# CFA
## LEVEL I
## (2027)

# Question Bank

February, May, August & November
Exam Prep

- Over 1,500 Exam like MCQs
- A separate question-bank for each reading
- Learning Outcomes (L.O.) based
- Answers Explained in detail

## Corporate Finance

**Volume 3**

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# Corporate Finance

## VOLUME 3

### Question & Answers

# *IFT* VOLUME 3 - INDEX


| Corporate Finance | Questions | Answers |
|---|---|---|
| LM1 Organizational Forms, Corporate Issuer Features, and Ownership | 4 | 8 |
| LM2 Investors and Other Stakeholders | 12 | 16 |
| LM3 Corporate Governance: Conflicts, Mechanisms, Risks, and Benefits | 20 | 24 |
| LM4 Working Capital and Liquidity | 28 | 34 |
| LM5 Capital Investments and Capital Allocation | 38 | 42 |
| LM6 Capital Structure | 46 | 52 |
| LM7 Business Models | 57 | 61 |



# Corporate Finance

## LM1 Organizational Forms, Corporate Issuer Features, and Ownership

**Questions**

## Question 1

Which of the following is a shared similarity among the four major business structure types?

**A)** Sole proprietorships and general partnerships have unbounded access to capital.

**B)** Corporate shareholders and limited partners have limited liability.

**C)** Corporations and partnerships can be listed on a stock exchange.

## Question 2

Maxwell Corp. generated operating income of USD 900 million and paid corporate taxes of USD 270 million. Investors in Maxwell Corp. also pay a 10% tax on dividends received. If Maxwell had distributed all its after-tax income to investors as a dividend, the effective tax rate on each dollar of operating earnings is:

**A)** 30%.

**B)** 37%.

**C)** 40%.

## Question 3

Which of the following business structures is generally the *most* expensive to form and operate?

**A)** Sole proprietorships

**B)** Limited Partnerships

**C)** Corporations

## Question 4

Which of the following types of corporations does not have shareholders?

**A)** Public for-profit

**B)** Private for-profit

**C)** Nonprofit

## Question 5

Compared to public companies, private companies can *most likely*:

**A)** have much higher potential returns.

**B)** have an observable stock price.

**C)** easily transfer ownership.

## Question 6

In developed economies, many private companies simply choose to remain private because:

**A)** of the declining venture capital.

**B)** it has become difficult for private companies to access capital by going public.

**C)** it helps companies avoid regulatory burden.

## Question 7

The term ‘blank check’ in corporate finance is used for which of the following methods by which a private company can go public?

**A)** IPO

**B)** DL

**C)** SPAC

## Question 8

As compared to an IPO, a DL:

**A)** involves new capital raising.

**B)** requires an underwriter.

**C)** is much faster to execute.

## Question 9

Non-financial disclosures are generally required in:

**A)** public companies.

**B)** private companies.

**C)** both A) and B).

## Question 10

To be considered accredited, an investor must have:

**A)** a certain level of net worth or possess a certain amount of professional experience.

**B)** lower appetite for risk.

**C)** higher need for regulatory supervision.

## Question 11

In a general partnership, if one partner is unable to pay their share of the business’ debts, which of the following best describes the liability of the remaining partners?

**A)** The remaining partners have no liability for the insolvent partner’s share.

**B)** The remaining partners are fully liable for the business’ debts.

**C)** Liability is limited to the amount each partner originally invested in the partnership.

## Question 12

Which of the following is *most likely* a key difference between a corporation and a limited partnership regarding the power of owners to influence management?

**A)** Shareholders in a corporation can enact change through statutory voting rights, whereas limited partners typically lack the unilateral power to replace a general partner for poor performance.

**B)** Limited partners have full control over day-to-day operations, while corporate shareholders do not.

**C)** Corporations have no separate legal identity, allowing owners more direct control than in a limited partnership.

## Question 13

Which organizational form is *most likely* subject to “double taxation”?

**A)** Sole Proprietorship

**B)** Limited Partnership

**C)** Corporation

## Question 14

A private company is considering going public via a direct listing (DL) rather than an initial public offering (IPO). A primary characteristic of a direct listing is that:

**A)** The company raises a significant amount of new capital.

**B)** No underwriter is involved in the process.

**C)** The company must be acquired by a Special Purpose Acquisition Company (SPAC).

## Question 15

Which of the following best describes the typical process and motivation for a company going from public to private?

**A)** The company issues new shares to increase its regulatory disclosure requirements.

**B)** An investor acquires all outstanding shares, typically at a premium, and delists the company because the public market is believed to be undervaluing the shares.

