



# CORPORATE ISSUERS

CFA<sup>®</sup> Program Curriculum  
**2025 • LEVEL 1 • VOLUME 3**

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**Glossary**

**G-1**

# How to Use the CFA Program Curriculum

The CFA® Program exams measure your mastery of the core knowledge, skills, and abilities required to succeed as an investment professional. These core competencies are the basis for the Candidate Body of Knowledge (CBOK™). The CBOK consists of four components:

A broad outline that lists the major CFA Program topic areas ([www.cfainstitute.org/programs/cfa/curriculum/cbok/cbok](http://www.cfainstitute.org/programs/cfa/curriculum/cbok/cbok))

Topic area weights that indicate the relative exam weightings of the top-level topic areas ([www.cfainstitute.org/en/programs/cfa/curriculum](http://www.cfainstitute.org/en/programs/cfa/curriculum))

Learning outcome statements (LOS) that advise candidates about the specific knowledge, skills, and abilities they should acquire from curriculum content covering a topic area: LOS are provided at the beginning of each block of related content and the specific lesson that covers them. We encourage you to review the information about the LOS on our website ([www.cfainstitute.org/programs/cfa/curriculum/study-sessions](http://www.cfainstitute.org/programs/cfa/curriculum/study-sessions)), including the descriptions of LOS “command words” on the candidate resources page at [www.cfainstitute.org/-/media/documents/support/programs/cfa-and-cipm-los-command-words.ashx](http://www.cfainstitute.org/-/media/documents/support/programs/cfa-and-cipm-los-command-words.ashx).

The CFA Program curriculum that candidates receive access to upon exam registration

Therefore, the key to your success on the CFA exams is studying and understanding the CBOK. You can learn more about the CBOK on our website: [www.cfainstitute.org/programs/cfa/curriculum/cbok](http://www.cfainstitute.org/programs/cfa/curriculum/cbok).

The curriculum, including the practice questions, is the basis for all exam questions. The curriculum is selected or developed specifically to provide candidates with the knowledge, skills, and abilities reflected in the CBOK.

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## CFA INSTITUTE LEARNING ECOSYSTEM (LES)

Your exam registration fee includes access to the CFA Institute Learning Ecosystem (LES). This digital learning platform provides access, even offline, to all the curriculum content and practice questions. The LES is organized as a series of learning modules consisting of short online lessons and associated practice questions. This tool is your source for all study materials, including practice questions and mock exams. The LES is the primary method by which CFA Institute delivers your curriculum experience. Here, candidates will find additional practice questions to test their knowledge. Some questions in the LES provide a unique interactive experience.

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## DESIGNING YOUR PERSONAL STUDY PROGRAM

An orderly, systematic approach to exam preparation is critical. You should dedicate a consistent block of time every week to reading and studying. Review the LOS both before and after you study curriculum content to ensure you can demonstrate the

knowledge, skills, and abilities described by the LOS and the assigned reading. Use the LOS as a self-check to track your progress and highlight areas of weakness for later review.

Successful candidates report an average of more than 300 hours preparing for each exam. Your preparation time will vary based on your prior education and experience, and you will likely spend more time on some topics than on others.

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## ERRATA

The curriculum development process is rigorous and involves multiple rounds of reviews by content experts. Despite our efforts to produce a curriculum that is free of errors, in some instances, we must make corrections. Curriculum errata are periodically updated and posted by exam level and test date on the Curriculum Errata webpage ([www.cfainstitute.org/en/programs/submit-errata](http://www.cfainstitute.org/en/programs/submit-errata)). If you believe you have found an error in the curriculum, you can submit your concerns through our curriculum errata reporting process found at the bottom of the Curriculum Errata webpage.

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## OTHER FEEDBACK

Please send any comments or suggestions to [info@cfainstitute.org](mailto:info@cfainstitute.org), and we will review your feedback thoughtfully.

# Corporate Issuers



## LEARNING MODULE

## 1

## Organizational Forms, Corporate Issuer Features, and Ownership

### LEARNING OUTCOMES

<i>Mastery</i>	<i>The candidate should be able to:</i>
<input type="checkbox"/>	compare the organizational forms of businesses
<input type="checkbox"/>	describe key features of corporate issuers
<input type="checkbox"/>	compare publicly and privately owned corporate issuers

### INTRODUCTION

1

This learning module introduces the Corporate Issuers topic area, which covers the fundamentals of how corporations are organized and governed and how they make operating, investing, and financing decisions. Financial analysts must have a strong understanding of corporate issuers because they are the largest type of issuer in financial markets globally; many analysts are focused entirely on analyzing and investing in their debt or equity instruments. In the first lesson of this module, we describe and compare the legal organizational forms of businesses, emphasizing their similarities and differences and important implications for investors. The second lesson focuses on the corporate organizational form and its key features, such as the separation of ownership and management, limited shareholder liability, access to financing, and tax issues. In the final lesson, we compare privately held and public corporate issuers, including the mechanisms of how corporate issuers go public and are taken private.

#### LEARNING MODULE OVERVIEW



- Businesses are legally organized as sole proprietorships, partnerships, or limited companies, which differ by several attributes, including legal identity, owner–manager relations, owner liability, taxation, and access to financing. In practice, organizational forms are jurisdiction specific; our focus is on common characteristics.
- The limited company form, often known as the corporation, offers advantages over the other two forms by improving the ability to raise capital, through limited shareholder liability, the separation of ownership and management, and fewer restrictions on the number of

owners and transferring ownership. In most jurisdictions, there are two types of limited companies: private limited companies and public limited companies.

- Private limited companies tend to have some restrictions on ownership but pass-through taxation like partnerships. Public limited companies have no ownership restrictions, but their income can be taxed at both the company and shareholder level. While public limited companies do not have to go public by selling their shares on an exchange, it is this form that is most suitable for becoming a publicly traded company.
- Corporate shareholders elect a board of directors that appoints executive management to operate the company. Shareholders effect change primarily through their ability to replace directors.
- Corporations that seek external financing in financial markets, known as corporate issuers, can utilize either public or private markets, and these choices have implications for the liquidity and price transparency of the company's securities, as well as its ability to raise future financing and the degree to which it must disclose information.
- Corporate issuers can change their status from privately held to publicly traded (or "listed") through a variety of mechanisms, including an initial public offering. Publicly traded issuers can be taken private through several mechanisms, including a leveraged buyout.
- Shareholders of corporate issuers include not only individuals and institutional investors, such as pension funds and mutual funds, but also governments, non-profits, and other corporations.

