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Financial-Management Test

FINANCIAL MANAGEMENT

TEST 01



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WGU Financial Management VBC1 Sample Questions (Q26-Q31):

NEW QUESTION # 26

What distinguishes free cash flow to equity (FCFE) from free cash flow to the firm (FCFF)?

- A. FCFE represents the total cash flow from operations that is available at the end of the period.
- B. FCFE includes depreciation, amortization, and other non-cash expenses, while FCFF does not.
- C. FCFE is distributable only to debt holders, whereas FCFF is distributable only to equity holders.
- D. **FCFE measures cash distributable to equity holders after all obligations are met, including debt payments.**

Answer: D

Explanation:

Free cash flow concepts are central to valuation. Free cash flow to the firm (FCFF) represents cash available to all capital providers-both debt and equity-before interest and principal repayments. In contrast, free cash flow to equity (FCFE) measures the cash available exclusively to common shareholders after all operating expenses, capital expenditures, working capital needs, and debt obligations (interest and principal) have been satisfied. This distinction determines which discount rate analysts use: FCFF is

discounted at the weighted average cost of capital (WACC), while FCFE is discounted at the cost of equity. FCFE is especially useful when valuing equity directly or when a firm's leverage is stable and predictable. Option C correctly captures this defining difference, while the other options misstate cash flow allocation or confuse accounting adjustments with distributable cash.

NEW QUESTION # 27

In the capital asset pricing model (CAPM), what does a beta (#) greater than 1 signify for a portfolio?

- A. The portfolio has more risk than the market.
- B. The portfolio is expected to move in the opposite direction of the market.
- C. The portfolio will always outperform the market.
- D. The portfolio has less risk than the market.

Answer: A

Explanation:

Within the CAPM framework, beta quantifies the degree of systematic risk relative to the market portfolio, which by definition has a beta of 1. A portfolio with a beta greater than 1 carries more systematic risk than the market, meaning its returns are expected to be more sensitive to market movements. This higher sensitivity increases both upside potential and downside exposure. According to CAPM, investors require a higher expected return for bearing this additional risk. Importantly, a higher beta does not guarantee superior performance; it simply reflects greater volatility relative to the market. Option B accurately captures this risk-based interpretation.

NEW QUESTION # 28

What is the dividend yield of a stock that pays annual dividends of \$4 per share and has a current market price of \$80?

- A. 2.5%
- B. 20%
- C. 5%
- D. 10%

Answer: C

Explanation:

Dividend yield measures the cash return an investor receives relative to the stock's current market price. It is calculated as Annual Dividend \div Market Price per Share. In this case, the dividend yield is

$\$4 \div \$80 = 0.05$, or 5%. Dividend yield is a key valuation metric, particularly for income-oriented investors, as it indicates the immediate cash return from holding the stock, excluding capital gains.

Financial managers monitor dividend yield to understand how dividend policy affects investor appeal and market valuation. Option B correctly reflects this calculation and interpretation.

NEW QUESTION # 29

What are opportunity costs in the context of inventory management?

- A. Costs for the labor involved in managing inventory levels
- B. Costs related to the insurance of inventory against loss or damage
- C. Costs incurred from the physical space used to store inventory
- D. Costs of not investing capital tied up in inventory elsewhere

Answer: D

Explanation:

Opportunity cost represents the return a firm forgoes by investing resources in one use instead of the next best alternative. In inventory management, capital tied up in inventory cannot be used for other value-generating activities such as investing in new projects, paying down debt, or returning cash to shareholders. Financial management emphasizes opportunity cost as a key component of inventory carrying costs, along with storage, insurance, and obsolescence. Ignoring opportunity costs can lead to excessive inventory levels and reduced firm value. Option B correctly identifies this fundamental concept.

NEW QUESTION # 30

What is a benefit of a firm extending credit to customers in a competitive market?

- A. Reduced customer base due to credit terms
- B. **Increased sales to non-cash buyers**
- C. Immediate cash inflows from sales
- D. Decreased sales due to increased prices

Answer: B

Explanation:

Extending credit allows firms to attract customers who are unable or unwilling to pay cash at the time of purchase. In competitive markets, offering favorable credit terms can increase sales volume, improve customer relationships, and enhance market share. While credit sales delay cash inflows and introduce default risk, they can generate higher revenues and profits if managed properly. Financial management texts stress the importance of balancing increased sales against the costs of credit, including collection expenses and bad debt losses. Option C correctly identifies the primary strategic benefit of extending credit in competitive environments.

NEW QUESTION # 31

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