

Corporate Finance – DBA – Spring/Summer 2016 (Fin 6930)

Subject Matter: The DBA program is structured so that participants can understand and engage in academic research in Corporate Finance and related areas. Hence the course stresses understanding basic theoretical paradigms pertaining to

- how capital markets function
- how firms make investment decisions and maximize shareholder value
- how firms finance their operations (and if it impacts firm value)
- how firms pay out cash flows (and does it impact firm value)
- how ownership patterns and managerial compensation impact financial decisions
- how behavioral finance (irrationality) can cause deviations from standard theoretical predictions

We also look at applying critical thinking to the above topics and basic statistical knowledge required to understand and execute research in the area.

- how to critically evaluate research on the above topics
- how to access data and understand statistical techniques commonly used in corporate finance research

Course Materials

1. My power point notes and handouts (handed out in class and on Canvas): This pertains more to the basic ideas in finance (especially with regards to topics like optimal capital structure, dividend policy, conflict of interest (agency) issues arising in finance, financial signaling and some taxation issues (though the chapter by John Graham on taxation - chapter 3 of Handbook of the Economics of Finance does a pretty good job with this).

2. Handbook of the Economics of Finance, Vol 2A, North Holland Publishing. There are a number of excellent surveys in various topic areas that are fairly up to date (for a textbook of sorts). Some of the discussion is a bit theoretical and all of it does not pertain to what we will be doing in class. There are some key chapters however that are worth discussing (or discussing pieces of them). Many review basic ideas and cite research that one can access if sufficiently interested in the topic (or look for that research being cited in subsequent academic work).

3. Course packet of articles: Some are for class, but most of these are for group presentations. The readings will vary from year to year dependent on new research in the topic areas. The topic area readings are listed at end of syllabus but are subject to change based on new article or your interests.

4. Access to WRDS: I believe you all have access to WRDS and the data that we use in finance and basic statistical package available from UF: STATA.

We will probably use class time in your first full visit to talk about accessing data. If not, I will provide a detailed set of instructions.

Class Schedule:

First Weekend Meeting Topics:

1. Usefulness of Theories: Some discussion about the usefulness of theories, unrealistic assumptions used in theories, the value of theory as an approximation to reality, the importance of theory and interesting testable propositions, and applying theoretical models in the real world. Note that in a business school, we do not have the luxury of developing generally useless models (we leave that to mathematical economists). Students expect to be able to apply concepts and they need to be “sold” on the idea that even though certain theories are built with assumptions of dubious validity, in many cases the assumptions merely simplify the problem and do not change the basic conclusions and/or key takeaway points from a theory that has some empirical validity. While most financial economists prescribe to the notion that theories are useful if they explain reality, in some cases they “come close” with varying degrees of precision. Modifying models or explaining why the data does not conform to the model is discussed as well. We use the Capital Asset Pricing Model as an example of these issues. The model is widely used and of great importance in terms of finding a firm’s weighted average cost of capital and predictions of the rate of return on stocks. I also stress that it takes a model to beat a model. Hence even flawed models are sometimes employed in practice, which is okay if one has an awareness of their weaknesses.

2. The Basic Finance Paradigm assuming “perfect capital markets”

A review of some of the basic ideas of corporate finance like investment decision rules when there are multiple investors and extending the decision rule from perfect certainty to a setting that deals with the risk of investments. In the process, I will discuss why financing might not matter (or is possibly a second order concern relative to optimal investment policies) and introduce you to a few different ways of modeling risk (it’s all algebra) and how debt financing impacts equity risk. One of the key ideas that fall out of dividend and financing irrelevance propositions (the Miller & Modigliani Theorems) is that investors and businesses are essentially “price takers.” There are lots of perfect (or near perfect) substitutes out there for any given security thing (e.g., Ford for GM). This implies an infinitely elastic demand curve for stocks. We look at evidence on this. Besides some notes on this topic that I will provide, you may want to look at the three readings in the Course Packet under the heading “Are securities substitutable (or are capital market participants always price takers).” These papers are pretty accessible, even though published in top journals.

