

HUMBOLDT UNIVERSITÄT ZU BERLIN

Hauptseminar Corporate Finance

WS 2011/12: Mondays 16:00-18:00, Room DOR1-05

Prof. Tim Adam, Ph.D.

The purpose of this seminar is to introduce students to a major research topic and empirical methods in corporate finance, in order to prepare them for writing a Master thesis at the Institute of Corporate Finance. In the first part of the seminar we will review some of the main econometric techniques such as regression analysis, time series models, panel data estimation, and event studies. You will also learn how to analyze this data with STATA[®], a simple but powerful statistical software package. The second part of the seminar consists of student presentations of important research papers in area of *financial regulation*. In particular, we will discuss the effects of the Sarbanes–Oxley Act (SOX), Regulation FD, and Rule 12h-6. In addition, students are required to replicate an empirical research paper with new data.

Prerequisites

The seminar has a strong quantitative orientation. Participants should therefore be comfortable with standard econometric techniques. In addition, a good understanding of the principles of corporate finance is necessary. Before enrolling in the Hauptseminar you should have successfully completed Introduction to Finance I & II, Advanced Corporate Finance I and the Case Seminar Corporate Finance.

Registration

Please submit your CV and evidence of completed relevant courses to the secretary, Mrs. Haberzettel, in hard copy (copies only, no originals) by 8. July 2011, and indicate which paper you would like to present. Preference will be given to those applicants with the strongest background in corporate finance and econometrics.

Evaluation

Class participation (20%), presentation of a research paper (40%), replication of an empirical study (40%). Seminar attendance is obligatory.

References

Jeffrey Wooldridge, *Introductory Econometrics: A Modern Approach*, 2nd – 4th edition, Thomson South-Western.¹

A. Craig MacKinlay, 1997, *Event studies in economics and finance*, Journal of Economic Literature, Vol. 35, pp. 13-39.

¹ Students intending to write a Diplom or Master thesis at the Institute of Corporate Finance should be in possession of a standard econometrics book such as the one above.

Course Outline

Date	Topics	Readings
Oct. 24	Introduction, seminar overview, intro to scientific writing	Wooldridge 19
Oct. 31	The linear regression model, multiple regression analysis, binary variables	Wooldridge 1-2, 3-4, 6-7
Nov. 7	Estimation problems in the standard regression model	Wooldridge 9
Nov.14	Time series models and panel data analysis	Wooldridge 10, 13-15
Nov. 21	Event studies in finance R.A. Heron and E. Lie, 2007, Does backdating explain the stock price pattern around executive stock option grants? Journal of Financial Economics 83 (2), 271-295	MacKinlay (1997)
Nov. 28	Introduction to STATA [®]	
Dec. 5	TBA	
Dec. 12	The Effect of SOX Section 404: Costs, Earnings Quality, and Stock Prices	
Jan. 2	Corporate Governance and Firm Value: The Impact of the 2002 Governance Rules	
Jan. 19	The Effects and Unintended Consequences of the Sarbanes-Oxley Act on the Supply and Demand for Directors	
Jan. 16	Information asymmetry, information dissemination and the effect of regulation FD on the cost of capital	
Jan. 23	Informational effects of regulation FD: Evidence from rating agencies	
Jan. 30	Why Do Foreign Firms Leave U.S. Equity Markets?	
Feb. 6	Escape from New York: The market impact of loosening disclosure requirements	
Feb. 13	Capital-Market Effects of Securities Regulation: The Role of Implementation and Enforcement	

Paper presentations

Each student must present one research paper during the course of the seminar. This semester all papers are from the area of behavioral corporate finance. Papers will be assigned on a first-come-first-serve basis. Please indicate your preferences when applying for the Hauptseminar.

Presentations should be conducted in English and last for 90 minutes, including answering questions from the audience. As a general rule, presenting one slide requires at least 3 minutes on average. Thus, the presentation should not exceed 30 slides. The presentation should first provide an overview of the research area, i.e., discuss the main theories that are relevant to a particular topic, and the importance of the research question. For this it may be necessary to read more than just the assigned paper. It may also be helpful to consult an

advanced textbook of corporate finance to familiarize yourself with the necessary background. Second the presentation should focus on the main innovation/result of the paper. Spend some time developing good intuition for the theoretical model or the econometric technique used. This requires you to have a good understanding of the main ideas of the paper. Extensive robustness checks or secondary results of the paper are of secondary importance.

