FINANCE 7801
FUNDAMENTALS OF CORPORATE FINANCE
Syllabus - Fall 2023

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Sessions	Days	Times	Location
10242	Thursday	12:00 PM – 3:00 PM	SFEBB 7122

Course Description

This course provides a rigorous introduction to fundamental concepts in corporate finance. The goal of the course is to familiarize students with central ideas underpinning research in corporate finance and develop an ability to frame phenomena in terms of existing theory. By the end of the course, students will have a working knowledge of the main tools of corporate finance research, and be equipped to begin independent research. This class begins with the neoclassical and tradeoff models, moves to agency problems and asymmetric information, then security design and control rights, and financial intermediation. It will then delve into the recent developments in corporate such as ESG, shareholder voting, etc.

Learning Objectives

- Become familiar with central theoretical ideas underpinning research in corporate finance.
- Become familiar with the central scholarly papers that form the foundation for modern corporate finance.
- Become familiar with the main empirical findings in the literature.
- Understand the limitations as well as strengths of core concepts in the field, and the areas where our understanding is most tenuous.
- Develop the ability to formulate and solve mathematical models in the field.
- Develop the ability to interpret and critique empirical evidence in the field.
- Develop the skill to summarize and present research findings.

Course Methods

Class meetings are structured around lectures that elaborate on models and analyze empirical results. Some papers will be presented by students to enhance presentation skills and foster a collaborative environment. Homework assignments will concentrate on modeling. The process of working through models offers multiple advantages: it fosters a more profound understanding of the underlying theory, equips students for independent theoretical research, and lays the groundwork for empirical studies.

In every class, students will present one or two papers, with each presentation typically lasting 20-30 minutes. The aim of these presentations is to acquaint students with the techniques used in presenting academic research. Students are encouraged to emulate the manner in which speakers present during our seminars.

By the end of the semester, each student is required to submit a mock referee report that mirrors the format of an authentic one. Students may select any published or unpublished papers from the past three years. The purpose of writing mock referee reports is to cultivate critical thinking in students and demonstrate how a research paper can encounter pushback.

In addition to referee reports, each student will be encouraged to write an empirical paper related to corporate finance. The topic of the paper may be freely chosen by the student. Since this is the first semester of your PhD career, we do not expect the paper to be publishable in AER. The purpose of this research paper is to encourage students to contemplate how to approach questions and to train them in identifying compelling research inquiries. If a student cannot develop a research paper, a sophisticated replication of existing papers published in top economics or finance journals may be submitted instead.

Grades

Grades will be assigned on the following basis:

Homework	25%
In-class presentations and participation	25%
Referee report	25%
Replication or research paper	25%

At times this class will follow a standard lecture format, but we will also approach learning in a variety of other ways. Your responsibilities are:

1. Attend class, and learn the lecture material.
2. Read the assigned papers.
3. In-class presentations.
4. Complete homework assignments.
5. Attend the Finance Seminar when the paper is in the area of corporate finance, and be prepared to discuss the paper in the following class.

READINGS

The following list is provisional and may be modified as the semester progresses. Required readings will be identified as we go. Asterisks indicate readings to pay more attention to.

Part I. Capital Structure: Debt versus Equity

1. *Neoclassical Model and Tradeoff Model*

E. F. Fama & M. H. Miller, The Theory of Finance, Dryden Press, 1972, Chapters 1, 2, .[Neoclassical model. Book is out of print but can be downloaded at http://faculty.chicagobooth.edu/eugene.fama/research/.]

R. G. Rajan and L. Zingales, "What Do We Know About Capital Structure? Some Evidence from International Data," Journal of Finance, December 1995. [Stylized facts.]

F. Modigliani and M. H. Miller, "The Cost of Capital, Corporation Finance, and the Theory of Investment," American Economic Review, June 1958. [The classic article.]

F. Modigliani and M. H. Miller, "Reply to Heins and Sprenkle," American Economic Review, September 1969. [Simpler proof using the risk-class method.]

M. H. Miller, "Debt and Taxes," Journal of Finance, May 1977. [Fundamental article.]

*G. Andrade & S. N. Kaplan, "How Costly is Financial (not Economic) Distress?," Journal of Finance, October 1998.