3. How financing matters: Bankruptcy and conflicts of interest between bondholders and shareholders

The progression of corporate finance theory is to start with “perfect” capital markets” and then start introducing “imperfections.” One is transaction costs and the inability of bondholders to monitor their financial interests in their investments in a firm with both debt and equity. This can result in poor investment decisions and expropriation of bondholder wealth (though arguably this behavior is priced out). The possibility of the behavior occurring could reduce the value of the firm’s securities (i.e., financing impacts firm value).

4. Tradeoff theory: Balancing debt related costs with the tax benefit of debt

Debt financing can introduce unwanted costs and value loss, but in the United States in particular it shields income from taxation. Bond interest is tax deductible for firms and goes directly to bondholders. Dividend payments NOT tax deductible and go directly to security holders (equity). The “optimal capital structure argument is often posed as a tradeoff between tax breaks from debt versus the costs of debt financing. This leads to empirical work on observed capital structures and whether the data is consistent with this tradeoff.

5. Asymmetric information and signaling theory

Managers know more than investors. This raises thorny issues when managers of a firm attempt to market their securities to investors (e.g., are the managers selling securities much like a car owner would try to sell a “lemon” of an automobile. How this impacts marginal financing decisions and how to mitigate these problems is a long established line of research in finance.

6. Opportunistic Financing (when capital markets are not always efficient)

Much of the literature on asymmetric information assumes rationality. Recent (and not so recent) events in capital markets bring this assumption into question this (1929 crash, internet bubble, housing bubble, etc...). This naturally leads into behavioral finance issues. Why would mispricing of securities occur in a systematic and seemingly irrational (from an economists perspective) way? Whether managers can exploit such mispricing is a topic of interest.

7. Managerial/Shareholder conflicts

Financial Economists have crept into the domain of more mainstream economics and the theory of the firm. In the United States, the predominant mode of conducting for large scale enterprise is the corporation with publicly traded stock issued to investors and investors being given voting power over certain corporate decisions and electing a board of directors to oversee their interests. Most shareholders have insufficient incentives or ability to monitor management and certain state laws may further limit that ability. Managers can often stack boards with friendly related parties. To what extent and under what circumstances do shareholders tend to be exploited (expropriated) by managers is an interesting question. Potentially, excessive executive pay or the ability of poor managers to retain their positions would be good examples of this.

8. Overview of Data access (if not here in class, then a handout on how to do it).

Certain statistical techniques are of the essence to understand and properly conduct academic research. We will talk about some and in the process have you access data and analyze it in a fairly structured assignment.

Second set of meetings:

Class presentations, review of data analysis and further discussion of some key data issues in finance, and time permitting discussion of potential research ideas

Note the class presentations cover a number of areas that you have signaled some interest in (first meeting session). I have provided articles that you can read and synthesize for the class. Generally, it will make sense for to form groups of three and present a series of papers that relate to one another in a topic area. Combined, this might require about a 30-40 minute Power point presentations with follow up questions and discussions. They can be complimented with material from the Handbook. In fact, if none of the articles interest a group, one can go to the handbook and select some articles of interest.

Class Assignments:

1. In our second round of meetings, I will have 6 or 7 groups that present overviews of specific areas that relate to the articles assigned. Each group should be prepared for a 30-40 minute PowerPoint presentation as to the key ideas and issues in the articles that they are assigned. We will then allow ten minutes of questioning and I will add some additional points from there.
2. A short empirical exercise using WRDS data. This will allow you to access the data and do some simple analysis.
3. A brief two page proposal for a research project. I am not expecting something incredibly profound in that you will have gotten a very brief introduction and exposure to ideas. I am looking for a “testable proposition” and a brief discussion of how you might go about testing it with real data.

Grading

Grade is 25% class participation, 15% empirical project, 30% class presentation, 30% two page proposal. Each graded on 0-100 scale, with curve to get a B+ average.

