

# FIN530 (S1)

## Corporate Finance

### Module 2, 2019-2020

#### Course Information

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Office Hour: Monday & Thursday 13:30-15:30 (or by appointment via email)

**Teaching Assistant:**

Phone: -

Email:

Office Hour:

**Classes**

Lectures: Monday & Thursday 15:30-17:20

Venue: PHBS Building, Room 313

## 1. Course Description

### 1.1 Context

**Course overview:**

In the first part of this course, we will focus on the practical aspects of corporate finance, i.e., “valuation”: understanding the value implications of investment and financing decisions that firms make. We will build on the time value of money concepts and risk and return concepts that you have learned in earlier finance courses. However, this class is much more detailed and practical. As you will see, a large component of the grade comes from real-life projects, which require complex spreadsheet modeling in Excel. The in-class exercises and exams will also handle applications of concepts to solving real-life problems faced by businesses. We will also make extensive use of some of the accounting concepts. So, it’s a good idea to brush up on your accounting concepts, specifically, the organization of the balance sheet and the income statement. In the second part of this course, you will have an opportunity to get exposed to academic papers that emphasizes the theoretical foundations of corporate finance. This exercise will enable you to bridge a gap between theoretical and practical aspects of corporate finance.

By the end of this course, you should be able to:

- Evaluate corporate projects and make decisions based on financial data.
- Analyze a firm's financial statements and value the firm.
- Understand how investment and financing decisions impact the value of the firm.
- Develop complex spreadsheet models in Excel.
- Understand key theoretical papers and corresponding solution techniques.

The course is a mix of lecture and discussion. Lecture notes must be downloaded from the course website before class. I expect students to come to class prepared for active participation. Class attendance is strongly encouraged and is required during group presentations. To make

the most efficient use of limited class time, students who miss a class or are late are responsible themselves for getting notes, assignments, and announcements from their classmates. It is your responsibility to keep yourself informed of important developments pertaining to the course. Keeping your University email account updated is important. We do problems in class, so bring a calculator. A basic financial calculator is best, though a good basic scientific calculator that does powers is fine. Solutions to in-class exercises will not be distributed or posted.

Please remember to turn off your cell phone before class.

**Prerequisites:** N/A

## 1.2 Textbooks and Reading Materials

Lecture notes, assignments, academic articles and other useful information will be posted on the course web page.

**Required Text:** *Corporate Finance* by Ross, Westerfield, Jaffe, and Jordan, McGraw-Hill Inc., 11<sup>th</sup> Edition

**Reference Text:** *Financial Markets & Corporate Strategy* by Grinblatt and Titman, McGraw-Hill/Irwin, 2<sup>nd</sup> Edition

**Reference Text:** *The Theory of Corporate Finance* by Tirole, Princeton University Press.

## 2. Learning Outcomes

### 2.1 Intended Learning Objectives / Outcomes

Learning Goals	Objectives/Outcomes	Assessment
1. Our graduates will be effective communicators.	1.1. Our students will produce quality business and research-oriented documents.	✓
	1.2. Students are able to professionally present their ideas and also logically explain and defend their argument.	✓
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.	✓
	2.2. Students will be able to apply leadership theories and related skills.	
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.	
	3.2. Our students will practice ethics in the duration of the program.	
4. Our graduates will have a global perspective.	4.1. Students will have an international exposure.	✓
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.	✓
	5.2. Our students will be prepared to face problems in various business settings and find solutions.	✓
	5.3. Our students will demonstrate competency in critical thinking.	✓

### 2.2 Course specific objectives

### 2.3 Assessment/Grading Details

Assessment task	Weighting
Mid-term Exam	120
Final Project* Write-up	50
Final Project Presentation	40
Class participation	20
Quizzes	20
Total	250