*J. R. Graham, "How Big Are the Tax Benefits of Debt?," Journal of Finance, 2000.

H. Almeida & T. Philippon, "The Risk-Adjusted Cost of Financial Distress," Journal of Finance, December 2007. [Risk-adjusted estimates.]

2. Tradeoff Theory

* Miller, Merton H., "Debt and Taxes," *JF*, May 1977. [Fundamental article.]

* Andrade, Gregor & Steven N. Kaplan, "How Costly is Financial (not Economic) Distress?," *JF*, October 1998.

* Graham, John R., "How Big Are the Tax Benefits of Debt?," *JF*, 2000.

* Faccio, Mara and Jin Xu, "Taxes and Capital Structure," *JFQA*, 2015.

Almeida, Heitor & Thomas Philippon, "The Risk-Adjusted Cost of Financial Distress," *JF*, December 2007. [Risk-adjusted estimates.]

Blouin, Jennifer L., John E. Core, and Wayne R. Guay, "Have the Tax Benefits of Debt Been Overestimated?," *JFE*, 2010. [Improved simulations; earnings mean reverting.]

Van Binsbergen, Jules H., John R. Graham, and Jie Yang, "The Cost of Debt," *JF*, 2010 . [Using 1986 TRA to trace out marginal cost functions.]

Elkamhi, Redouane, Jan Ericcson, and Christopher A. Parsons, "The Cost and Timing of Financial Distress," *JFE*, 2012. [Broader conception of bankruptcy cost.]

Maksimovic, Vojislav and Josef Zechner, "Debt, Agency Costs, and Industry Equilibrium," *JF*, 1990. [Industry equilibrium model.]

Korteweg, Arthur, "The Net Benefits to Leverage," *JF*, 2010.

3. Security Choice: Agency Problems & Asymmetric Information

*M. C. Jensen and W. H. Meckling, "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure," JFE, 1976. [Asset substitution.]

*S. C. Myers, "Determinants of Corporate Borrowing," Journal of Financial Economics, 1977. [Debt overhang/underinvestment.]

D. W. Diamond, "Reputation Acquisition in Debt Markets," Journal of Political Economy, August 1989. [Reputation as a solution.]

*S. C. Myers and N. S. Majluf, "Corporate Financing and Investment Decisions When Firms Have Information that Investors Do Not Have," Journal of Financial Economics, 1985. [Asymmetric information/adverse selection.]

S. A. Ross, "The Determinants of Financial Structure: The Incentive Signalling Approach," Bell Journal of Economics, 1977. [Signaling.]

*M. C. Jensen, "Agency Costs of Free Cash Flow, Corporate Finance and Takeovers," American Economic Review, May 1986. [Free cash flow problem.]

*R. Stulz, "Managerial Discretion and Optimal Financing Policies," Journal of Financial Economics, 1990. [Attempt to formalize FCF idea.]

J. Zwiebel, "Dynamic Capital Structure under Managerial Entrenchment," American Economic Review, 1996. [Endogenous debt in free cash flow environment.]

4. Financial Intermediation Theory (banks)

*Diamond, Douglas D. and Philip H. Dybvig, "Bank Runs, Deposit Insurance and Liquidity," JPE, 1983.

*Allen, Franklin and Douglas Gale, "Financial Contagion," JPE, 2000.

Diamond, Douglas W. "Financial intermediation and delegated monitoring." The review of economic studies 51.3 (1984): 393-414.

Keeley, Michael C. "Deposit insurance, risk, and market power in banking." The American economic review (1990): 1183-1200.

*Acemoglu, Daron, Asuman Ozdaglar, and Alireza Tahbaz-Salehi, 2015, Systemic risk and stability in financial networks, American Economic Review 105, 564–608.

Shu, "Endogenous Risk-Exposure and Systemic Instability", Working Paper

5. Evidence

*I. Shyam-Sunder and S. C. Myers, "Testing Static Tradeoff Against Pecking Order Models of Capital Structure," Journal of Financial Economics, 1999. [Tradeoff versus pecking order theory.]

*E. F. Fama & K. R. French, "Financing Decisions: Who Issues Stock?," Journal of Financial Economics, June 2005. [Evidence against the "pecking order" theory.]