If you think there are flaws with a paper's methodology, econometric technique, or interpretation of the results, makes this clear in your presentation. It is not necessary to vigorously defend obvious errors or inconsistencies.

Students should submit their presentation slides one day prior to the presentation. Tables and graphs should be formatted so that their contents are readable to the audience (minimum font size 16 pt). It is highly recommendable to start reading a paper several weeks before the scheduled presentation.

Research project

Each student needs to replicate the following empirical study with a new data set.

Frank, M., and V. Goyal, 2003, Testing the pecking order theory of capital structure. *Journal of Financial Economics* 67 (2), 217-248.

Students should form teams of 2 people, and submit one research report per team. The main task is to replicate Tables 2 and Tables 4-7 of the paper. All necessary data will be provided. The research report should discuss the main findings of the replication exercise, i.e., highlight and interpret differences in findings if any. The form should be like a journal-style article and conform to the *Journal of Finance* style guidelines. Intermediate results are due at several times during the course. The final research reports are due in hard copy on **28.02.2012**. The computer code should be e-mailed as an attachment. It must run with the original, unaltered dataset. Cases of plagiarism will be treated with zero credit.²

For the replication exercise you need to use STATA[®], a simple but powerful statistical software package from StataCorp LP (<http://www.stata.com>). STATA[®] is available in the PC Pool. Individual student licenses can also be purchased from the German distributor DPC (www.dpc.de) for €9. Alternatively, you can borrow a license from the Institute of Corporate Finance for the duration of the Hauptseminar.

² Definition of *no-gap companies*: Firms need to report assets in each of the years during the sample period for it to be in the "no gaps permitted" sample. It is still possible that in some years the observations are dropped because of missing debt issuance or deficit. I wanted to make sure that the firm was operating in each of the years during the period. Definition of outliers: We trim the ratios at the 0.05th and the 99.5th percentiles.

Papers Available for Student Presentation

The Effect of SOX Section 404: Costs, Earnings Quality, and Stock Prices

Peter Iliev

THE JOURNAL OF FINANCE • VOL. LXV, NO. 3 • JUNE 2010

Abstract: This paper exploits a natural quasi-experiment to isolate the effects that were uniquely due to the Sarbanes–Oxley Act (SOX): U.S. firms with a public float under \$75 million could delay Section 404 compliance, and foreign firms under \$700 million could delay the auditor’s attestation requirement. As designed, Section 404 led to conservative reported earnings, but also imposed real costs. On net, SOX compliance reduced the market value of small firms.

Corporate Governance and Firm Value: The Impact of the 2002 Governance Rules

VIDHI CHHAOCHHARIA and YANIV GRINSTEIN

THE JOURNAL OF FINANCE • VOL. LXII, NO. 4 • AUGUST 2007

Abstract: The 2001 to 2002 corporate scandals led to the Sarbanes–Oxley Act and to various amendments to the U.S. stock exchanges’ regulations. We find that the announcement of these rules has a significant effect on firm value. Firms that are less compliant with the provisions of the rules earn positive abnormal returns compared to firms that are more compliant. We also find variation in the response across firm size. Large firms that are less compliant earn positive abnormal returns but small firms that are less compliant earn negative abnormal returns, suggesting that some provisions are detrimental to small firms.

The Effects and Unintended Consequences of the Sarbanes-Oxley Act on the Supply and Demand for Directors

James S. Linck, Jeffry M. Netter, Tina Yang

The Review of Financial Studies / v 22 n 8 2009

Abstract: Using eight thousand public companies, we study the impact of the Sarbanes-Oxley Act (SOX) of 2002 and other contemporary reforms on directors and boards, guided by their impact on the supply and demand for directors. SOX increased directors’ workload and risk (reducing the supply), and increased demand by mandating that firms have more outside directors. We find both broad-based changes and cross-sectional changes (by firm size). Board committees meet more often post-SOX and Director and Officer (D&O) insurance premiums have doubled. Directors post-SOX are more likely to be lawyers/consultants, financial experts, and retired executives, and less likely to be current executives. Post-SOX boards are larger and more independent. Finally, we find significant increases in director pay and overall director costs, particularly among smaller firms. (JEL D23, G32, G34, G38, K22, M14)

Information asymmetry, information dissemination and the effect of regulation FD on the cost of capital

