

Rutgers Business School

Corporate Finance

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Objective: To introduce doctoral students to the basic and current research questions and methods – theoretical and empirical – in corporate finance.

Requirements: Students are required to read and be ready to discuss the materials assigned for class. A tentative list of the topics and the papers/materials is provided below. On occasion ‘take-home’ problems will be assigned. My plan is to have students present papers on a fairly regular basis in class. There will be a take-home final exam that takes the form of developing research proposals and/or the review of a recent research paper.

Recommended Books: There are several books that provide surveys/overviews of one or more areas in corporate finance. Among these:

- Tirole, *Corporate Finance*
- Finance Handbooks such as: Jarrow, R. A., V. Maksimovic and W.T. Ziemba, Finance, (Vol. 9, Handbooks in Operations Research and Management)
- Matos, Joao Amaro De, *Theoretical Foundations of Corporate Finance*
- Hart, O., *Firms Contracts and Financial Structure*

Journal Abbreviations:

Journal of Financial Economics: **JFE**; *Journal of Finance:* **JF**; *Review of Financial Studies:* **RFS**; *Journal of Business:* **JB**; *Journal of Political Economy:* **JPE**; *Quarterly Journal of Economics:* **QJE**; *American Economic Review:* **AER**

Topics and Readings

Note:

- The **tentative** topics and readings are below – the topics and papers for the various sessions will be finalized as the semester proceeds.
- My plan is to provide an overview of the main issues/approaches in corporate finance. After the initial sessions indicated, our focus will be on topics such as: (i) corporate control (ii) liquidity (iii) property rights (iv) security design (v) product markets (vi) internal capital markets (vii) financial intermediaries such as banks, mutual funds and VC (viii) legal environment and emerging markets.
- In general, papers should be read by students before class. After the **initial 2-3 sessions** – specific papers will be regularly assigned to students for presentation/discussion in class.

A. Introduction and traditional theories of capital structure

- Introduction to course; quick (subjective) overview of issues and approaches in corporate finance.
- M&M and Optimal Capital Structure with corporate and personal taxes
- Trade-off with dissipative bankruptcy costs

Readings:

- Miller, Merton (1977). Debt and Taxes, JF
- Titman S., and R. Wessels (1988). The determinants of capital structure choice, JF
- Warner, J., (1977). Bankruptcy costs: Some evidence, JF

B. Agency and Information Asymmetry in Corporate Finance

- Basic concepts of moral hazard and adverse selection.
- Implications for:
 - Capital structure: under/over investment; bond covenants; signaling through capital structure choice; financing choice and information
 - Free Cash Flow
 - Financial distress
 - IPOs
 - Payout policy – dividends

Readings:

- Myers, S., (1977). Determinants of corporate borrowing, JFE
- Smith, C., and J. Warner (1979). On financial contracting: An analysis of bond covenants
- Myers, S. and N. Majluf (1984). Corporate financing and investment decisions when firms have information that investors do not have, JFE

- Leland, H., and D. Pyle (1977). Information asymmetry, financial structure and financial intermediation, JF
- Jensen, M. (1986). Agency costs of free cash flow, corporate finance and takeovers, AER
- M. Miller and K. Rock, Dividend Policy under Asymmetric Information, Journal of Finance, 40 (1985), 1031-51.
- Easterbrook, Frank H., 1984, Two Agency-Cost Explanations of Dividends, American Economics Review, 74 (4) 650-659.
- Rock, K., 1986, Why new issues are underpriced, Journal of Financial Economics

C. *Banking Theory*

- # Diamond, D., (1984) Financial Intermediation and Delegated Monitoring (Review of Economic Studies)
- # Diamond, D., and P. Dybvig (1983), Bank Runs, Deposit Insurance, and Liquidity (The Journal of Political Economy)
- # Holmstrom, Bengt, and Jean Tirole, 1997, Financial intermediation, loanable funds, and the real sector, *Quarterly Journal of Economics* 112, 663-691.

