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Chapter 02: Corporate Governance

1. A stakeholder is:
A. any person or entity that owns shares of a corporation.
B. any person or entity that has voting rights based on share ownership of a corporation.
C. a person who initially started a firm and currently has management control over the cash flows of the firm due to his/her current ownership of company equity.
D. creditor to whom the firm currently owes money and who consequently has a claim on the cash flows of the firm.
E. any person or entity other than a shareholder or creditor who potentially has a claim on the cash flows of the firm.

2. Corporate Governance Regulation is intended to:
A. protect financial managers from investors.
B. not have any affect on foreign companies.
C. reduce corporate revenues.
D. protect investors from corporate abuses.
E. decrease audit costs for firms.

3. The treasurer and the controller of a corporation generally report to the:
A. board of directors.
B. chairman of the board.
C. chief executive officer.
D. president.
E. vice president of finance.

4. Which one of the following statements is correct concerning the organizational structure of a corporation?
A. The vice president of finance reports to the chairman of the board.
B. The chief executive officer reports to the board of directors.
C. The controller reports to the president.
D. The treasurer reports to the chief executive officer.
E. The chief operations officer reports to the vice president of production.

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5. Which one of the following statements concerning a sole proprietorship is correct?
A. The life of the firm is limited to the life span of the owner.
B. The owner can generally raise large sums of capital quite easily.
C. The ownership of the firm is easy to transfer to another individual.
D. The company must pay separate taxes from those paid by the owner.
E. The legal costs to form a sole proprietorship are quite substantial.

6. A general partner:
A. has less legal liability than a limited partner.
B. has more management responsibility than a limited partner.
C. faces double taxation whereas a limited partner does not.
D. cannot lose more than the amount of his/her equity investment.
E. is the term applied only to corporations which invest in partnerships.

7. A partnership:
A. is taxed the same as a corporation.
B. agreement defines whether the business income will be taxed like a partnership or a corporation.
C. terminates at the death of any general partner.
D. has less of an ability to raise capital than a proprietorship.
E. allows for easy transfer of interest from one general partner to another.

8. Which of the following are disadvantages of a partnership?
I. limited life of the firm
II. personal liability for firm debt
III. greater ability to raise capital than a sole proprietorship
IV. lack of ability to transfer partnership interest
A. I and II only.
B. III and IV only.
C. II and III only.
D. I, II, and IV only.
E. I, III, and IV only.

9. The articles of incorporation:
A. can be used to remove company management.
B. are amended annually by the company shareholders.
C. set forth the number of shares that can be issued.
D. set forth the rules by which the corporation regulates its existence.
E. can set forth the conditions under which the firm can avoid double taxation.

10. The owners of a limited liability company prefer:
A. being taxed like a corporation.
B. having liability exposure similar to that of a sole proprietor.
C. being taxed personally on all business income.
D. having liability exposure similar to that of a general partner.
E. being taxed like a corporation with liability like a partnership.

11. Which one of the following business types is best suited to raising large amounts of capital?
A. Sole proprietorship.
B. Limited liability company.
C. Corporation.
D. General partnership.
E. Limited partnership.

12. Which type of business organization has all the respective rights and privileges of a legal person?
A. Sole proprietorship.
B. General partnership.
C. Limited partnership.
D. Corporation.
E. Limited liability company.

13. Which of the following help convince managers to work in the best interest of the shareholders?
I. compensation based on the value of the equity
II. share option plans
III. threat of a proxy fight
IV. threat of conversion to a partnership
A. I and II only.
B. II and III only.
C. I, II and III only.
D. I and III only.
E. I, II, III, and IV.

14. Sole proprietorships are predominantly started because:
A. they are easily and cheaply setup.
B. the proprietorship life is limited to the business owner's life.
C. all business taxes are paid as individual tax.
D. All of the above.
E. None of the above.

15. Managers are encouraged to act in shareholders' interests by:
A. shareholder election of a board of directors who select management.
B. the threat of a takeover by another firm.
C. compensation contracts that tie compensation to corporate success.
D. Both A and B.
E. All of the above.

