77 ESSENTIAL FINANCE QUESTIONS

By Compounding Quality

1. What is the time value of money?
The concept that money available today is worth more than the same amount in the future due to its potential earning capacity.

2. What is the difference between NPV and IRR?
A: NPV is the difference between the present value of cash inflows and outflows. IRR is the discount rate that makes the NPV of all cash flows from a project zero.

3. What is CAPM?
A: The Capital Asset Pricing Model (CAPM) calculates the expected return on an asset based on its risk (beta) relative to the market.

4. What is WACC?
A: The Weighted Average Cost of Capital(WACC) is the average rate of return a company is expected to pay its investors,weighted by the proportion of debt and equity.

5. What is the difference between a balancesheet and an income statement?
A: The balance sheet shows a company’s assets, liabilities, and equity at a specific point in time, while the income statement reports revenue and expenses over a period.

6. What is financial modeling?
A: Financial modeling involves building abstract representations (models) of a company's financial situation to forecast future performance.

7. What is EBITDA?
A: EBITDA stands for Earnings Before Interest,Taxes, Depreciation, and Amortization. It measures a company’s profitability before accounting for these expenses

8. What is a DCF analysis?
A: A Discounted Cash Flow (DCF) analysis is a valuation method that estimates the value of an investment based on its future cash flows,discounted back to present value.

9. What are working capital and its components?
A: Working capital is the difference between current assets and current liabilities.Components include cash, accounts receivable, inventory, and accounts payable.

10. What is accrual accounting?
A: Accrual accounting records revenues and expenses when they are incurred, regardless of when cash is exchanged.

11. What is a liquidity ratio?
A: A liquidity ratio measures a company’s ability to meet its short-term obligations, with common examples being the current ratio and quick ratio.

12. What is the debt-to-equity ratio?
A: The debt-to-equity ratio measures a company’s financial leverage by dividing its total liabilities by shareholders' equity.

13. What is free cash flow (FCF)?
A: Free cash flow is the cash a company generates after accounting for capital expenditures. It’s used to pay dividends,reduce debt, or invest.

14. What are derivatives?
A: Derivatives are financial contracts whose value is derived from an underlying asset,index, or interest rate, like options or futures.

15. What is a leveraged buyout (LBO)?
A: An LBO is when a company is acquired using a significant amount of borrowed money, with the acquired company’s assets often serving as collateral.

16. What is the difference between a merger and an acquisition?
A: In a merger, two companies combine to forma new entity, while in an acquisition, one company takes over another.

17. What is beta in finance?
A: Beta measures a stock’s volatility relative to the overall market. A beta greater than 1indicates higher volatility, while less than 1indicates lower volatility.

18. What is the efficient market hypothesis(EMH)?
A: The EMH suggests that asset prices fully reflect all available information, meaning it's impossible to consistently outperform the market.

19. What is a bond?
A: A bond is a debt security in which an investor loans money to an entity that borrows the funds for a defined period at a fixed interest rate.

21. What is a stock option?
A: A stock option gives the holder the right, but not the obligation, to buy or sell a stock at a specified price before a specified date.

20. What is the payback period?
A: The payback period is the amount of time it takes to recover the initial investment in a project.

22. What is the purpose of a financial audit?
A: A financial audit provides an independent assessment of whether a company’s financial statements are accurate and free from material misstatement.

23. What are retained earnings?
A: Retained earnings are the portion of net income that is not paid out as dividends but reinvested in the business.

24. What is a capital structure?
A: Capital structure is the mix of a company’s debt, equity, and other financial instruments used to finance its operations.

25. What is the difference between a primary and secondary market?
A: The primary market is where new securities are issued, while the secondary market is where investors buy and sell previously issued securities.

26. What is an IPO?
A: An Initial Public Offering (IPO) is when a company offers shares to the public for the first time.

27. What are the four main financial statements?
A: The four main financial statements are the balance sheet, income statement, cash flow statement, and statement of shareholders’ equity.

28. What is an annuity?
A: An annuity is a series of equal payments made at regular intervals over a period of time.

29. What is a corporate bond?
A: A corporate bond is a debt security issued by a corporation to raise capital, with fixed interest payments made to bondholders.

30. What is goodwill in accounting?
A: Goodwill is an intangible asset that arises when a company acquires another for more than its fair market value.

31. What is financial leverage?
A: Financial leverage refers to using borrowed funds to increase the potential return on investment.

32. What is the DuPont analysis?
A: DuPont analysis breaks down Return on Equity (ROE) into three components: profit margin, asset turnover, and financial leverage.

33. What is a dividend?
A: A dividend is a portion of a company's earnings paid out to shareholders.

34. What is capital expenditure (CapEx)?
A: CapEx refers to funds used by a company to acquire or upgrade physical assets like property, buildings, or equipment.

35. What is ROI?
A: Return on Investment (ROI) measures the gain or loss generated relative to the amount of capital invested.

36. What is a hedge fund?
A: A hedge fund is an investment vehicle that uses various strategies to earn active returns for its investors.

37. What is a mutual fund?
A: A mutual fund pools money from multiple investors to invest in a diversified portfolio of securities.

38. What is alpha in investing?
A: Alpha is a measure of an investment’s performance relative to a benchmark, representing the excess return achieved.

39. What is arbitrage?
A: Arbitrage involves profiting from price differences of identical or similar financial instruments on different markets or in different forms.