*\*Details will be announced later.*

## 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

Weeks	Topics ( <i>tentative</i> )
1-2	<p><b>Introduction of corporate finance</b></p> <ul style="list-style-type: none"> <li><input type="checkbox"/> Syllabus: administrative information</li> <li><input type="checkbox"/> What is corporate finance?</li> <li><input type="checkbox"/> Goal of a financial manager</li> </ul> <p><b>Review of financial tools</b></p> <ul style="list-style-type: none"> <li><input type="checkbox"/> Valuation basics</li> <li><input type="checkbox"/> Time value of money, perpetuity, annuity</li> <li><input type="checkbox"/> Inflation, constant dollar adjustment</li> </ul> <p><u>Reading List</u></p> <ul style="list-style-type: none"> <li><input type="checkbox"/> Hart and Zingales, "Companies Should Maximize Shareholder Welfare Not Market Value", 2017, Journal of Law, Finance, and Accounting</li> </ul>

	<p><b>Cash flows</b></p> <ul style="list-style-type: none"> <li><input type="checkbox"/> Accrual accounting</li> <li><input type="checkbox"/> Free cash flow vs. net income</li> <li><input type="checkbox"/> Examples (handouts)</li> </ul> <p><b>Capital budgeting</b></p> <ul style="list-style-type: none"> <li><input type="checkbox"/> Incremental project cash flow</li> <li><input type="checkbox"/> Net present value, payback period, internal rate of return</li> </ul>
2-3	<p><b>Comparing projects</b></p> <ul style="list-style-type: none"> <li><input type="checkbox"/> Projects of equal life</li> <li><input type="checkbox"/> Equivalent annual cost</li> <li><input type="checkbox"/> Setting the bid price, break-even analysis</li> </ul> <p><b>Project analysis</b></p> <ul style="list-style-type: none"> <li><input type="checkbox"/> Managerial options, value of options</li> <li><input type="checkbox"/> Scenario analysis</li> <li><input type="checkbox"/> Sensitivity analysis</li> <li><input type="checkbox"/> Simulation analysis</li> </ul>
	<p><b>Projecting sales growth</b></p> <ul style="list-style-type: none"> <li><input type="checkbox"/> Trends in sales growth</li> <li><input type="checkbox"/> Relation to industry</li> <li><input type="checkbox"/> Regression analysis / time-series analysis / theoretical (accounting identity) analysis</li> </ul> <p><b>Financial statement analysis</b></p> <ul style="list-style-type: none"> <li><input type="checkbox"/> Ratio analysis to forecast financial statement</li> </ul>
3-4	<p><b>Financial statement analysis</b></p> <ul style="list-style-type: none"> <li><input type="checkbox"/> Dupont Identity (examples)</li> <li><input type="checkbox"/> Operating Leverage</li> </ul> <p><b>Financial modelling</b></p> <ul style="list-style-type: none"> <li><input type="checkbox"/> Building pro-formas</li> <li><input type="checkbox"/> Relation between financial statements</li> </ul>
	<p><b>Discounted cash flow valuation</b></p> <ul style="list-style-type: none"> <li><input type="checkbox"/> Sequential Valuation</li> </ul> <p><b>Multiples valuation</b></p> <ul style="list-style-type: none"> <li><input type="checkbox"/> Definition of Market Ratios</li> <li><input type="checkbox"/> Price-Earnings Ratio</li> </ul>

