FIN 6115, PhD seminar in Corporate Finance (Fall 2010)

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Time and Location: 3010 Pamplin Hall (subject to change), T/R 5:30-6:45pm.

Office Hours: By appointment.

Overview: In the first part of the course, we will focus primarily on the foundations of the theory of corporate finance. We will cover a small number of studies in great depth. In the second part, we will review important empirical papers primarily from capital structure, equity issuance and payout policy literatures. We will also get into econometrics of corporate finance where appropriate.

Material: Lectures and discussions will be based primarily on academic papers. The classics in the field and other important papers for our discussions are listed below in the outline. We may not cover all of the papers listed and additional papers may be added as we along. I may also give out lecture notes occasionally.

Supplementary readings:

1) J. A. de Matos, *Theoretical Foundations of Corporate Finance*, Princeton University Press.
2) Any major MBA level corporate finance textbook if you need help with the fundamentals.

Grading and assignments:

- Weekly paper summary
- A referee report (10%)
- Midterm project (20%)
- Class presentations and participation (35%)
- Final project (35%)

Paper summaries: Starting with the second week, each week you will be required to turn in a one-page summary of a finance journal article. You may choose articles from the *Journal of Finance*, the *Journal of Financial Economics,* and the *Review of Financial Studies.* The articles should be published in the last five years or forthcoming. Your summary should *briefly* describe the objective, methodology, and the conclusion of the paper. It should show that you have carefully read and understood the paper. You should use your own words and absolutely not copy-paste from the article. The papers you choose should be on a corporate finance topic.

Referee Report: An important aspect of this profession is the critical evaluation and constructive criticism of research papers. I will ask you to submit a 2-5 page referee report on a recent working paper.

Midterm project: I will ask you to replicate the central empirical findings of a paper we are reviewing. This is intended for you to get your hands dirty with data and be more familiar with the empirical process. Your submission should include descriptions of the empirical question, the data, and the methodology, as well as well-prepared tables, an interpretation of the findings, and the code you used to conduct the tests, if any.

Class presentations: I will ask you to present some of the important papers we are covering in class. You will be expected to understand and successfully communicate the central idea, the methodology, the conclusions etc. of the paper, as well as critically evaluate it and answer questions. Presentations should last about 15-20 minutes + Q&A.

Final project: 1st year PhD students have two options for the final project and can choose either one. Those with at least a year of PhD studies in finance or accounting have to pick the second option.

1) Write an in depth literature review on a corporate finance topic. The goal is not to put together a long list of articles, but rather to communicate how papers relate to each other; and to discuss where there are holes in the literature worth pursuing. In addition, replicate the central empirical findings of one of the important papers in that literature using recent data. We will choose the paper together; check with me.
2) Submit a package that consists of at least one one mini-paper and several brief research ideas on a corporate finance topic. The mini-paper should include a good description of the research question and potential contribution; a careful and extensive literature review; description of the data and methodological approach; and descriptive statistics and preliminary results if the idea is empirical in nature. The goal is to ultimately turn the mini-paper and/or the research ideas into a paper with publication potential.

Outline and Reading List (Tentative)

1. Fundamentals of Corporate Finance Theory (Fama & Miller's 1972 book)

- Allocation of resources by individuals
- Separation of ownership and management
- Objective of management

2. Perfect Capital Markets: The Modigliani-Miller Propositions

* Modigliani, F. and M. Miller "The Cost of Capital, Corporation Finance and the Theory of Investment," *American Economic Review,* June 1958, 261-297.

* Modigliani, F. and M. Miller "Dividend Policy, Growth, and the Valuation of Shares," *Journal of Business,* October 1961, 411-433.

3. Market Imperfections and Capital Structure

3.a. Taxes and Capital Structure

* Miller, M.H. "Debt and Taxes," *Journal of Finance*, May 1977, 261-275.

* DeAngelo, H. and R. Masulis "Optimal Capital Structure Under Corporate and Personal Taxation," *Journal of Financial Economics,* March 1980, 3-30.

* Graham, J. "How Big are the Tax Benefits of Debt?" *Journal of Finance* 55, 2000, 1901-1941.

Graham, J. and A. L. Tucker "Tax Shelters and Corporate Debt Policy" *Journal of Financial Economics* 81, 2006, 563 - 594.

Andrade, G. and S. N. Kaplan "How Costly is Financial (Not Economic) Distress? Evidence from Highly Levered Transactions that Became Distressed," *Journal of Finance* 53, 1998, 1443 – 1493.

* Almeida, H. and Philippon T. "The Risk-Adjusted Cost of Financial Distress," *Journal of Finance* 62, 2007, 2557-2586.

3.b. Agency Problems and Capital Structure

* Jensen, M. and W. Meckling "Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure," *Journal of Financial Economics*, October 1976, 305-360.

* Myers, S.C. "Determinants of Corporate Borrowing" *Journal of Financial Economics,* November 1977, 147-176.

* Jensen, M. "Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers," *American Economic Review*, May 1986, 323-329.

R.M. Stulz "Managerial discretion and optimal financing policies," *Journal of Financial Economics*, July 1990, 3-27.

