CHAPTER 16
Raising Capital

I. DEFINITIONS

VENTURE CAPITAL

a 1. The financing provided for start-up, often high-risk, private business enterprises is called:
- a. venture capital.
- b. junk bonds.
- c. flotation costs.
- d. initial public offerings.
- e. financial futures.

REGISTRATION STATEMENT

b 2. The document(s) filed with the SEC disclosing all material information relating to the firm making an offering of public securities is called the:
- a. offering prospectus.
- b. registration statement.
- c. red herring filing.
- d. indenture contract.
- e. SEC Form 13-J.

REGULATION A

c 3. The SEC regulation that exempts public issues of less than $5 million from most registration requirements is called:
- a. the Green Shoe Provision.
- b. the red herring Provision.
- c. Regulation A.
- d. Regulation Q.
- e. the Open Markets Exemption.

PRELIMINARY PROSPECTUS

d 4. The preliminary prospectus distributed to investors during the SEC waiting period is often called a(n):
- a. indenture contract.
- b. signature form 10-W.
- c. letter of comment.
- d. red herring.
- e. Green Shoe.

LETTER OF COMMENT

e 5. The _____ is transmitted to the prospective issuing firm by the SEC when they have suggestions for changes to the registration statement and/or its supporting documents.
- a. indenture contract
- b. Green Shoe statement
- c. Regulation A statement
- d. preliminary prospectus
- e. letter of comment

PROSPECTUS

a 6. The legal document describing details of the issuing corporation and its security offering to potential investors is called the:
- a. prospectus.
- b. tombstone advertisement.
- c. letter of comment.
- d. Regulation A statement.
- e. rights offering.

TOMBSTONE

b 7. Advertisements in, for example, *The Wall Street Journal* announcing a corporation's public offering of securities, along with a list of the investment banks handling the offering, are called:
- a. red herrings.
- b. tombstones.
- c. Green Shoes.
- d. registration statements.
- e. letters of comment.

GENERAL CASH OFFER

c 8. An issue of securities offered for sale to the general public on a direct cash basis is called a _____ offering.
- a. best efforts
- b. firm commitment
- c. general cash
- d. rights
- e. red herring

RIGHTS OFFER

d 9. A public offering of securities where existing shareholders of the firm have the first opportunity to buy the new securities is called a _____ offering.
- a. best efforts
- b. firm commitment
- c. general cash
- d. rights
- e. red herring

INITIAL PUBLIC OFFERING

e 10. A corporation's first sale of equity made available to the public is called a(n):
- a. share repurchase program.
- b. shelf registration filing.
- c. private placement.
- d. seasoned equity offering (SEO).
- e. initial public offering (IPO).

SEASONED EQUITY OFFERING

d 11. A public offering of equity by a corporation that has previously issued securities to the public is called a(n):
- a. share repurchase program.
- b. shelf registration filing.
- c. private placement.
- d. seasoned equity offering (SEO).
- e. initial public offering (IPO).

UNDERWRITERS

c 12. The investment bank(s) that act as intermediaries between the company issuing securities and the investing public are called:
- a. privileged intermediaries.
- b. venture capitalists.
- c. underwriters.
- d. standby investors.
- e. primary investors.

UNDERWRITING SYNDICATE

b 13. A group of underwriters formed to share the risk in marketing and distributing a sale of securities to the investing public is called a(n):
- a. cartel.
- b. syndicate.
- c. cooperative venture capital system.
- d. oligopoly.
- e. insider consortium.

UNDERWRITING SPREAD

a 14. The difference between the underwriters' buying price and the offering price of the securities to the public is called the:
- a. spread.
- b. underpricing.
- c. filing fee.
- d. new issue premium.
- e. extortion premium.

