

## MN20211 Advanced Corporate Finance

Spring Semester, 2012

Final Version: 12/4/12

**Textbook(s):**

**Required:-**

**Advanced Corporate Finance:** This is a book specially compiled by the lecturer for the course, taking relevant focused chapters from Berk and DeMarzo's textbook.

In addition to this textbook, the following books are good, and I thoroughly recommend that you may like to view them (they are available in the library, if you do not wish to buy them!):

**Corporate Finance (European Edition):** by Hillier, Ross, Westerfield, Jaffe, and Jordan.

**Behavioural Corporate Finance** by Hersch Shefrin.

**6 roundtable discussions of corporate finance** Editor Joel Stern.

**Revolution in Corp Finance** Stern and Chew editors.

**Dividend policy: its impact on firm value:** Lease et al.

You do not have to obtain any of these, but if you can view any of them, they will strengthen your knowledge/understanding of the subject of corporate finance, and the issues being researched and analyzed at academic and practitioner level.

The lectures will NOT simply be carbon-copies of the book, but will cover material BEYOND the book, such as academic articles. Therefore, it is essential that you attend the lectures AND read the book and recommended articles.

*Please note that the text-books support (and are complementary to) the lecture slides. That is, the lectures do not follow the text-book exactly. The lectures cover material beyond the text-books (such as journal articles). It is up to the student to read/research beyond the text-book and the lectures (eg read the articles, use Google, SSRN and the financial press).*

*Furthermore, if the recommended textbook is unavailable to you, the library has a whole host of alternative corporate finance books around the 658.15 reference. They all cover similar topics.*

*In addition to the lectures and the books, you will be expected to read some academic articles around the subject. I have suggested some good articles below (list to be updated)..*

**General Corporate Finance articles:**

- “The theory and practice of corporate finance: Evidence from the field”, Graham and Harvey, *Journal of Financial Economics*, 2001.
- “How do CFOs make Capital Budgeting and Capital Structure Decisions?” Graham and Harvey, *Journal of Applied Corporate Finance*, 2002.
- “The Role of the Board of Directors in the Capital Budgeting Process – Evidence from S and P 500 firms.” Grintstein, Y, and E. Tolkowsky. 2004.
- “Payout Policy in the 21<sup>st</sup> Century”, Graham, Harvey, and Michaely., *Journal of Financial Economics* 2005.

**1. Investment Appraisal /Decision Trees/real options.**

Suggested Readings:

- Real Options Primer: A Practical Synthesis of Concepts and Valuation Approaches.” Kathleen T. Hevert, *Journal of Applied Corporate Finance*. 2001
- “Real Options and Games: Competition, alliances and other applications of valuation and strategy.” Smit, H, and L. Trigeorgis. *Review of Financial Economics* 15 (2006); 95-112.
- “A Two-stage Investment Game in Real Option Analysis.” Imai, J, and T. Watanabe. Downloadable from Google.
- “A Real Options and Game-Theoretic Approach to Corporate Investment Strategy under Competition.” Smit and Ankum. (1993). *Financial Management*.
- “Applications of Real Options analysis for Pharmaceutical R and D Project Valuation – Empirical Results from a Survey,” Hartmann and Hassan, *Research Policy* (2006).

**2. The Financing Decision/ Optimal Capital Structure, Agency Costs, Signalling.**

- Jensen and Meckling. "Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership structure." Journal of Financial Economics, October 1976, 305-360.
- Jensen. "Agency Costs of Free Cashflow, Corporate Finance and Takeovers." American Economic Review. May 1986.
- Myers and Majluf. "Corporate Financing and Investment Decisions when Firms Have Information that Investors do not have." Journal of Financial Economics November 1977, 147 – 176.
- Ross. S.A. "The Determinants of Financial Structure: The Incentive Signalling Approach." Bell Journal of Economics Spring 1977, 23 – 40.
- Harris and Raviv. "The Theory of Capital Structure." Pg 297-355 Journal of Finance 1991.
- "An investigation of the determinants of BT's debt levels: what does it tell us about the optimal capital structure?" Fairchild, R. International Business and Economics research Journal. Paper downloadable from Bath Working paper series.
- Fairchild, R. "Conflicts between Managers and Investors over the Optimal Financial Contract." International Journal of Business and Economics December 2003 Vol 2 No.3.

### **III Payout Policy.**

#### **a) Dividend Policy.**

- Fairchild "Dividend Policy, Signalling and Free-cashflow: an Integrated Approach." Managerial Finance. September 2010
- Jensen. "Agency Costs of Free Cashflow, Corporate Finance and Takeovers." American Economic Review. May 1986.
- Wooldridge and Ghosh. "Dividend cuts: do they always signal bad news?" In the Revolution in Corporate Finance third edition.
- 6 roundtable discussions of corporate finance.