4-5	<p><b>Cost of capital</b></p> <ul style="list-style-type: none"> <li><input type="checkbox"/> WACC without and with taxes</li> <li><input type="checkbox"/> Divisional WACC</li> </ul> <p><b>Capital structure (I): Perfect market</b></p> <ul style="list-style-type: none"> <li><input type="checkbox"/> Proposition I: WACC</li> <li><input type="checkbox"/> Proposition II: Cost of equity</li> <li><input type="checkbox"/> Business and financial risk</li> <li><input type="checkbox"/> Unlevering beta / leveringing beta</li> </ul> <p><u>Reading List</u></p> <ul style="list-style-type: none"> <li><input type="checkbox"/> Modigliani and Miller, "The Cost of Capital, Corporation Finance, and the Theory of Investment", 1958, American Economic Review</li> <li><input type="checkbox"/> Modigliani and Miller, "Corporate Income Taxes and the Cost of Capital: A Correction", 1963, American Economic Review</li> <li><input type="checkbox"/> Berger and Ofek, "Diversification's Effect on Firm Value", 1995, Journal of Financial Economics</li> </ul>
5-6	<p><b>Capital structure (II): Imperfect market</b></p> <ul style="list-style-type: none"> <li><input type="checkbox"/> WACC with taxes</li> <li><input type="checkbox"/> WACC with bankruptcy costs</li> <li><input type="checkbox"/> Incorporating changes in leverage</li> <li><input type="checkbox"/> Value of levered firm</li> <li><input type="checkbox"/> Dollar gain from tax benefit</li> <li><input type="checkbox"/> Dollar cost due to bankruptcy</li> </ul> <p><b>Capital structure (III): The real world</b></p> <ul style="list-style-type: none"> <li><input type="checkbox"/> Agency costs: Debtholders and shareholders</li> <li><input type="checkbox"/> Agency costs: Managers and shareholders</li> </ul> <p><u>Reading List</u></p> <ul style="list-style-type: none"> <li><input type="checkbox"/> Jensen and Meckling, "Theory of the Firm: Managerial Behavior, Agency Cost, and Capital Structure", 1976, Journal of Financial Economics</li> </ul>
	<p><b>Agency cost and information asymmetry</b></p> <ul style="list-style-type: none"> <li><input type="checkbox"/> Agency costs</li> <li><input type="checkbox"/> Equity holder vs. manager</li> <li><input type="checkbox"/> Debt holder vs. equity holder</li> <li><input type="checkbox"/> Large shareholders vs. minority shareholders ("free-rider")</li> <li><input type="checkbox"/> Convertibles</li> <li><input type="checkbox"/> Capital structure</li> </ul> <p><u>Reading List</u></p> <ul style="list-style-type: none"> <li><input type="checkbox"/> Jensen and Meckling, "Theory of the Firm: Managerial Behavior, Agency Cost, and Capital Structure", 1976, Journal of Financial Economics</li> <li><input type="checkbox"/> Myers and Majluf, "Corporate Financing and Investment Decisions When Firms Have Information that Investors Do Not Have", 1984, Journal of Financial Economics</li> <li><input type="checkbox"/> Green, "Investment Incentives, Debt and Warrants", 1984, Journal of Financial Economics</li> <li><input type="checkbox"/> Shleifer and Vishny, "Large Shareholders and Corporate Control", 1986, Journal of Political Economy</li> </ul>

	<p><b>Raising capital</b></p> <ul style="list-style-type: none"> <li><input type="checkbox"/> IPOs</li> <li><input type="checkbox"/> Private equity market</li> <li><input type="checkbox"/> Rights</li> <li><input type="checkbox"/> Corporate bond</li> </ul> <p><u>Reading List</u></p> <ul style="list-style-type: none"> <li><input type="checkbox"/> Rock, "Why New Issues are Underpriced?", 1986, Journal of Financial Economics</li> </ul>
<b>6-7</b>	<p><b>Payout policy (I)</b></p> <ul style="list-style-type: none"> <li><input type="checkbox"/> Types of dividends</li> <li><input type="checkbox"/> Irrelevancy of dividends</li> <li><input type="checkbox"/> Taxes</li> <li><input type="checkbox"/> Stock repurchases</li> </ul> <p><b>Payout policy (II)</b></p> <ul style="list-style-type: none"> <li><input type="checkbox"/> The real world</li> <li><input type="checkbox"/> Dividend clienteles</li> <li><input type="checkbox"/> Signalling under asymmetric information</li> </ul> <p><u>Reading List</u></p> <ul style="list-style-type: none"> <li><input type="checkbox"/> Miller and Rock, "Dividend Policy Under Asymmetric Information", 1985, Journal of Finance</li> </ul>
<b>7-8</b>	<p><b>MIDTERM (18:30 – 21:30, Dec 26 - Thursday)</b></p> <p><b>No Classes on Jan 2 and Jan 6</b></p>
<b>8-9</b>	<p><b>Corporate governance</b></p> <ul style="list-style-type: none"> <li><input type="checkbox"/> Executive compensation</li> <li><input type="checkbox"/> Board of directors</li> </ul> <p>OR</p> <p><b>Endogeneity issues in empirical research</b></p> <p><b>Final project DUE (Jan 8 - Wednesday)</b></p> <p><b>Group presentations (Jan 9 and 13: in-class)</b></p> <p><b>Mandatory attendance day</b></p>