FIRM COMMITMENT OFFERS

e 15. The type of underwriting where a syndicate buys the entire issue from the issuing firm and assumes full financial responsibility for any unsold shares, is called a _____ offering.
- a. best efforts
- b. shelf
- c. direct rights
- d. private placement
- e. firm commitment

BEST EFFORTS OFFERS

a 16. The type of underwriting where a syndicate sells as much of the issue as possible, but can return any unsold securities to the issuing firm without any further financial responsibility, is called a _____ offering.
- a. best efforts
- b. shelf
- c. direct rights
- d. private placement
- e. firm commitment

DUTCH AUCTION UNDERWRITING

c 17. The type of underwriting in which the offer price is set based on competitive bidding by investors is called _____ underwriting.
- a. open market
- b. open auction
- c. Dutch auction
- d. tombstone
- e. discretionary

AFTERMARKET

b 18. The period after a new issue is initially sold to the public is referred to as the:
- a. private placement market.
- b. aftermarket.
- c. waiting period.
- d. filing period.
- e. tombstone period.

OVERALLOTMENT OPTION

c 19. The contract provision whereby the underwriting syndicate may, at their option, purchase additional securities from the issuing corporation at the initial offering price is called:
- a. Regulation A.
- b. the Red Herring provision.
- c. the Green Shoe provision.
- d. the best efforts option.
- e. the direct rights option.

IPO UNDERPRICING

d 20. The phenomenon where the price of newly-issued shares in the marketplace increases above the initial offering price is called:
- a. Green Shoe pricing.
- b. yield burning.
- c. yield bumping.
- d. underpricing.
- e. aftermarket support.

EX-RIGHTS DATE

e 21. The first day that a stock trades in the market without a recently declared right attached to the stock is called the:
- a. pre-issue date.
- b. aftermarket.
- c. declaration date.
- d. holder-of-record date.
- e. ex-rights date.

HOLDER-OF-RECORD DATE

d 22. The date on which existing shareholders are designated as the recipients of stock rights is called the:
- a. pre-issue date.
- b. offering date.
- c. declaration date.
- d. holder-of-record date.
- e. ex-rights date.

STANDBY UNDERWRITING

a 23. A rights offering in which the underwriting syndicate agrees to purchase the unsubscribed portion of the issue is called _____ underwriting.
- a. standby
- b. best efforts
- c. firm commitment
- d. direct fee
- e. tombstone

OVERSUBSCRIPTION PRIVILEGE

b 24. The privilege that allows existing shareholders to purchase unsubscribed shares in a rights offering at the subscription price is called the _____ privilege.
- a. standby
- b. oversubscription
- c. open offer
- d. new issues
- e. overallotment

DILUTION

c 25. A loss in shareholder value as measured in terms of percentage ownership in the firm, market value of the firm, book value of equity, or earnings per share is known as:
a. oversubscription.
b. underpricing.
c. dilution.
d. rights pricing.
e. downsampling.

TERM LOANS

e 26. Direct business loans from a limited number of investors to a corporation with maturities typically ranging from one to five years are called:
a. private placements.
b. debt SEOs.
c. notes payable.
d. debt IPOs.
e. term loans.

PRIVATE PLACEMENTS

a 27. Loans provided directly from a limited number of investors to a corporation with maturities typically in excess of five years are called:
a. private placements.
b. debt SEOs.
c. notes payable.
d. debt IPOs.
e. term loans.

SHELF REGISTRATION

b 28. Registration permitted under SEC Rule 415 allowing a company to register just once in a two-year period for all security issuances it expects to make during that time period is called:
a. standby registration.
b. shelf registration.
c. Regulation A.
d. Regulation Q.
e. private registration.

II. CONCEPTS

VENTURE CAPITAL

e 29. Venture capitalists often are:
I. individuals.
II. insurance companies.
III. university endowment funds.
IV. pension funds.
a. II and IV only
b. I, II, and IV only
c. II, III, and IV only
d. I, II, and III only
e. I, II, III, and IV

VENTURE CAPITAL

d 30. Venture capital is primarily found through:
- a. internet web sites.
- b. a bidding process.
- c. newspaper advertisements.
- d. personal contacts.
- e. letters submitted to venture capital firms.