40. What is a credit default swap (CDS)? A: A CDS is a financial derivative that allows an investor to swap or offset credit risk with another party.

41. What is corporate governance?
A: Corporate governance refers to the system of rules, practices, and processes by which a company is directed and controlled

42. What is the cost of equity?
A: The cost of equity is the return that equity investors expect to receive from an investment in a company, often estimated using CAPM.

43. What is a cash flow statement?
A: The cash flow statement shows the inflow and outflow of cash from operating, investing,and financing activities over a period of time.

44. What is an equity multiplier?
A: The equity multiplier measures a company’s financial leverage by dividing total assets by total equity, indicating the proportion of a company’s assets financed by shareholders.

45. What is financial distress?
A: Financial distress occurs when a company cannot meet or has difficulty paying off its financial obligations, which may lead to bankruptcy.

46. What is a variable cost?
A: A variable cost changes in proportion to the level of output or sales, such as raw materials or production supplies.

47. What is an economic moat?
A: An economic moat refers to a company's competitive advantage that allows it to protect its market share and profitability from competitors.

48. What is the Modigliani-Miller theorem?
A: The Modigliani-Miller theorem states that, in a perfect market, the value of a firm is unaffected by how it is financed, whether through debt or equity.

49. What is an interest rate swap?
A: An interest rate swap is a financial derivative where two parties exchange interest rate payments, typically switching between fixed and floating rates.

50. What is securitization?
A: Securitization is the process of pooling various types of debt, like mortgages, and selling them as securities to investors.

51. What is venture capital?
A: Venture capital is funding provided by investors to startups or small businesses with long-term growth potential in exchange for equity.

52. What is operating leverage?
A: Operating leverage refers to the extent to which a company uses fixed costs in its operations, which can magnify profits as sales increase.

53. What is a credit rating?
A: A credit rating assesses the creditworthiness of a borrower, indicating the risk level of default for bonds or loans.

54. What is systematic risk?
A: Systematic risk is the inherent risk that affects the entire market or a large segment of the market, such as interest rate changes or recessions

55. What is unsystematic risk?
A: Unsystematic risk is the risk that is unique to a specific company or industry, such as management changes or regulatory impacts.

56. What is a leveraged loan?
A: A leveraged loan is a loan extended to companies or individuals with high levels of debt, usually at higher interest rates due to increased risk.

57. What is the dividend payout ratio?
A: The dividend payout ratio measures the proportion of earnings a company pays out to shareholders in the form of dividends,calculated as dividends per share divided by earnings per share.

58. What is a convertible bond?
A: A convertible bond is a bond that can be converted into a specified number of shares of the issuing company’s stock.

59. What is return on equity (ROE)?
A: ROE measures a company’s profitability by showing how much profit it generates with the money shareholders have invested, calculated as net income divided by shareholders' equity.

60. What is a junk bond?
A: A junk bond is a high-yield, high-risk security issued by companies with lower credit ratings.

61. What is the internal rate of return (IRR)?
A: IRR is the discount rate that makes the net present value (NPV) of all cash flows from an investment equal to zero.

62. What is the primary market?
A: The primary market is where new securities are issued and sold to investors directly, often through initial public offerings (IPOs).

63. What is goodwill impairment?
A: Goodwill impairment occurs when the carrying value of goodwill on a company’s balance sheet exceeds its fair market value,requiring a write-down.

64. What is the price-to-earnings (P/E) ratio?
A: The P/E ratio measures a company’s current share price relative to its per-share earnings,used to gauge market expectations of future earnings growth.

65. What is an earnings call?
A: An earnings call is a conference call in which a company discusses its financial results with investors, analysts, and the media.

66. What is the difference between forward and futures contracts?
A: A forward contract is a customized agreement between two parties to buy or sell an asset at a specific price in the future, while a futures contract is standardized and traded on exchanges.

67. What is portfolio diversification?
A: Portfolio diversification is the practice of spreading investments across various asset classes or sectors to reduce risk.

68. What is the Sharpe ratio?
A: The Sharpe ratio measures the risk-adjusted return of an investment, calculated by dividing the difference between the investment return and the risk-free rate by its standard deviation.

69. What is capital allocation?
A: Capital allocation is the process of deciding how to distribute financial resources across various investment opportunities to maximize returns.

70. What is a rights issue?
A: A rights issue is an offer by a company to existing shareholders to purchase additional shares at a discounted price, typically to raise capital.

71. What is inflation?
A: Inflation is the rate at which the general price level of goods and services rises, eroding purchasing power over time.

72. What is a zero-coupon bond?
A: A zero-coupon bond does not pay periodic interest; instead, it is issued at a discount and redeemed at face value upon maturity.

73. What is the Altman Z-score?
A: The Altman Z-score is a formula that predicts the likelihood of a company going bankrupt based on its financial ratios and performance metrics.

74. What is operational risk?
A: Operational risk refers to the potential loss resulting from inadequate or failed internal processes, people, systems, or external events.

75. What is asset-backed security (ABS)?
A: An ABS is a security whose income payments and value are derived from and backed by a pool of underlying assets,typically loans, leases, or credit card debt.

76. What is quantitative easing (QE)?
A: QE is a monetary policy where a central bank purchases government securities or other financial assets to inject liquidity into the economy and encourage lending and investment.

77. What is book value?
A: Book value is the value of a company's assets as reported on the balance sheet,calculated as total assets minus liabilities.

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