### LEARNING MODULE SELF-ASSESSMENT



These initial questions are intended to help you gauge your current level of understanding of this topic.

1. Fill in the two blanks below using the two of the following four possible terms:

Sole proprietorship

General partnership

Limited partnership

Public limited company (corporation)

A \_\_\_\_\_ likely has the greatest access to financing, while a \_\_\_\_\_ likely has the least access to financing.

**Solution:**

A public limited company (corporation) likely has the greatest access to financing, while a sole proprietorship likely has the least access to financing. A primary difference across organizational forms is access to financing to fund investments. The sole proprietorship is limited to its individual owner's ability to invest her own money and borrowing capacity as an individual. At the other end of the spectrum, a public limited company can access a broad array of outside investors by issuing debt and/or equity securities.

2. Which of the following organizational forms provides for the *least* owner liability of business debts?

- A. General partnership
- B. Private limited company
- C. Sole proprietorship

**Solution:**

B is correct. In both the sole proprietorship and general partnership forms of organization, the owners are personally liable for all debts assumed by the company. In a private limited company, owner (shareholder) liability is limited to the value of their ownership stake.

3. Voting rights of a corporate issuer's shareholders generally refer to which of the following?

- A. The ability of the corporation to vote in political elections
- B. The direct ability to elect a chief executive officer of the company
- C. The ability to elect members of the company's board of directors

**Solution:**

C is correct. The voting rights of shareholders generally allow them to elect board members as well as vote on other matters outlined in the company's charter. The board of directors has the responsibility to hire (or retain) the company's chief executive officer (CEO); thus, voting rights do not give shareholders the *direct* ability to hire the CEO. Despite the status of a corporation as a distinct legal entity, this status does not provide voting rights in political elections.

4. Explain how the following situation reflects double taxation on the corporate organizational form: The corporation pays a 21% tax rate on pre-tax income of USD100 million. The corporation distributes USD10 million to its shareholders. Individuals pay a 20% tax on dividend income.

**Solution:**

The corporation pays USD21 million in income taxes at the corporate level and, collectively, the shareholders pay USD2 million in individual income taxes on dividends received. In total, USD23 million in income taxes were paid on the pre-tax income of USD100 million. Effectively, the USD10 million paid as dividends was taxed twice, first as business income and again as personal income.

5. True or false: The term "public" for a public corporate issuer means that the company is wholly or partially owned by a government.

- A. True
- B. False

**Solution:**

B is correct. The statement is false because while a public corporate issuer could be owned partly by a government, this condition is not necessary. The term "public" refers only to the fact that a company's equity securities are traded on an exchange and thus are available for investment by the public.

6. Fill in the blanks:

A public company's shares can be exchanged on a \_\_\_\_\_,  
while a private company's shares suffer from a lack of price  
\_\_\_\_\_.

**Solution:**

A public company's shares can be exchanged on a stock exchange, while a private company's shares suffer from a lack of price transparency.

## 2

## ORGANIZATIONAL FORMS OF BUSINESSES

- | compare the organizational forms of businesses

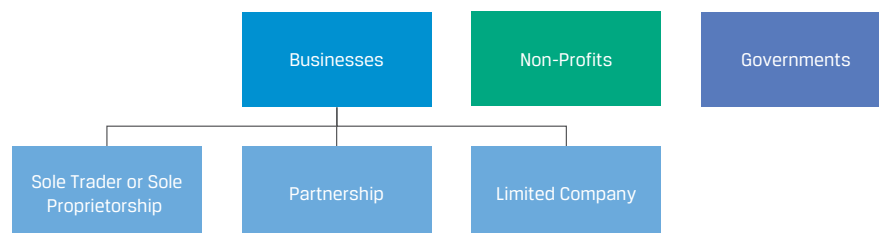
In most market economies, there are three general types of organization, each with distinct purposes, stakeholders, and governing legal frameworks: for-profit organizations, known as **businesses** or **companies**; not-for-profit non-governmental organizations, or simply non-profits; and governments.

The focus of this and subsequent modules are businesses, because financial analysts are important participants in the markets for their financial resources. However, non-profits and governments often are investors in businesses, which will be covered in later lessons. Governments as issuers of debt and other securities are covered in modules on fixed income.

### Organizational Forms of Businesses

Business owners choose a legal **organizational form** that defines how returns, risks, and ownership and operational responsibilities are distributed. There are three general forms common to most jurisdictions.

**Exhibit 1: Organizational Forms of Businesses**



The organizational forms of businesses differ by several attributes:

- *Legal identity*: Whether the business is legally considered a separate entity or person apart from its owners
- *Owner–manager relationship*: The relationship between the owner(s) of the business and those who manage the business

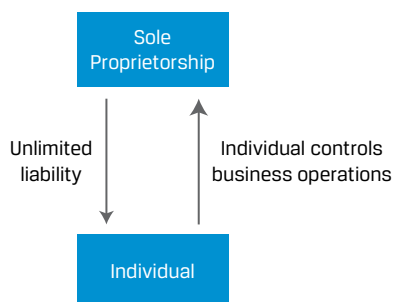
- *Owner liability:* The extent to which owners are personally legally liable for actions or debts undertaken by the business
- *Taxation:* The treatment of business profits or losses for tax purposes
- *Access to financing:* The ability to raise capital to fund expansion and distribute risks

Every jurisdiction has its own specific versions and variants of organizational forms, including different names for them. We are not attempting to provide an exhaustive treatment of jurisdictional specifics; rather, we provide the general and common attributes that analysts must know to ask the right questions in their own research on specific investment candidates and business cases.

