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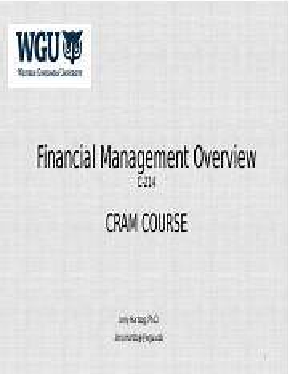

Financial Management Overview

C-214

CRAM COURSE

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WGU Financial Management VBC1 Sample Questions (Q39-Q44):

NEW QUESTION # 39
Why might investors choose to invest in junk bonds?

- A. They are backed by government guarantees.
- B. They offer guaranteed returns with minimal risk.
- C. They always outperform the stock market in terms of returns.
- D. They offer the potential for higher returns in exchange for higher risk.

Answer: D

Explanation:
Junk bonds, also known as high-yield bonds, are issued by firms with lower credit ratings and therefore higher default risk. To compensate investors for this additional risk, these bonds offer higher interest rates than investment-grade bonds. From a financial management and portfolio perspective, investors may include junk bonds to enhance portfolio returns, particularly when they believe default risk is overstated or when economic conditions are favorable. Junk bonds do not guarantee returns and are not backed by government guarantees, making options A and D incorrect. They also do not consistently outperform equities, especially during periods of financial stress. Option B accurately reflects the risk- return tradeoff that underpins investment decisions in capital market theory: higher expected returns are associated with higher risk.

NEW QUESTION # 40
What is the relationship between the length of the cash cycle and the amount of cash a firm needs to operate?

- A. Shorter cash cycles require more cash to handle rapid transactions.
- B. Companies must keep more cash on hand if they maintain a longer cash cycle.
- C. The cash cycle length has no impact on operational cash needs.
- D. A longer cash cycle reduces the need for operational cash due to increased efficiency.

Answer: B

Explanation:
The cash conversion cycle measures the time between cash outflows for production and cash inflows from customer payments. A longer cash cycle means that cash is tied up for a longer period in inventory and receivables before being recovered through sales. As a result, firms with longer cash cycles require larger cash balances or greater access to short-term financing to support ongoing operations. Financial managers aim to shorten the cash cycle by improving inventory turnover, accelerating collections, and managing payables efficiently. Option D correctly reflects this fundamental relationship emphasized in working capital management.

NEW QUESTION # 41
A company is looking to invest in new machinery that will enhance overall efficiency. The projected assets needed for the project are $590,000, the projected liabilities are $431,000, and the projected equity is $49,000.
What is the discretionary financing need (DFN)?

- A. $382,000
- B. $110,000
- C. $10,000
- D. $159,000

Answer: B

Explanation:
Discretionary financing need (DFN), also called external financing needed, represents the additional funds a company must raise after accounting for the financing provided by liabilities and equity. The basic relationship is: DFN = Projected Assets # Projected Liabilities # Projected Equity. Using the numbers in this problem, DFN = $590,000 # $431,000 # $49,000 = $110,000. Therefore, answer B is correct. This means the company will need to obtain an additional $110,000 in financing, such as new debt or new equity, to support the machinery investment and the related growth. Financial managers use DFN calculations in pro forma planning

to estimate whether internal sources and spontaneous liabilities are enough to support expansion. If DFN is positive, the firm must seek outside financing or change its operating assumptions, such as improving profit margins, retaining more earnings, or reducing asset intensity. If DFN is negative, the firm has excess financing capacity. Understanding DFN is essential in capital management because growth often requires more assets than can be supported by existing internal funds. Therefore, B correctly reflects the amount of external financing required.

NEW QUESTION # 42

A recent news article reported that a popular tech start-up has not yet reached profitability or experienced a period of positive cash flows from operations. Instead, the company has been focused primarily on capturing market share and attracting new customers. What does the continued negative cash flow from operations (CFO) signal about this firm?

- A. It shows the firm is generating too much cash from operations and will not be able to continue to do so.
- B. It indicates the firm is effectively managing its assets and using them to generate earnings for the firm.
- C. It suggests the firm is burning cash in its operations and may eventually run out of funding sources.
- D. It implies the firm is investing minimally in the future growth of the company and its operations.

Answer: C

Explanation:
Cash flow from operations reflects the cash generated (or consumed) by a firm's core business activities. When CFO is consistently negative, it indicates that operating expenses and working capital needs exceed cash inflows from sales. For start-ups, this is common during early growth phases, as firms spend heavily on marketing, technology, and customer acquisition to build scale and future revenue potential. However, from a financial management perspective, negative CFO also signals cash burn. Unless offset by financing inflows (equity or debt) or expected future positive cash flows, continued operating losses can threaten liquidity and solvency. Analysts closely monitor burn rate, funding runway, and the firm's ability to transition to sustainable operations. Option C accurately captures this risk-focused interpretation, whereas the other options either mischaracterize negative CFO or contradict its fundamental meaning.

NEW QUESTION # 43

Why is understanding exchange rate risk crucial for multinational corporations?

- A. Because fluctuations in exchange rates can impact firm value
- B. Because it allows companies to avoid the complexities of international operations
- C. Because exchange rates are stable and enhance investment outcomes
- D. Because multinational operations simplify the financial planning process

Answer: A

Explanation:
Understanding exchange rate risk is crucial because exchange-rate movements can change the value of a multinational corporation's future cash flows, assets, liabilities, and reported earnings. A firm may sell products abroad, import raw materials, repay foreign-currency loans, or own subsidiaries in other countries. If exchange rates move unfavorably, the domestic-currency value of those transactions can decline, reducing profitability and potentially lowering the overall value of the firm. Exchange rate risk affects both operating decisions and financing decisions. For example, it can influence where a firm produces goods, which currency it borrows in, how it prices exports, and whether it should hedge future receipts or payments. This makes exchange-rate analysis a central part of international financial management, not a side issue. Choice A is incorrect because exchange rates are not stable. Choice C is incorrect because understanding the risk does not eliminate the complexity of international operations. Choice D is also incorrect because multinational business generally makes financial planning more difficult, not simpler. Therefore, B is correct because exchange-rate fluctuations can materially affect shareholder value and the financial performance of multinational corporations.

NEW QUESTION # 44

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