D. *Banking Empirical Papers*

- # Chava and Roberts (2008), How Does Financing Impact Investment? The Role of Debt Covenants, *Journal of Finance*
- # Sufi, A (2009) Bank Lines of Credit in Corporate Finance: An Empirical Analysis, *Review of Financial Studies*
- # Bharath, Sridhar, Sandeep Dahiya, Anthony Saunders, and Anand Srinivasan (2007), So What Do I Get? The Banks View of Lending Relationships, *Journal of Financial Economics*, vol. 85(2), 368-419.
- # Rajan, Raghuram G., 1994, Why bank credit policies fluctuate: A theory and some evidence, *Quarterly Journal of Economics* 109, 399-442.

E. *Investment Banking, Institutional Investors, Stock Exchanges*

- # Benveniste, L.M., and P.A. Spindt (1989), How investment bankers determine the offer price and allocation of new issues, Journal of Financial Economics
- # Welch, I. (1992), Sequential sales, learning, and cascades, Journal of Finance
- # Tufano P., (1989) Financial Innovation and First-Mover Advantages, JFE
- # Parrino, R., RW Sias and LT Starks (2003), Voting with their feet: institutional ownership changes around forced CEO turnover, JFE
- # Siegel, Jordan I. (2003?), Can Foreign Firms Bond Themselves Effectively by Renting U.S. Securities Laws? JFE

F. *Private Equity – Venture Capital*

- # T Hellman and M Puri (2000) The interaction between product market and financing strategy: the role of venture capital, RFS
- # S Kortum, J Lerner (2000), Assessing the Contribution of Venture Capital to Innovation (Rand Journal of Economics)
- # Kaplan, Steven, and Antoniette Schoar, 2005(?), Private Equity performance: Returns, persistence and capital, Journal of Finance.
- # Fulghieri, Paolo and Merih Sevilir, 2009, “Size and Focus of a Venture Capitalist’s Portfolio,” forthcoming at *Review of Financial Studies*.
- # Hochberg, Y.V., A. Ljungqvist, and Y. Lu, 2007, “Whom You Know Matters: Venture Capital Networks and Investment Performance,” *Journal of Finance* 62, 251-301.
- # Metrick, A. and Yasuda, A., 2010, “The Economics of Private Equity Funds,” *Review of Financial Studies* 23, 2303-2341.
- # Sorensen, Morten, 2007, “How Smart is Smart Money: A Two-Sided Matching Model of Venture Capital,” *Journal of Finance*, 62, 2725-2762
- # Gompers, P. A., Anna Kovner and Josh Lerner, 2009, “Specialization and Success: Evidence from Venture Capital,” *Journal of Economics & Management Strategy*, Vol. 18, Issue 3, pp. 817-844.
- # Benson, David and Rosemarie H. Ziedonis, Corporate venture capital and the returns to acquiring portfolio companies, JFE, 2010

Product market considerations

- # Bolton and Scharfstein (1990). A theory of predation based on agency problems in financial contracting, AER
- # Brander, J.A., and T. Lewis (1986). Oligopoly and financial structure: The limited Liability Effect, American Economic Review
- # Chevalier, J. (1995), Do LBO Supermarkets Charge More? An Empirical Analysis of the Effects of LBOs on Supermarket Pricing, JF
- # Campello, M. (2003). Capital structure and product markets interactions: evidence from business cycles, JFE
- # Khanna, N., Tice, S., 2000, Strategic Responses of Incumbents to New Entry: the Effect of Ownership Structure, Capital Structure, and Focus, RFS
- # Hoberg, G. and G. Philips, 2010, Product market synergies and competition in mergers and acquisitions: A text-based analysis, Review of Financial Studies