M. T. Leary & M. R. Roberts, "Do Firms Rebalance Their Capital Structures?," Journal of Finance, 2005. [Evidence for tradeoff model with adjustment costs.]

J. Graham & C. Harvey, "The Theory and Practice of Corporate Finance: Evidence from the Field," Journal of Financial Economics, 2001. [What managers say they do.]

I. Welch, "Capital Structure and Stock Returns," Journal of Political Economy, 2004.[Capital structure changes driven by stock price changes.]

I. Strebulaev, "Do Tests of Capital Structure Theory Mean What They Say?," Journal of Finance, 2007.

I. Strebulaev & B. Yang, "The Mystery of Zero-Leverage Firms," Journal of Financial Economics, 2013.

Part II. Capital Market

1. *Takeovers, M&A, and boundaries of the firm*

Manne, "Mergers and the Market for Corporate Control," Journal of Political Economy, April 1965.

Coase, "The Nature of the Firm," undergraduate thesis, 1937.

Williamson, Oliver E. "Transaction-cost economics: the governance of contractual relations." The journal of Law and Economics 22.2 (1979): 233-261.

Grossman, Sanford J., and Oliver D. Hart. "The costs and benefits of ownership: A theory of vertical and lateral integration." Journal of political economy 94.4 (1986): 691-719.

Grossman and Hart, "Takeover Bids, the Free-Rider Problem, and the Theory of the Corporation," Bell Journal of Economics, Spring 1980. [Get the basic idea.]

Jensen, Michael C., and Richard S. Ruback. "The market for corporate control: The scientific evidence." *Journal of Financial economics* 11.1-4 (1983): 5-50.

Shleifer and Vishny, "Large Shareholders and Corporate Control," Journal of Political Economy, June 1986. [Single firm model. Understand how to construct the equilibrium and comparative statics.]

Boyan Jovanovich and Serguey Braguinsky, "Bidder Discounts and Target Premia in Takeovers," American Economic Review, March 2004. [Equilibrium model. Understand how to construct the equilibrium.]

2. *Diversification*

Lang and Stulz, "Tobin's q, Corporate Diversification, and Firm Performance," JPE, 1994.
Montgomery, "Corporate diversification," Journal of Economic Perspectives, 1994 [Survey of theories in strategy literature, with some useful facts]

Maksimovic and Phillips, "Conglomerate Firms, Internal Capital Markets, and the Theory of the Firm" Annual Review of Financial Economics, November 2013. [Survey]

Matsusaka, "Corporate Diversification, Value Maximization, and Organizational Capabilities," Journal of Business, 2001. [Endogenous diversification]

Maksimovic and Phillips, “Do Conglomerate Firms Allocate Resources Efficiently? Evidence from Plant-Level Data,” Journal of Finance, 2002. [Neoclassical]

Kaplan and Weisbach, “The success of acquisitions: Evidence from divestitures,” Journal of Finance, 1991. [High divestiture rate for conglomerate acquisitions]

Lins and Servaes, “International evidence on the value of corporate diversification,” Journal of Finance, December 1999. [Diversification discount in Japan and UK, but not in Germany]

3. *Investment-Cash Flow Sensitivity and Collateral Channel*

Fazzari, Hubbard, and Petersen, “Financing Constraints and Corporate Investment,” Brookings Papers on Economics Activity, 1988. [Initial evidence.]

Hoshi, Kashyap, and Scharfstein, “Corporate Structure, Liquidity, and Investment: Evidence from Japanese Panel Data,” Quarterly Journal of Economics, 1991. [Influential early evidence.]

Blanchard, Lopez-de-Silanes, and Sheifer, “What Do Firms Do with Cash Windfalls?,” Journal of Financial Economics, 1994. [Another kind of evidence.]

Kaplan and Zingales, “Do Investment-Cash Flow Sensitivities Provide Useful Measures of Financing Constraints?, Quarterly Journal of Economics, 1997. [Counterargument.]

Hoberg and Maksimovic, “Redefining Financial Constraints: A Text-Based Analysis,” Review of Financial Studies, 2015.

Almeida and Campello, “Financial Constraints, Asset Tangibility, and Corporate Investment,” Review of Financial Studies, 2007.