Jefferson Duarte, Xi Han, Jarrad Harford, Lance Young
Journal of Financial Economics 87 (2008) 24–44,

Abstract: This paper considers the impact of Regulation Fair Disclosure (FD) on firms' information environments and costs of capital. For NYSE/Amex firms we find little evidence of a change in the cost of capital attributable to Regulation FD. For Nasdaq firms we find that Regulation FD increased firms' costs of capital by 10–19 basis points per annum though the statistical significance of this change is modest for some of our models. We also show substantial cross-sectional variation in the cost of capital changes. We find that cost of capital changes were negatively related to both pre-regulation firm size and PIN. In addition to the findings regarding Regulation FD, this research contributes to a growing literature that documents links between firms' information environments and their costs of capital.

Informational effects of regulation FD: evidence from rating agencies

Philippe Jorion, Zhu Liu, Charles Shi
Journal of Financial Economics 76 (2005) 309–330

Abstract: Regulation Fair Disclosure, implemented on October 23, 2000, prohibits U.S. public companies from making selective, nonpublic disclosures to favored investment professionals. Regulation Fair Disclosure has a number of exclusions, however, including disclosure of nonpublic information to credit rating agencies. As a result, credit analysts at rating agencies have access to confidential information that is no longer made available to equity analysts, potentially increasing the information content of credit ratings. We examine the effect of credit rating changes on stock prices and find that the informational effect of downgrades and upgrades is much greater in the post-FD period.

Why Do Foreign Firms Leave U.S. Equity Markets?

CRAIG DOIDGE, G. ANDREW KAROLYI, and RENÉ M. STULZ
THE JOURNAL OF FINANCE • VOL. LXV, NO. 4 • AUGUST 2010

Abstract: Foreign firms terminate their Securities and Exchange Commission registration in the aftermath of the Sarbanes–Oxley Act (SOX) because they no longer require outside funds to finance growth opportunities. Deregistering firms' insiders benefit from greater discretion to consume private benefits without having to raise higher cost funds. Foreign firms with more agency problems have worse stock-price reactions to the adoption of Rule 12h-6 in 2007, which made deregistration easier, than those firms more adversely affected by the compliance costs of SOX. Stock-price reactions to deregistration announcements are negative, but less so under Rule 12h-6, and more so for firms that raise fewer funds externally.

Escape from New York: The market impact of loosening disclosure requirements

Nuno Fernandes , Ugur Lel, Darius P. Miller

Journal of Financial Economics 95 (2010) 129–147

Abstract: We examine the first significant deregulation of U.S. disclosure requirements since the passage of the 1933/1934 Exchange and Securities Acts: the 2007 Securities and Exchange Commission (SEC) Rule 12h-6. Rule 12h-6 has made it easier for foreign firms to deregister with the SEC and thereby terminate their U.S. disclosure obligations. We show that the market reacted negatively to the announcement by the SEC that firms from countries with weak disclosure and governance regimes could more easily opt out of the stringent U.S. reporting and legal environment. We also find that since the rule's passage, an unprecedented number of firms have deregistered, and these firms often had been previous targets of U.S. class action securities lawsuits or SEC enforcement actions. Our findings suggest that shareholders of non-U.S. firms place significant value on U.S. securities regulations, especially when the home country investor protections are weak.³

Capital-Market Effects of Securities Regulation: The Role of Implementation and Enforcement

Hans B. Christensen, Luzi Hail, Christian Leuz

December 2010, working paper

Abstract: This paper examines capital market effects of changes in securities regulation. We analyze two key capital market directives in the European Union (EU) that tightened market abuse and transparency regulation and, in particular, their enforcement. All EU member states were required to adopt these two directives but did so at different points in time. Our research design exploits this differential timing of the same regulatory change for identification and uses cross-sectional variation in the capital-market effects to highlight the role of implementation and enforcement for regulatory outcomes. We find that, on average, market liquidity increases and firms' cost of capital decreases as EU member states tighten market abuse and transparency regulation. The effects are larger in countries that implement and enforce the directives more strictly. They are also stronger in countries with traditionally stricter securities regulation and with a better track record of implementing regulation and government policies in general. Overall, these findings show that the effects of regulation depend crucially on implementation and enforcement. Moreover, the results indicate that the same forces that have limited the effectiveness of securities regulation in the past are still at play when new rules are introduced, which has important implications for the expected outcomes of regulatory reforms as well as efforts to harmonize regulation across countries.