## Sole Trader or Proprietorship

The simplest organizational form is the sole trader or proprietorship, shown in Exhibit 2. In a sole proprietorship, the owner provides the capital needed to start and operate the business and retains full control over management, while participating fully in the firm's financial returns and risks. In some jurisdictions, this form is the default form, requiring no formal legal registration, and is dissolved when the owner ceases business activity or dies.

**Exhibit 2: Sole Trader or Proprietorship**



An example of a sole proprietorship is a family-owned business. The individual owner usually uses savings or a personal loan to start the business and to run daily operations and retains full management control. The owner retains all return (profits), which is taxed as personal income, and is personally responsible for losses and obligations of the business, such as debts.

While sole proprietorships comprise the largest *number* of businesses in most market economies and are preferred by small business owners for their simplicity and flexibility, their growth is constrained by an owner's ability to access financing, assume risk, and serve as the sole owner.

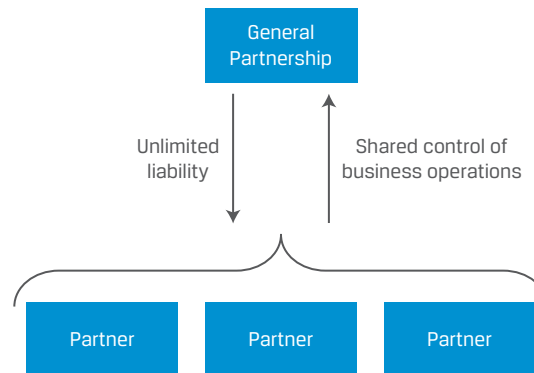
## Partnerships

Partnerships allow multiple owners to pool their resources and share business risk and return. There are three common types in most jurisdictions: general partnerships, limited partnerships, and limited liability partnerships.

A **general partnership**, shown in Exhibit 3, has two or more owners called partners or **general partners (GPs)**. General partnerships are like sole proprietorships, with the important distinction that they allow for additional resources to be brought into the

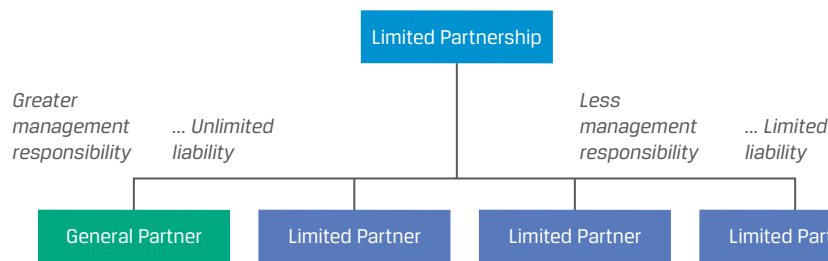
business by the additional owners, along with the sharing of business risk and return. Partnerships are often formed and governed by a written partnership agreement that outlines specific partner roles and responsibilities and the sharing of profits, losses, and obligations. However, a written agreement is not required; partnerships can be formed verbally or incidentally through actions.

### Exhibit 3: General Partnership



Examples of general partnerships include service businesses, such as builders or contractors, and joint ventures of multiple businesses. Such businesses have a small number of partners who usually contribute equal or similar amounts of capital. The partners bring complementary expertise, such as expertise in business development, financial acumen, operations, or legal/compliance, and they share responsibility in running the business. All profits, losses, and risks of the business are collectively assumed and shared by the partners. If one partner is unable to pay his share of the business's debts, the remaining partners are fully liable. As with a sole proprietorship, potential for growth is limited by the partners' ability to source financing and expertise and their collective risk tolerance because the partners are still personally liable for business losses and debt.

Exhibit 4 shows a type of partnership called a **limited partnership**, which addresses some of the shortcomings of general partnerships. In a limited partnership, there must be at least one general partner (GP) with unlimited liability that often manages the business. Remaining partners, however, called **limited partners (LPs)**, have limited liability, meaning their losses are limited to the size of their investment in the limited partnership, and may not have any management responsibilities. With limited liability, personal assets are considered separate and thus protected from the obligations of the business. All partners are entitled to a share of the profits and losses as specified in the partnership agreement, with GPs typically receiving a larger portion in exchange for their greater risk and personal liability. Partnership agreements are customized and negotiated by the partners and can be highly complex, with multiple partnership tiers that have varying profit and loss sharing arrangements.

**Exhibit 4: Limited Partnership**

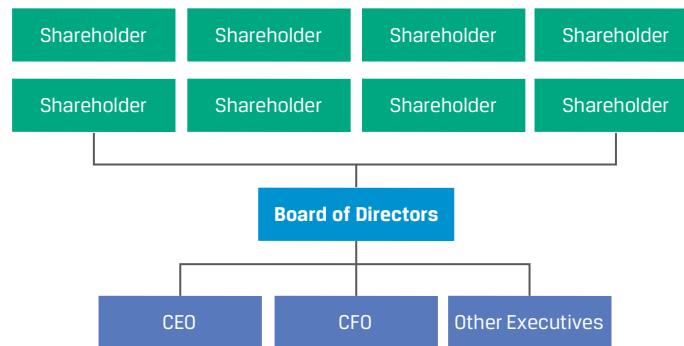
In a limited partnership, while financial risk and reward are shared, such resources as capital and expertise are typically limited to what the partners can contribute, and limited partners usually grant managerial responsibilities to the GP, which entails risk. Partnership agreements are customized and often limit the transferability of ownership interest or expansion beyond a small group of partners. Like sole proprietorships, partnerships are typically **pass-through businesses** for tax purposes. Pass-through businesses are not taxed at the entity level, passing on all their profits or losses to the partners who are taxed personally. Business income from these entities is passed through and taxed regardless of whether income was actually distributed or retained in the partnership and reinvested.

In some jurisdictions, there is a special form of limited partnership known as a **limited liability partnership (LLP)**, which does not require a general partner and is instead composed entirely of limited partners, thus resolving the risk of unlimited liability for the GP. Instead, all partners have limited liability, and the partners share in management responsibilities, typically appointing one or more partners as managing partners. In some jurisdictions, such as the United States, LLPs are permitted only for professional services firms, such as law, accounting, engineering, and architecture, and have limits on the number of partners and legal restrictions on equity investment.