Part III. Capital Market

Shleifer and Vishny, “A Survey of Corporate Governance,” Journal of Finance, 1997.

Jensen and Murphy, “Performance Pay and Top-Management Incentives,” Journal of Political Economy, 1990.

Burkart, Gromb, and Panunzi, “Large Shareholders, Monitoring and the Value of the Firm,” Quarterly Journal of Economics, 1997.

Larcker, Ormazabal, and Taylor, “The Market Reaction to Corporate Governance Regulation,” Journal of Financial Economics, 2011.

Morck, Shleifer, and Vishny, “Management Ownership and Market Valuation: An Empirical Analysis,” Journal of Financial Economics, 1988.

Demsetz and Lehn, “The Structure of Ownership: Causes and Consequences,” Journal of Political Economy, 1985.

Gompers, Ishii, and Metrick, “Corporate Governance and Equity Prices,” Quarterly Journal of Economics, 2003.

Brav, Jiang, and Kim, “Recent Advances in Research on Hedge Fund Activism: Value Creation and Identification,” Annual Review of Financial Economics, 2015.

Adams and Ferreira, “A Theory of Friendly Boards,” Journal of Finance, 2007.
Harris and Raviv, “A Theory of Board Control and Size,” Review of Financial Studies, 2008.

Duchin, Matsusaka, and Ozbas, “When Are Outside Directors Effective?,” Journal of Financial Economics, 2010.

Ferreira, Ferreira, and Raposo, “Board Structure and Price Informativeness,” Journal of Financial Economics, 2011.

Nielsen and Nguyen, “The Value of Independent Directors: Evidence from Sudden Deaths,” Journal of Financial Economics, 2010.

Anabtawi, “Some Skepticism about Increasing Shareholder Power,” UCLA Law Review, 2006.

Bebchuk, “The Case for Increasing Shareholder Power,” Harvard Law Review, 2005.

Part IV. Recent Development in Corporate Governance

1. Shareholder Proposals

Cunat, Gine, and Guadalupe, “The Vote Is Cast: The Effect of Corporate Governance on Shareholder Value,” Journal of Finance, 2012.

Bach, Laurent, and Daniel Metzger. "How close are close shareholder votes?." The Review of Financial Studies 32.8 (2019): 3183-3214.

Denes, Karpoff, and McWilliams, “Thirty Years of Shareholder Activism: A Survey of Empirical Results,” Journal of Corporate Finance, forthcoming.

Karpoff, Malatesta, and Walkling, “Corporate Governance and Shareholder Initiatives: Empirical Evidence,” Journal of Financial Economics, 1996.

Matsusaka and Ozbas, “A Theory of Shareholder and Approval Rights,” Journal of Law, Economics, and Organization, 2017.

Matsusaka, Ozbas, and Yi, “Opportunistic Proposals by Union Shareholders,” working paper, 2017.

Matsusaka, Ozbas, and Yi, “Can Shareholder Proposals Hurt Shareholders? Evidence from No-Actin Letter Decisions,” working paper, 2017.

2. Shareholder Votes & Proxy Advisors

Malenko, Nadya, and Yao Shen, 2016, The role of proxy advisory firms: Evidence from a regression-discontinuity design, The Review of Financial Studies 29, 3394–3427.

Iliev, Peter, and Michelle Lowry. "Are mutual funds active voters?." The Review of Financial Studies 28.2 (2015): 446-485.

Shu, Chong, The Proxy Advisory Industry: Influencing and Being Influenced, Working Paper

Li, Tao, 2018, Outsourcing corporate governance: Conflicts of interest within the proxy advisory industry, Management Science 64, 2951–2971

Matsusaka, John G, and Chong Shu, 2021, A theory of proxy advice when investors have social goals, USC Marshall School of Business Working Paper .

Matsusaka, John G, and Chong Shu, 2022, Does proxy advice allow funds to cast informed votes?, USC Marshall School of Business Working Paper .

Malenko, Andrey, and Nadya Malenko, 2019, Proxy advisory firms: The economics of selling information to voters, The Journal of Finance 74, 2441–2490.

Malenko, Andrey, Nadya Malenko, and Chester S Spatt, 2021, Creating controversy in proxy voting advice, National Bureau of Economic Research w29036.

