LM01 · CORPORATE ISSUERS · CFA LEVEL I

Organizational Forms, Corporate Issuer Features & Ownership

How businesses are structured, what makes a corporation distinctive, and how ownership differs for public vs. private issuers

What This Reading Covers

This module lays the foundation for every later Corporate Issuers reading. You will learn the **four organizational forms** businesses adopt, the **defining features of corporate issuers** that let them raise capital at scale, and the **differences between publicly and privately owned** corporations — including how firms *go public* (IPO, direct listing, SPAC) and *go private*.

Learning Outcome Statements

- **LOS a** Compare the organizational forms of businesses
- **LOS b** Describe key features of corporate issuers
- **LOS c** Compare publicly and privately owned corporate issuers

The Big Picture

Businesses differ along five axes:

1. **Legal identity** — is the business a separate legal entity from its owner(s)?
2. **Owner–operator relationship** — do owners also operate the business?
3. **Owner liability** — is liability for debts and actions limited or unlimited?
4. **Taxation** — pass-through to owner, or taxed at the entity level?
5. **Access to financing** — constrained by owners' capital, or open to broad markets?

Exam Tip: Corporations that raise capital in the financial markets are called **corporate issuers**. The corporation is the *only* form of the four that has a separate legal identity, limited liability for all owners, and unbounded access to capital — which is why it dominates large-scale business.

LOS A · ORGANIZATIONAL FORMS OF BUSINESSES

Four Business Structures

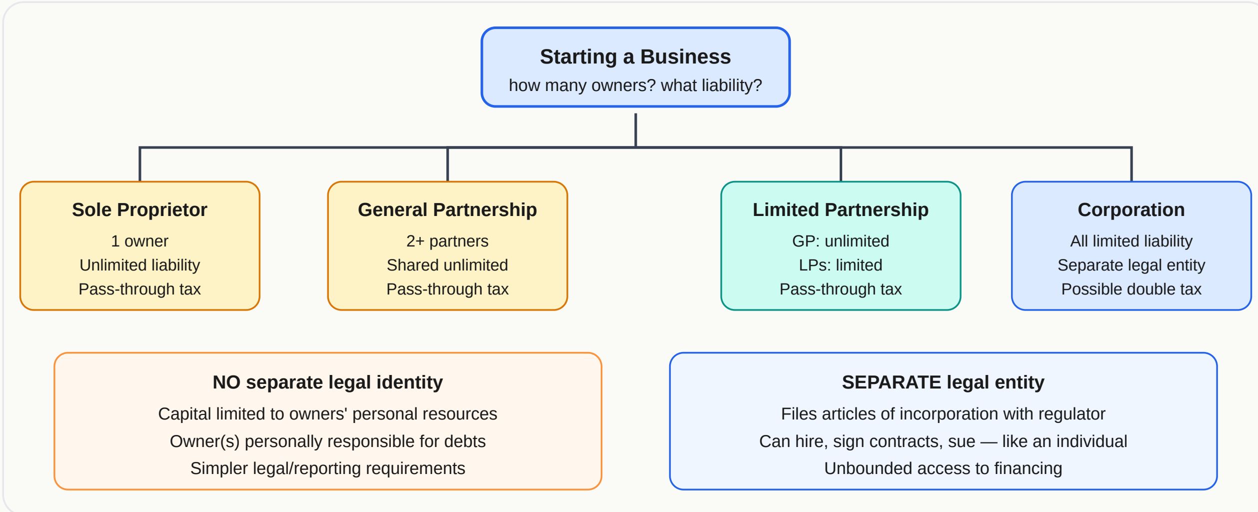
There are four commonly used business structures. They differ systematically across the five features below.