16. In a limited partnership:
A. each limited partner's liability is limited to his net worth.
B. each limited partner's liability is limited to the amount he put into the partnership.
C. each limited partner's liability is limited to his annual salary.
D. there is no limitation on liability; only a limitation on what the partner can earn.
E. None of the above.

17. Do you think agency problems arise in sole proprietorships and/or partnerships?

18. Assume for a moment that the shareholders in a corporation have unlimited liability for corporate debts. If so, what impact would this have on the functioning of primary and secondary markets for ordinary equity?

19. One thing lenders sometimes require when loaning money to a small corporation is an assignment of the ordinary equity as collateral on the loan. Then, if the business fails to repay its loan, the ownership of the stock certificates can be transferred directly to the lender. Why might a lender want such an assignment? What advantage of the corporate form of organization comes into play here?

Chapter 02: Corporate Governance Key

1. A stakeholder is:
A. any person or entity that owns shares of a corporation.
B. any person or entity that has voting rights based on share ownership of a corporation.
C. a person who initially started a firm and currently has management control over the cash flows of the firm due to his/her current ownership of company equity.
D. creditor to whom the firm currently owes money and who consequently has a claim on the cash flows of the firm.
E. any person or entity other than a shareholder or creditor who potentially has a claim on the cash flows of the firm.

Difficulty: Basic
Hillier - Chapter 02 #1
Topic: Stakeholders

2. Corporate Governance Regulation is intended to:
A. protect financial managers from investors.
B. not have any affect on foreign companies.
C. reduce corporate revenues.
D. protect investors from corporate abuses.
E. decrease audit costs for firms.

Difficulty: Basic
Hillier - Chapter 02 #2
Topic: Corporate Governance Regulation

3. The treasurer and the controller of a corporation generally report to the:
A. board of directors.
B. chairman of the board.
C. chief executive officer.
D. president.
E. vice president of finance.

Difficulty: Basic
Hillier - Chapter 02 #3
Topic: Organisational Structure

4. Which one of the following statements is correct concerning the organizational structure of a corporation?
A. The vice president of finance reports to the chairman of the board.
B. The chief executive officer reports to the board of directors.
C. The controller reports to the president.
D. The treasurer reports to the chief executive officer.
E. The chief operations officer reports to the vice president of production.

Difficulty: Intermediate
Hillier - Chapter 02 #4
Topic: Organisational Structure

5. Which one of the following statements concerning a sole proprietorship is correct?
A. The life of the firm is limited to the life span of the owner.
B. The owner can generally raise large sums of capital quite easily.
C. The ownership of the firm is easy to transfer to another individual.
D. The company must pay separate taxes from those paid by the owner.
E. The legal costs to form a sole proprietorship are quite substantial.

Difficulty: Basic
Hillier - Chapter 02 #5
Topic: Sole Proprietorship

6. A general partner:
A. has less legal liability than a limited partner.
B. has more management responsibility than a limited partner.
C. faces double taxation whereas a limited partner does not.
D. cannot lose more than the amount of his/her equity investment.
E. is the term applied only to corporations which invest in partnerships.

Difficulty: Basic
Hillier - Chapter 02 #6
Topic: Partnership

7. A partnership:
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B. agreement defines whether the business income will be taxed like a partnership or a corporation.
C. terminates at the death of any general partner.
D. has less of an ability to raise capital than a proprietorship.
E. allows for easy transfer of interest from one general partner to another.

Difficulty: Basic
Hillier - Chapter 02 #7
Topic: Partnership

8. Which of the following are disadvantages of a partnership?
I. limited life of the firm
II. personal liability for firm debt
III. greater ability to raise capital than a sole proprietorship
IV. lack of ability to transfer partnership interest
A. I and II only.
B. III and IV only.
C. II and III only.
D. I, II, and IV only.
E. I, III, and IV only.

Difficulty: Intermediate
Hillier - Chapter 02 #8
Topic: Partnership

9. The articles of incorporation:
A. can be used to remove company management.
B. are amended annually by the company shareholders.
C. set forth the number of shares that can be issued.
D. set forth the rules by which the corporation regulates its existence.
E. can set forth the conditions under which the firm can avoid double taxation.

