FIN534, ECON582
Theoretical Foundations of Corporate Finance
Module 4, 2016-2017

Course Information

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Classes:
Lectures: Mondays and Thursdays, 13:30–15:20
Venue: 229/230

1. Course Description

1.1 Context

Course overview:

The goal of this course is to provide students with an understanding of the fundamentals and main ideas behind various corporate finance theories at the Master's level. This course will cover theoretical aspects of capital structure, financing, payout and investment policy choices and derive some practical and policy implications on the real world.

Prerequisites:

None

1.2 Textbooks and Reading Materials

My recommended reading materials are as follows.
1. Grinblatt & Titman (2001) is an excellent book, which covers practical aspects of corporate finance and asset pricing and some of the theory that we will need.
2. Brealey, Myers & Allen (2006) is a slightly more practical book, with a more intuitive coverage of the material. In this sense, this book is still useful.
3. Tirole (2006) covers contract-theoretic material in a clear, succinct and easy-to-follow fashion. From Class 8, I will closely follow this book.
4. I closely follow "Lecture Notes on Corporate Finance" written by Professor Alan Morrison, University of Oxford. You will get a copy of the lecture notes at the beginning of the course.
5. I also recommend a number of academic papers. You can download these papers from the University's online library.

2. Learning Outcomes

2.1 Intended Learning Outcomes

Learning Goals	Objectives	Assessment
1. Our graduates will be effective communicators.	1.1. Our students will produce quality business and research-oriented documents.	In-class discussion
	1.2. Students are able to professionally present their ideas and also logically explain and defend their argument.	In-class discussion
2. Our graduates will be skilled in team work and leadership.	2.1. Students will be able to lead and participate in group for projects, discussion, and presentation.	In-class discussion
	2.2. Students will be able to apply leadership theories and related skills.	In-class discussion
3. Our graduates will be trained in ethics.	3.1. In a case setting, students will use appropriate techniques to analyze business problems and identify the ethical aspects, provide a solution and defend it.	In-class discussion
	3.2. Our students will practice ethics in the duration of the program.	In-class discussion
4. Our graduates will have a global perspective.	4.1. Students will have an international exposure.	In-class discussion
5. Our graduates will be skilled in problem-solving and critical thinking.	5.1. Our students will have a good understanding of fundamental theories in their fields.	Mid-term and Final Exams
	5.2. Our students will be prepared to face problems in various business settings and find solutions.	Mid-term and Final Exams
	5.3. Our students will demonstrate competency in critical thinking.	Mid-term and Final Exams

2.2 Course specific objectives

Learning Goals	Objectives	Assessment
1. Our graduates will understand various fundamental theories in corporate finance.	1.1. Students are able to understand various tools required to understand corporate finance theories.	Mid-term and Final Exams
	1.2. Students are able to understand chief implications of major theories regarding corporate investment, financing, payout, and capital structure decisions.	Mid-term and Final Exams

2.3 Assessment/Grading Details

Type	Weighting	Date
Class participation and attendance	*10%*	
Mid-term examination 1	*30%*	*TBA*
Mid-term examination 2	*30%*	*TBA*
Final examination	*30%*	*TBA*
Total	*100%*	

2.4 Academic Honesty and Plagiarism

It is important for a student's effort and credit to be recognized through class assessment. Credits earned for a student work due to efforts done by others are clearly unfair. Deliberate

dishonesty is considered academic misconducts, which include plagiarism; cheating on assignments or examinations; engaging in unauthorized collaboration on academic work; taking, acquiring, or using test materials without faculty permission; submitting false or incomplete records of academic achievement; acting alone or in cooperation with another to falsify records or to obtain dishonestly grades, honors, awards, or professional endorsement; or altering, forging, or misusing a University academic record; or fabricating or falsifying of data, research procedures, or data analysis.

All assessments are subject to academic misconduct check. Misconduct check may include reproducing the assessment, providing a copy to another member of faculty, and/or communicate a copy of this assignment to the PHBS Discipline Committee. A suspected plagiarized document/assignment submitted to a plagiarism checking service may be kept in its database for future reference purpose.

Where violation is suspected, penalties will be implemented. The penalties for academic misconduct may include: deduction of honour points, a mark of zero on the assessment, a fail grade for the whole course, and reference of the matter to the Peking University Registrar.

For more information of plagiarism, please refer to *PHBS Student Handbook*.