VENTURE CAPITAL

d 31. Which one of the following statements concerning venture capital are correct?
- I. Venture capitalists often hold voting preferred stock.
- II. Venture capital is relatively easy to acquire in today's market.
- III. Venture capitalists frequently assume active roles in the management of the financed firm.
- IV. Venture capitalists often assume 40 percent or more ownership in a firm as a condition of financing.
- a. I and III only
- b. II and IV only
- c. III and IV only
- d. I, III, and IV only
- e. I, II, III, and IV

VENTURE CAPITAL

b 32. Which one of the following statements concerning venture capitalists is correct?
- a. All venture capitalists become actively involved in the day-to-day management of the financed firm.
- b. Financial strength is a key consideration when selecting a venture capitalist.
- c. Venture capitalists seldom offer any benefit other than the funds they provide.
- d. Most venture capitalists are long-term investors in a firm.
- e. How a venture capitalist handled other ventures has no relevance to you when you are seeking funding.

ISSUING SECURITIES

d 33. All new interstate security issues are regulated by the:
- a. registration statement.
- b. Green Shoe provision.
- c. Securities Exchange Act of 1934.
- d. Securities Act of 1933.
- e. Federal Reserve Act of 1931.

ISSUING SECURITIES

d 34. The Securities and Exchange Commission:
- a. verifies the accuracy of the information contained in the prospectus.
- b. verifies the accuracy of the information contained in the red herring.
- c. examines the registration statement during the Green Shoe period.
- d. is concerned only that the rules and regulations are adhered to.
- e. determines the final offer price once they have approved the registration statement.

UNDERWRITING

c 35. Underwriters generally:
- a. pay a spread to the issuing firm.
- b. provide only best efforts underwriting in the U.S.
- c. receive less compensation under a competitive agreement than under a negotiated agreement.
- d. handle an entire issue within their own firm.
- e. pass the risk of unsold shares back to the issuing firm.

UNDERWRITING

e 36. With firm commitment underwriting, the issuing firm:
- a. is unsure of the total amount of funds they will receive until after the offering is completed.
- b. is unsure of the number of shares they will issue until after the offering is completed.
- c. knows exactly how many shares will be purchased by the general public during the offer period.
- d. accepts the entire risk of the stock offer.
- e. knows up-front the amount of money they will receive from the stock offering.

UNDERWRITING

b 37. With Dutch auction underwriting:
- a. each winning bidder pays the price they bid.
- b. all successful bidders pay the same price.
- c. all bidders receive at least a portion of the quantity on which they bid.
- d. the selling firm receives the maximum possible price for each item sold.
- e. the bidder for the largest quantity receives the first allocation of the item.

IPOS AND UNDERPRICING

e 38. If an IPO is underpriced then:
- a. investors in the IPO are generally unhappy with the underwriters.
- b. the issue is less likely to sell out.
- c. the stock price will generally decline on the first day of trading.
- d. the issuing firm is guaranteed to be successful in the long term.
- e. the issuing firm “leaves money on the table”.

IPOS AND UNDERPRICING

e 39. Arguments that have been presented to support IPO underpricing include:
- I. counteracting the “winner’s curse”.
- II. rewarding institutional investors for sharing their opinion of a stock’s market value.
- III. diminishing the risk to the underwriter who has agreed to a firm commitment underwriting.
- IV. diminishing the odds that investors will sue investment banks.
- a. I and III only
- b. II and IV only
- c. I and II only
- d. I, II, and III only
- e. I, II, III, and IV

IPOS AND UNDERPRICING

a 40. The first day returns on IPOs:
- a. vary significantly over time.
- b. are limited by the SEC to a maximum of 50 percent.
- c. were unusually high during the early 1990s.
- d. tend to greatly increase the funding received by the issuing firms.
- e. cannot exceed 100 percent.

IPO ALLOCATIONS

a 41. Which one of the following statements is correct?
- a. The IPOs which are the most underpriced are generally the most oversubscribed.
- b. You will always receive your desired allotment of IPO shares if you agree to purchase shares in every IPO.
- c. As long as you submit your order during the waiting period you will receive the number of shares you desire for every IPO issue.
- d. The allocation of shares you receive will tend to be greater the more the issue is underpriced.
- e. IPO allocations are generally more restrictive when an IPO is overpriced.

