UNIVERSITE PARIS 1 PANTHEON-SORBONNE

ECOLE DE MANAGEMENT DE LA SORBONNE / DEPARTEMENT DES LANGUES

LICENCE DE GESTION ET ECONOMIE D'ENTREPRISE, Semestres 1 & 2

Examen de rattrapage d'anglais appliqué à la gestion

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No documents allowed. Write your answers on the official answer sheets provided.

PART 1: READING

*Read the text below entitled "**The Market Mirage**" and address the ensuing comprehension and vocabulary exercises.*

The Market Mirage

What stock prices do— and don't — tell us about the actual value of a company

1. One of the hardest-dying ideas in economics is that stock price accurately reflects the fundamental value of a given firm. It's easy to understand why this misunderstanding persists: price equals value is a simple idea in a complex world. But the truth is that the value of firms in the market and their value within the real economy are, as often as not, disconnected. In fact, the Street regularly punishes firms hardest when they are making the decisions that most enhance their real economic value, causing their stock price to sink.

2. There are thousands of examples I could cite, but here's a particularly striking one: the price of Apple stock fell roughly 25% the year it introduced the iPod. The technology that would kick-start the greatest corporate turnaround in the history of capitalism initially disappointed, selling only 400,000 units in its debut year, and the company's stock reflected that. Thankfully, Steve Jobs didn't give a fig. He stuck with the idea, and today nine Apple iDevices are sold somewhere in the world every second.

3. This story illustrates the truth: Stock prices are usually short-term distractions, while true value is built up over time. According to McKinsey, 70% to 90% of a company's value is related to its likely cash flow three or more years from the present. That makes sense–making money from new inventions takes time. Yet Wall Street analysts, whose opinions help set stock prices, typically base their assessments of a firm on one-year cash-flow projections. What's more, like all individuals, they have their biases; during boom periods, they tend to believe that corporate earnings will be higher than during bear markets, regardless of the underlying corporate story.

4. CEOs, who are paid mostly in stock and live in fear of being punished by the markets, race to hit the numbers rather than simply making the best decisions for their businesses long term. One National Bureau of Economic Research study found that 80% of executives would

forgo innovation-generating spending if it meant missing their quarterly earnings figures. It's a system that, as behavior economist and Nobel laureate Robert Shiller puts it, has emerged from "convenience rather than logic."

5. That's not to say that stock prices don't give valuable insight into what's driving corporate America. A recent report from the Office of Financial Research (OFR), a government body that monitors financial stability, dug into why U.S. stocks have tripled over the past six years. While the gains in the market have indeed been driven by rising corporate earnings, that fact obscures a more troubling truth beneath–sales growth is trailing well behind earnings growth. Companies have higher profit margins (and thus higher stock prices) not because the economy is booming and they are selling more stuff but because they have cut costs, kept salaries flat and not invested in new factories or research and development.

6. Share prices have also been driven up by low interest rates that have allowed companies to borrow money on the cheap and use it for short-term gain. Corporate debt (not including debt held by banks) has risen from $5.7 trillion in 2006 to $7.4 trillion today. Much of that money has been used for stock buybacks, dividend increases and mergers and acquisitions. The OFR believes that "although this financial engineering has contributed to higher stock prices in the short run, it detracts from opportunities to invest capital to support longer-term organic growth." As William Lazonick, an economics professor at the University of Massachusetts at Lowell who does research on the topic, puts it, "We've moved from a world in which companies retain and reinvest their earnings to one in which they downsize and distribute them."

7. Nobody–not Economists, not CEOs and not policymakers–thinks that's good for real economic growth. Yet the markets stay up because of the dysfunctional feedback loops. Eventually, of course, interest rates will rise, money won't be cheap anymore, and markets will go back down. None of it will reflect the reality on the ground, for companies or consumers, any more than it did during the boom times. For individual investors, there's no clever strategy to get around any of this–you simply buy an index fund and hold it as long as you can before moving into T-bills (Treasure bills) or cash.

8. But there's a deeper conversation to be had about how we might fix our system to bridge this gap between markets and reality. There are plenty of ideas out there, from a sliding capital gains tax based on how long you hold a stock to big limits on buybacks and corporate options pay. Any or all of these might help stock prices reflect what they should–the real value of a corporation.

Rana Foroohar TIME magazine, March 26, 2015

A. COMPREHENSION

I. Answer the questions below briefly (6 points)

1. What did Apple's stock price show when the iPod was launched and what could not have been predicted about the company's future performance at that time?
2. What do company top executives, whose remuneration is mainly in stocks, target as they run their firms?
3. What does Robert Shiller mean when he says: *a system that has emerged from "convenience rather than logic."*
4. What, according to the Office of Financial Research, are the two factors that have brought about a rise in share prices in recent years?
5. What advantage have decreased interest rates brought to companies and what have companies been able to do with it?
6. What do Economists, CEOs and policymakers seem to agree upon?