## Limited Companies

Finally, a **limited company** has many similarities to limited partnerships but includes several more features that allow greater access to financing and expertise for growth. In many jurisdictions, there are two types of limited companies: private limited companies and public limited companies.

The **private limited company** is similar to a limited partnership. But the form includes limited liability for *all* owners, improved transferability of ownership interests by dividing ownership into units called **shares** that are more easily tradeable, and a distinction between owners and managers. Owners, known as **shareholders** or members, elect a **board of directors** to manage the company and authorize any distributions of profits to owners. Boards of directors typically appoint professional managers. Private limited companies are known by many names in different jurisdictions, including limited liability company (LLC) and S corporation in the United States, G.K. in Japan, SARL in France, GmbH in Germany, and company with limited liability in China.

**Exhibit 5: Organization of Limited Company**

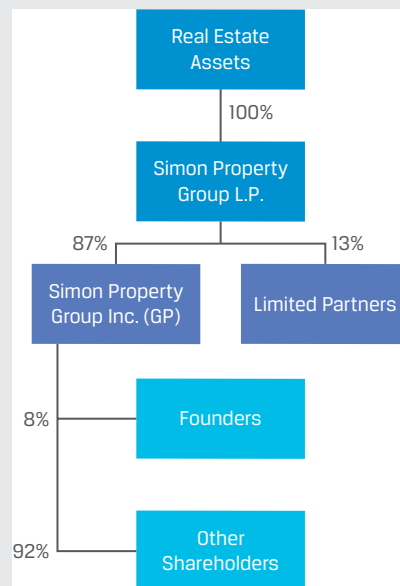
In many jurisdictions, including the United States, private limited companies have legal limits on the number of owners and require votes for transferring ownership interest but are pass-through businesses (like LPs), meaning that taxes on business income are paid only at the shareholder, not company, level.

Finally, **public limited companies**, often called **corporations**, are similar to private limited companies but in most jurisdictions face no legal restrictions on the number of owners or ownership transferability, while still featuring limited liability and separation of ownership and management. For these reasons, public limited companies are the most suitable form for companies that seek to go public and are the dominant organizational form globally by revenues and asset values. However, public limited companies are disadvantaged in most jurisdictions compared to the other organizational forms in one respect: taxation. While other forms are taxed only on business income and loss at the owner (personal) level, public limited companies are taxed at the business level and *again* at the personal level if profits are distributed to shareholders. But if profits are retained and reinvested in the company, the shareholder level of tax does not apply, which makes this organizational form more suitable for companies intending to retain profits to fund investment.

Public limited companies are known by different names in different jurisdictions, including C-corporation in the United States, corporation in China, Société anonyme in France, AG in Germany, and K.K. or stock company in Japan. Examples are numerous, including most if not all well-known multinational companies.

**EXAMPLE 1****Simon Property Group**

Simon Property Group (“Simon”) is one of the largest owners of retail real estate in the world, with over \$33 billion in assets. Its assets primarily include shopping centers in the United States and some retail properties in Europe and Asia. Simon is organized in two layers, each with a distinct organizational form.



The retail real estate assets are wholly owned by Simon Property Group L.P., a limited partnership. Its partners include Simon Property Group Inc., the general partner, and approximately 200 limited partners. The general partner has full managerial responsibilities and unlimited liability and has an ownership interest of 87% in the partnership.

Importantly, the general partner, Simon Property Group Inc., is itself a corporation. It is broadly owned by thousands of shareholders, including the founding family, which owns 8% of shares. Simon Property Group Inc. has a single asset: its partnership interest in Simon Property L.P.

Simon's structure allows co-investing with limited partners, full management control, and receiving most of the income from the assets, while benefiting from broad access to financing, because while the GP has unlimited liability, its *shareholders* have limited liability. Partnerships composed of entities with limited liability, such as corporations, are common because they shield the ultimate owners (in this case, shareholders of Simon Property Group Inc.) from business risk but allow for the sharing of profit and loss in the underlying business.

The key distinctions between sole proprietorships, partnerships, and public limited companies or corporations are outlined in Exhibit 6.

#### Exhibit 6: Features of Sole Proprietorships, Partnerships, and Corporations

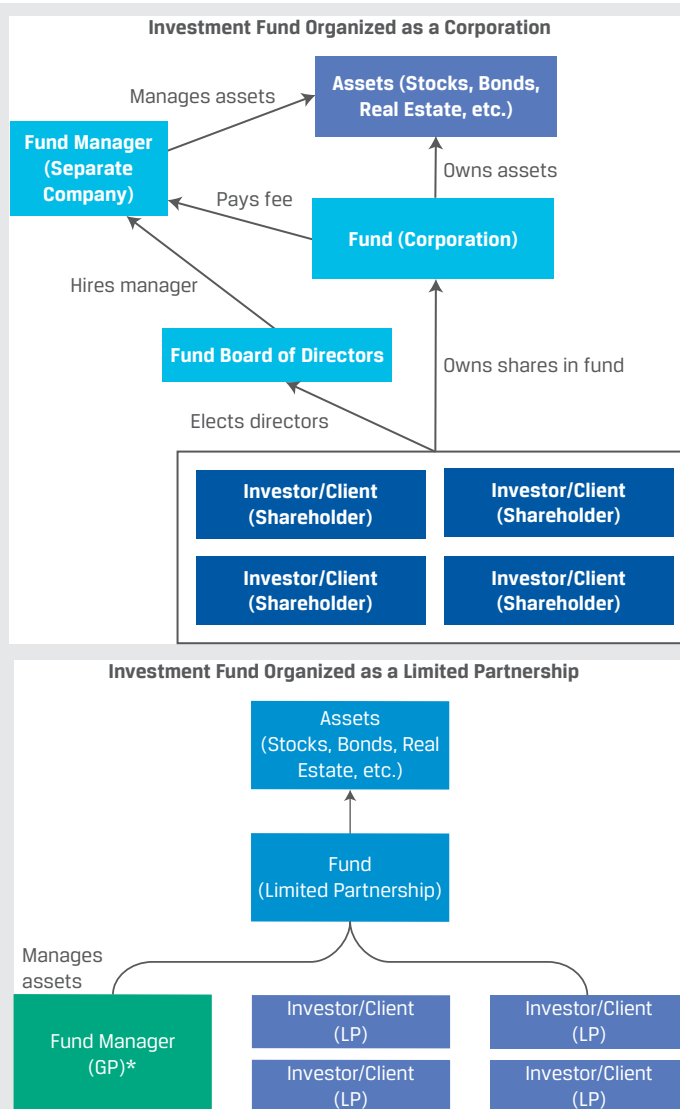
Feature	Sole Proprietor	General Partnership	Limited Partnership	Corporation
Legal Identity	No separate legal identity; extension of owner	No separate legal identity; extension of partner(s)	No separate legal identity; extension of partner(s)	Separate legal entity
Owner–Operator Relationship	Owner operated	Partners operated	GP operated	Board and management operated
Owner Liability	Sole unlimited liability	Shared unlimited liability	GP has unlimited liability; LPs have limited liability	Limited liability