IPO ALLOCATIONS

d 42. An individual investor with a small portfolio who wishes to purchase 100 shares of an IPO is more likely to receive an allocation of shares when:
- a. an IPO is substantially oversubscribed than when it is not.
- b. they bid a higher amount as their offer price.
- c. an IPO is underpriced than when it is correctly priced.
- d. the odds are greater that the IPO will lose money once it commences trading.
- e. the issuing firm is young and has minimal, if any, sales in the prior year.

SEASONED OFFERINGS

b 43. A news release stating that a firm is going to do a seasoned offering generally tends to cause the stock price of that firm to:
- a. increase.
- b. decrease.
- c. remain constant.
- d. respond but the direction of the response is not predictable as shown in past studies.
- e. decrease momentarily and then immediately increase substantially within the hour.

COSTS OF ISSUING SECURITIES

b 44. Which one of the following is NOT a cost of issuing securities?
- a. Green Shoe option
- b. red herring option
- c. abnormal returns
- d. gross spread
- e. management time

COSTS OF ISSUING SECURITIES

d 45. Which one of the following statements is correct concerning the costs of issuing securities?

a. Domestic bonds are generally more expensive to issue than equity IPOs.
b. The total direct costs of an equity IPO is typically 15 percent of the amount raised.
c. A seasoned offering is typically more expensive on a percentage basis than an IPO.
d. There tend to be substantial economies of scale when issuing securities.
e. The costs of issuing convertible bonds tend to be less on a percentage basis than the costs of issuing straight debt.

RIGHTS OFFERING

a 46. Existing shareholders:

a. may be granted a preemptive right by a firm's articles of incorporation to maintain their proportional ownership position.
b. are required to purchase shares in every new equity offering in an amount equal to their proportional ownership of the firm.
c. do not have the option of selling any of the rights they are granted in a rights offering.
d. are generally well advised to let the rights they receive expire.
e. can maintain their proportional ownership position without purchasing additional shares when there is a seasoned equity offering.

RIGHTS OFFERING

e 47. To purchase shares in a rights offering, you generally just need to:

a. pay the subscription amount in cash.
b. submit the required form along with the required number of rights.
c. pay the difference between the market price of the stock and the subscription price.
d. submit the required number of rights along with a payment for the amount of the difference between the market price of the stock and the subscription price.
e. submit the required number of rights along with the subscription price.

RIGHTS OFFERING

d 48. The value of a right granted by a rights offering depends upon:

I. the number of rights required to purchase one new share
II. the market price of the security
III. the subscription price
IV. the price-earnings ratio of the stock

a. II and III only
b. II and IV only
c. I and II only
d. I, II, and III only
e. I, II, III, and IV

DILUTION

b 49. Before a seasoned stock offering, you owned 500 shares of a firm that had 120,000 shares outstanding. After the seasoned offering, you still owned 500 shares but the number of shares outstanding rose to 135,000. This is an example of _____ dilution.

a. market value
b. percentage ownership
c. earnings per share
d. book value
e. equity

DILUTION

c 50. Which one of the following statements is correct concerning dilution related to a new project?

a. As long as the book value of a firm increases when a project is undertaken, the book value per share will remain constant.
b. As long as the market value of a firm increases when a project is undertaken, the market value per share will increase.
c. Even if the market value of a firm increases when a project is undertaken, the market value per share can decrease.
d. The proportionate ownership of each shareholder always remains constant when new projects are taken on.
e. The market price per share of stock tends to increase when the net present value of a project that is taken on is negative.

LONG-TERM DEBT

b 51. Which one of the following statements is correct concerning the issuance of long-term debt?

a. A direct long-term loan has to be registered with the SEC.
b. Direct placement debt tends to have more restrictive covenants than publicly issued debt.
c. Distribution costs are lower for public debt than for private debt.
d. It is easier to renegotiate public debt than private debt.
e. Wealthy individuals tend to dominate the private debt market.

