



Corporate Finance Theory

Friday (bi-weekly) 8:30 – 12:00 Dorotheenstr. 1, Room 07
April 23, May 7, 21
June 11, 25, 26, 30, July 1

Overview

This course is based on academic articles and covers major theories and empirical studies in corporate finance, including contract theory, financing & investment decisions, risk management, behavioral theories, capital structure, corporate governance and the market for corporate control.

The course is intended for students wishing to write academic journal-style articles.

Prerequisites

It is recommended to take the Hauptseminar Corporate Finance before enrolling in this course.

Final grade

Seminar paper (100%) due: 30. September 2010

Seminar Paper

Each student is required to complete a term project. For most students, the project will involve replicating the main findings of an academic paper with some modification (it is not necessary to replicate every test and table, but you must capture the main results of the paper). A

student may choose to replicate an older paper with new data to see if results continue to hold, or may use international data to replicate US findings. Alternatively, students can replicate a paper using the same data, but provide improved tests (different techniques, different measures or variables, or correcting other problems in the original work).

Students should select an original paper in empirical corporate finance that they find interesting and believe they can improve upon. It is important to think carefully about the data requirements before selection. The paper is due 30. September 2010.

Preliminary Outline

<i>Date</i>	<i>Topic</i>
23. April	Foundations of Corporate Finance
7. May	Corporate Investment and Internal Capital Markets
21. May	Corporate Risk Management
11. June	Behavioral Finance
25. June	Capital structure
26. June (Saturday 9-12)	Governance and Agency, Board of Directors
30. June (Wednesday 18-19:30)	Ownership structure
1. July (Thursday 18-19:30)	Management Turnover

Literature

Every student is expected to read the following papers (available from Moodle) **before** each session.

1. Foundations of Corporate Finance (Principal-Agent Problems)

Aghion, Phillippe, and Patrick Bolton, 1992, An incomplete contracts approach to financial contracting, *Review of Economic Studies* 77, 338–401.

Diamond, Douglas, 1991, Debt maturity structure and liquidity risk, *Quarterly Journal of Economics* 106, 709–737.

Hart, Oliver, and John Moore, 1994, A theory of debt based on the inalienability of human capital, *Quarterly Journal of Economics* 109, 841–879.

Holmström, Bengt, 1979, Moral hazard and observability, *Bell Journal of Economics* 10, 74–91.

Steven N. Kaplan & Per Strömberg, 2004. "Characteristics, Contracts, and Actions: Evidence from Venture Capitalist Analyses," *Journal of Finance*, American Finance Association, vol. 59(5), pages 2177-2210

2. The Classical Papers in Corporate Finance

Jensen, Michael C., and William Meckling, "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure," *Journal of Financial Economics* 3 (October 1976), pp. 305 60.

Myers, Stewart C., "The Determinants of Corporate Borrowing," *Journal of Financial Economics* 5 (Nov. 1977), pp. 147 176.

Myers, Stewart C. and Nicholas S. Majluf, "Corporate Financing and Investment Decisions When Firms Have Information Investors Do Not Have," *Journal of Financial Economics* 13 (June 1984), pp. 187 221.

Jensen, Michael C., "Agency Costs of Free Cash Flow, Corporate Finance and Takeovers," *American Economic Review* 76 (May 1986), pp. 323 329.

Miller, Merton H. and Kevin Rock, "Dividend Policy Under Asymmetric Information," *Journal of Finance* 40 (September 1985), pp. 1031-1051.

3. Internal vs. External Capital Markets – Corporate Risk Management

Lamont, Owen, 1997, Cash flow and investment: evidence from internal capital markets, *Journal of Finance* 52, 83-109

Scharfstein, David, 1998, The dark side of internal capital markets II: Evidence from Diversified Conglomerates, NBER working paper, No. 6352

Khanna and Tice, S., 2001, The Bright Side of Internal Capital Markets, *Journal of Finance* 56, 1489-1528

Sapienza, P., 2001, Discussion of The Bright Side of Internal Capital Markets, *Journal of Finance* 56, 1528-1531

Rauh, Joshua D., "Investment and Financing Constraints: Evidence from the Funding of Corporate Pension Plans," *Journal of Finance* 61 (February 2006), pp. 33-71. [Brattle-First]

Smith, Clifford W., Jr. and Rene M. Stulz, "The Determinants of Firms' Hedging Policies," *Journal of Financial and Quantitative Analysis* 20 (December 1985), pp. 391-405.

Froot, Kenneth A., David S. Scharfstein, and Jeremy C. Stein, "Risk Management: Coordinating Corporate Investment and Financing Policies," *Journal of Finance* 48 (December 1993), pp. 1629-1658.

Adam, Tim, Sudipto Dasgupta and Sheridan Titman, Financial Constraints, Competition, and Hedging in Industry Equilibrium, *Journal of Finance*, 2007, Vol. 62(5)

Lel, Ugur, Currency Hedging and Corporate Governance: A Cross-Country Analysis (November 17, 2009). FEDS Discussion Paper No. 858; Indiana University Working Paper.

4. Behavioral Finance

Shefrin, H., Behavioral Corporate Finance – Decisions that Create Value, McGraw-Hill 2007, 1st edition.

Baker, Ruback and Wurgler (2004) Behavioral Corporate Finance: A Survey, Harvard Business School working paper

5. Capital structure

Hovakimian, Armen, Tim Opler, and Sheridan Titman, 2001. The debt-equity choice. *Journal of Financial and Quantitative Analysis* 36, 1-24.

Flannery, Mark, and Kasturi Rangan, 2006. Partial adjustment towards target capital structures. *Journal of Financial Economics* 79, 469-506.

Lemmon, Michael, Michael Roberts, and Jaime Zender. 2008. Back to the Beginning: Persistence and the Cross Section of Corporate Capital Structure. *Journal of Finance*, Forthcoming.

Frank, Murray, and Vidhan K. Goyal, 2003. Testing the pecking order theory of capital structure. *Journal of Financial Economics* 67, 217-248

Baker, M., Wurgler, J., 2002. Market timing and capital structure. *Journal of Finance* 57, 1-32.

6. Governance and Agency, Board of Directors

Gompers, P., Ishii, J., Metrick, A., 2003. Corporate governance and equity prices. *Quarterly Journal of Economics* 118, 107-155.

Core, J. Guay, W., and Rusticus, 2006. Does Weak Governance Cause Weak Stock Returns? An Examination of Firm Operating Performance and Analysts' Expectations. *Journal of Finance* 61, --.

Coles, J.L., Daniel, N.D., Naveen, L., 2008. Boards: Does one size fit all? *Journal of Financial Economics* 87, 329-356.

Duchin, R., Matsusaka, J.G., Ozbas, O., 2010. When are outside directors effective? *Journal of Financial Economics*, forthcoming.

7. Ownership structure, Management Turnover

Himmelberg, C., Hubbard, R.G., Palia, D., 1999, Understanding the determinants of managerial ownership and the link between ownership and performance, *Journal of Financial Economics* 53, 353-384.

Denis, D.J., Denis, D.K., 1995, Performance Changes Following Top Management Dismissals, *Journal of Finance* 50, 1029-1057.

Huson, M.R., Malatesta, P.H., Parrino, R., 2004. Managerial Succession and Firm Performance. *Journal of Financial Economics* 74, 237-275.