3. Topics, Teaching and Assessment Schedule

No.	Topic	Reading
1	**Classical capital structure theories I** • Why do we care about the firms' financial structure? • Modigliani & Miller Propositions I • Modigliani & Miller Propositions II	Morrison (M): Chapter 6 Tirole (T): Chapter 2 Modigliani and Miller (1958) Miller and Modigliani (1961) Graham & Harvey (2001)
2	**Classical capital structure theories II** • Valuing tax shields • Bankruptcy and capital structure • Trade-off theory of capital structure • Theoretical Background of using tax-adjusted weighted average cost of capital	M: Chapters 7-8 Modigliani and Miller (1963) Miles & Ezzell (1980; 1985) Graham (2000)
3	**Tax-Adjusted WACC, Company Valuation, and Delevering** • Theoretical Background of using tax-adjusted weighted average cost of capital • Delevering company betas	M: Chapters 8-9 Inselbag & Kauford (1997) Hamada (1972)
4	**Dividends; Credit Rationing** • Dividend • Credit rationing: concepts and evidence	M: Chapters 10 & 11 GT: Chapter 15 BMA: Chapter 16 T: Chapter 3 Fazzari, Hubbard & Petersen (1988) Hoshi, Kashyap & Scharfstein (1991) Kaplan & Zingales (1997)
5	**Adverse selection in corporate finance** • Informational efficiency and allocative efficiency • Lemons problems and the pecking order theory of capital structure • Adverse selection and IPO underpricing	M: Chapter 12 GT: Chapters 16-20 Myers (1984) Myers & Majluf (1984) Jenkinson, Morrison & Wilhelm (2005) Ritter (2008) Rock (1986)
6	**Moral hazard and corporate finance** • Moral hazard and commitment problems • Resolving commitment problems: takeover markets	M: Chapter 13 GT: Chapters 16-20 Myers (1977) Grossman & Hart (1980)

	• Moral hazard and leverage • Risk-shifting • Debt overhang	Andrade, Mitchell & Stafford (2001) Jensen & Meckling (1976)
7	**Moral hazard and compensation contracts** • A simple model of managerial compensation • Evidence on managerial compensation	M: Chapter 14 Migrom & Roberts (1992, chapter 7) Jensen & Murphy (1990) Hall & Liebman (1998) Bebchuk and Grinstein (2005)
8	**Costly state verification and optimal contracting** • Introduction to contract theory • The revelation principle • Costly state verification	M: Chapter 15 T: Chapter 3 Appendix Townsend (1978) Gale & Hellwig (1985)
9	**Non-verifiable cash flows and optimal contracting** • Non-verifiable cash flows • Predation and financial contracting	M: Chapter 16 T: Chapter 3 Appendix Bolton & Scharfstein (1990)
10	**Verifiable cash flows and optimal contracting I** • Two-state models of pledgeability • Tirole's canonical model of moral hazard in corporate finance	M: Chapter 17 T: Chapter 4 Tirole (2001)
11	**Verifiable cash flows and optimal contracting II** • Application of Tirole's canonical model to debt overhang and a CRS project	M: Chapter 17 T: Chapter 4 Tirole (2001)
12	**Verifiable cash flows and optimal contracting III** • Monotone likelihood ratio property • Pledgeability with multiple states • Optimal contracting with moral hazard and verifiable cash flows	M: Chapter 18 T: Chapter 4 Milgrom (1981) Holmstrom (1979) Innes (1990)
13	**Liquidity in corporate finance** • Verifiable liquidity shocks • Non-verifiable liquidity shocks • Interim signals and speculative monitoring	M: Chapter 23 T: Chapter 4 Aghion, Bolton & Tirole (2004) Gomes & Philips (2005)
14	**Collateral** • Adverse selection models of collateral • Moral hazard models of collateral • Empirical evidence about collateral	M: Chapter 19 T: Chapter 4 Bester (1985) Berger & Udell (1990) Gonas, Highfield & Mullineaux (2004) Berger, Espinosa-Vega, Frame & Miller (2006)
15	**Optimal debt structure** • Optimal structure for debt issues • Another model of non-verifiable cash flows	M: Chapter 24 Bolton & Scharfstein (1996)
16	**Control Rights and Ownership** • A simple model of control rights • Multiple control rights • Control rights and performance	M: Chapter 25 T: Chapter 10 Aghion & Bolton (1992)