FEATURE	SOLE PROPRIETOR	GENERAL PARTNERSHIP	LIMITED PARTNERSHIP	CORPORATION
Legal Identity	No separate legal identity; extension of owner	No separate legal identity; extension of partner(s)	No separate legal identity; extension of partner(s)	**Separate legal entity**
Owner–Operator	Owner operated	Partners operated	General partner (GP) operated	Board & management operated
Owner Liability	Sole **unlimited** liability	Shared **unlimited** liability	GP has unlimited liability; LPs have **limited** liability	All owners have **limited** liability
Taxation	Pass-through: profits taxed as personal income	Pass-through: profits taxed as personal income	Pass-through: profits taxed as personal income	Corporate income taxed; **distributions (dividends) taxed as personal income**
Access to Financing	Limited by owner's access to capital	Limited by partners' access to capital	Limited by GP/LP access to capital	**Unbounded access to capital**; unlimited business potential

Key Idea — Pass-through vs. Double Taxation

Sole proprietorships and partnerships enjoy **pass-through taxation**: profits flow straight to owners' personal tax returns, taxed once. A **corporation** is taxed on its profits at the corporate level, and shareholders are then taxed again on dividends — potential **double taxation**.

BUSINESS STRUCTURE DECISION TREE — KEY TRADE-OFFS



Limited Partnership — Who Bears the Risk?

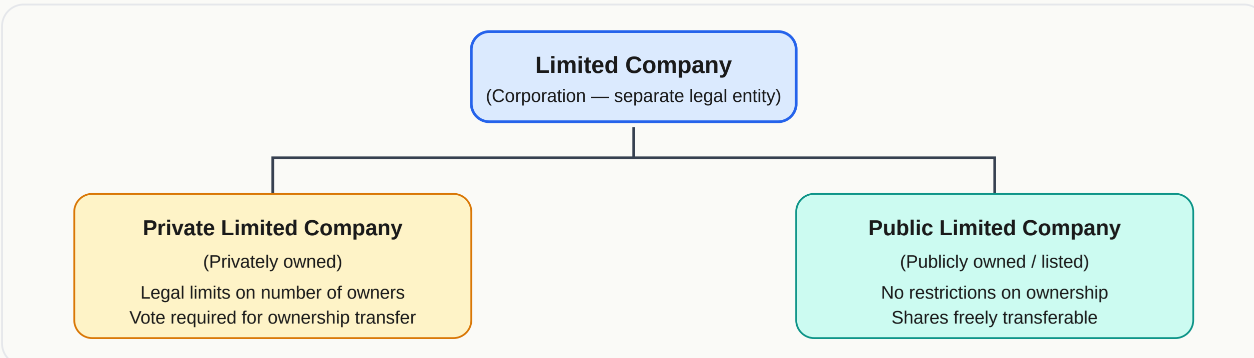
In a limited partnership, the **general partner** runs the business and faces **unlimited** liability. **Limited partners** contribute capital and are liable only up to the amount they invest. Limited partners typically have no say in day-to-day operations.

LOS A · LIMITED COMPANIES (CORPORATIONS)

Inside the Corporation — Private vs. Public Limited Company

The corporation (also called a "limited company") is the organizational form behind every corporate issuer. It comes in two sub-types — **private** and **public** — which share many features but differ on ownership and transferability.

LIMITED COMPANY FAMILY TREE



Shared Features (both private & public corporations)

1. **Separate legal entity** — distinct from owners
2. **Board & management operated** — shareholders elect the board; the board hires senior management
3. **Limited liability** for all owners (shareholders)
4. **Access to capital** via debt and equity markets

Where Private & Public Differ

PRIVATE LIMITED COMPANY

Taxation: In many jurisdictions, profits are taxed as personal income (pass-through)

Ownership transfer: Legal limits may restrict the number of owners; transfer of ownership may require a shareholder vote

Disclosures: Fewer reporting requirements

PUBLIC LIMITED COMPANY

Taxation: Profits taxed at the corporate level; dividends then taxed as personal income (potential double taxation)

Ownership transfer: No restrictions; shares freely transferable on exchange

Disclosures: Extensive disclosure and reporting requirements

Exam Tip: Private limited companies are sometimes called "LLCs" (limited liability companies) in the US; they keep limited-liability protection while retaining the simpler pass-through tax treatment of a partnership.

