CFA LEVEL I STUDY SHEET · TOPIC 5

Corporate Finance

Chartered Financial Analyst (CFA®) Program Level I exam

6-9% of the exam · 7 learning modules · 2027 curriculum

Corporate Finance covers how companies are organised and owned, whose interests they serve, how they are governed, and how they manage liquidity, choose investments and finance them. Level I questions test definitions and comparisons, plus calculations of the cash conversion cycle, NPV, IRR, ROIC and WACC.

You should be able to: You should be able to compare business forms and stakeholder claims, describe governance mechanisms, and compute the cash conversion cycle, NPV, IRR, ROIC and WACC.

Every learning module: the key point and the trap

CORP.1 Business forms and ownership structures

A sole proprietorship has one owner with unlimited liability and profits taxed as personal income.

Trap: In a limited partnership, only the general partner has unlimited liability.

CORP.2 Lenders, shareholders and other stakeholders

Lenders hold a fixed, senior claim: their upside is capped at interest and principal, and they prefer stable cash flows and low risk.

Trap: Lenders gain nothing from upside beyond full repayment, yet bear losses in a default.

CORP.3 Governance, agency conflicts and controls

The principal-agent relationship: shareholders (principals) delegate to managers (agents), whose goals may differ.

Trap: Entrenchment devices such as staggered boards protect insiders, not minority shareholders.

CORP.4 Managing working capital and liquidity

Cash conversion cycle = days of inventory on hand + days of sales outstanding - days of payables.

Trap: Days of payables are subtracted, not added, in the cash conversion cycle.

CORP.5 Choosing investments with NPV, IRR and ROIC

Capital investments include going concern projects (maintenance, efficiency), regulatory and compliance projects, expansion and new lines of business.

Trap: Sunk costs already spent do not belong in the analysis, while forgone opportunities do.

CORP.6 Cost of capital and the debt mix

WACC = wE x rE + wP x rP + wD x rD x (1 - t), using target or market-value weights.

Trap: Under MM without taxes, cheaper debt does not lower WACC because the cost of equity rises to offset it.

CORP.7 How companies create and capture value

A business model describes who the customers are, what value is offered, how it is delivered and how the company earns money.

Trap: Economies of scope (shared costs across products) are not the same as network effects (value from more users).

Key terms

Limited liability: An owner can lose no more than the amount invested.

Residual claim: Shareholders' right to what remains after all other claims are paid.

Agency cost: The loss and monitoring cost from agents not acting in principals' interests.

Cash conversion cycle: Days from paying suppliers to collecting from customers.

Net present value: Present value of future cash flows less the initial investment.

Internal rate of return: The discount rate at which a project's NPV is zero.

Return on invested capital: After-tax operating profit divided by average invested capital.

Weighted average cost of capital: The blended required return of all capital providers, net of the interest tax saving.

Real option: A right, not an obligation, to change a project as information arrives.

Network effect: Value to each user rises as more users join.

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