

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

### **Updated Reading List/timetable (as at 17th March 2009)**

#### **Course Outline:**

<b><u>Topic</u></b>	<b><u>Relevant Chapters in RWJJ</u></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. Control Rights Versus Cashflow rights.	Not applicable: but see papers below
6. Payout Policy (Dividend Policy)	18
7. Payout Policy (share repurchases)	18
8. Efficient Markets and Corporate News	13
9. Venture Capital/Private Equity	Not applicable: but see papers below
<i>Easter Vacation.</i>	
10: Behavioural Corporate Finance	Textbook by Hersch Shefrin (optional) Plus papers below
11/12. Revision	

#### **4. Reading List**

##### **Recommended Books:**

1. **Modern Financial Management (Eight Edition)**: Ross, Westerfield, Jaffe and Jordan.
2. **Behavioral Corporate Finance**: (optional) Hersch 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 that you focus on the following articles. You may read beyond these articles at your discretion!

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

- “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.

### **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.
- 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.

### **Control Rights Versus Cashflow Rights:**

"A Rent-protection theory of corporate ownership and control" by L.A. Bebchuk (downloadable from Google),

"Separation of Control Rights and Cash-flow Rights in Emerging Economies: Theory and Mexican evidence" by Fairchild and Garro Paulin in Corporate Ownership and Control Vol 5 Issue 1, Fall 2007. Downloadable from Business Source Premier.

## **III Payout Policy.**

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

*A starting point is:*

- Fairchild “Dividend Policy, Signalling and Free-cashflow: an Integrated Approach.” SSRN.

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

*A starting point is:*

- Fairchild (2007) “Behavioural Corporate Finance: Existing Research and Future Directions.” SSRN database.
- Fairchild (2005) “The Effect of Managerial Overconfidence, Asymmetric Information, and Moral Hazard on Capital Structure Decisions.” Posted to SSRN database 29/04/05.

## **Venture Capitalism:**

*A starting point is:*

Tykvova, T. "What Economists tell us about Venture Capital." SSRN/Google.

- Fairchild (2004) "Financial Contracting between Managers and Venture Capitalists – The role of Value-added Services, Reputation seeking and Bargaining Power." *Journal of Financial Research* Winter 2004 volume XXVI Number 4.
- "The Effects of Self-interest and Fairness on Entrepreneur/Venture Capitalist Financial Contracting and Performance." Posted to SSRN Database January 16<sup>th</sup> 2006. [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=875833](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=875833)
- Fairchild (2007) Angels versus Venture Capitalists: The Effect, of fairness, Trust, and the Legal System" SSRN database.

*Other highly recommended papers:*

Cable, D.M, and S. Shane (1997). "A Prisoner's Dilemma Approach to Entrepreneur-Venture capitalist relationships." *Academy of Management Review*, Vol 22, no 1, 142 – 176.

Casamatta, C. (2003). "Financing and Advising: Optimal Financial Contracts with Venture Capitalists." *Journal of Finance* vol 58, no 5, 2059 – 2085.

Elitzur, R., and A. Gavious. (2003). "Contracting, Signalling, and Moral Hazard: a Model of Entrepreneurs, 'angels', and Venture Capitalists." *Journal of Business Venturing* 18, 709 – 725.

Kaplan, S. and P. Stromberg. (2000). "Financial Contracting Meets the Real World: An Empirical Analysis of Venture Capital Contracts." SSRN database.

Klausner and Litvak. (2001). "What Economists have taught us about Venture Capital Contracting." SSRN Database.

Tykvova, T. "What Economists tell us about Venture Capital." SSRN/Google.

Repullo and Suarez (2004). "Venture Capital Finance: A Security Design Approach." *Review of Finance* 8: 75 – 108.

Houben, E. (2002) "Venture Capital, Double-sided Adverse Selection, and Double-sided Moral Hazard." SSRN.

## **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	Capital Structure Exercises 1 and 2 (continued).
25/26	Debt Signalling Game.
30/31	Venture Capital Game