A= 4.0 , A- = 3.7, B+ = 3.3, B=3, B- = 2.7. C+ = 2.3, C = 2, C- = 1.7, D+ = 1.3, D=1, D- = 0.7, F =0

Course Packet(1):

Are securities substitutable or Are capital market participants always price takers?

Scholes, Myron, The Market for Securities: substitution Versus Price Pressure and the Effects of Information on Share Prices, The Journal of Business, Volume 45, Issue 2, (Apr. 1972), 179-211.

Wurgler, Jeffery and Zhuravskaya, Ekaterine, Does Arbitrage Flatten Demand Curves for Stocks?, The Journal of Business, Vol. 75, No. 4, October, 2002.

Gao, Xiahui, and Jay Ritter, "the Marketing of Seasoned Equity Offerings," Journal of Financial and Quantitative Analysis, Journal of Financial Economics, (July 2010), Vol. 67, no. 1, pp. 1371-1395.

Trade-off Theories and the Pecking Order Theories of Corporate Finance

John, Graham, Estimating the Tax Benefits of Debt, Journal of Applied Corporate Finance, Volume 14, No. 1, Spring 2001.

Barclay, Michael, Cliff Smith, and Ross Watts, "The Determinants of Corporate Leverage and Dividend Policies, Journal of Applied Corporate Finance, Winter 1995, Vo. 7, no. 4.

Murray Frank and Vidhan Goyal, Capital Structure Decisions: Which Factors are Reliably Important, Financial Management, Spring 2009, pp. 1-37.

Course packet(2):

These are possible papers to examine from various areas – you may have others that would interest you

Do financial constraints force public firms to rely on internal cash flow for investment (or does management with excess cash flow use it wisely?)

Fazzari, Steven, R. Glenn Hubbard and Bruce Peterson, 1988, Financing constraints and corporate Investment. Brookings Papers on Economic Activity, 141-195.

Kaplan, Steven and Luigi Zingales, 1997, Do Investment-cash Flow sensitivities provide useful measures of financing constraints? Quarterly Journal of Economics, 169-215.

Lewellen, J. and K. Lewellan, forthcoming 2014, Investment and cash flow: New Evidence.

Lamont, Owen 1997, Cash flow and Investment: Evidence from internal capital markets, Journal of Finance 42, 83-109.

Jensen, Michael, "Agency Cost of Free Cash Flow, Corporate Finance and Takeovers, American Economic Review, Vol. 76, No. 2, May 1986.

Financial Signaling

Theo, Vermaelen, Common Stock Repurchases and Market Signaling, Journal of Financial Economics, 9 (1981), 139-183.

Bonaime, Alice and Michael Ryngaert, Insider Trading and Share Repurchases: Do Insiders and Firms Trade in the Same Direction?, Journal of Corporate Finance 22 (2013) 35-53.

Houston, Joel and Michael Ryngaert, Equity Issuance and Adverse Selection,: A direct Test Using Conditional Stock Offers, Vol LII, no. 1, March 1997.

Bayless, M. and S. Chaplinsky, Expectations of Security Type and the Information Content of Debt and Equity Offers, Journal of Financial Intermediation, 1, 195-214.

Mergers & Acquisitions: Are certain kinds of acquisitions “bad” and impact of takeover defenses influence firm value and hostile takeover outcomes

Phillip G. Berger and Eli Ofek, Diversification's effect on firm value, Journal of Financial Economics, 37 (1995), 39-65

Morck, Randall, Andre Shleifer, and Robert Vishny, Do Managerial Objectives Drive Bad Acquisitions, Journal of Finance, Vol. XLV, No. 1, March 1990.

Ryngaert, Michael, The Effect of Poison Pill Securities on Shareholder Wealth, Journal of Financial Economics, 1988

Ryngaert, M. and R. Scholten, Have changing takeover defense rules and strategies entrenched management and damaged shareholders? The case of defeated takeover bids.

Souther, Matthew, The Effects of takeover defenses: Evidence from closed-end funds, forthcoming JFE.