Difficulty: Intermediate
Hillier - Chapter 02 #9
Topic: Articles of Incorporation

10. The owners of a limited liability company prefer:
A. being taxed like a corporation.
B. having liability exposure similar to that of a sole proprietor.
C. being taxed personally on all business income.
D. having liability exposure similar to that of a general partner.
E. being taxed like a corporation with liability like a partnership.

Difficulty: Intermediate
Hillier - Chapter 02 #10
Topic: Limited Liability Company

11. Which one of the following business types is best suited to raising large amounts of capital?
A. Sole proprietorship.
B. Limited liability company.
C. Corporation.
D. General partnership.
E. Limited partnership.

Difficulty: Basic
Hillier - Chapter 02 #11
Topic: Corporation

12. Which type of business organization has all the respective rights and privileges of a legal person?
A. Sole proprietorship.
B. General partnership.
C. Limited partnership.
D. Corporation.
E. Limited liability company.

Difficulty: Basic
Hillier - Chapter 02 #12
Topic: Corporation

13. Which of the following help convince managers to work in the best interest of the shareholders?
I. compensation based on the value of the equity
II. share option plans
III. threat of a proxy fight
IV. threat of conversion to a partnership
A. I and II only.
B. II and III only.
C. I, II and III only.
D. I and III only.
E. I, II, III, and IV.

Difficulty: Intermediate
Hillier - Chapter 02 #13
Topic: Agency Problem

14. Sole proprietorships are predominantly started because:
A. they are easily and cheaply setup.
B. the proprietorship life is limited to the business owner's life.
C. all business taxes are paid as individual tax.
D. All of the above.
E. None of the above.

Difficulty: Basic
Hillier - Chapter 02 #14
Topic: Sole Proprietorships

15. Managers are encouraged to act in shareholders' interests by:
A. shareholder election of a board of directors who select management.
B. the threat of a takeover by another firm.
C. compensation contracts that tie compensation to corporate success.
D. Both A and B.
E. All of the above.

Difficulty: Intermediate
Hillier - Chapter 02 #15
Topic: Governance

16. In a limited partnership:
A. each limited partner's liability is limited to his net worth.
B. each limited partner's liability is limited to the amount he put into the partnership.
C. each limited partner's liability is limited to his annual salary.
D. there is no limitation on liability; only a limitation on what the partner can earn.
E. None of the above.

Difficulty: Basic
Hillier - Chapter 02 #16
Topic: Limited Partnership

17. Do you think agency problems arise in sole proprietorships and/or partnerships?

Agency conflicts typically arise when there is a separation of ownership and management of a business. In a sole proprietorship and a small partnership, such separation is not likely to exist to the degree it does in a corporation. However, there is still potential for agency conflicts. For example, as employees are hired to represent the firm, there is once again a separation of ownership and management.

Difficulty: Intermediate
Hillier - Chapter 02 #17
Topic: Agency Theory

18. Assume for a moment that the shareholders in a corporation have unlimited liability for corporate debts. If so, what impact would this have on the functioning of primary and secondary markets for ordinary equity?

With unlimited liability, you would be very careful which stocks you invest in. In particular, you would not invest in companies you expected to be unable to satisfy their financial obligations. Both the primary and secondary markets for equity would be severely hampered if this rule existed. It would be very difficult for a young, untested business to acquire enough capital to grow.

Difficulty: Challenge
Hillier - Chapter 02 #18
Topic: Limited Liability Company

19. One thing lenders sometimes require when loaning money to a small corporation is an assignment of the ordinary equity as collateral on the loan. Then, if the business fails to repay its loan, the ownership of the stock certificates can be transferred directly to the lender. Why might a lender want such an assignment? What advantage of the corporate form of organization comes into play here?

In the event of a loan default, a lender may wish to liquidate the business. Often it is time consuming and difficult to take title of all of the business assets individually. By taking control of the equity, the lender is able to sell the business simply by reselling the equity in the business. This illustrates once again the ease of transfer of ownership of a corporation.

Difficulty: Challenge
Hillier - Chapter 02 #19
Topic: Transfer of Ownership in a Corporation

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Chapter 02: Corporate Governance Summary

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