

Reading 34: Corporate Governance and ESG: An Introduction

Question #1 of 23

Question ID: 683886

Risks that may arise from ineffective corporate governance *least likely* include:

- ☐ A) weaker financial performance.
- ☒ B) reduced default risk.
- ☐ C) less effective decision making.

Explanation

Ineffective corporate governance is likely to increase default risk.

References

Question From: Session 10 > Reading 34 > LOS h

Related Material:

- Key Concepts by LOS
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Question #2 of 23

Question ID: 683883

A company director's duty of loyalty is *most accurately* described as requiring a director to:

- ☒ A) act in the interests of the company and its shareholders.
- ☐ B) carry out the duties assigned by the managers of the company.
- ☐ C) perform his or her duties in good faith and with due diligence.

Explanation

The duty of loyalty requires a company director to act in the interests of the company and its shareholders. The duty of care requires a director to act in good faith, with due diligence, and in an informed manner. The board of directors is responsible for appointing the company's managers; in companies that do not practice CEO duality, the managers do not assign duties to board members.

References

Question From: Session 10 > Reading 34 > LOS f

Related Material:

- Key Concepts by LOS
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Question #3 of 23

Question ID: 683889

Which of the following environmental factors is *least likely* to arise from inadequate internal controls and safety standards?

- ☒ A) Stranded assets.

- X **B)** Waste contamination.
- X **C)** Local resource depletion.

Explanation

In the context of ESG factors, stranded assets refer to carbon resources that become uneconomic because of outside forces such as changes in regulation.

References

Question From: Session 10 > Reading 34 > LOS k

Related Material:

- Key Concepts by LOS
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Question #4 of 23

Question ID: 683880

A conflict of interest between corporate stakeholders is *least likely* to be mitigated by:

- X **A)** covenants in debt indentures.
- X **B)** including stock options as part of manager compensation.
- ✓ **C)** issuing stock dividends.

Explanation

Issuing stock dividends does not necessarily favor one group of stakeholders over another because neither firm value nor earnings are affected by issuing a stock dividend. Covenants in debt issues protect creditor interests from management actions that would increase the risk of the debt. Including stock options as part of manager compensation serves to align the interests of senior management and shareholders.

References

Question From: Session 10 > Reading 34 > LOS e

Related Material:

- Key Concepts by LOS
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Question #5 of 23

Question ID: 683875

The stakeholders *most likely* to be concerned with their legal liabilities are:

- ✓ **A)** directors.
- X **B)** regulators.
- X **C)** creditors.

Explanation

Directors are legally responsible for their decisions and actions as board members. Neither regulators nor creditors face significant legal liabilities for their actions.

References

Question From: Session 10 > Reading 34 > LOS b

Related Material:

- Key Concepts by LOS
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Question #6 of 23

Question ID: 683873

The stakeholder group that typically prefers the greatest amount of business risk is:

- ☐ A) directors.
- ☒ B) shareholders.
- ☐ C) senior managers.

Explanation

Compared to the other two groups, shareholders have the greatest potential gains from riskier strategies and can diversify their holdings across firms in order to reduce the influence of company specific risk. While senior managers can gain from company outperformance, they typically prefer less risk than shareholders because managers' risk of poor company performance on the value of their options and on their careers cannot be easily diversified away.

References

Question From: Session 10 > Reading 34 > LOS b

Related Material:

- Key Concepts by LOS
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Question #7 of 23

Question ID: 683882

Smith Company's board of directors assigns responsibilities to three committees. The committee that is *most likely* to be responsible for establishing the chief executive officer's compensation package is Smith's:

- ☐ A) investment and risk committee.
- ☒ B) nominations and remuneration committee.
- ☐ C) audit and governance committee.

Explanation

Compensation for a company's senior executives is typically a responsibility of a remuneration or compensation committee.

References

Question From: Session 10 > Reading 34 > LOS f

Related Material:

- Key Concepts by LOS
-

Question #8 of 23

Question ID: 683872

The stakeholders of a company that prefer a relatively riskier company strategy that has the potential for superior company performance are:

- X **A)** creditors.
- X **B)** suppliers.
- ✓ **C)** shareholders.

Explanation

Shareholders have the greatest gains from superior company performance. Suppliers may benefit but, in general, have a preference for stable business operations and continuation of their business relationship with the company. Creditors prefer less risk because their potential gains from superior company performance are limited while they have significant downside risk.