G. Stock Market Liquidity

- # Stock Market Liquidity and the Cost of Issuing Equity (2005), Butler, Grullon, and Weston, Journal of Financial and Quantitative Analysis
- # Stock splits, trading continuity, and the cost of equity capital (2009), Lin, Singh and Yu, JFE
- # Stock Market Liquidity and Firm Dividend Policy Banerjee, Gatchev and Spindt Journal of Financial and Quantitative Analysis

- # Market liquidity and performance monitoring (1993), Holmstrom and Tirole, *Journal of Political Economy*
- # Asset liquidity and stock liquidity (2010), Gopalan, Kadan and Pevzner, Washington University in St. Louis Working Paper
- # The cash flow sensitivity of cash (2004), Almeida, Campello and Weisbach, *The Journal of Finance*
- # Discretionary disclosure and stock-based incentives (2003), Nagar, Nanda and Wysocki, *JFE*

H. *Law and Finance and Emerging Markets*

- # Deming-Kunt, Asli and Vojislav Maksimovic (1998), "Finance and firm growth" *The Journal of Finance*
- # La Porta, Rafael, Florencio Lopez-de-Silanes, Andrei Shleifer and Robert W. Vishny (1998) "Law and Finance," *Journal of Political Economy*, 106 (6), 1113-1155.
- # Almeida, H. and D. Wolfenzon (2006), A theory of pyramidal ownership and family business groups, *The Journal of Finance*
- # Gopalan, R., V. Nanda and A. Seru (2008), Affiliated Firms and Financial Support: Evidence from Indian Business Groups, *Journal of Financial Economics*
- # La Porta, Rafael, Florencio Lopez-de-Silanes, and Guillermo Zamarippa (2003), Related Lending, *Quarterly Journal of Economics*
- # Bae, Kee-Hong, Jun-Koo Kang and Jin-Mo Kim (2002) Tunneling or Value Added? Evidence from Mergers by Korean Business Groups, *The Journal of Finance*
- # Bertrand, Marianne, Paras Mehta, and Sendhil Mullainathan. 2002. "Ferretting out tunneling: An application to Indian business groups, *Quarterly Journal of Economics*
- # Fisman, R. and Love, I (2003) "Trade credit, financial intermediary development, and industry growth" *The Journal of Finance*,
- # Doidge, Craig, Andrew Karyoli and Rene Stulz (2004) "Why Are Foreign Firms that List in the U.S. Worth More?" *Journal of Financial Economics*

I. *Incomplete Contracts & Property Rights*

- # Hart, O., Chapters 2, 5 in *Book: Firms Contracts and Financial Structure*
- # Elfenbein, D., and J. Lerner, (2003). Ownership and Control Rights in Internet Portal Alliances, 1995-1999 *Rand Journal of Economics*
- # Kaplan, Steve and Per Stromberg, 2003, Financial Contracting Theory Meets the Real World: An Empirical Analysis of Venture Capital Contracts, *Review of Economic Studies*

J. *Incentive Contracts & CEO compensation*

- *Background Reading – everyone should read/skim through*

- Jensen, M. C. and K. J. Murphy, 1990a, Performance Pay and Top Management Incentives, *Journal of Political Economy* (Vol. 98), 225-264.
- Bebchuk, Lucian, Jesse Fried and David Walker, (2002), *Managerial Power and Rent Extraction in the Design of Executive Compensation*, (University of Chicago Law Review)
- # Mehran, H, 1995, Executive Compensation Structure, Ownership, and Firm Performance, *Journal of Financial Economics* (Vol. 38), 163-184.
- # Bertrand, M. and S. Mullainathan, 2001, Are CEOs rewarded for luck? The ones without principals are, *Quarterly Journal of Economics* 116, 901-932.
- # Core, John, Robert Holthausen and David Larcker, (1999), Corporate Governance, Chief Executive Officer Compensation, and Firm Performance, *JFE*
- # Adams, Renee, Heitor Almeida, and Daniel Ferreira, (2005), “Powerful CEOs and their Impact on Corporate Performance”, *RFS*
- # Fernandes, Ferreira, Matos and Murphy ”The Pay Divide: (Why) are U.S. Top Executives Paid More?” (working paper SSRN (2010)).
- # Gillan, Hartzell and Parrino, “Explicit versus Implicit Contracts: Evidence from CEO Employment Agreements” (2009) *The Journal of Finance*