SHELF REGISTRATION

e 52. Shelf registration grants a firm some flexibility:

I. in the number of securities sold in a single day.
II. in whether or not a public issue is registered with the SEC.
III. as to whether they register a securities issue with the SEC or with the Federal Reserve.
IV. in the timing of a securities sale.

a. I and III only
b. II and IV only
c. I and II only
d. III and IV only
e. I and IV only

III. PROBLEMS

ISSUING SECURITIES

b 53. You decide to take your company public by offering a total of 50,000 shares of common stock to the public in an initial public offering (IPO). You hire an underwriter who arranges a full commitment underwriting and suggests an initial selling price of $28 a share with an 8 percent spread. As it turns out, the underwriters only sell 48,500 shares. How much cash will you receive from your IPO?

a. $1,249,360
b. $1,288,000
c. $1,299,360
d. $1,308,600
e. $1,400,000

ISSUING SECURITIES

a 54. Wexford Industries offers 60,000 shares of common stock to the public in an initial public offering (IPO). The underwriters agree to pay $35 a share and to provide their services in a best efforts underwriting. The offer price is set at $39. After completing their sales efforts the underwriters determine that they were able to sell a total of 48,250 shares. How much cash did Wexford Industries receive from their IPO?

a. $1,688,750
b. $1,703,250
c. $1,881,750
d. $2,100,000
e. $2,340,000

DUTCH AUCTION

b 55. You decide to sell an additional 1,500 shares of stock in your firm through a Dutch auction. The bids that you receive include:

Bidder	Quantity	Price
A	1,000	$42
B	200	$41
C	100	$40
D	1,000	$39
E	1,200	$38

How much will you receive in total from selling the additional 1,500 shares? Ignore all transaction and flotation costs.

a. $57,000
b. $58,500
c. $60,750
d. $60,782
e. $63,000

DUTCH AUCTION

b 56. Bid Wars, Inc. is selling 1,200 shares of stock through a Dutch auction. The bids they received are:

Bidder	Quantity	Price
A	100	$27
B	600	$26
C	800	$22
D	1,200	$21
E	1,500	$19

How much cash will Bid Wars receive from selling these shares of stock? Ignore all transaction and flotation costs.

a. $25,200
b. $26,400
c. $28,720
d. $29,300
e. $32,400

DUTCH AUCTION

b 57. Grizzley Bare, Inc. is offering 1,500 shares of stock in a Dutch auction. The bids include:

Bidder	Quantity	Price
A	750	$56
B	300	$54
C	1,000	$52
D	100	$51
E	500	$50

How much cash will Grizzley Bare receive from selling these shares? Ignore all transaction and flotation costs.

a. $77,000
b. $78,000
c. $80,400
d. $80,633
e. $84,000

IPO ALLOCATIONS

b 58. You have placed an order to purchase 100 shares of every IPO that comes to market. The next two IPOs are each priced at $20 a share and will begin trading on the same day. You are allocated 10 shares of IPO A and 100 shares of IPO B. At the end of the first day of trading, IPO A was selling for $42 a share and IPO B was selling for $16 a share. What is your total profit or loss on these two IPOs as of the end of the first day of trading?

a. -$400
b. -$180
c. $20
d. $220
e. $1,800

IPO ALLOCATIONS

d 59. Maria has an outstanding order with her stock broker to purchase 300 shares of every IPO. The next three IPOs are each priced at $24 a share and will all start trading on the same day. Maria is allocated 100 shares of IPO A, 50 shares of IPO B, and 300 shares of IPO C. On the first day of trading IPO A opened at $24.50 a share and ended the day at $26.50 a share. IPO B opened at $29 a share and finished the day at $33 a share. IPO C opened at $23 a share and ended the day at $17 a share. What is Maria's total profit or loss on these three IPOs as of the end of the first day of trading?

a. -$12,200
b. -$2,800
c. -$2,300
d. -$1,400
e. $700

IPO ALLOCATIONS

d 60. There are two IPOs that will commence trading next week. Juan places an order to buy 400 shares of IPO A. Bonita places an order to purchase 200 shares of IPO A and 200 shares of IPO B. Both IPOs are priced at $25 a share. Juan is allocated 200 shares of IPO A. Bonita is allocated 100 shares of IPO A and 100 shares of IPO B. At the end of the first day of trading, IPO A is selling for $29 a share and IPO B is selling for $22 a share. What is the difference in the total profits or losses that Juan and Bonita have as of the end of the first day of trading?

