

Solution:

1. **C is correct.** Preference shares have characteristics of both debt securities and common shares. Similar to interest payments on debt securities, the dividends on preference shares are fixed but not contractual obligations. Similar to common shares, preference shares can be perpetual and can pay dividends indefinitely. A is incorrect. The price of convertible preference shares is less volatile than their underlying common shares because there is less uncertainty about future cash flows as dividend payments are known and more stable. In addition, convertible preference shares allow investors the opportunity to share in the profits of the company. B is incorrect. Both common and preference shareholders are owners of the company and will have claims on assets after liabilities to all creditors including bondholders have been completely paid. Preference shareholders rank before common shareholders but after bondholders to receive net distributions.
2. **C is correct.** Industry classification systems developed by governments do not distinguish between public and private companies, whereas commercial classification systems include only publicly traded organizations. A is incorrect. Commercial industry classification systems are updated more frequently than government classification systems. B is incorrect. Unlike commercial industry classification systems, most government classification systems do not disclose information about specific businesses.
3. **B is correct.** Arbitrage is a set of transactions that produces riskless profits. Arbitrageurs are traders who engage in such trades to benefit from pricing discrepancies (inefficiencies) in markets. Such trading activity contributes to market efficiency. If arbitrage opportunities increase, it means that there are either more pricing discrepancies or fewer arbitrageurs (or both), and this situation will lead to a reduction in market efficiency. A is incorrect. An increase of rules and regulations that promote financial disclosure will lead to an increase of market efficiency. C is incorrect. An increase of the number of market participants will lead to an increase market efficiency.
4. **A is correct.** External factors affecting an industry's growth include macroeconomic, technological, demographic, governmental, and social influences. A change in interest rates, or the cost of debt, is an example of a macroeconomic influence on

industry growth, profitability, and risk. C is incorrect. Changes in population size is an example of a demographic influence on industry growth, profitability, and risk. B is incorrect. Changes in personal spending habits is an example of a social influence on industry growth, profitability, and risk.

5. **A is correct.** Putable preference shares are less risky than their callable counterparts. They give the investor the option to put the shares back to the company. Because of the lower risk, they will provide a lower expected rate of return. Common shares are the most risky, whether or not they are dividend paying, and are likely to offer the highest expected return. B is incorrect. Common shares are the most risky, whether or not dividend paying, and are likely to offer the highest expected return. Though these preference shares have non-cumulative dividend feature, preference shareholders will receive priority if the company is liquidated. C is incorrect. Callable preference shares are more risky than their putable counterparts and so they are likely to offer higher expected returns than putable preference shares.