Private Equity and Venture Capital

Sahlman, William, Aspects of Financial Contracting in Venture Contracting, Journal of Applied Corporate Finance, Vol. 1, No. 2, 1988

Steve Kaplan and Antoinette Schoar, Private Equity Performance: Returns, Persistence, and Capital Flows, Journal of Finance, Vol LX, No. 4, August 2005.

Harris, Robert, Tim Jenkinson, Steve, Kaplan, Ruediger Stucke, Has Persistence Persisted in Private Equity? Evidence from Buyout Venture Capital Funds, working paper (2014).

Executive Compensation determinants and impact of pay package on firm decisions

Armstrong, Christopher, C. Ittner, and D. Larcker, Corporate Governance, compensation consultants, and CEO pay levels, *Review of Accounting Studies* (2012), 17: 322-351

Hartzell, Jay, Eli Ofek, and David Yermack, What's in it for me? CEOs whose firms are acquired, *Review of Financial Studies*, 2004, Vol. 17, No. 1, pp. 37-61

Steve Kaplan, CEO Pay and Corporate Governance in U.S.: Perceptions, Facts, and Challenges, *Journal of Applied Corporate Finance*, Volume 25, number 2, Spring 2013

Tufano, Peter, Who Manages Risk? An Empirical Examination of Risk Management Practices in the Gold Mining Industry, *Journal of Finance*, Vol. 51, No. 4 (September 1996), pp. 1097-1137.

Behavioral Finance topics

Baker, Malcolm and Jeffrey Wurgler, Investor Sentiment and the Cross Section of Stock Returns, *Journal of Finance*, Vol LXI, No. 4, August 2006.

Malmendier, Ulrike, and Geoffrey Tate, Who Makes Acquisitions? CEO overconfidence and the market's reaction, *Journal of Financial Economics*, 89 (2008) 20-43.

Chan, Louis and Josef Lakonishok, Value and Growth Investing Review and Update, *Financial Analysts Journal*, Vol. 60, No. 1 (Jan-Feb 2004), pp. 71-86.

Bergstresser, Daniel, Mihir Desai and Josua Rauh, Earnings Manipulation, Pension Assumptions and Managerial Investment Decisions, *Quarterly Journal of Economics*, February 2006.

Kelley, Peter, The Information Content of Realized Losses, (2015 Yale Working Paper)

Graham, John and Campbell Harvey, How Do CFOs Make Capital Budgeting and Capital Structure Decisions?, *Journal of Applied Corporate Finance*, Vol 15, Number 1, Spring 2002.

Family Firms and Related Party Transactions

Anderson, Ronald, and David Reeb, Founding Family Ownership and Firm Performance: Evidence from the S&P 500, *Journal of Finance*, Vol. 58, No. 3, June 2003, pp. 1301-1328.

Villalonga, Belen, and Raphael Amit, How do family ownership, control and management affect firm value?, *Journal of Financial Economics*, 80 (2006), 385-417.

Villalonga, Belen, and Raphael Amit, HowAre U.S. Family Firms Controlled?, Review of Financial Studies, vol 22, no. 8, 2009. **(NOT IN PACKET)**

Ryngaert, Michael and Shawn Thomas, Not All Related Party Transactions (RPTS) are the same: Ex ante versus Ex Post RPTS, Journal of Accounting Research, Vol. 50, No. 3, June 2012.

Law and Finance - Looks at how different legal settings result in different financial policies around the world

La Porta, Rafael, Florencio Lopez-De-Silanes, Andrei Shleifer and Rob Vishny, Legal Determinants of External Finance, Journal of Finance, Vol. 52, No. 3, Proceedings Fifty-Seventh Annual Meeting, American Finance Association (July 1997).

La Porta, Rafael, Florencio Lopez-De-Silanes, Andrei Shleifer and Rob Vishny, Law and Finance, Journal of Political Economy, Vol 106, No. 6, December 1998, pp. 1113-1155.

La Porta, Rafael, Florencio Lopez-De-Silanes, Andrei Shleifer and Rob Vishny, Agency Problems and Dividends around the World, Journal of Finance, Vol. 55, No. 1 (Feb 2000), pp. 1-33.