#1-178A

EASY INTERMEDIATE HARD

CFA® SAMPLE QUESTION – LEVEL I

Corporate Finance

Q: Under which of the below situation, a typical firm will need to increase it capital investment for the current period?

CORRECT ANSWER:

ⓐ An increase in the firm's expected marginal tax rate

A good question that can test your understanding of different concepts of Corporate Finance.

First, for a typical firm, it will have both equity and debt financing. An increase in the firm's expected marginal tax rate will decrease the after tax-cost of debt (i.e. the Tax Shield effect: rd (1-t)). And it will consequently decrease the firm's WACC, which can finally change a project's NPV from negative to positive ==> increase it capital investment!!!

A decrease in the market value of the firm's debt will increase the market yield on the debt, which will increase the after-tax cost of debt and thus the firm's WACC.

Increase in inventory increase current assets and working capital needs, but not the capital investment.

CFA Society Hong Kong
Candidate Services

Mr. Zap Cheng, CFA
Candidate Services Committee

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