LOS B · KEY FEATURES OF CORPORATE ISSUERS

Two Defining Features — Legal Entity & Owner-Manager Separation

A **corporate issuer** is a corporation that raises capital in the financial markets. Five features distinguish corporate issuers — we examine the first two here.

Feature 1 — Separate Legal Entity

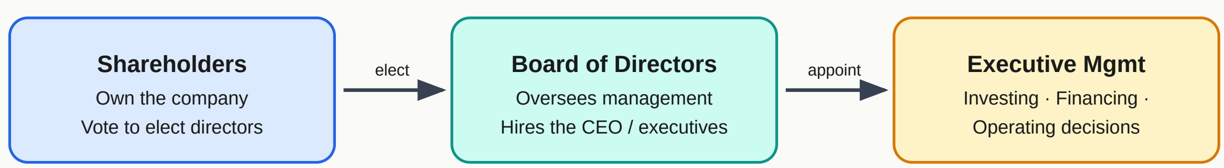
A corporation is formed through **filing articles of incorporation** with a regulatory authority. Once formed, it can:

1. Hire employees, sign contracts, own property, sue and be sued — similar to an individual
2. Be subject to regulation in jurisdictions where it is **incorporated**, **conducts business**, or **finances itself**

Feature 2 — Owner-Manager Separation

Shareholders own the business but are *not* involved in day-to-day operations. A clear chain of delegation connects the two:

WHO APPOINTS WHOM — THE GOVERNANCE CHAIN



If directors/management fail to act in shareholders' best interests, shareholders can vote to replace the board.

Why Separation Matters

Separation of ownership and management allows the corporation to obtain financing from a much wider range of sources — many passive investors can own shares without needing to run the business.

Fiduciary Responsibility

Directors and management are charged with a simple mandate:

> *"Act in the best interests of shareholders and, indirectly, all stakeholders."*

If they do not, shareholders can vote to replace the board.

LOS B · LIABILITY, RISK/RETURN & FINANCING

Limited Liability, Risk/Return & Sources of Finance

Feature 3 — Limited Liability

Risk and return are **shared equally** between all shareholders (owners), all of whom enjoy **limited liability**.

Minimum share value = 0

A shareholder's loss is capped at the amount invested — the share price cannot go negative.

Not responsible for debt

If the corporation defaults on its obligations, shareholders are not personally liable.

Feature 4 — Sources of Finance

EQUITY

Sources: Sale of shares to investors · reinvestment of profits

Returns to investor: Dividends (and capital gains on share price)

DEBT

Sources: Loans · bonds · leases

Returns to investor: Interest payments + return of principal

Private vs. Public Financing Channels

Equity or debt can be raised either via:

1. A **private contractual agreement** between two parties, or
2. A **standardized instrument** that might be tradeable between investors on a public exchange — this is a **security**.

Financial and Economic Balance Sheet

Financial Balance Sheet	Assets, obligations (liabilities), equity — the accounting view
Economic Balance Sheet	Adds other intangible / hard-to-quantify assets & liabilities (e.g., human capital, customer relationships)

Financial and Economic Income Statement

Financial Income Statement	Income after fixed obligations have been met — **accounting profit**

Economic Income Statement Return in excess of owner's required return on equity — **economic profit**

$$NetIncome/Equity = ReturnonEquity$$

$$Economicprofit = Returnonequity - Requiredreturnonequity$$

Exam Tip: Limited liability is what lets a corporation attract capital from many small, passive investors: they can diversify widely because *no single investment can lose more than its cost*.

LOS B · CORPORATE TAXATION

Feature 5 — Taxation & Double Taxation

The Double-Taxation Problem

Shareholders of a corporation may suffer **double taxation**: the corporation pays tax on its profits, and the shareholder then pays **personal tax on dividends** received.

