

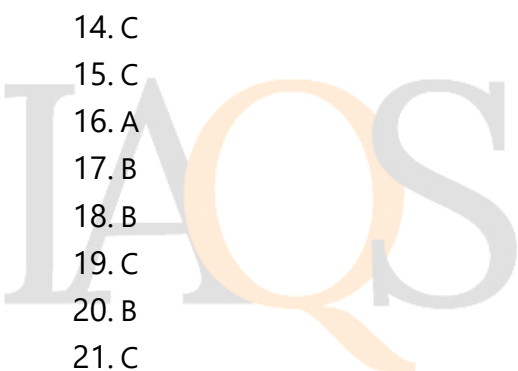


Subject: PTSA

Chapter: Unit 4

Category: Practice questions solutions

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



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Answer 30:

i.

The first is to limit the amount of control that foreign investors can exert on domestic companies. For example, some countries prevent foreign investors from acquiring a majority interest in domestic companies.

The second is to give domestic investors the opportunity to own shares in the foreign companies that are conducting business in their country.

The third reason is to reduce the volatility of capital flows into and out of domestic equity markets.

ii.

A depository receipt is a security that trades like an ordinary share on a local exchange and represents an economic interest in a foreign company. It allows the publicly listed shares of a foreign company to be traded on an exchange outside its domestic market.

A depository receipt is created when the equity shares of a foreign company are deposited in a bank (i.e., the depository) in the country on whose exchange the shares will trade. The depository then issues receipts that represent the shares that were deposited. The number of receipts issued, and the price of each DR is based on a ratio, which specifies the number of depository receipts to the underlying shares. Consequently, a DR may represent one share of the underlying stock, many shares of the underlying stock, or a fractional share of the underlying stock.

The price of each DR will be affected by factors that affect the price of the underlying shares, such as company fundamentals, market conditions, analysts' recommendations, and exchange rate movements.

iii

A sponsored DR is when the foreign company whose shares are held by the depository has a direct involvement in the issuance of the receipts. Investors in sponsored DRs have the same rights as the direct owners of the common shares (e.g., the right to vote and the right to receive dividends).

In contrast, with an unsponsored DR, the underlying foreign company has no involvement with the issuance of the receipts. Instead, the depository purchases the foreign company's shares in its domestic market and then issues the receipts through brokerage firms in the depository's local market. In this case, the depository bank, not the investors in the DR, retains the voting rights.

Sponsored DRs are generally subject to greater reporting requirements than unsponsored DRs.

iv

A global registered share (GRS) is a common share that is traded on different stock exchanges around the world in different currencies. Currency conversions are not needed to purchase or sell them, because identical shares are quoted and traded in different currencies. Thus, the same share purchased on the Swiss exchange in Swiss francs can be sold on the Tokyo exchange for Japanese yen. As a result, GRSs offer more

flexibility than depository receipts because the shares represent an actual ownership interest in the company that can be traded anywhere, and currency conversions are not needed to purchase or sell them.

A basket of listed depository receipts (BLDR), which is an exchange-traded fund (ETF) that represents a portfolio of depository receipts. An ETF is a security that tracks an index but trades like an individual share on an exchange. An equity-ETF is a security that contains a portfolio of equities that tracks an index. It trades throughout the day and can be bought, sold, or sold short, just like an individual share. Like ordinary shares, ETFs can also be purchased on margin and used in hedging or arbitrage strategies. The BLDR is a specific class of ETF security that consists of an underlying portfolio of DRs and is designed to track the price performance of an underlying DR index.

v.

In direct investing, all transactions—including the purchase and sale of shares, dividend payments, and capital gains—are in the company's, not the investor's, domestic currency. In addition, investors must be familiar with the trading, clearing, and settlement regulations and procedures of that market. Investing directly often results in less transparency and more volatility because audited financial information may not be provided on a regular basis and the market may be less liquid.

For most flexibility in trading, I would choose global registered shares.

Answer 31:

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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