Feature	Sole Proprietor	General Partnership	Limited Partnership	Corporation
Taxation	Pass-through: Profits taxed as personal income	Pass-through: Profits taxed as personal income	Pass-through: Profits taxed as personal income	Corporation income taxed; distributions (dividends) taxed as personal income
Access to Financing	Limited by owner access to capital	Limited by partner access to capital	Limited by GP/LP access to capital	Unbounded access to capital, unlimited business potential

**EXAMPLE 2****How Are Investment Funds Organized?**

Investment funds are pools of capital contributed by one or more investors for earning returns and managing risks. Investment funds are like other companies in a market economy: They hire professional management to invest capital, sometimes with additional borrowed money, in various assets to achieve return objectives subject to risk constraints. Major differences between funds and other companies include employing few people directly, primarily investing in financial instruments rather than operating assets, diversification of assets, and having specific rather than general objectives (e.g., exceed a benchmark rate of return).

Two common organizational forms for investment funds are corporations and limited partnerships, as illustrated in the following two diagrams. When organized as a corporation, fund investors hold shares that represent their proportionate interests in the pool of underlying assets. When organized as a limited partnership, fund investors hold partnership units that either represent their proportionate interests in the pool of underlying assets or varying interests of specific assets.



\*In this structure, which will be discussed in greater detail later in the curriculum in lessons on alternative investment, fund managers typically create a wholly owned private limited company entity that serves as the GP to protect the fund manager from unlimited liability.

## QUESTION SET



1. Identify two features that distinguish a general partnership from a limited partnership.

### Solution:

**Owner–manager relationship:** The management of a general partnership is typically shared by the general partners, while in a limited partnership, the general partner often exercises most managerial responsibilities.

**Owner liability of business debts and obligations:** In a general partnership, the partners are personally legally liable for business debt and actions undertaken by the company. In a limited partnership, only the general partner faces personal liability; limited partners' liability is limited to their investment in the partnership.

2. Match the following business attributes with the most appropriate organizational form.

Business Attribute	Organizational Form
A. Significant capital needs	1. Limited liability partnership
B. Single owner, desires simplicity	2. Corporation
C. Company provides professional services	3. Sole proprietorship

**Solution:**

- A. 2. Corporation  
 B. 3. Sole proprietorship  
 C. 1. Limited liability partnership

A company with significant capital needs will want broad access to financing. In such a case, the corporate organizational form likely is most appropriate.

For the single owner who desires simplicity, a sole proprietorship is a suitable mechanism. In some jurisdictions, it is the “default” organizational form and does not require registration.

Professional service companies, such as a law firm, require the owners to have the skill sets to manage the company. A partnership structure is suitable, and a limited liability partnership structure allows for the partners to share managerial control without any partner assuming unlimited liability.

3. If a company owner expects to have a significant need for financing, which of the following organizational forms is the *least* appropriate choice?

- A. Corporate  
 B. Partnership  
 C. Sole proprietorship

**Solution:**

C is correct. A sole proprietorship is limited in financing to the owner’s funds and by the amount the owner can borrow personally. A partnership expands access to financing by adding owners, spreading risk, and adding borrowing capacity. The corporate form provides for the broadest access to financing because there are no limits to the number of shareholders and, with limited liability, shareholders are relatively more comfortable with the company borrowing.

4. Fill in the blanks in the following sentence:

\_\_\_\_\_ liability is a benefit to the corporate organizational form, but the form does face a possible disadvantage because of \_\_\_\_\_ taxation of distributed business income.

**Solution:**

Limited liability is a benefit to the corporate organizational form, but the form does face a possible disadvantage because of double taxation of distributed business income.

5. True or False: Partnerships are typically taxed at the entity level rather than at the individual partner level.

A. True

B. False

**Solution:**

B is correct. Partnerships are typically pass-through entities, meaning that business income earned by the partnership is passed through to the partners according to the terms of partnership agreement, and each partner is taxed at the personal level.

## KEY FEATURES OF CORPORATE ISSUERS

### 3

describe key features of corporate issuers

The prior lesson addressed several advantages of the corporate organizational form over others, such as limited owner liability, owner–manager separation, and improved access to external financing. In this lesson, we explore the features of corporations in greater depth. Corporations that raise capital in the financial markets, known as **corporate issuers**, are essential for financial analysts to understand, because they raise more capital from investors than even governments worldwide.

### Legal Identity

A corporation is a legal entity separate and distinct from its owners formed through the filing of articles of incorporation with a regulatory authority. Corporations share many of the rights and responsibilities of an individual and may engage in similar activities. For example, a corporation can enter into contracts, hire employees, sue and be sued, borrow and lend money, make investments, and pay taxes.