Worked Example from the Source

WORKED EXAMPLE

Given: Pre-tax income = 838 · Corporate tax rate = 31.5% · Personal (dividend) tax rate = 30%

STEP	AMOUNT
Pre-Tax Income	838
Less: Corporate tax (31.5% × 838)	(264)
After-tax corporate income	574
Less: Personal tax on dividend (30% × 574)	(172.2)
Dividend after personal tax	**401.8**

SOLUTION

```
Total tax burden = (264 + 172.2) / 838 = 436.2 / 838 =
\mathbf{52.05%}
```

Of every 838 of pre-tax income, the shareholder keeps only 401.8 — the remainder (52.05%) has been absorbed by the combined corporate + personal tax.

Jurisdictional Relief

Some jurisdictions offer relief from double taxation. Two common mechanisms:

1. **Personal tax credits** on dividend income — the shareholder gets credit for tax already paid at the corporate level

2. **Low or zero corporate tax rates** on earnings paid out as dividends — profits distributed are effectively taxed only at the personal level

Exam Tip: Pass-through entities (sole proprietors, partnerships, many LLCs) avoid this problem entirely — profits are taxed *once* as personal income. This is a key structural advantage when the owner is also the operator.

QUIZ 1 · CHECKPOINT

Test Your Understanding: Forms & Features

Q1. Which organizational form is *most likely* to have unlimited liability for at least one owner *and* pass-through taxation?

Q2. Which feature is *unique* to the corporation among the four business structures?

Q3. In a corporation with standard governance, *who* directly appoints senior executive management?

Q4. A corporation earns 1,000 in pre-tax income. Corporate tax is 25% and the shareholder's personal tax on dividends is 20%. If all after-tax income is paid out as dividends, the shareholder's effective combined tax rate is *closest to*:

LOS C · PUBLIC VS. PRIVATE CORPORATE ISSUERS

Public vs. Private — Listing, Liquidity & Disclosure

PUBLIC (LISTED) COMPANY

Shares listed on a stock exchange.

- **Liquidity** — a secondary market for shares exists
- **Price transparency** — market price is observable at all times
- **Extensive disclosure** and reporting requirements
- Ownership easily transferred

PRIVATE (UNLISTED) COMPANY

Shares *not* listed on an exchange.

- **No ready market** — sale requires finding a buyer and company agreement
- **No price transparency** — valuation requires a model
- **Fewer disclosures** and reporting requirements
- Ownership difficult to transfer

Free Float — A Public-Company Concept

Free float = the percentage of outstanding shares that are actively traded — i.e., *not* held by insiders, family, strategic investors, or sponsors. The market capitalization metric relies on shares × price:

$$MarketCapitalization = NumberofShares \times PriceperShare$$

Example from the source — L'Oréal S.A. ownership:

HOLDER	% OF SHARES
Family (Bettencourt-Meyers)	33%
Nestlé (strategic stake)	23%
Free float (actively traded)	**44%**

Who Governs the Listing Process?

TWO GATEKEEPERS FOR PUBLIC COMPANIES

Regulator

- Registration
- Ongoing disclosures
- Enforcement of securities law

Stock Exchange

- Listing requirements
- Minimum float, governance
- Trading rules & surveillance

Capital-Raising Contrast

Public companies typically raise *very large* amounts of capital from many investors — first through an IPO, then through additional issues after listing. Investors then actively trade shares among themselves in the secondary market.

Private companies raise *much smaller* amounts from far fewer investors, who have *much longer holding periods*.

Disclosure Obligations — Public vs. Private

Public companies are subject to greater regulatory and disclosure requirements. They are required to disclose their financial reports and other information that may affect stock price, such as:

1. Major changes in the holding of voting rights
2. Any stock transactions made by officers and directors

Private companies are generally **not** required to make such disclosures and are **not subject to the same level of regulatory oversight**.

LOS C · SHARE ISSUANCE

How Corporations Issue Shares

Private Company — Private Placements

When a private company needs capital, it typically uses a **private placement**:

Who buys	**Accredited investors** — institutional investors, corporations, high-net-worth individuals
Documentation	Risks and terms outlined in a **private placement memorandum** (PPM)
Regulation	Lighter — not offered to the public, so fewer disclosures required

Because private placements are restricted to accredited investors, the costs and disclosure burdens are **much lower** than for public offerings. In exchange, the market is much narrower and investors usually have long holding periods.