References

Question From: Session 10 > Reading 34 > LOS b

Related Material:

- Key Concepts by LOS
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Question #9 of 23

Question ID: 684025

Which of the following statements about corporate governance is most accurate? Corporate governance:

- X **A)** is defined in the same way in most countries.
- ✓ **B)** may be focused only on shareholder interests.
- X **C)** best practices are essentially the same in developed economies.

Explanation

Under the shareholder theory of corporate governance, practices are primarily those that support shareholder interests, while under the stakeholder theory of corporate governance, the interests of various affected groups are considered and balanced. Corporate governance practices and definitions vary across countries.

References

Question From: Session 10 > Reading 34 > LOS a

Related Material:

- Key Concepts by LOS
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Question #10 of 23

Question ID: 683887

To judge whether management's incentives are aligned with a firm's stated goals, an analyst should examine the firm's:

- X **A)** share class structure.
- X **B)** cross-shareholdings.
- ✓ **C)** remuneration programs.

Explanation

Disclosures of a firm's remuneration programs enable an analyst to judge whether its compensation structure aligns management's incentives with the firm's objectives and shareholders' interests.

References

Question From: Session 10 > Reading 34 > LOS i

Related Material:

- Key Concepts by LOS
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Question #11 of 23

Question ID: 683877

The relationship between a company's shareholders and its senior managers is *best* described as a(n):

- ✓ **A)** agency relationship.
- X **B)** principal relationship.
- X **C)** working partnership.

Explanation

This is an example of an agency relationship, which is also known as a principal-agent relationship. A company's senior managers are acting as agents, hired to act in the interest of shareholders who are the principal in the relationship.

References

Question From: Session 10 > Reading 34 > LOS c

Related Material:

- Key Concepts by LOS
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Question #12 of 23

Question ID: 683879

A company's internal systems and practices for managing stakeholder relationships are *most accurately* described as its:

- X **A)** contractual infrastructure.
- X **B)** governance infrastructure.
- ✓ **C)** organizational infrastructure.

Explanation

Organizational infrastructure is a company's corporate governance procedures and internal systems and practices for managing stakeholder relationships.

References

Question From: Session 10 > Reading 34 > LOS e

Related Material:

- Key Concepts by LOS
-

Question #13 of 23

Question ID: 683870

The stakeholder theory of corporate governance is primarily focused on:

- ☐ A) increasing the value a company.
- ☒ B) resolving the competing interests of those who manage companies and other groups affected by a company's actions.
- ☐ C) the interests of various stakeholders rather than the interests of shareholders.

Explanation

Resolving the conflicting interests of both shareholders and other stakeholders is the focus of corporate governance under stakeholder theory. Shareholders are among the groups whose interests are considered under stakeholder theory.

References

Question From: Session 10 > Reading 34 > LOS a

Related Material:

- Key Concepts by LOS
-

Question #14 of 23

Question ID: 683874

Which of the following stakeholders are *most likely* to benefit from a company's growth and excellent financial performance?

- ☐ A) Customers.
- ☐ B) Creditors.
- ☒ C) Governments.

Explanation

Governments receive greater tax revenues when financial performance is excellent and profits are higher. Creditors do not receive extra returns for performance better than that is adequate to repay debt. Customers seek company stability and ongoing relationships with the company.

References

Question From: Session 10 > Reading 34 > LOS b

Related Material:

- Key Concepts by LOS
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Question #15 of 23

Question ID: 765494

In the absence of any ESG-related constraints specified in an investment policy statement, a portfolio manager is *most likely* to violate fiduciary duty by using ESG factors to:

- ☐ A) assess the expected return and risk of potential portfolio investments.
- ☐ B) choose among investments with similar risk and return characteristics.
- ☒ C) exclude investments with negative ESG characteristics from the investor's portfolio.

Explanation

Constructing a portfolio based on ESG factors may violate fiduciary duty if doing so reduces expected returns. Analyzing ESG factors when assessing investment risk or using ESG factors to choose among otherwise equivalent investments would likely not violate fiduciary duty.

References

Question From: Session 10 > Reading 34 > LOS j

Related Material:

- Key Concepts by LOS
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Question #16 of 23

Question ID: 683885

Shareholders who use their share voting power or other means to pressure companies to make changes they believe will increase shareholder value are *most accurately* described as:

- X **A)** ESG shareholders.
- ✓ **B)** activist shareholders.
- X **C)** proxy shareholders.