Large corporations frequently have business operations in many different geographic regions and are subject to each regulatory jurisdiction where

- the company is incorporated,
- the business is conducted, and
- the company finances itself

and for such activities as

- registration,
- financial and non-financial reporting and disclosure, and
- capital market activities (issuance, trading, investment).

### Owner–Manager Separation

A key feature of most corporations is the separation between those who own the business (the shareholders) and those who operate it, as represented by the board of directors and management. In a corporation, shareholders are largely removed from the

day-to-day operations of the business. Instead, shareholders elect a board of directors that, in turn, appoints executive-level management, such as the chief executive officer, who is accountable for investing, financing, and operating decisions. Directors and managers have a primary responsibility to act in the best interest of shareholders and, indirectly, all stakeholders. The separation of ownership and management enables the corporation to obtain financing from a larger universe of potential investors who do not need (or want) to be involved in management.

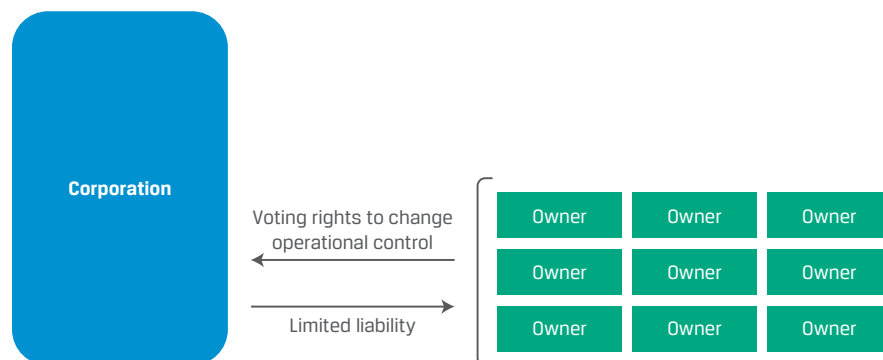
If a board or management does not act in shareholders' best interests, shareholders can enact change through exercising **voting rights** attached to their shares—for example, by voting to replace the board of directors—though this can take time. Influencing operations or changing management outright using engagement and voting rights is a strategy pursued by some investors and will be discussed in detail in later lessons.

### Owner/Shareholder Liability

Risk is shared among all shareholders, who face limited liability. That is, the maximum amount shareholders can lose is what they have invested in the company (i.e., the value of their shares can fall to zero but no further), and they are not responsible for the debts of the corporation unless they separately, specifically guarantee them.

Shareholders share in the risk and return of the company in proportion to their share ownership unless the corporate charter specifies differently. Unlike partnerships, ownership units are divided into shares of smaller unit size, allowing investors to more easily purchase or sell ownership interests as represented by their shares. For example, some issuers have more than 1 billion shares outstanding, meaning that ownership interests are divided into extremely small increments. Additionally, some corporations issue multiple types or classes of shares with different risk and return characteristics, which will be discussed in a later lesson. Exhibit 7 shows the relationship between owners and the corporation.

**Exhibit 7: Corporate Shareholder Liability**



### External Financing

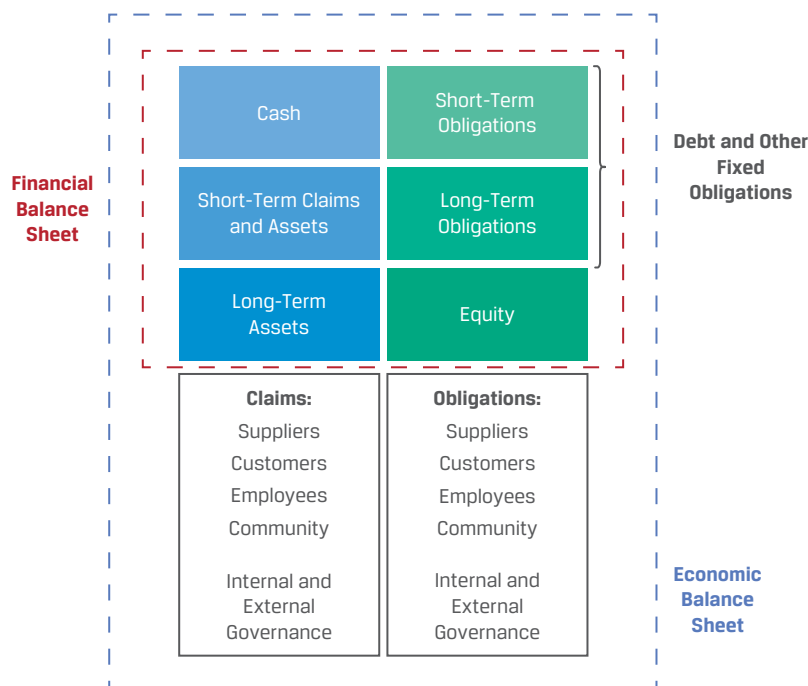
The separation between ownership and management allows corporations to access external financing more easily than other business structures because purchasing a share is the only requirement to become an owner. While more expensive to form and operate than other forms, the corporate form is typically preferred when capital needs

exceed what could be raised by an individual or small group of partners. Financing may be provided by individuals or by institutions, such as mutual funds, pension funds, banks, governments, non-profits, and other corporations.

Corporations are financed in two ways: with **equity**, by selling shares to investors or reinvesting profits, and with borrowings, or **debt**, in the form of loans, bonds, and leases. Equity investors (shareholders) have a right to receive any distributions of profits, known as **dividends**, while debt must be repaid on a pre-specified date in the future with interest. Equity or debt financing can be raised based on a private contractual agreement between an issuer and investors or in the form of a **security**, a standardized instrument that might be tradeable among investors on a public exchange, which will be covered in the next lesson.