*II. Say whether the following statements are **True (T)** or **False (F).** Justify your answer with a quotation from the text. Indicate the paragraph number and the line number within the paragraph. (2.5 points)*

1. The idea that stock price is a precise indication of the underlying value of a given firm is not very strong and can easily be changed. **T/F**
2. The value of firms in the market is usually related to their value within the real economy. **T/F**
3. The long-term performance of a firm cannot be accurately predicted from its present stock price. **T/F**
4. When interest rates go up, money becomes expensive and the real value of firms will be reflected by the value of its stocks. **T/F**

5. The system causing the market mirage discussed in the text can be corrected. **T/F**

B. VOCABULARY

Find the words or phrases that best correspond to the following definitions. Give the paragraph and line numbers. (1.5 points)

1. the movement of money into and out of a business over a given period of time:
2. periods of fast increase or economic prosperity:
3. the net income of a business for a specified period of time:
4. the amalgamation and takeovers of companies:
5. the repurchase by a company of stocks it had previously issued:

PART 2: GRAMMAR

I. <u>Passive voice</u>

Put the verbs in brackets in the correct tense to complete the e-mail message a managing director has written to all company staff. Use the passive voice. <u>(2.5 points</u>)

FROM: The Managing Director

TO: All staff

It .... (1)(decide) to adopt a flexi-time system for a trial period of three months. After this period .... (2) (elapse) all members of staff .... (3) (consult) through their line manager, and feedback .... (4) (seek).
Comments .... (5) (collect) and analysed before a decision .... (6) (make) as to whether the system .... (7) (adopt) permanently or not. Alternatively, the trial period .... (8) (extend) for a further month.
All employees .... (9) (require) to arrive between the hours of 8.00 and 9.30 a.m, and to leave after they have fulfilled their contractual obligations of eight hours.
It .... (10) (hope) that this arrangement meets with your enthusiastic approval!

<u>II. Gerund and to-infinitive forms</u>

*Fill in the blanks with the verb in brackets using either an –**<u>ing</u>** or a **<u>to-infinitive</u>** form. <u>(1.25 points</u>**<u>)</u>***

1. We intend __________________ (merge) our two firms this month.
2. Can you imagine__________________ (work) without Trade Unions to defend us?
3. They tolerate__________________ (smoke) but they prefer people not to.
4. An acquisition involves __________________ (negotiate) with all stakeholders.
5. I understand __________________ (be) late once or twice, but every day is just too much.

<u>III. Quantifiers</u>

Fill in the blanks with <u>little , a little, few</u> or <u>a few</u> : <u>(1.25 points)</u>

1. I have _______ time left to the end of the test. I must speed up.
2. I have _______ good grades. I'm confident of getting through to year two.
3. He has _______ education. He can't read or write, and he can hardly count.
4. There are _______ people she really trusts. It's a bit sad.
5. There are _______ women executives. Many people think there should be more.

<u>PART 3: ESSAY WRITING (5 points</u>)

In the last paragraph the author says *"But there's a deeper conversation to be had about how we might fix our system to bridge this gap between markets and reality."* Using your own words, briefly outline what system the speaker is referring to / the current link between markets and reality / what the existing gap is / the solutions proposed in the text / give

your opinion on what could be done or is being done to bridge the gap.
Write a minimum of 200 words or a maximum of 250.

You will be marked on the substance of your arguments, on how you structure them, (punctuation and use of paragraphs), on your (personal) knowledge of the subject and on the standard of your English. Be sure to include your word count at the end of the essay.

Key to answers and guidelines for marking

<u>Part 1 : Reading</u>

<u>A. COMPREHENSION</u>

I. Answer the questions below briefly in your own words <u>(6 points)</u>

<u>Marking:</u> up to a point for each correctly written answer. Award O.25, 0.5, or 0.75 point for a perfectible answer and nothing for an ill-written one or for a blank.

1. What did Apple's stock price show when the iPod was launched and what could not be predicted about the company's future performance at that time?

Apple's stock price fell significantly the year the company introduced the iPod on the market. The poor performance of the iPod and consequently of the firm at the time the device was launched could not predict the firm's long-term turnaround thanks to this technology. (Paragraph 2, lines 2-5)

2. What do company top executives, whose remuneration is mainly in stocks, target as they run their firms?
Such CEOs run their companies targeting short-term high stock market earnings rather than making long-term best decisions for their firms. (Paragraph 4, lines 1-3)

3. What does Robert Shiller mean when he says: *a system that has emerged from "convenience rather than logic."?*
Mr Robert Shiller means that, for a number of company CEOs, it is convenient to run after quarterly performance (short-term goals) whereas the logic would require them to invest more on innovation (long-term perspective). (Paragraph 4, lines 3-6)

4. What, according to the Office of Financial Research, are the two factors that have brought about a rise in share prices in recent years?
The two factors that have brought about the recent share price rise are higher profit margins (paragraph 5, line 6) *and low interest rates* (Paragraph 6, line 1).