Demsetz, H. and K. Lehn, "The Structure of Corporate Ownership: Causes and Consequences," *Journal of Political Economy* 93, 1985, 1155 – 1177.

Morck, R., A. Shleifer, and R. W. Vishny, "Management Ownership and Market Valuation: An Empirical Analysis," *Journal of Financial Economics* 20, 1988, 293 – 315.

Himmelberg, C. P., R. G. Hubbard, and D. Palia "Understanding the Determinants of Managerial Ownership and the Link Between Ownership and Performance," *Journal of Financial Economics* 53, 1999, 353 – 384.

* Rajan, R. G. and J. Wufl "Are Perks Purely Managerial Excess," *Journal of Financial Economics* 79, 2006, 1 – 33.

* Parrino, R. and M. S. Weisbach "Measuring Investment Distortions Arising from Stockholder – Bondholder Conflicts," *Journal of Financial Economics*, 1999, 3 – 42.

Ang, J. S., R. A. Cole, and J. W. Lin "Agency Costs and Ownership Structure," *Journal of Finance* 55, 2000, 81 – 106.

Roberts, M. R. and A. Sufi "Control Rights and Capital Structure: An Empirical Investigation," *Journal of Finance* 64, 2009, 1657 – 1695.

* Flannery, M.J. and Rangan, K.P. "Partial Adjustment toward Target Capital Structures," *Journal of Financial Economics*, 2006, 469-506.

3.c. Information Asymmetries and Capital Structure

Ross, S. "The Determination of Financial Structure: The Incentive Signalling Approach," *Bell Journal of Economics*, Spring 1977, 23-40.

* Myers, S. and N. Majluf "Corporate Financing and Investment Decisions When Firms Have Information that Investors Do Not Have," *Journal of Financial Economics*, June 1984, 187 221.

Frank, M.Z. and Goyal, V.K. "Testing the Pecking Order Theory of Capital Structure," *Journal of Financial Economics*, 2003, 217-248.

* Bharath, S. T., P. Pasquariello, and G. Wu "Does Asymmetric Information Drive Capital Structure Decisions?" *Review of Financial Studies* 22, 2009, 3211 -3243.

* Leary, M. T. and M. R. Roberts "The Pecking Order, Debt Capacity, and Information Asymmetry," *Journal of Financial Economics* 95, 2010, 332 – 355.

3.d. Market Timing

* Baker, M. and Wurgler, J. "Market Timing and Capital Structure," *Journal of Finance*, 2002, 1-32.

Alti, A. "How Persistent is the Impact of Market Timing on Capital Structure?" *Journal of Finance*, 2006, 1681-1710.

3.e. Managerial Characteristics

Heaton, J.B. "Managerial Optimism and Corporate Finance," *Financial Management*, Summer 2002, 33-45.

Lewellen, K. “Financing Decisions When Managers are Risk Averse,” *Journal of Financial Economics* 82, 2006, 551 - 589.

Malmendier U., G. A. Tate, and J. Yan “Managerial Beliefs and Corporate Finance Policies,” unpublished working paper.

3.f. Syntheses

* Frank, M.Z. and Goyal, V.K. “Capital Structure Decisions: Which Factors are Reliably Important,” *Financial Management* 38, 2009, 1 – 37.

Fama, E.F. and French K.R. “Testing Trade-Off and Pecking Order Predictions About Dividends and Debt,” *Review of Financial Studies*, 2002, 1-33.

Dittmar, A. “Capital Structure in Corporate Spin-Offs,” *Journal of Business* 77, 2004.

* Strebulaev, I.A. “Do Tests of Capital Structure Theory Mean What They Say?” *Journal of Finance*, 2007, 1747-1787.

* Byoun, S. “How and When Do Firms Adjust Their Capital Structures towards Targets,” *Journal of Finance* 63, 2008, 3069 – 3096.

* Lemmon, M.L., Roberts, M.R. and Zender J.F. “Back to the Beginning: Persistence and the Cross-Section of Corporate Capital Structure,” *Journal of Finance*, 2008, 1575-1608.

4. Payout Policy

4.a. Theory

Black, F. “The Dividend Puzzle,” *Journal of Portfolio Management*, 1976.

Bhattacharya, S. "Imperfect Information, Dividend Policy, and the 'Bird in the Hand' Fallacy," *Bell Journal of Economics*, Spring 1979, 259-270.

* Miller, M. and K. Rock "Dividend Policy under Asymmetric Information," *Journal of Finance*, September 1985, 1031-1051.

* Easterbrook, F. “Two Agency Cost Explanations of Dividends,” *American Economic Review,* September 1984, 650-659.

4.b. Empirical Evidence

Barclay, M.J. “Dividends, Taxes, and Common Stock Prices,” *Journal of Financial Economics* 19, 1987, 31-44.

Karpoff, J.M. and R.A. Walkling, "Short-term Trading Around Ex-Dividend Days: Additional Evidence," *Journal of Financial Economics* 21, 1988, 291-298.

