Learning Module 2: Investors and other Stakeholders

Q.162 Which one of the following statements is *least accurate* regarding shareholder rights?

A. Shareholders do not like takeover defenses.

B. Shareholders cannot vote without attending meetings.

C. Cumulative voting gives small shareholders more rights.

The correct answer is **B.**

Shareholders have the ability to vote without attending meetings. This is facilitated through proxy voting, a process that allows shareholders to delegate their voting power to a representative, who then votes on their behalf at the shareholder meeting.

Proxy voting ensures that shareholders' voices are heard and their votes counted, even if they cannot physically attend the meeting. This mechanism is crucial for the exercise of shareholder rights, as it enables broader participation in the company's decision-making processes.

A is incorrect. They can entrench management and prevent takeovers that might otherwise offer a premium to the current stock price, thereby benefiting shareholders.

C is incorrect. Cumulative voting is a mechanism that can give small shareholders more rights, particularly in the election of board members.

In a cumulative voting system, shareholders have a number of votes equal to the number of shares they own multiplied by the number of directors to be elected. They can allocate these votes in any manner they choose, including concentrating all their votes on a single candidate. This system contrasts with straight voting, where shareholders can only vote their shares once per candidate.

Cumulative voting allows minority shareholders to have a greater impact on the election outcome, potentially securing representation on the board. This can lead to more balanced governance and ensure that the interests of minority shareholders are considered.

CFA Level I, Topic 4 - Corporate Issuers, Learning Module 2: Investors and other Stakeholders. LOS (b): Describe a company’s stakeholder groups and compare their interests.

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Q.1591 Which of the following ESG factors would *most likely* be considered a social factor?

A. Biodiversity

B. Data security and privacy

C. Lobbying and political contributions

The correct answer is **B.**

Data security and privacy are crucial aspects of the social dimension within the Environmental, Social, and Governance (ESG) framework. This factor primarily concerns how companies manage and protect personal and sensitive information of their customers and employees.

Effective management of data security and privacy can enhance customer trust and loyalty, which are vital for long-term business sustainability. Moreover, it addresses broader social concerns related to individual rights and freedoms, making it a key social factor in ESG considerations.

A is incorrect. Biodiversity falls under the environmental category of ESG factors. It concerns the variety and variability of life on Earth and is critical for maintaining ecosystem services that humans rely on, such as pollination, water purification, and climate regulation. Environmental factors like biodiversity are essential for assessing a company's environmental stewardship and its impact on natural resources and ecosystems.

C is incorrect. Lobbying and political contributions are considered governance factors within the ESG framework. These activities relate to how a company interacts with governments, political processes, and regulatory frameworks. Effective governance practices, including transparency and accountability in lobbying and political contributions, are crucial for preventing corruption and ensuring that a company is managed in the interests of all its stakeholders.

CFA Level I, Corporate Issuers, Learning Module 2: Investors and other Stakeholders. LOS C: Describe environmental, social, and governance factors of corporate issuers considered by investors.

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Q.1596 Which of the following corporate structural issues *least likely* requires the shareholders' approval?

A. The approval of an anti-takeover measure.

B. The sale of 10% of the firm to a third party.

C. Moving a factory from one continent to another.

The correct answer is **C.**

Moving a factory from one continent to another is a decision that typically falls under the purview of the company's management and operational strategy, rather than requiring direct approval from shareholders. This type of decision is considered part of the day-to-day operations and strategic management of the company, aimed at optimizing production, reducing costs, or accessing new markets.

While significant in terms of operational impact and potential financial implications, such decisions are generally not subject to shareholder vote unless they significantly alter the nature or scope of the business. The management team is expected to make these decisions based on their expertise and understanding of the company's strategic needs.

A is incorrect. The approval of an anti-takeover measure is a significant decision that directly affects the ownership and control structure of the company. Anti-takeover measures, such as poison pills or golden parachutes, are designed to make it more difficult or less attractive for another entity to take over the company.

These measures can significantly impact shareholder value and rights, making it essential for shareholders to have a say in their implementation. Shareholder approval is required for such measures to ensure that the interests of the shareholders are adequately considered and protected.

B is incorrect. The sale of a significant portion of the firm, such as 10% to a third party, is a decision that can have a profound impact on the company's ownership structure, control, and strategic direction. Transactions of this magnitude can affect shareholder value and dilute existing ownership percentages.

Therefore, it is a common practice and often a legal requirement for companies to seek shareholder approval for such transactions. This ensures that shareholders have a voice in decisions that could materially affect their investment and the future direction of the company. Shareholder approval in this context serves as a mechanism for ensuring transparency and fairness in significant corporate transactions.