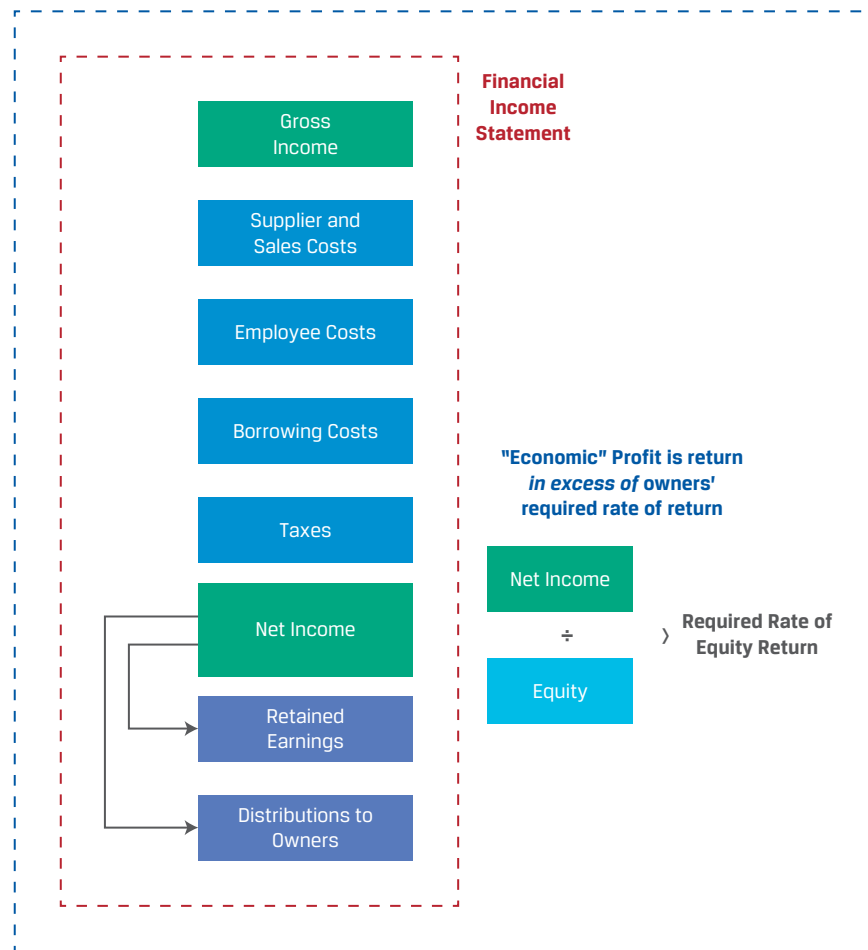
Exhibit 8 shows the relationship between debt and equity on a corporation's balance sheet and how these are related to its assets.

**Exhibit 8: Financial and "Economic" Balance Sheet**



While the "financial" balance sheet at the top of Exhibit 8 shows an issuer's assets (left-hand side) and its sources of financing (right-hand side) from short term to long term measured in financial terms, other intangible or hard-to-quantify assets or liabilities of a firm, such as the human capital associated with its employees and supplier and customer relationships, are included on what may be referred to as an issuer's broader "economic" balance sheet.

Similarly, Exhibit 9 shows an issuer's income statement and distinguishes between its financial income or net income once fixed obligations have been met and its "economic" profit, or return to a firm's owners in excess of what they could have earned elsewhere on different investments, known as their required rate of return on equity.

**Exhibit 9: Financial and "Economic" Income Statement**


## Taxation

While taxation for corporations can differ greatly from country to country, the corporation is ultimately subject to the tax authority and tax code governing the issuer's tax reporting, payment, and status. In most countries, corporations are taxed on their profits. Taxable profits are usually *not* the same as profits reported on financial statements, because tax codes and accounting standards differ.

In many countries, shareholders pay an additional tax on distributions (dividends) that are passed on to them. This is referred to as the **double taxation** of corporate profits. In some countries, shareholders do not pay a personal tax on dividends if the corporation has paid tax previously on the earnings distributed to shareholders or shareholders receive a personal tax credit for their proportional share of taxes paid by the corporation. In other countries, corporations pay no tax at all or may face different tax regimes within one country.

**EXAMPLE 3****Double Taxation of Corporate Profits**

1. The French retail giant Auchan Holding generated pre-tax income of €838 million last year and paid corporate taxes of €264 million. Investors in France also pay a 30% tax on dividends received. If Auchan had fully distributed its after-tax income to investors as a dividend and all its investors are in France, what is the total tax rate as a percentage of Auchan's pre-tax income?

**Solution:**

Pre-Tax Income	€838
Corporate Taxes (31.5%)	€264
After-Tax Income	€838 – €264 = €574
Distributed Dividend	€574
Investor Dividend Tax (30%)	€574 × 0.30 = €172.2
Total Tax Rate	(€264 + €172.2)/€838 = 52.1%

If the after-tax income of €574 million were paid to investors as a dividend, investors would pay €172.2 million in personal taxes on the dividends received. Total taxes paid would be €436.2 million (€264 million at the corporate level plus €172.2 million at the personal level), resulting in a total tax rate of 52.1%.

Despite the tax disadvantage illustrated in the prior example, the corporate form remains attractive for several reasons. While corporate shareholders are taxed on distributions, sole proprietors and partners are often taxed on all profits regardless of whether they are distributed as dividends (exceptions exist with allowances for profit reserves). This difference makes the corporate structure attractive to businesses that expect to reinvest undistributed profits in, for example, additional capacity for growth. Also, in jurisdictions where corporate tax rates are lower than personal income tax rates, it can be advantageous to “store” profits in the business.

**QUESTION SET**

1. Explain why the separation of ownership from management allows for corporate issuers to have greater access to capital.

**Solution:**

By separating ownership from management responsibilities, corporations can attract a broad range of owners, especially individuals and institutions, who do not want to be involved in management but would like to participate as investors.

2. Fill in the blanks in the following sentence:

Limited liability of shareholders refers to the fact that the \_\_\_\_\_ amount shareholders may lose on their investment is the \_\_\_\_\_ paid to buy the shares.

**Solution:**

Limited liability of shareholders refers to the fact that the maximum amount shareholders may lose on their investment is the price paid to buy the shares.

3. In which of the following situations does the double taxation of the corporate organizational form matter the *least*?

- A. The company expects to pay all its after-tax income as a dividend to shareholders each year.
- B. The company's shareholders reside in a tax jurisdiction with a high tax rate on dividend income.
- C. The company is expecting to reinvest all its after-tax profits each year into growth of the business.