a. $400
b. $500
c. $600
d. $700
e. $800

FLOTATION COSTS

d 61. Your firm is expanding and you need $10 million to help fund this growth. You estimate that you can sell new shares of stock for $30 a share. You also estimate that it will cost you $300,000 for legal, accounting, and other costs related to the stock issue. The underwriters have agreed to a 7 percent spread. How many shares of stock must you sell if you are going to have $10 million available for your expansion needs?

a. 320,872 shares
b. 358,423 shares
c. 367,367 shares
d. 369,176 shares
e. 388,423 shares

FLOTATION COSTS

e 62. Betsy's Flags wants to raise $5 million to open a new distribution center. The company estimates the issue costs including the legal and accounting fees will be $210,000. The underwriters have set the stock price at $18 a share and the underwriting spread at 7.5 percent. How many shares of stock does Betsy's have to sell to meet their cash need?

a. 269,251 shares
b. 300,300 shares
c. 310,872 shares
d. 311,153 shares
e. 312,913 shares

FLOTATION COSTS

c 63. Winter's Edge needs $45 million to finance a new facility and new snow removal equipment. The management has met with underwriters who feel that the firm could sell additional shares of stock at $26 a share with an 8 percent underwriting spread. The estimated issue costs are $475,000. How many shares of stock will Winter's Edge need to sell if they choose firm commitment underwriting for their new facility and equipment?

a. 1,749,038 shares
b. 1,871,471 shares
c. 1,901,129 shares
d. 1,948,718 shares
e. 2,053,219 shares

SHARES NEEDED IN A RIGHTS OFFERING

c 64. You would like to expand your firm's operations into a neighboring state but you need $4 million in additional funding to do this. After talking with your key shareholders, you decide to raise the necessary funds through a rights offering with a subscription price of $30 a share. The current market price of your stock is $38 a share. How many shares of stock will you need to sell through the rights offering to fund your expansion plans?

a. 105,263 shares
b. 125,000 shares
c. 133,333 shares
d. 250,000 shares
e. 500,000 shares

SHARES NEEDED IN A RIGHTS OFFERING

c 65. Down South, Inc. wants to raise $14 million through a rights offering so they can build a new retail super store. How many shares of stock will the firm need to sell through this offering if the current stock price is $52 a share and the subscription price is $45 a share?

a. 269,231 shares
b. 288,660 shares
c. 311,111 shares
d. 328,660 shares
e. 333,333 shares

NUMBER OF RIGHTS

d 66. Turner Wins! plans on raising $20 million through a rights offering. The subscription price is set at $20. Currently, the company has 2.4 million shares outstanding with a current market price of $24.50 a share. Each shareholder will receive one right for each share of stock they currently own. How many rights will be needed to purchase one new share of stock in this offering?

a. 1.2 rights
b. 1.3 rights
c. 2.0 rights
d. 2.4 rights
e. 4.5 rights

NUMBER OF RIGHTS

a 67. Thursday's N' Mor wants to raise $1 million through a rights offering to renovate their current facilities. The subscription price for the offering is set at $25 a share. Currently, the company has 90,000 shares of stock outstanding at a market price of $29 a share. Each shareholder will receive one right for each share of stock they own. How many rights will be needed to purchase one new share of stock in this offering?

a. 2.25 rights
b. 2.50 rights
c. 2.61 rights
d. 2.90 rights
e. 4.00 rights

NUMBER OF RIGHTS

d 68. Ben and Jennie's wants to expand their operations into the cookie business. They need $20 million to build a bakery and establish a distribution system. Currently, the firm has 1,300,000 shares of stock outstanding. The market price of the stock is $34 a share. Ben and Jennie's decides to raise the needed capital through a rights offering wherein every stockholder will receive one right for every share of stock they own. The subscription price will be $28. How many rights will be needed to purchase one new share of stock in this offering?