Explanation

Activist shareholders seek changes in company operations that they believe will increase shareholder value.

References

Question From: Session 10 > Reading 34 > LOS g

Related Material:

- Key Concepts by LOS
-

Question #17 of 23

Question ID: 683876

A principal-agent relationship *most likely* exists between a company's:

- X **A)** customers and suppliers.
- ✓ **B)** shareholders and managers.
- X **C)** directors and regulators.

Explanation

The relationship between shareholders and managers is a principal-agent relationship. Shareholders, as principals, through the board of directors hire managers, as agents, to act in the best interests of the shareholders.

References

Question From: Session 10 > Reading 34 > LOS c

Related Material:

- Key Concepts by LOS
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Question #18 of 23

Question ID: 683881

Minority shareholder groups are *most likely* to have influence over corporate strategy when board elections:

- ✓ **A)** use cumulative voting.
- X **B)** use majority voting.
- X **C)** are staggered.

Explanation

With cumulative voting, minority shareholders are more likely to gain seats on the board of directors and influence corporate strategy and decisions than with majority voting. Staggered board elections limit the ability of shareholders to select an entirely new board, except over a period of years.

References

Question From: Session 10 > Reading 34 > LOS e

Related Material:

- Key Concepts by LOS
-

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Question ID: 683884

With a one-tier board structure:

- ✓ **A)** both executives and non-executives can serve on the board of directors.
- X **B)** independent directors determine company strategy.
- X **C)** senior managers determine corporate strategy.

Explanation

Independent directors and senior managers both serve on a single board with a one-tier board structure and are jointly responsible for determining corporate strategy.

References

Question From: Session 10 > Reading 34 > LOS f

Related Material:

- Key Concepts by LOS
-

Question #20 of 23

Question ID: 683890

Thematic investing is *most accurately* described as:

- X **A)** excluding companies or sectors from consideration for investment based on environmental and social factors.

- ✓ **B)** considering a single environmental or social factor when selecting investments.
- ✗ **C)** identifying the best companies in each sector with respect to environmental and social factors.

Explanation

Thematic investing refers to selecting investments with a view to a specific environmental, social, or governance factor. Identifying the best companies in each sector with respect to environmental and social factors is referred to as best-in-class investing. Excluding companies or sectors from consideration for investment based on environmental and social factors is referred to as negative screening.

References

Question From: Session 10 > Reading 34 > LOS k

Related Material:

- Key Concepts by LOS
-

Question #21 of 23

Question ID: 683878

In the context of stakeholder management, organizational infrastructure is *most accurately* described as:

- ✗ **A)** contractual arrangements a company enters into with its stakeholders.
- ✗ **B)** a framework for defining the rights and responsibilities of stakeholders.
- ✓ **C)** a company's internal procedures for addressing stakeholder relationships.

Explanation

Organizational infrastructure refers to the practices and governance procedures that a company adopts to manage its stakeholder relationships.

References

Question From: Session 10 > Reading 34 > LOS d

Related Material:

- Key Concepts by LOS
-

Question #22 of 23

Question ID: 683869

The interests of community groups affected by a company's operations are *most likely* to be considered in corporate governance under:

- ✓ **A)** stakeholder theory.
- ✗ **B)** shareholder theory.
- ✗ **C)** special interest theory.

Explanation

Community groups may be one of the stakeholder groups considered under stakeholder theory.

References

Question From: Session 10 > Reading 34 > LOS a

Related Material:

- Key Concepts by LOS
-

Question #23 of 23

Question ID: 765493

Environmental, social, and governance (ESG) investing is *most accurately* described as:

- X **A)** investing only in companies that promote environmental or social initiatives favored by an investor.
- X **B)** excluding companies in carbon production based industries from consideration for investment.
- ✓ **C)** integrating environmental and social considerations into the investment decision making process.

Explanation

ESG investing is using environmental, social, and governance factors when making investment decisions. Investing only in companies that promote environmental or social initiatives favored by an investor is best described as impact investing. Excluding companies in carbon production based industries from consideration for investment is best described as negative screening.

References

Question From: Session 10 > Reading 34 > LOS j

Related Material:

- Key Concepts by LOS