Public Company — Seasoned / Secondary Offerings

Once a company is public, it can raise additional capital by issuing more shares — a **seasoned (secondary) offering**.

Secondary offering	Company raises capital from the public by issuing new shares
Secondary market	Already-issued shares trade between market participants (investor ↔ investor) — no capital raised for the company

Exam Tip: Don't confuse **secondary offering** (issuer raises new capital by selling more shares) with **secondary market** (existing shares trading between investors — no capital flows to the company).

Corporate Ownership — Who Holds the Shares?

Shareholders of a corporation may include a diverse mix:

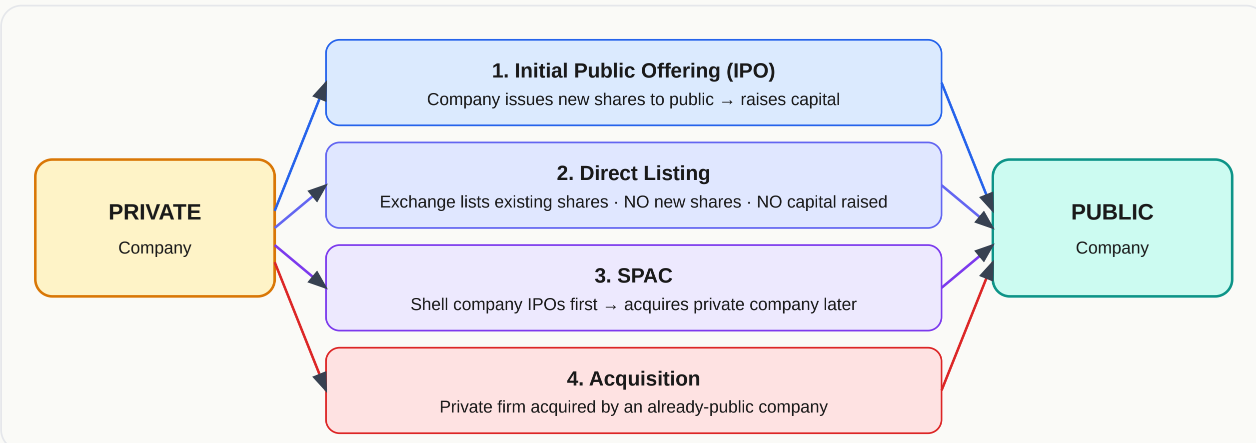
1. Individual (retail) investors
2. Institutional investors (pension funds, mutual funds, insurance companies)
3. Other corporations (strategic stakes)
4. Non-profit organizations
5. Governments (sometimes 100% owners)

LOS C · GOING PUBLIC (PRIVATE → PUBLIC)

Going Public — Three (Plus One) Routes

A private company can become a public company in several ways. The three primary methods are **IPO**, **direct listing**, and **SPAC**. Going public via **acquisition** (being bought by an already-public firm) is also possible.

GOING PUBLIC — PATHWAYS FROM PRIVATE TO PUBLIC



1. Initial Public Offering (IPO)

The company issues **new shares** to the public, raising capital. The company must meet exchange-specific listing requirements and typically engages an **investment bank** to underwrite the issue.

Cash flow to company: Yes — capital is raised.

2. Direct Listing

A stock exchange agrees to list the private company's **existing** shares. No new shares are created, so **no capital is raised for the company**. Existing shareholders gain a liquid market for their holdings.

Cash flow to company: *None*. The purpose is liquidity, not fundraising.

3. Special Purpose Acquisition Company (SPAC)

A SPAC is a corporate structure set up to acquire a private company in the future. The sequence is:

1. The SPAC (a **shell company**) raises capital through its *own* IPO

2. Proceeds are placed into a trust that **must be used to make an acquisition** within a specified time
3. The SPAC acquires a private target; the target effectively becomes a public company

4. Acquisition (another route)

A private company can also go public simply by **being acquired by an already-public company**. The target's business becomes part of the acquirer's public structure.

