The Economics of Corporate Finance
(208, A08640, 08 08344)

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1 Goals

Corporate finance studies firms' investment and financial decisions. The economics of corporate finance studies these decisions in the light of incentives, information and institutions. The module thus introduces students to major themes in modern economic research.[1]. The module seeks both to present the clearest statements of the relevant theories, and their application to contemporary issues in corporate finance.

2 Lectures, classes and office hours

2.1 Lectures

Lectures are held on Mondays (3 - 4pm, Gisbert-Kapp LT1) and Tuesdays (1 - 2pm, Muirhead G15), starting 9 January. Two lectures will not be held; their dates will be announced later in term. One is likely to be 20 February.

2.2 Classes

Five problem sets will be assigned over the term. Preparing the answers before the classes is one of the best ways of preparing for the exam. While the problem sets are not assessed, students are encouraged to submit their worked answers at the beginning of each problem class.

Each student will register via WebCT to attend one of eight identical classes. Each group will meet once a fortnight, starting in the week beginning 16 January. Four groups will meet in even weeks, and four in odd ones.

[1] The arguments presented over the term have yielded three Nobel Memorial Prizes in Economic Sciences so far: Franco Modigliani in 1985, Merton Miller in 1990 and Joe Stiglitz in 2001

Classes will be taught by Trong Ngo at tvn754@bham.ac.uk.

2.3 Office hours

My term time office hours are: 13:30 - 15:00pm on Mondays and 14:30 - 16:00 on Tuesdays. In emergencies, I can make arrangements to see you outside these hours.

3 Lecture overview

This working outline for the lectures may shift over time. Familiarity with the main readings (marked by a ★) cited in advance of lectures is advised.

1. Introduction and preliminaries, inc. NPV (q.v. Brealey and Myers (2003, Chapters 1, 2), Brealey, Myers, and Marcus (2007, Parts 1, 2), Berk and DeMarzo (2011, Parts 1, 2), Tirole (2005, Chapters 1, 2))
2. Modigliani-Miller's capital structure irrelevance: ★ Fama (1978) structure; reflections from ★ Myers (2001)
3. transaction costs
4. taxes: tradeoff theory (Myers, 2001, ★)
5. agency costs: moral hazard Tirole (2005, ★,Chapter 3); liquidity management (Tirole, 2005, ★,Chapter 5); free-cash flow ★ Jensen (1986) and ★ Myers (2001); Jensen and Meckling (1976) and Ross (1977) are classics
6. investment rules depend on financing: debt overhangs (★ Myers (1977), ★ Myers (2001))
7. incomplete agreement and heterogeneous expectations: Myers (1984) and ★ Myers and Majluf (1984) are the classics; ★ Myers (2001) reviews; ★ Grossman and Hart (1980, ch.1 & 2) on takeovers
8. costly bankruptcy
9. not only wealth counts

4 Reading material

The module has no set textbook. Instead, each section covered typically draws on a main reading, usually a journal article. Corporate finance textbooks such as Milgrom and Roberts (1992), Brealey and Myers (2003), Brealey et al. (2007), or Berk and DeMarzo (2011), may be useful as references, but are generally too superficial. To simplify notation, I follow that of Tirole (2005) whenever possible; this generally does cover topics in the depth expected.

Journal articles are often held both in the library and electronically. I typically use Google Scholar to identify an article, and then click on the 'Find it at B'ham' link to find a local copy.[2]

Anything handed out in class will also be posted on my website. Announcements will also be posted either there or to the module's WebCT page.[3]

Students are also encouraged to read the FT's *Companies and Markets* section daily: the topics covered here are designed to explain many of the phenomena reported on there.

5 Assessment

The module is assessed by:

1. a term project of no more than 1,500 words, due into the Departmental Office on noon, 19 March, and worth 20% of the module mark; and

2. a two hour exam, worth 80% of the module mark.

For the project, you are to write an analyst's report on the S&P 500 company assigned to you on my website[4], according to the following format:

1. executive summary supporting your conclusion that your firm is over-, under- or fairly valued ($\leq$ 1 page)

2. overview of publicly available data (inc. SEC filings, public commentary) on capital structure ($\leq$ 1 page)

3. overview of privately collected data and analysis (inc. through correspondence with your firm's investor relations department ($\leq$ 1.5 pages)[5]

4. analysis of its capital structure, identifying particularly good or bad decisions, and commenting on a major upcoming issue faced, possibly with a recommendation ($\leq$ 1.5 pages)

The best guide to the exam's *scope* and *style* are the lectures, problem sets and main readings. Students intending to do well on the exam should therefore attend the lectures, work through the problem sets in advance, and thoroughly understand (rather than just memorise) the main readings. If something does not make sense, please ask

[2]If you are having IT difficulties, including finding articles online, please seek help either from a classmate or from the University's dedicated IT support. Steve Bull, s.a.bull@bham.ac.uk, the Economics subject specialist, is particularly helpful.

[3]Thus, if you miss a lecture, please catch up by first speaking to a classmate.

[4]If you and a classmate wish to swap companies, please e-mail me clearly listing the original and new allocation.

[5]Before writing your firm, read all of the public data carefully so that you can ask good questions. When writing, identify yourself as an undergraduate student writing an analyst's report on their capital structure. Make **NO** spelling or grammatical errors: have a classmate double-check your e-mail, and then wait a day before re-reading it.

either Trong or myself during our office hours. Past 208 exams that I have set were in 2003 – 2005, 2010 and 2011. The exam's *structure* will follow 2011's. As the module's coverage evolves over time, the exam's *content* will obviously differ.

References

J. Berk and P. DeMarzo. *Corporate Finance: Global Edition.* Pearson, second edition, 2011.

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