a. 1.21 rights
b. 1.27 rights
c. 1.54 rights
d. 1.82 rights
e. 2.21 rights

VALUE OF A RIGHT

c 69. Frank Enterprises is sponsoring a rights offering wherein every shareholder will receive one right for every share of stock they own. The new shares in this offering are priced at $25 plus 5 rights. The current market price of Frank Enterprises stock is $31 a share. What is the value of one right?

a. $0
b. $.60
c. $1.00
d. $1.20
e. $1.50

VALUE OF A RIGHT

a 70. The stock of Violets 4 U is currently selling for $46 a share. The company has decided to raise funds through a rights offering wherein every shareholder will receive one right for every share of stock they own. The new shares being offered are priced at $40 plus four rights. What is the value of one right?

a. $1.20
b. $1.50
c. $2.40
d. $3.60
e. $6.00

VALUE OF A RIGHT

b 71. You decide to raise $2 million in additional funding via a rights offering. Every shareholder will receive one right for every share of stock they own. The offering consists of a total of 250,000 new shares. The current market price of your stock is $10. Currently, there are 1 million shares outstanding. What is the value of one right?

a. $.25
b. $.40
c. $.75
d. $1.20
e. $1.50

OWNERSHIP DILUTION

c 72. You currently own 5 percent of the 1.2 million outstanding shares of the Jemison Co. The company has just announced a rights offering with a subscription price of $40. Every shareholder will receive one right for every share of stock they own. This offering will provided $12 million of new financing for the firm, ignoring all issue costs. What will be your new ownership position if you opt to sell your rights rather than exercise them?

a. 3.5 percent
b. 3.75 percent
c. 4.00 percent
d. 4.25 percent
e. 4.50 percent

OWNERSHIP DILUTION

c 73. Jenna owns 600 shares of stock in the Digital Sound Company. Currently, there are 900,000 shares of stock outstanding. The company has just announced a rights offering whereby 300,000 shares are being offered for sale at a subscription price of $30 a share. The current stock price is $39 a share. Assume that Jenna sells her rights and that all rights are exercised. What will Jenna's ownership percentage in the Digital Sound Company be after the rights are exercised?

a. .0005 percent
b. .0025 percent
c. .0500 percent
d. 2.500 percent
e. 5.000 percent

DILUTION - ACCOUNTING AND FINANCIAL

d 74. A firm is considering a new project which requires the purchase of $250,000 of new equipment. The net present value of the project is $100,000. The price-earnings ratio of the project equals that of the existing firm. What will the new book value per share be after the project is implemented given the following current information on the firm?

Number of shares outstanding	100,000
Book value	$400,000
Market value	$800,000
Net income	$ 80,000
Return on equity	.20
Price-earnings ratio	10
Earnings per share	$ .80

a. $4.00
b. $4.13
c. $4.67
d. $4.95
e. $5.00

DILUTION – ACCOUNTING AND FINANCIAL

e 75. A firm is considering a new project which requires the purchase of $250,000 of new equipment. The net present value of the project is $100,000. The price-earnings ratio of the project equals that of the existing firm. What will the new market value per share be after the project is implemented given the following current information on the firm?

Number of shares outstanding	100,000
Book value	$400,000
Market value	$800,000
Net income	$ 80,000
Return on equity	.20
Price-earnings ratio	10
Earnings per share	$ .80

a. $6.86
b. $7.94
c. $8.00
d. $8.08
e. $8.76

DILUTION – ACCOUNTING AND FINANCIAL

c 76. You are considering a new project with a net present value of $25,000 and an initial cash outlay for fixed assets of $120,000. You are planning on funding this project by selling 2,500 new shares of stock. Currently, your firm has 45,000 shares of stock outstanding and a book value per share of $30. What will the new book value per share be if you accept this project?

a. $28.42
b. $28.95
c. $30.95
d. $31.47
e. $33.22

DILUTION – PORTFOLIO VALUE

a 77. You own 5 percent or 4,000 shares of Tonka, Inc. These shares have a total market value of $92,000. By what percentage will the total value of your investment in Tonka change if the company sells an additional 10,000 shares of stock at $21 a share and you do not buy any?