CFA Level I, Topic 4 - Corporate Issuers, Learning Module 2: Investors and other Stakeholders. LOS (b): Describe a company’s stakeholder groups and compare their interests.

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Q.1598 Which of the following firms will *most likely* face adversity in raising equity capital for fixed investments?

A. Firms that separate voting rights across different classes.

B. Firms that regularly hold meetings with shareholders.

C. Firms that regularly pay dividends.

The correct answer is **A.**

Firms that separate voting rights across different classes of shares are likely to face more challenges in raising equity capital for fixed investments. This structure can create a disparity between ownership and control, leading to potential conflicts of interest between different shareholder groups. When voting rights are separated from economic rights, it can deter potential investors who may feel that their ability to influence company decisions is limited, despite having a financial stake in the company.

This separation can also signal to the market that the company's management or controlling shareholders are unwilling to share control, which can be perceived negatively by potential investors. As a result, these firms may find it more difficult to attract equity capital since investors might be wary of investing in a company where they could have limited say in its operations and strategic direction.

B is incorrect. Regular communication and engagement with shareholders are generally viewed positively by investors. Holding meetings with shareholders allows firms to provide updates on their performance, strategy, and future plans, fostering transparency and trust.

It also provides an opportunity for shareholders to voice their concerns and ask questions, which can help strengthen the relationship between the company and its investors.

C is incorrect. Regular dividend payments can be perceived positively by investors, as they indicate a company's profitability and ability to generate consistent returns for shareholders. In some cases, dividend-paying firms may even be more attractive to investors seeking stable income streams.

CFA Level I, Topic 4 - Corporate Issuers, Learning Module 2: Investors and other Stakeholders. LOS (b): Describe a company's stakeholder groups and compare their interests.

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Q.1599 While evaluating a firm's ownership structure, which of the following issues regarding equity is *most likely* considered negative?

A. Shareholders have the power to nominate board members.

B. In a recently privatized firm, all voting rights are held by previous owners.

C. The safeguard of inferior voting rights of shareholders are in bylaws and articles of association.

The correct answer is **B.**

This situation can significantly limit the power and influence of new shareholders in the company's decision-making processes. Voting rights are a critical aspect of share ownership, providing shareholders with a mechanism to influence the company's strategic direction, elect the board of directors, and make decisions on significant corporate actions.

When voting rights are concentrated in the hands of previous owners, it can lead to a misalignment of interests between the controlling parties and the minority shareholders. Furthermore, this scenario can deter potential investors who seek an active role in governance, thereby affecting the company's ability to raise capital and potentially impacting its market valuation.

A is incorrect. The power of shareholders to nominate board members is generally viewed as a positive aspect of a firm's ownership structure. This power ensures that shareholders have a say in the composition of the board, which is responsible for overseeing the company's management and strategic direction. The ability to nominate board members can lead to a more accountable and transparent governance structure, where the board is more closely aligned with the interests of the shareholders.

C is incorrect. The safeguard of inferior voting rights of shareholders through bylaws and articles of association can also be seen as a positive feature. This mechanism can provide a balance between protecting the interests of minority shareholders and allowing for efficient decision-making by the company. By establishing clear rules on voting rights in the company's bylaws and articles of association, firms can prevent potential abuses of power and ensure that all shareholders are treated fairly.

CFA Level I, Corporate Issuers, Learning Module 2: Investors and other Stakeholders. LOS b: Describe a company's stakeholder groups and compare their interests.

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Q.4049 Which of the following is *least likely* accurate about dual-class structures?

A. Dual-class shares are difficult to remove.

B. Dual-class shares enable founders or insiders to maintain control over a company.

C. There is no conflict of interest between management and shareholders with dual-class shares.

The correct answer is **C.**

Dual shares can exacerbate these conflicts due to the disproportionate voting power they grant to certain classes of shareholders, typically founders or insiders. This structure allows a small group of shareholders to maintain control over significant corporate decisions, including the election of board members, strategic direction, and mergers and acquisitions, despite owning a minority of the company's equity. This concentration of power can lead to decisions that favor the interests of controlling shareholders over those of the minority shareholders, thereby increasing the potential for conflicts of interest rather than mitigating them.

A is incorrect. Their structure is designed to concentrate voting power with a certain class of shareholders, often the company's founders or insiders. This concentration of power means that any changes to the share structure, including the removal of dual-class shares, would require the approval of these controlling shareholders. Given that the dual-class structure is typically established to maintain their control over the company, it is unlikely that these shareholders would vote in favor of removing this mechanism. Therefore, while difficult, it is not impossible to dismantle dual-class shares, but it requires the consent of those who benefit most from their existence.