**Solution:**

C is correct. Reinvestment of all profits implies that the company pays no dividend to shareholders, and thus, no double taxation occurs.

A is incorrect. Double taxation occurs because dividend income is taxed at both the corporate level and the shareholders' personal levels. If all after-tax profits are distributed, shareholders are taxed twice on the business's income.

B is incorrect because a high tax rate on shareholders' dividend income received would be a strong impetus to retain profits, find alternative means of distributing profits, or change the organizational form.

4. Referring to the Auchan Holding example in this lesson, calculate the amount of the tax disadvantage (in euros) Auchan has in its corporate form compared to if it were organized as a limited partnership. Recall that Auchan's pre-tax profit was €838 million, the corporate tax rate was 31.5%, the personal income tax rate was 30%, and all after-tax profits were distributed.

**Solution:**

If Auchan were organized as a limited partnership, its pre-tax profit would be passed through to the owner(s) and taxes would only be paid at the personal level. Thus, total taxes paid would be €251.4 million (= €838 million × 0.30), or €184.8 million lower than total taxes paid under the corporate organizational form, and this tax of €251.4 million would be paid regardless of whether the partnership distributed the profit to partners.

5. Corporate issuers are characterized by all of the following *except*:

- A. Corporate income is taxed at both the corporate and personal levels.
- B. Owners do not need to be involved in management of the company.
- C. The owners of the corporation are not legally distinct from the corporation.

**Solution:**

C is correct. A corporation is a legally separate entity from its owners.

A is incorrect because corporate income is taxed at both the corporate and personal levels unless the company pays zero dividends.

B is incorrect because shareholders are not required to exercise management control over the company. While in some cases, a large shareholder may serve as senior management or be on the board of directors, most shareholders do not take on management responsibilities.

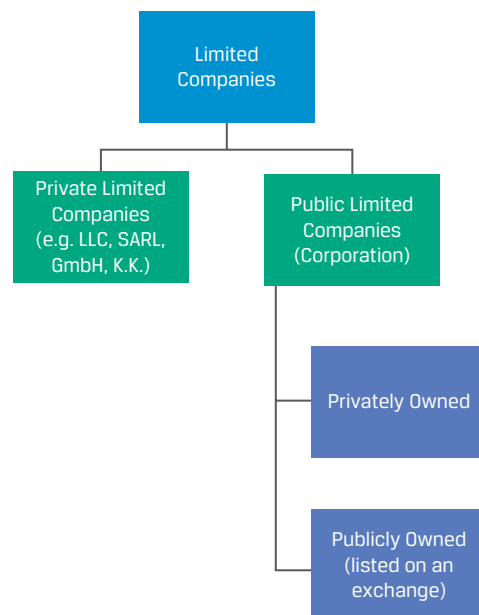
## PUBLICLY VS. PRIVATELY OWNED CORPORATE ISSUERS

# 4

- compare publicly and privately owned corporate issuers

For corporations, “public” and “private” (or “listed” and “unlisted”) are often defined by whether the company’s shares are listed and tradeable on an **exchange**. Somewhat confusingly, this is different from the discussion of private and public limited companies in an earlier lesson; most public or listed companies are public limited companies, but public limited companies are not obliged to list their shares on an exchange.

### Exhibit 10: Publicly vs. Privately Owned Limited Companies



An exchange, which for equities is referred to as a **stock exchange**, is a rules-based, open access market venue where financial instruments are traded, with price and volume transparency accessible by issuers, investors, and their intermediaries. In addition to an exchange listing, primary features distinguishing public and private companies include

- the ability to transfer ownership between investors,

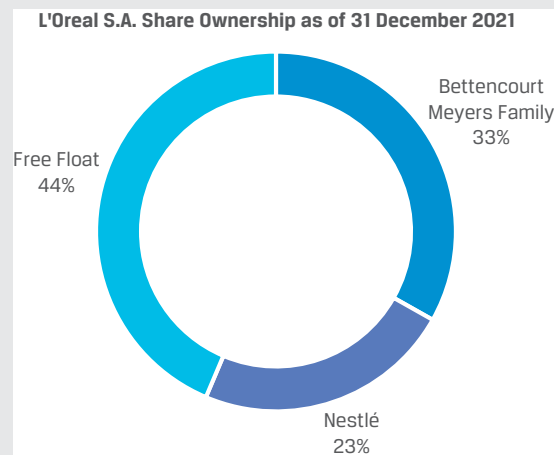
- the process of issuing new shares, and
- registration and disclosure requirements.

A **public (listed) company** has some or all of its shares listed and traded on an exchange. These shares may be widely held or involve a majority or controlling owner. Shareholders may include individuals, employees, institutions on behalf of individuals (e.g., pension funds), other corporations, governments, and non-profits. The shares that are traded actively—and thus are not held by insiders, strategic investors, or sponsors but are more freely available on exchanges—are known as an issuer’s **free float**. Free float is often expressed as a percentage of total shares outstanding.

#### EXAMPLE 4

L’Oréal S.A., the world’s largest beauty company, is a French *société anonyme*, or public limited company. It has been public since listing its shares on the Paris Stock Market (now Euronext) in 1963. As of 31 December 2021, L’Oréal had approximately 535 million shares outstanding.

L’Oréal’s shares are mostly owned by Françoise Bettencourt Meyers, her family, and Nestlé (a large, listed Swiss consumer goods company), and the remainder—the free float, approximately 44% of shares—is owned by institutional investors, individual investors, and L’Oréal employees.



### Exchange Listing, Liquidity, and Price Transparency

An exchange listing allows ownership to be more easily transferred because investors transact directly with one another in the secondary market on the exchange. An investor can become a shareholder in a public company by executing a buy order in a brokerage account or reduce an ownership position by executing a sell order. This can be done immediately for a relatively small number of shares in a liquid stock or take longer for many shares in a company whose shares trade infrequently. An exchange listing provides share price transparency, allowing investors to track how a company’s value changes.