Exam Tip: Exam trap: only **IPOs and SPAC mergers raise new capital** for the target. A **direct listing** is purely about liquidity — existing shares simply become tradeable on an exchange.

LOS C · GOING PRIVATE (PUBLIC → PRIVATE) & TRENDS

Going Private & Public/Private Trends

Going Private — Mechanics

To take a public company private, an investor (or group) must **acquire all of the company's shares and delist it from the exchange**.

Price paid	Typically a **premium** to the current market price
Financing	Commonly financed using **debt** (LBO-style)
Outcome	Company is **delisted** from the exchange; becomes privately owned

Motivation — Why Go Private?

To Realize Value

The acquirer intends to **restructure**, change management, sell assets, or otherwise take actions to unlock value that the public market did not reflect. Lower regulatory burden and cost savings are additional benefits.

Public vs. Private — Global Trends

EMERGING ECONOMIES

Growing number of public companies, driven by:

- High growth
- Transition to open market structures
- Foreign capital inflows

DEVELOPED ECONOMIES

Declining number of public companies, due to:

- Mergers & acquisitions
- Growing private capital sources (VC, PE, private debt)
- Preservation of ownership and control

Government-Owned Corporations

Governments may create **legally separate corporations** and maintain ownership (possibly 100%).

Example	United States Postal Service (USPS) — government-owned corporation
Common use	Provision of public goods
Alternative use	Profit from major domestic industries
Emerging economy pattern	Banks often established as government-owned entities, then transferred to private ownership via IPO. **Technology** may be a catalyst for this shift (e.g., telecommunications).

QUIZ 2 · CHECKPOINT

Test Your Understanding: Public, Private & Ownership

Q5. A private company wishes to list its existing shares on an exchange *without raising new capital*. The most appropriate mechanism is:

Q6. Which statement *best* describes how a SPAC takes a company public?

Q7. When a company is taken private, the acquirer is *most likely* to:

Q8. Which of the following is *least likely* to characterize a private (unlisted) company relative to a public (listed) one?

Q9. The number of public companies has been *declining* in many developed economies. Which factor is *least likely* a driver of this trend?

LOS B · SHAREHOLDERS AS RESIDUAL CLAIMANTS

Lenders vs. Owners — Priority of Claims

When a corporation raises capital, it creates two fundamentally different claims on the firm's assets: **debt** (lenders) and **equity** (owners). Understanding their different payoff profiles clarifies why corporate governance exists.

LENDERS (DEBT HOLDERS)

Priority: *Higher* — legal claim to interest and principal before owners receive anything

Upside: Capped at promised interest + principal

Concern: The company's ability to *repay obligations* — firm growth benefits them little

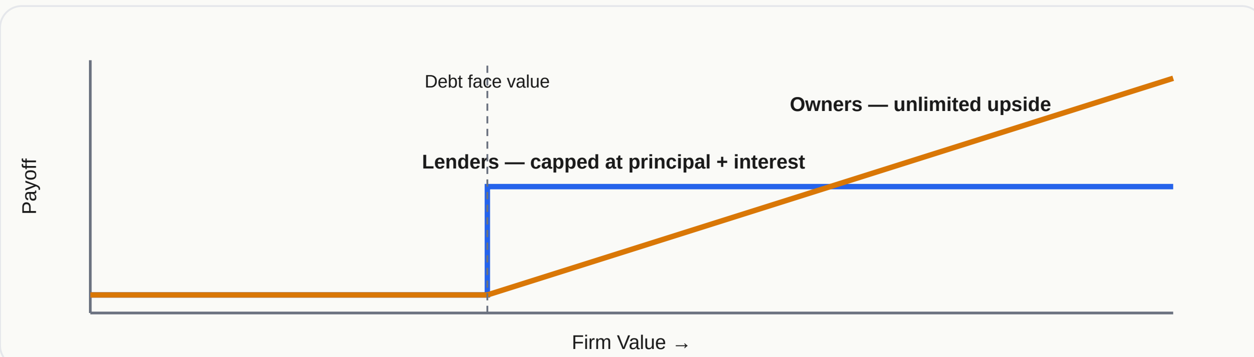
OWNERS (SHAREHOLDERS)