#### **b) Repurchases:**

- "Management's View on Share Repurchases and Tender Offer Premiums" by Wansley, Lane and Sarkar Financial Management 1989
- "An Empirical Survey of the Motivation for Share Repurchases in the UK" by Dixon et al Managerial Finance 2008
- "Stock Repurchases and the EPS Enhancement Fallacy" by Oded and Michel Financial Analysts Journal 2008

- "Share Repurchases and Managerial Opportunism" by Fried, California Law Review 2005
- "Why do Firms announce open market repurchase programs?" by Oded 2003
- Isagawa, N. "Open Market Repurchase Announcements and Stock price behaviour in Inefficient markets"
- Isagawa, N. "Open Market Stock Repurchase and Stock price behavior when management values real investment."

### **Mergers and Acquisitions:**

1. "The Management of Corporate Capital Structure: Theory and Evidence." Garvey, G., and G. Hanka.
2. "Mergers and Acquisitions: A Financial Economics Perspective": by S. Kaplan 2006.
3. "What do returns to acquiring firms tell us? Evidence from Firms that make many acquisitions." Fuller, Netter and Stegemoller. (2001).
4. "New evidence and perspectives on mergers." Andrade et al (2001).
5. "The Effects of antitakeover provisions on acquisition targets." Sokolyk, T. Journal of Corporate Finance 2011.

And, specifically examining the behavioural effects of overconfidence on M and A:

- "Who makes acquisitions? CEO Overconfidence and the Market's reaction." Malmendier and Tate (2003).
- "Acquisitions, Overconfident Managers, and Self-attribution Bias." Doukas and Petmezas.
- "Damned out of their own mouth: CEO Overconfidence in M and A Decision Making and its Impact on Firm Performance." Liu and Taffler (2008).
- "Managerial Overconfidence in High and Low Valuation Markets and gains to Acquisitions." Croci et al 2010.

### **Behavioral Corporate Finance: Text-book: Hersh Shefrin**

- Fairchild (2005). "The Effect of Managerial overconfidence, Asymmetric information, and Moral Hazard on Capital Structure Decisions." SSRN Working Paper.
- Fairchild (2007): "Behavioural Corporate Finance: Existing Research and Future Directions." SSRN working paper.
- Fairchild (2009): "From Behavioural to Emotional Corporate Finance: a new research direction" SSRN working paper.
- Baker, Ruback and Wurgler 2005. "Behavioral Corporate Finance: a survey". Online working paper.

- Statman and Caldwell. “Applying behavioural finance to capital budgeting: project terminations.” Financial Management 1987.
- Heaton. “Managerial Optimism and Corporate Finance.” Financial Management 2002.
- Gervais et al. “Overconfidence, Investment Policy, and Executive stock Options.” 2003 SSRN.
- Shefrin. “Behavioral Corporate Finance.” SSRN working paper.
- “Behavioral Finance in a Principal-agent Model of Capital Budgeting.” The ICFAI Journal of Behavioral Finance Vol II No. 1. March 2005.
- “Investor Irrationality and Optimal Open-Market Share Repurchasing.” Co-authored with G. Zhang. The ICFAI Journal of Behavioral Finance Vol II No. 3. September 2005.

The lecture schedule is as follows:

Week	Week Commencing	Topic	Book chapters
19	6/2/12	Investment Appraisal	4, 5, 6, 7
20	13/2/12	Investment Flexibility/real options	N/A: see lecture and articles
21	20/2/12	Portfolio theory/CAPM	N/A: see lecture
22	27/2/12	Capital Structure	14, 15, 16
23	5/3/12	Capital Structure	14, 15, 16
24	12/3/12	Dividends	17
25	19/3/12	Dividends/repurchases	17
26	26/3/12	M and A	28
29	16/4/12	M and A	28
30	23/4/12	Intro to Behavioural corporate finance	N/A: see lecture and articles
31	30/4/12	Revision I	
32	7/5/12	Revision II	

The exam will consist of two sections:

Section A: Numerical section: two questions (answer both: each worth 20 marks).

Section B: Essay section: (answer two out of three): each worth 30 marks.

Numerical questions (there will be a chance for you to practice example numerical questions during the semester to help you prepare for these), and essays, testing your understanding of the concepts of CF. Past exam papers are available on the library website. You are advised to look at these so that you are prepared for the exam.

Typical Questions to consider during your revision:

1. Is Investment appraisal a now-or-never decision?
2. "It does not matter how we finance our projects. It has no effect on firm value."  
Discuss.
3. Is a firm's dividend policy irrelevant?
4. Who gets most of the gains from M and A (bidder or target)? Why?