just because there is an increase in the resources available in an economy, it does not mean that more goods and services will automatically be produced. There would have to be increased demand (a shift upward in the aggregate demand line) for more goods and services to actually be produced. Choice "c" is incorrect. If there is an increase in the resources available in an economy, the standard of living in the economy will not necessarily rise. It could rise, but it will not necessarily do that. Choice "d" is incorrect. If there is an increase in the resources available in an economy, the technological efficiency of the economy will not automatically improve. This statement is backwards. An increase in technological efficiency of an economy will normally increase the resources available in the economy by increasing productivity.

### QUESTION 2

Assume the following facts about Martin Corporation:

- The long-term debt was originally issued at par (\$1,000/bond) and is currently trading at \$1,250 per bond.
- Martin Corporation can now issue debt at 150 basis points over U.S. treasury bonds.
- The current risk-free rate (U.S. treasury bonds) is 7 percent.
- Martin's common stock is currently selling at \$32 per share.
- The expected market return is currently 15 percent.
-



The beta value for Martin is 1.25.

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Martin's effective corporate income tax rate is 40 percent.

Based on these assumptions, what is the current net after-tax cost of debt for Martin Corporation?

- A. 5.5 percent.
- B. 7.0 percent.
- C. 5.1 percent.
- D. 8.5 percent.

Correct Answer: C

Choice "c" is correct. 5.1 percent current net cost of debt.

The fact pattern states that debt can be currently secured at 150 basis points above the Treasury bond rate. A basis point is equal to 1/100 of 1% (1% of 1%).

Applying the decimals, it's:

150 basis points x 1/100 of 1% (or .0001)

this yields .015 or 1.5%

Add the additional basis points converted to percentage (1.5%) to the Treasury bond rate of 7% to arrive at the pre-tax debt cost of 8.5%. Apply 1 - tax rate to arrive at the current net cost of debt as follows:

	<u>Decimal</u>	<u>%</u>
Basis points over U.S. Treasury bond rate	150	150
One basis point = 1/100 of 1%	x .0001	.01%
	.015	1.5%
Current risk-free rate (U.S. Treasury bonds = baseline)	.070	7.0
Pretax cost	.085	8.5
Income tax at 40%	.034	3.4
Net (after-tax) cost of debt (60%)	<u>.051</u>	<u>5.1%</u>

### QUESTION 3

Which of the following is not considered a factor that increases the bargaining power of the customer?

- A. Much information is available to the customer to compare and contrast features of all products on the market.
- B. One group of customers makes up a large volume of the firm's business.



- C. Buyers have low switching costs of changing products.
- D. The firm is unable to change suppliers easily.

Correct Answer: D

Choice "d" is correct. When a firm is unable to change suppliers easily, that is a factor that increases the bargaining power of the suppliers. Choices "a", "b", and "c" are incorrect because they all are factors that increase the bargaining power of the customer, which are:

- ?Customers make up a large volume of a firm's business.
  - ?There is much information available to customers.
  - ?The buyers have low switching costs.
  - ?There are a high number of alternate suppliers.
- 

#### QUESTION 4

Which of the following statements regarding competitive advantage is not true?

- A. The two major forms of competitive advantage are product differentiation and cost leadership.
- B. If the manufacturing costs of a firm are less than those of close rivals, then the firm has a competitive market advantage.
- C. Cost leadership advantage may be the best be obtained by a firm when a firm builds market shares or matches the price of its rivals.
- D. Differentiation advantage may best be obtained by a firm when a firm builds market share or increases its price.

Correct Answer: B

Choice "b" is the proper choice, as it is not a true statement. Simply because the manufacturing costs of a firm are less than those of close rivals, this does not necessarily mean that the firm has a competitive market advantage. Only if TOTAL costs to a firm are less than those of close rivals will a firm have a competitive market advantage. Choices "a", "c", and "d" are incorrect, as they are all true statements.

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#### QUESTION 5

Unless the partnership agreement prohibits it, a partner in a general partnership may validly assign rights to:



	<u>Partnership property</u>	<u>Partnership distributions</u>
A.	Yes	Yes
B.	Yes	No
C.	No	Yes
D.	No	No

A. Option A

B. Option B

C. Option C

D. Option D

Correct Answer: C

Choice "c" is correct.

Rules: A partner has no right to assign an interest in partnership property because a partner's rights in partnership property are limited to using the property for partnership purposes. However, a partner does have a right to assign her interest in partnership distributions. The assignee does not become a partner, but merely has a right to receive whatever distributions the assignor would have received.

Choices "a", "b", and "d" are incorrect, per the above rules.

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