

## **MAF: Corporate Finance MN50324: Semester 2, 2009.**

### **1. Lecturer's Details**

**Name:** Dr Richard Fairchild

**Office:** WH 8.52

**Email:** [mnsrf@bath.ac.uk](mailto:mnsrf@bath.ac.uk)

**Personal home page:** <http://staff.bath.ac.uk/mnsrf/>

### **2. Teaching Assistant's Details:**

**Name:** Alma Garro Paulin

**Office:** WH 9.27

**Email:** [axgp20@bath.ac.uk](mailto:axgp20@bath.ac.uk)

The course covers numerical, analytical and conceptual aspects of corporate finance. Therefore, students are expected to gain expertise in numerical and game-theoretic analysis, and deeper, conceptual understanding. The exam consists of numerical/game theoretic and essay questions.

### **3. Course Outline:**

<b>Topic</b>	<b>Relevant Chapters in RWJJ</b>
1. Investment Appraisal, decision trees. Real options	4, 6, 7, 8
2. Cost of Capital (bridging section)	9, 10
3. Capital Structure and Firm Value.	14, 15
4. Optimal Capital Structure.	16
5. Mergers and acquisitions.	29
6. Convertible Debt	24
7. Payout Policy (dividends/share repurchases)	18
8. Efficient Markets and Corporate News	13
9. Venture Capital/Private Equity	Not applicable: but see papers below
10. Behavioural Corporate Finance	Textbook by Hersch Shefrin

### **4. Reading List**

#### **Recommended Books:**

1. **Modern Financial Management (Eight Edition)**: Ross, Westerfield, Jaffe and Jordan.
2. **Behavioral Corporate Finance**: Hersh Shefrin.

*Please note that the RWJJ text-book supports (and is 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 RWJJ 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 chapters of RWJJ identified above, I recommend the following articles.

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

### Highly recommended:

- “Why the NPV Criterion does not Maximise NPV.” Berkovitch, A, and Israel, R. The Review of Financial Studies Spring 2004. vol 17 no 1; pp 239 – 255.
- “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.
- “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.
- “The Valuation of Projects.” Tony Bishop (2002/3). Downloadable form Google.

### Other possible reading:-

- CIMA Pamphlet “Assessing flexibility in capital investments: a guide to applying real option principles in investment appraisal”. Busby and Pitts.
- “Option Valuation of Claims on Real Assets: The Case of Offshore Petroleum Leases.” Paddock, Siegel and Smith. QJE: 1988.
- “Real Options and Interactions with Financial Flexibility.” Trigeorgis. Financial Management 1993.
- “Case Studies on Real Options.” Kemna. Financial Management 1993.
- “Real Options in Practice: an exploratory survey of how finance officers deal with flexibility in capital appraisal.” Busby and Pitts. Management Accounting Research 1997.
- “Do foregone earnings matter when modelling and valuing real options?: A Black-Scholes Teaching exercise.” Lander, D. Financial Practice and Education 2000.
- “The Options Approach to Capital Investment.” Dixit and Pindyck. Harvard Business Review 1995.
- “Real Options and Strategic Decisions.” Copeland and Howe. Strategic Management 2002.
- “Real Options Valuations: Taking out the rocket science”. Amram and Howe. Strategic Finance 2003.
- “Real Option Analysis: The Profession’s Next Cutting-edge Tool.” Kautt. Journal of Financial Planning.

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

### Highly Recommended:

- Modigliani and Miller. “The Cost of Capital, Corporation Finance, and the Theory of Investment.” American Economic Review 1958, 261 – 297.
- 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.
- Graham and Harvey (1999): “The Theory and Practice of Corporate Finance: Evidence From the Field.” SSRN data base.
- Beattie et al (2004). “Diversity and determinants of corporate financing decisions: survey evidence.” University of Stirling working paper.

### Other possible reading:-

- Wu, X. and Z. Wang. “Equity financing in a Myers-Majluf framework with private benefits of control.” Journal of Corporate Finance 11 (2005) 915-945.
- Thepot, J. “Jensen-Meckling 30 years after: a game theoretic view.” Downloadable from Google.
- “Corporate Financial Structure and Managerial Incentives.” Grossman and Hart 1982: in **The Economics of Information and Uncertainty**. Edited by John McCall.\*
- Ang, Cole and Lin. “Agency Costs and Ownership Structure.” Journal of Finance 2000.
- Stultz. “Managerial Discretion and Optimal Financing Policies.” JFE 1990.
- Leland and Pyle. “Informational Asymmetries, financial structure, and financial intermediation.” Journal of Finance 1977.
- Harris and Raviv. “Capital Structure and the Informational Role of Debt.” Journal of Finance 1990.

- Goswami, G, et al. (1995). “Debt Financing Under Asymmetric Information.” Journal of Finance Vol 1 no 2; pg 633 – 658.
- Fairchild, R. “Conflicts between Managers and Investors over the Optimal Financial Contract.” International Journal of Business and Economics December 2003 Vol 2 No.3.

Reading for the other topics will follow shortly.

You do not have to read all of these articles! Highly recommended articles are very important! Use your discretion regarding the other articles!

### **Seminars: Class Exercises.**

In addition to the lectures, there will be weekly seminars (run by teaching assistant Alma Garro Paulin). These will commence in week 19 (week beginning 2<sup>nd</sup> February).

In the exam, there will be an essay section, and a numerical/analytical section. The analytical section consists of a numerical question, and a game-theoretic question.

Throughout the course, you will receive exercises to do in your own time (these will provide good practice for the *sort of* questions that *may* arise in the numerical/game theoretic section of the Summer Exam). In the seminars, Alma will work through the answers.

Each of you will attend fortnightly seminars. Your exercise schedule is as follows:

Week	Class Exercise
19 (W/C 2/2/09) 20	Decision Tree exercise/real options game theoretic exercise.
21/22	Capital Structure Exercise 1 and 2
23/24	Debt/dividend Signalling games.
25/26	M and A exercise.
30/31	Venture Capital Game/ Behavioural Corporate Finance: debt signalling game with overconfidence.