K. *Internal Capital Markets*

- *Background Reading – everyone should read/skim through*
 - Lamont, O., 1997. Cash flow and investment: evidence from internal capital markets. *Journal of Finance*
- # Stein, J., 1997. Internal capital markets and the competition for corporate resources. *Journal of Finance*
- # Berger, P., Ofek, E., 1995. Diversification’s effect on firm value. *Journal of Financial Economics*
- # Shin, H., Stulz, R., 1998. Are internal capital markets efficient? *Quarterly Journal of Economics*

L. *Corporate Governance & Boards*

- # Duchin, Ran, John G. Matsusaka, and Oguzhan Ozbas, 2010, When are Outside Directors Effective?, *Journal of Financial Economics*
- # Coles, Jeffrey L., Naveen D. Daniel, Lalitha Naveen, 2008, Boards: Does One Size Fit All? *Journal of Financial Economics*, vol. 87, 329-356.
- # Masulis, Ronald W., and Shawn Mobbs, 2010, Are All Inside Directors the Same? CEO Entrenchment or Board Enhancement, *Journal of Finance*, forthcoming.
- # Cotter, J.F., A. Shivdasani and M. Zenner (1997), Do independent directors enhance target shareholder wealth during tender offers?, *Journal of Financial Economics*

M. *Large Shareholders and Corporate Governance*

- # Shleifer, A., and R Vishny, (1986), Large Shareholders and Corporate Control, The Journal of Political Economy
- # Dyck, A., and L. Zingales (2004), Private benefits of control: an international comparison, The Journal of Finance
- # Dennis, David J. and Jan M. Serrano, Active Investors and Management Turnover Following Unsuccessful Control Contests, Journal of Financial Economics, 40 (February 1996) 239-266.

N. *Free Cash Flows, Corporate Governance and Market for Corporate Control*

- *Background Reading – everyone should read/skim through*
 - Jensen, M.C. (1986), Agency costs of free cash flow, corporate finance, and takeovers, American Economic Review
- # Harford, J. and Mansi, S.A. and Maxwell, W.F. 2008, “Corporate governance and firm cash holdings in the US” Journal of Financial Economics
- # Pinkowitz, L. and Stulz, R. and Williamson, R, (2006) “Does the Contribution of Corporate Cash Holdings and Dividends to Firm Value Depend on Governance? A Cross-country Analysis” The Journal of Finance
- # Bertrand, Marianne and Sendhil Mullainathan, 2003, “Enjoying the Quiet Life? Corporate Governance and Managerial Preferences” The Journal of Political Economy
- # Mitchell, Mark L. and Kenneth Lehn (1990), “Do Bad Bidders Make Good Targets?” Journal of Political Economy
- # Masulis, R.W. and Wang, C. and Xie, F. (2007), “Corporate governance and acquirer returns”, The Journal of Finance
- # Gompers, Paul A., Joy L. Ishii, and Andrew Metrick, 2003, Corporate Governance and Equity Prices, Quarterly Journal of Economics
- # Moeller, Schlingemann, and Stulz, 2004, ”Firm Size and the Gains from Acquisitions,” Journal of Financial Economics
- # Mulherin, J. Harold and Annette B. Poulsen, Proxy contests and corporate change: implications for shareholder wealth, Journal of Financial Economics, 47 (March 1998).
- # Burkart, M., D Gromb, F Panunzi (1997) Large Shareholders, Monitoring, and the Value of the Firm - Quarterly Journal of Economics