**C)** The company undergoes a direct listing (DL) to allow existing shareholders to exit without using an underwriter.

## Question 16

Which of the following statements *most* accurately describes a characteristic of a publicly listed company compared to a private company?

**A)** Private companies offer higher price transparency because their valuations are based on privately negotiated transactions between sophisticated investors.

**B)** Public companies have higher liquidity, as shares can be traded in seconds, and an observable stock price that reflects the company’s value over time.

**C)** Publicly listed shares are typically “locked up” for long periods, whereas private company ownership is easily transferred without negotiation.

# Corporate Finance

## LM1 Organizational Forms, Corporate Issuer Features, and Ownership

**Answers**

## Explanation 1 - B ✔

B is correct. Similar to corporate shareholders, ‘limited partners’ (LPs) have limited liability, i.e., they can only lose up to the amount invested in the business.

## Explanation 2 - B ✔

B is correct.

| | |
|---|---|
| Operating Income | USD 900 mn |
| Corporate Taxes (30%) | USD 270 mn |
| After-Tax Income | (USD 900 − USD 270) = USD 630 mn |
| Distributed Dividend | USD 630 mn |
| Investor Dividend Tax (10%) | USD 630 mn × 0.10 = USD 63 mn |
| Effective Tax Rate | (USD 270 mn + USD 63 mn) / USD 900 mn = 37% |

If the remaining after-tax income of USD 630 million was paid to investors as a dividend, investors would pay USD 63 million in taxes on the dividends received. Total taxes paid would be USD 333 million (USD 270 million at the corporate level plus USD 63 million at the personal level), resulting in an effective tax rate of 37%.

## Explanation 3 - C ✔

C is correct. Corporations are more expensive to form and operate than other business structures. Nonetheless, the corporate structure is typically preferred when capital requirements for a business overwhelm what could be raised by an individual or limited number of individuals.

## Explanation 4 - C ✔

C is correct. Nonprofit corporations are formed to promote a public benefit, religious benefit, or charitable mission. They do not have shareholders, do not pay dividends, and generally do not pay taxes. Examples of nonprofits include Harvard University and the Asian Development Bank.

## Explanation 5 - A ✔

A is correct. The potential returns in private companies can be much larger than public companies. This is because investors in private companies usually join early in the company’s life cycle and they have greater control over management.

In contrast to public companies, private companies are not listed on an exchange and, therefore, have no observable stock price. Transactions between buyers and sellers have to be privately negotiated and transferring ownership is much more difficult. Investments in private companies are usually locked up until the company is acquired by another company, or it goes public.

## Explanation 6 - C ✔

C is correct. In developed economies, many private companies simply choose to remain private because it helps companies avoid regulatory burden and the associated compliance costs of going public.

Many private companies simply choose to remain private in these economies because of the thriving venture capital, private equity, and private debt markets. Hence, it has become easier for private companies to access the capital they need without having to go public.

### Explanation 7 - C ✔

C is correct. A SPAC is a shell company, often called a “blank check” company, because it exists solely for the purpose of acquiring an unspecified private company sometime in the future.

### Explanation 8 - C ✔

C is correct. As compared to an IPO, a DL is much faster to execute and involves lower costs.

A DL differs from an IPO in two key ways – (1) no underwriter is involved and (2) no new capital is raised. Instead, the company is simply listed on an exchange and shares are sold by existing shareholders.

### Explanation 9 - C ✔

C is correct. Generally, private companies are required to make only non-financial disclosures. On the other hand, public companies must make both financial and non-financial disclosures.

### Explanation 10 - A ✔

A is correct. To be considered accredited, an investor must have a certain level of income or net worth or possess a certain amount of professional experience or knowledge.

Accredited investors are those who are sophisticated enough to take greater risks and to have a reduced need for regulatory oversight and protection.

### Explanation 11 - B ✔

B is correct. In a general partnership, the partners share all risk and business liability. If one partner cannot pay their share, the remaining partners are fully liable.

### Explanation 12 - A ✔

A is correct. A key difference is that shareholders have voting rights to enact change if management underperforms. In a limited partnership, limited partners have no control over operations and cannot replace the general partner even if the business is run poorly.

### Explanation 13 - C ✔

C is correct. Corporate profits are often taxed twice: once at the corporate level and again at the individual level when profits are distributed as dividends. In contrast, sole proprietorships and partnerships are “pass-through” entities where profits are only taxed as personal income.

### Explanation 14 - B ✔

B is correct. A direct listing differs from an IPO because no underwriter is involved and no new capital is raised; instead, existing shareholders sell their shares directly on the exchange.