Priority: *Lower* — residual claim on net assets *after* all liabilities are settled

Upside: *Theoretically unlimited* if firm grows

Concern: Growth of firm value — but bounded by limited liability on the downside

PAYOFF PROFILES — LENDERS VS. OWNERS



Why This Drives Governance

Because owners capture all upside but lenders do not, owners may favor actions that **increase potential growth** even if they also **increase risk**. Lenders may oppose such actions because they increase default risk but do not share in the upside. This tension is why bond indentures include **covenants** and why board fiduciary duty matters.

Shareholder Voting Rights

Shareholders' legal remedy for a board that fails its fiduciary duty is the **vote**: they can replace directors. Common shareholders generally have voting rights; preferred shareholders typically do not (but receive priority on scheduled dividends).

Exam Tip: This tension between debt and equity claims foreshadows LM02 (Investors & Stakeholders) and LM03 (Corporate Governance) — where we examine principal-agent conflicts, ESG, and mechanisms to align stakeholder interests.

QUIZ 3 · FINAL CHECKPOINT

Test Your Understanding: Integrated Review

Q10. A corporation's shareholders are *best* described as having a claim on the firm's assets that is:

Q11. Which of the following best captures why separation of ownership and management matters for a corporation?

Q12. A private company is raising capital from a small group of institutional investors under a private placement memorandum. The key advantage of this route, relative to an IPO, is *most likely*:

Q13. Which combination of *features* is shared by both a public limited company and a private limited company?

MODULE COMPLETE

Your Scorecard

0 / 13

LM01 Key Takeaways — Exam-Ready Cheat Sheet

Organizational Forms (LOS a)

1. **Four structures:** sole proprietor · general partnership · limited partnership · corporation. Only the corporation is a **separate legal entity**.
2. **Liability:** unlimited (sole prop, GP), mixed (LP — GP unlimited, LPs limited), limited for all (corporation).
3. **Taxation:** pass-through for proprietorships and partnerships; corporate tax + personal dividend tax (possible double tax) for corporations.
4. **Limited company = corporation**, split into *private* (restricted transfer) and *public* (freely tradable, listed).

Key Features of Corporate Issuers (LOS b)

5. **Separate legal entity** formed via articles of incorporation — can hire, sign contracts, sue.
6. **Owner-manager separation**: shareholders → elect → board → appoints → executive management.
7. **Limited liability** (minimum share value = 0; no personal liability for firm debts).
8. **Sources of finance:** equity (dividends) + debt (interest). Each can be private (contractual) or public (security).
9. **Taxation:** possible double taxation (corporate + personal on dividends). Relief via credits or low corporate rate on distributed earnings.

Public vs. Private (LOS c)

10 **Public:** listed on exchange · liquidity · price transparency (market cap = shares × price) · extensive disclosures · regulator + exchange gatekeepers.

11 **Private:** no ready market · no price transparency · fewer disclosures · capital via private placements to accredited investors.

12 **Going public — 3 methods:** (1) IPO (raises capital), (2) direct listing (no new shares, no capital raised), (3) SPAC (shell IPOs first, then acquires target). Acquisition by a public firm is also possible.

13 **Going private:** all shares acquired at a *premium*; delisted; typically debt-financed; motivation is to *realize value* via restructuring.

14 **Trends:** emerging economies see *rising* public-company counts; developed economies see *falling* counts due to M&A, private-capital depth, and control preferences.

Last-Minute Exam Checklist

Only corporation = separate legal entity + limited liability for all + unbounded access to capital

Double taxation = corporate tax on profits + personal tax on dividends

Governance chain: shareholders → board → management

IPO raises capital · **Direct listing** does *not* · **SPAC** = shell IPO → acquires target

Go private: acquire all shares + delist + debt-financed + premium price

Free float = % of shares actively traded (not held by insiders/strategic owners)

Step 1 of 15