**ECON 404: Corporate Finance**

**Final Exam – Part 1**

**NAME: \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_**

**Please note the following:**

* The final exam consists of two parts. This is Part 1 of the exam, and will be marked out of 100 points. Part 2 of the exam is on Connect Finance and carries 200 points.
* Please note that you are expected to work on this test entirely on your own. Any collaboration with any other person will be considered as academic misconduct and will be dealt with in accordance with university policy.
* As a rule of thumb, you can keep your responses to the discussion questions between 150 and 300 words. However, I am not very particular about this, and your responses can be somewhat longer or shorter. In any case, your responses must clearly address all aspects of each question.
* Your primary submission must be in a Word Document or PDF.
* Please type your name on the test as well.
* Please do NOT use bold font. I have used bold font for the questions so that I can easily distinguish the questions from your answers.

**1. a) Briefly explain the concept of market efficiency.** (10 points)

**b) The textbook describes the field of Behavioral Finance as the study of “how reasoning errors influence financial decisions.” The textbook also contains a good discussion of how cognitive errors, biases and heuristics lead to irrational decisions by investors. What implications does all this have for stock market efficiency? Discuss.** (15 points)

2**.** **Suppose that a manufacturer has an ongoing need for silver as a raw material in the production process, and is concerned about the risk of the price of silver going up. The firm is considering two hedging choices: futures contracts and option contracts.**

**(i) Suppose that the firm decides to hedge using futures contracts. Should it buy or sell futures contracts? Explain.**

**(ii) Suppose that the firm decides to hedge using option contracts. Should it use call or put options? Should it buy or sell these options? Explain.**

**Lastly, briefly discuss the advantages and disadvantages of hedging using options as compared to futures contracts.** (25 points)

**3. Explain the rationale behind the idea that equity is a call option on a firm's assets. In other words, explain why equity ownership of a firm is equivalent to owning a call option on the firm’s assets. Next, explain what it would mean for shareholders to allow this call option to expire, and under what circumstances shareholders would do so.**(25 points)

**4. Defensive tactics such as poison pills and supermajority clauses are designed to resist unfriendly takeovers. Briefly describe how share rights plans work and why they might discourage takeover attempts. Do such tactics work to the advantage of all shareholders all of the time? Discuss.** (25 points)