B is incorrect. Dual-class shares are specifically designed to enable founders or insiders to maintain control over a company. This is achieved by creating different classes of shares, each with different voting rights. Typically, one class is granted significantly more voting power per share than the other, allowing a small group of shareholders to control major decisions without owning a majority of the company's equity. This structure is often used by companies seeking to go public while retaining decision-making power within a select group, ensuring that strategic vision and control remain consistent. The ability of dual-class shares to preserve founder or insider control is a defining characteristic and not an inaccuracy.

CFA Level I, Topic 4- Corporate Issuers, Learning Module 2: Investors and other Stakeholders. LOS (b): Describe a company's stakeholder groups and compare their interests.

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Q.4051 Which of the following stakeholder’s roles is *most likely* responsible for executing the strategy set by the board and running day-to-day operations?

A. Managers.

B. Employees.

C. Shareholders.

The correct answer is **A.**

Managers are most likely responsible for executing the strategy set by the board and running day-to-day operations within a company. This role is crucial as it bridges the gap between the company's strategic vision and its operational execution.

Managers are tasked with translating the board's strategic objectives into actionable plans and overseeing their implementation. Their responsibilities also include managing teams, solving operational problems, and adapting to changes in the business environment to maintain or improve the company's competitive position.

B is incorrect. While employees are indeed vital to a company's operations, their primary role is to perform specific tasks and duties as directed by their managers. They do not typically have the authority or responsibility to execute strategies or make high-level operational decisions. Their role is more focused on the execution of day-to-day tasks rather than strategic oversight or management of the company's overall operations.

C is incorrect. Shareholders are not directly involved in the day-to-day management or operational execution of the company's strategy. Shareholders invest capital into the company and have ownership interests, but their role is more aligned with governance and oversight through mechanisms like the election of the board of directors. They provide the necessary financial resources and expect returns on their investments, but the execution of strategies and daily operational management falls outside their purview.

CFA Level I, Corporate Issuers, Learning Module 2: Investors and other Stakeholders. LOS b: describe a company’s stakeholder groups and compare their interests.

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Q.4096 Regarding the risk-return profile, at which of the following investor perspectives do equity holders and bondholders *most likely* converge?

A. Maximum loss.

B. Return potential.

C. Investment risk.

The correct answer is **A.**

The convergence of investor perspectives between equity holders and bondholders at the point of maximum loss is primarily due to the nature of their investments. For both types of investors, the maximum loss is theoretically the total amount of their initial investment. This is because, in the worst-case scenario, such as the bankruptcy of the issuing company, both equity holders and bondholders could potentially lose their entire investment.

Equity holders, as shareholders of the company, have ownership stakes and thus directly bear the company's performance risks. In contrast, bondholders, as creditors, have a fixed claim on the company's assets and income. However, if the company fails to meet its obligations and goes bankrupt, both parties stand to lose their invested capital, aligning their interests at this extreme end of the risk spectrum.

B is incorrect. Equity holders benefit from the company's growth and profitability through stock price appreciation and dividends, which can significantly exceed the original investment. On the other hand, bondholders receive fixed interest payments and the return of the principal amount, limiting their return potential to the bond's interest rate, regardless of how well the company performs.

C is incorrect. Equity holders are exposed to higher levels of risk since they are residual claimants; they are paid after all other claims on the company's assets and earnings, such as bondholders, are satisfied. This makes equity investments riskier, especially in the event of a company's financial distress or bankruptcy.

Bondholders, being creditors of the company, have a higher claim on the company's assets and earnings than equity holders, making their investment generally less risky. Therefore, the risk profiles of equity holders and bondholders are inherently different, with equity holders facing higher risks and bondholders enjoying relatively lower risks due to their priority in the company's capital structure.

CFA Level I, Corporate Issuers, Learning Module 2: Investors and other Stakeholders. LOS a: Compare the financial claims and motivations of lenders and shareholders.

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Q.4647 Which of the following parties most likely retains residual claims on an issuer's cash flows?

A. Debtholders

B. Government

C. Shareholders

The correct answer is **C.**

Shareholders typically have residual claims on an issuer's cash flows, meaning they are entitled to any remaining funds after all other obligations, such as debt payments and operating expenses, have been satisfied.

A is incorrect. Debtholders have priority claims on cash flows, meaning they must be paid interest and principal before shareholders receive any distributions.

B is incorrect. The government generally does not have a residual claim on an issuer's cash flows unless it is owed taxes or other dues. However, these obligations do not constitute residual claims in the same sense as shareholder equity.

CFA Level I, Topic 4 - Corporate Issuers, Learning Module 2: Investors and other Stakeholders. LOS a: Compare the financial claims and motivations of lenders and shareholders.