5. What advantage have decreased interest rates brought to companies and what have companies been able to do with it?
Decreased interest rates have enabled companies to borrow money cheaply. With this cheap money companies have been able to buy back stocks, raise dividends and carry out mergers and acquisitions. (Paragraph 6, lines 1-5).

6. What do Economists, CEOs and policymakers seem to agree upon?
Economists, CEOs and policy makers agree that a system in which companies downsize and distribute earnings instead of retaining and reinvesting them, is not good for real economic growth. (Paragraph 6, lines 8-10 and paragraph 7, lines 1-2)

II. Say whether the following statements are <u>True (T)</u> or <u>False (F).</u> Justify your answer with a quotation from the text. Indicate the paragraph number and the line number within the paragraph. <u>(2.5 points)</u>

<u>Marking:</u> Half a point for a correct answer coupled with correct justification and text references. Nothing to be awarded, if otherwise.

1. The idea that stock price is a precise indication of the underlying value of a given firm is not very strong and can easily be changed. **T/F**

False: *It is one of the hardest-dying ideas in economics*. (Paragraph 1, lines 1-2)

2. The value of firms in the market is usually related to their value within the real economy.

T/F

False: *They are, as often as not, disconnected* (paragraph 1, line 4)

3. The long-term performance of a firm cannot be accurately predicted from its present stock price. **T/F**

True: *Stock prices are usually short-term distractions*. (Paragraph 3, line 1)

4. When interest rates go up, money becomes expensive and the real value of firms will be reflected by the value of its stocks. **T/F**

False: *None of it will reflect the reality on the ground* (paragraph 7, line 4)

5. The system causing the market mirage discussed in the text can be corrected. **T/F**

True: *There are plenty of ideas about" how we might fix our system to bridge the gap between markets and reality (Paragraph 8, lines 1-2)*

<u>B. VOCABULARY</u>

Find the words or phrases that best correspond to the following definitions. Give the paragraph and line numbers. <u>(1.5 points)</u>

<u>Marking</u>: 0.25 point for a correct answer. Nothing to be awarded, if otherwise.
0.25 bonus point if the vocabulary exercise is successfully completed

1. the movement of money into and out of a business over a given period of time: **cash flow (***paragraph 3 line 3 or 5*)
2. periods of fast increase or economic prosperity: **boom periods** (*paragraph 3, line 6*)
3. the net income of a business for a specified period of time: **earnings** *(paragraph 4, line 4, <u>or</u>, paragraph 5, line 5 or 6, <u>or again</u> paragraph 6, line 9)*
4. the amalgamation and takeovers of companies: **mergers and acquisitions** *(paragraph 6, line 4)*
5. the repurchase by a company of stocks it had previously issued: **stock buybacks** *(paragraph 6, line 4)*

Part 2: GRAMMAR

Marking: 0.25 point for a correct answer. Nothing to be awarded, if otherwise.

Answers:

I. Passive Voice

1. has been decided
2. has elapsed
3. will be consulted
4. will be sought
5. will be collected
6. is made
7. will be adopted / should be adopted
8. will be extended / may be extended
9. are required / will be required
10. is hoped

II. Gerund and to-infinitive forms

1. to merge
2. working
3. smoking
4. negotiating
5. being

III. Quantifiers

1. little
2. a few
3. little
4. few
5. few

Part 3: Essay Writing

Marking

1. Correct length of the essay; **---- 1 point**

2. Outlining what system the speaker is referring to; **up to 1 point**

Students could talk about a system in which:

- the performance of a firm is based not so much on long-term plans and prospects (investments) but on short-term interests, immediate gains.

- competition is based not so much on production of goods and services but on stock values.
- activity takes place not so much in factories but on stock markets, based not so much on real values but on virtual ones.

3. The current link between markets and reality; **up to 1 point**

The current link between markets and reality is that markets seem to set the pace, sometimes even before the launch of a product or based on other factors independent of the products or services provided. Reality follows behind, enhancing or weakening the initial market value or appreciation of a firm/product (examples from the text on iPod and other examples that students would be expected to know)

4. What the existing gap is; **up to 0.5 point**

For the existing gap students would be expected to refer to what has been said in the text e. g. The Apple (iPod) case, or referring to "*But the truth is that the value of firms in the market and their value within the real economy are, as often as not, disconnected*." Or else "*although this financial engineering has contributed to higher stock prices in the short run, it detracts from opportunities to invest capital to support longer-term organic growth*."

5. Solutions proposed in the text and opinion on what could be done or is being done to bridge the gap; **up to 1.5 points**

Regarding solutions proposed in the text and proposals of what could be done, students could refer to:

- "*a world in which companies retain and reinvest their earnings*";
- the setting of limits on stock buybacks and stock options pay;
- the control systems on Stock Markets – *Stock Markets regulations/controls* studied in class.

Further arguments from personal knowledge should be appreciated.