

1. C
2. B
3. A
4. C
5. B
6. B
7. C
8. A
9. A
10. C
11. C
12. A
13. B
14. B
15. C
16. B
17. C
18. A
19. A
20. B
21. B
22. A
23. B
24. A
25. B

Answer 26:

i

The primary goal of raising capital is to finance the company's revenue-generating activities in order to increase its net income and maximize the wealth of its shareholders.

In most cases, the capital that is raised is used to finance the

- purchase of long-lived assets,
- capital expansion projects,
- research and development,
- the entry into new product or geographic regions,
- the acquisition of other companies.

Alternatively, a company may be forced to raise capital to ensure that it continues to operate as a going concern. In these cases, capital is raised to fulfill regulatory requirements, improve capital adequacy ratios, or to ensure that debt covenants are met.

ii

In general, preference shares are less risky than common shares for three main reasons:

1. Dividends on preference shares are known and fixed, and they account for a large portion of the preference shares' total return. Therefore, there is less uncertainty about future cash flows.
2. Preference shareholders receive dividends and other distributions before common shareholders.
3. The amount preference shareholders will receive if the company is liquidated is known and fixed as the par (or face) value of their shares. However, there is no guarantee that investors will receive that amount if the company experiences financial difficulty.

With common shares, however, a larger portion of shareholders' total return (or all of their total return for non-dividend shares) is based on future price appreciation and future dividends are unknown. If the company is liquidated, common shareholders will receive whatever amount (if any) is remaining after the company's creditors and preference shareholders have been paid. In summary, because the uncertainty surrounding the total return of preference shares is less than common shares, preference shares have lower risk and lower expected return than common shares. Puttable common or preference shares are less risky than their callable or non-callable counterparts because they give the investor the option to sell the shares to the issuer at a pre-determined price. This pre-determined price establishes a minimum price that investors will receive and reduces the uncertainty associated with the security's future cash flow. As a result, puttable shares generally pay a lower dividend than non-puttable shares.

Callable common or preference shares are riskier than their non-callable counterparts because the issuer has the option to redeem the shares at a pre-determined price. Because the call price limits investors' potential future total return, callable shares generally pay a higher dividend to compensate investors for the risk that the shares could be called in the future. Similarly, puttable preference shares have lower risk than non-puttable preference shares.

iii

Investors require a return on the funds they provide to the company. This return is called the investor's minimum required rate of return.

When investors purchase the company's equity securities, their minimum required rate of return is based on the future cash flows they expect to receive. Because these future cash flows are both uncertain and unknown, the investors' minimum required rate of return must be estimated. Because companies try to raise capital at the lowest possible cost, the company's cost of equity is often used as a proxy for the investors' minimum required rate of return.

iv

If investors require a higher rate of return on equity than the company's cost of equity, they would sell their shares and invest their funds elsewhere resulting in a decline in the company's share price. As the share price declined, the cost of equity would increase to reach the higher rate of return that investors require.



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