Jagannathan, M., C. Stephens and M. Weisbach "Financial Flexibility and the Choice Between Dividends and Stock Repurchases," *Journal of Financial Economics*, September 2000, 355-384.

* Fama, E. and K. French "Disappearing Dividends: Changing Firm Characteristics or Lower Propensity to Pay?" *Journal of Financial Economics,* April 2001, 3-43.

* DeAngelo, H., L. DeAngelo and D.J. Skinner "Are Dividends Disappearing? Dividend Concentration and the Consolidation of Earnings," *Journal of Financial Economics*, June 2004, 425-456.

Guay, W. and Harford, J. "The Cash-Flow Permanence and Information Content of Dividend Increases versus Repurchases," *Journal of Financial Economics*, 2000, 385-415.

Dittmar, A. "Why Do Firms Repurchase Stock?" *Journal of Business*, July 2000, 331-355.

Grullon, G., R. Michaely "The Information Content of Share Repurchase Programs," *Journal of Finance*, April 2004, 651-680.

Nissim, D. and Ziv, A. "Dividend Changes and Future Profitability," *Journal of Finance, 2001*, 2111-2133.

Grullon, G., Michaely, R., Benartzi, S. and Thaler, R.H. "Dividend Changes Do Not Signal Changes in Future Profitability," *Journal of Business*, 2005.

Baker, M. and Wurgler, J. "A Catering Theory of Dividends," *Journal of Finance*, 2004, 1125-1165.

4.c. Review

Allen, F. and R. Michaely "Payout Policy," in *Handbook of the Economics of Finance*, 2003, edited by Constantinides, Harris, and Stulz.

Brav, A., Graham, J.R., Harvey, C.R. and Michaely, R. "Payout Policy in the 21st Century," *Journal of Financial Economics*, 2005, 483-527.

5. IPOs, VCs and Financial Intermediation

5.a. Theory

* Rock, K. "Why new issues are underpriced," *Journal of Financial Economics,* 1986, 15, 187 212.

* Beatty, R. P. and J. R. Ritter “Investment Banking, Reputation, and the Underpricing of Initial Public Offerings,” *Journal of Financial Economics* 15*,* 1986, 213 – 232.

Benveniste, L.M. and P.A. Spindt "How Investment Bankers Determine the Offer Price and Allocation of New Issues," *Journal of Financial Economics*, October 1989, 343-361.

Habib, M.A. and Ljungqvist A.P. “Underpricing and Entrepreneurial Wealth Losses in IPOs: Theory and Evidence,” *Review of Financial Studies*, 2001, 433-458.

* Loughran, T. and J.R. Ritter “Why Don’t Issuers Get Upset About Leaving Money on the Table?” *Review of Financial Studies*, 2002, Vol. 15, No. 2, 413-443.

* R.M. Edelen and G.B. Kadlec “Issuer surplus and the partial adjustment of IPO prices to public information,” *Journal of Financial Economics*, August 2005, 347-373.

5.b. Empirical Evidence

* Hanley, K., 1993, The Underpricing of Initial Public Offerings and the Partial Adjustment Phenomenon, *Journal of Financial Economics* 34, 231-250.

* Lowry, M., and G.W. Schwert, 2004, Is the IPO Pricing Process Efficient? *Journal of Financial Economics* 71, 3-26.

* Ince, O.S. “Why Do IPO Offer Prices Only Partially Adjust?” unpublished working paper, 2010.

James, C. “Relationship-Specific Assets and the Pricing of Underwriter Services,” *Journal of Finance* 47, 1992.

Schenone C. “The Effect of Banking Relationships on the Firm’s IPO Underpricing,” *Journal of Finance* 59, 2004.

Drucker S. and M. Puri “On the Benefits of Concurrent Lending and Underwriting,” *Journal of Finance* 60, 2005.

* Ljungqvist, A., F. Marston, and W. J. Wilhelm “Competing for Securities Underwriting Mandates: Banking Relationships and Analyst Recommendations,” *Journal of Finance* 61, 2006.

* Lee, P. M. and S. Wahal “Grandstanding, Certification and the Underpricing of Venture Capital Backed IPOs,” *Journal of Financial Economics* 73, 2004, 375 – 407.

Hellmann, T., L. Lindsey, and M. Puri “Building Relationships Early: Banks in Venture Capital,” *Review of Financial Studies*, 2007.

Schultz, P. "Pseudo Market Timing and the Long-Run Underperformance of IPOs," *Journal of Finance*, 2003, 483-517.

Yung, C., Colak, G. and Wang, W. "Cycles in the IPO Market," *Journal of Financial Economics*, 2008, 192-208,

Gao, X. and J. R. Ritter "The Marketing of Seasoned Equity Offerings," *Journal of Financial Economics* 97, 2010, 33 – 52.

5.c. Review

Ritter, J.R. and I. Welch "A Review of IPO Activity, Pricing, and Allocations," *Journal of Finance*, August 2002, 1795-1828.

Ritter, J.R. "Investment Banking and Securities Issuance," chapter 5 in Constantinides, Harris, and Stulz's North-Holland Handbook of the Economics of Finance, 2003.