a. -.96 percent
b. -.94 percent
c. -.92 percent
d. .00 percent
e. .02 percent

DILUTION – PORTOFLIO VALUE

a 78. Amy currently owns 15 percent of Aloft, Inc. The company has a total of 125,000 shares outstanding with a current market price of $20 a share. At present, the firm is offering an additional 12,500 shares at a price of $17.50 a share. Amy decides not to participate in this offering. What will Amy’s ownership position be after the offering is completed?

a. 13.64 percent
b. 14.33 percent
c. 15.06 percent
d. 15.87 percent
e. 16.50 percent

IV. ESSAYS

VENTURE CAPITAL PROS AND CONS

79. What are the pros and cons of using a venture capitalist?

    The primary advantage of using a venture capitalist is to gain access to the capital required for firm growth when traditional capital funding sources may be closed to the firm. In addition, a venture capitalist assists in the management of the firm by providing industry experience and expertise and may provide valuable contacts for suppliers and/or customers. A major drawback of using a venture capitalist is that the owners must give up a substantial fraction of their ownership in the firm.

VENTURE CAPITAL CONSIDERATIONS

80. The text lists five key considerations in choosing a venture capitalist. List and briefly explain four of these.

    The five listed in the text are:

financial strength:	financial reserves available for additional financing
style:	level of managerial involvement, degree of flexibility
references:	past venture capital experience
contacts:	suppliers, customers, industry leaders
exit strategy	withdrawal of venture capitalist from the firm

RIGHTS OFFERINGS

81. Why might a firm consider raising equity via a rights offering rather than via a general cash offer? What are the disadvantages? If you are a stockholder in the firm, which would you prefer?

    The major advantage to the firm with a rights offering is lower flotation costs which can result in significant savings especially if an underwriter is not employed.

    Arguments against using rights include: 1. underwriters increase the stock price, 2. underwriters may provide insurance against failed offerings, 3. the proceeds from a cash offer will be available sooner than with a rights offer, 4. underwriters provide a wider distribution of ownership and 5. consulting advice from underwriters may be beneficial.

    The shareholder benefits more from a rights offer due to the lower issuance costs for the firm along with the right to protect their proportionate ownership interest in the firm.

SEC

82. What would be wrong with eliminating the SEC from the security-issuance process?

    This is an open-ended question with many possible areas for expansion by the student. Would the quality of information provided to investors decline? Would firms find it worthwhile to misrepresent themselves? Would private ratings or certification-type agencies for new equity issues arise?

NEW ISSUE PROCESS

83. Suppose you are the chief financial officer of a small computer software development firm. Your firm needs $10 million to exploit investment opportunities that will allow it to retain its position in the software market. What type(s) of security(ies) might be most appropriate for your firm? What type(s) of offerings might be most appropriate? (Assume your firm is past the venture capital stage.)

    Better students will recognize that this firm is likely to (a) be in the early stages of its life-cycle, (b) entail a significant amount of risk, and (c) consist primarily of "non-equipment" assets (patents, human capital, etc.). As such, common equity is probably called for. Other issues that might be addressed include (a) is the firm currently publicly traded? (the question doesn't specify), (b) is loss of control a fear?, (c) is it more appropriate to use a "best efforts" rather than a "firm commitment" offering? and (d) will the market be receptive to yet another software firm?

PRICING AN IPO

84. Why is it so difficult to determine the appropriate price for an IPO? Who do you think has the most input: the issuing firm, the underwriter, or investors? Explain.

    It is impossible to accurately determine the market value of something that is not yet traded. While the issuing firm surely impacts the general offering price, ultimately the investors determine the acceptable price range via their submitted orders to the underwriters.

DEBT VS EQUITY

85. Why do you think debt offerings are more common than equity offerings and typically much larger as well?

    For one thing, debt offerings are much cheaper. For another, debt matures and must be replaced, while equity does not. Furthermore, it is much easier to determine the selling price for debt than it is for equity.