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Q.4648 Which of the following features is least likely associated with equity?

A. Variable returns

B. Perpetual existence

C. Priority in payment

The correct answer is **C.**

Equity typically does not have priority in payment compared to debt. Debt holders, such as bondholders or lenders, have priority claims on a company's assets and earnings, meaning they must be paid before equity holders receive any distributions.

A is incorrect. Variable returns are a characteristic of equity. Equity holders, such as shareholders, receive returns in the form of dividends, which are not fixed but rather variable and depend on the company's performance and the decisions of its management. The returns to equity holders can fluctuate based on factors such as the company's profitability, dividend policy, and overall market conditions.

B is incorrect. Unlike debt, which typically has a finite maturity date by which the principal amount must be repaid, equity investments represent ownership in a company and do not have a predetermined expiration date. If the company continues to operate, equity holders retain their ownership stake indefinitely. This perpetual nature of equity distinguishes it from debt.

CFA Level I, Topic 4 - Corporate Issuers, Learning Module 2: Investors and other Stakeholders. LOS a: Compare the financial claims and motivations of lenders and shareholders.

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Q.4649 Which of the following primary stakeholder groups in a corporation is most likely responsible for executing the board’s strategy and run operations?

A. Managers

B. Customers

C. Employees

The correct answer is **A.**

Managers are responsible for executing the strategic decisions made by the board of directors and overseeing the day-to-day operations of the corporation. They translate the board's vision and objectives into actionable plans, allocate resources, manage personnel, and ensure that the organization operates efficiently and effectively.

B is incorrect. Customers are external stakeholders who purchase goods or services from the corporation. While customers are essential to the success of a business and their needs and preferences inform strategic decisions, they are not responsible for executing the board's strategy or running the corporation's operations.

C is incorrect. While employees are tasked with executing the board's strategy and ensuring the smooth functioning of the organization, their responsibilities are typically defined by the senior management team, which includes executives and managers. These managers are responsible for translating the board's strategic decisions into actionable plans and overseeing their implementation across various departments and teams within the organization.

CFA Level I, Topic 4 - Corporate Issuers, Learning Module 2: Investors and other Stakeholders. LOS b: Describe a company’s stakeholder groups and compare their interests.

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Q.4650 Which stakeholders are expected to gain the most from a substantial rise in the company's market value?

A. Debtholders

B. Management

C. Shareholders

The correct answer is **C.**

Shareholders are expected to gain the most from a substantial rise in the company's market value because they are the owners of the company and hold equity stakes in it. When the company's market value increases, the value of shareholders' equity also rises, resulting in capital gains for them. Shareholders benefit directly from the appreciation of the company's value through increased stock prices and may also receive dividends if the company decides to distribute profits to its shareholders.

A is incorrect. Debtholders typically have fixed claims on a company's assets and cash flows, meaning their returns are predetermined by the terms of the debt contracts, such as interest payments and principal repayment schedules. Unlike shareholders, debtholders do not directly participate in the company's equity ownership, so they do not stand to benefit directly from an increase in the company's market value.

B is incorrect. Management often receives compensation in the form of salaries, bonuses, and stock options, but their compensation is usually not directly tied to the company's market value in the same way as shareholder returns. While an increase in the company's market value may indirectly benefit management in terms of job security, career advancement opportunities, and potentially higher bonuses or stock option values, the primary beneficiaries of a rise in market value are the shareholders.

CFA Level I, Topic 4 - Corporate Issuers, Learning Module 2: Investors and other Stakeholders. LOS b: Describe a company's stakeholder groups and compare their interests.

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Q.4651 Which of the following ESG considerations most likely falls under the social factors?

A. Lobbying

B. Human rights

C. Climate change

The correct answer is **B.**

Social factors in ESG considerations typically include aspects related to human rights, labor practices, employee relations, diversity and inclusion, and community engagement. Human rights, which encompass fundamental rights and freedoms inherent to all human beings, are a key component of social factors within the ESG framework.

A is incorrect. While lobbying can have social implications, it is typically categorized under governance factors rather than social factors in the ESG framework Lobbying activities are often associated with influencing government policies, regulations, and legislation, which can have broader societal impacts.

C is incorrect. Climate change is primarily categorized under environmental factors within the environmental, social, and governance (ESG) framework, rather than social factors. Environmental factors encompass various issues related to a company's impact on the natural environment, including its carbon footprint, energy efficiency, pollution levels, resource usage, and management of environmental risks.

CFA Level I, Topic 4 - Corporate Issuers, Learning Module 2: Investors and other Stakeholders. LOS c: Describe environmental, social, and governance factors of corporate issuers considered by investors.

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