Brav, A., W. Jiang, T. Li, and J. Pinnington. 2019. Picking friends before picking (proxy) fights: How mutual fund voting shapes proxy contests. Working Paper, Columbia Business School.

Cvijanovic, D., A. Dasgupta, and K. E. Zachariadis. 2016. Ties that bind: How business connections affect mutual ´ fund activism. Journal of Finance 71:2933–66.

Davis, G. F., and E. H. Kim. 2007. Business ties and proxy voting by mutual funds. Journal of Financial Economics 85:552–70.

Iliev, P., J. Kalodimos, and M. Lowry. 2018. Investors' attention to corporate governance. Working Paper, Pennsylvania State University.

3. *Passive Investors*

Appel, Ian R., Todd A. Gormley, and Donald B. Keim. "Passive investors, not passive owners." Journal of Financial Economics 121.1 (2016): 111-141.

Schmidt, C., and R. Fahlenbrach. 2017. Do exogenous changes in passive institutional ownership affect corporate governance and firm value? Journal of Financial Economics, 124:285–306

Heath, Davidson, Daniele Macciocchi, Roni Michaely, and Matthew C. Ringgenberg. "Do index funds monitor?." The Review of Financial Studies 35, no. 1 (2022): 91-131.

Azar, José, Martin C. Schmalz, and Isabel Tecu. "Anticompetitive effects of common ownership." The Journal of Finance 73.4 (2018): 1513-1565.

Antón, Miguel, et al. "Common ownership, competition, and top management incentives." Journal of Political Economy 131.5 (2023): 1294-1355.

Lund, D. S. 2017. The case against passive shareholder voting. Journal of Corporation Law 43:493.

4. *Political Economy of Finance*

Fisman, Raymond (AER, 2001), Estimating the value of political connections.

Fos, V., Kempf, E., & Tsoutsoura, M. (2022). The political polarization of corporate america. SSRN Working Paper.

Bolton, Patrick, Tao Li, Enrichetta Ravina, and Howard Rosenthal, 2020, Investor ideology, Journal of Financial Economics 137, 320–352

Bubb, Ryan, and Emiliano M. Catan. "The party structure of mutual funds." The Review of Financial Studies 35.6 (2022): 2839-2878.

Ringgenberg, Matthew C. and Shu, Chong and Werner, Ingrid M., The Politics of Academic Research. Working Paper

Fabo, B., Jancokova, M., Kempf, E., & Pastor, L. (2021). Fifty shades of qe: Comparing findings of central bankers and academics. Journal of Monetary Eco- nomics, 120, 1-20.

Kempf, E., & Tsoutsoura, M. (2021). Partisan professionals: Evidence from credit rating analysts. The Journal of Finance, 76(6), 2805–2856

Hong, Harrison, and Leonard Kostovetsky. "Red and blue investing: Values and finance." Journal of financial economics 103.1 (2012): 1-19.

Di Giuli, Alberta, and Leonard Kostovetsky. "Are red or blue companies more likely to go green? Politics and corporate social responsibility." Journal of financial economics 111.1 (2014): 158-180.

5. *ESG: Shareholder v.s. Stakeholder*

Friedman, Milton, "A Friedman Doctrine – The Social Responsibility of Business Is to Increase Its Profits," New York Times, September 13, 1970.

Hart, Oliver and Luigi Zingales, "Companies Should Maximize Shareholder Welfare Not Market Value," Journal of Law, Finance, and Accounting, 2017, Vol. 2(2), 247-275.

Hartzmark, Samuel M. and Kelly Shue, "Counterproductive Sustainable Investing: The Impact Elasticity of Brown and Green Funds," working paper, Boston College and Yale University, March 2023.

Duchin, Ran, Janet Gao, and Qiping Xu, "Sustainability or Greenwashing: Evidence from the Asset Market for Industrial Pollution," working paper, Boston College, Georgetown University, University of Illinois, 2022.

Broccardo, E, Oliver Hart, and Luigi Zingales, "Exit versus Voice," Journal of Political Economy, 2022, Vol. 130(2), 3101-3145.

Berk, Jonathan B. and Jules H. van Binsbergen, "The Impact of Impact Investing," working paper, Stanford University and University of Pennsylvania, 2021.

Heath, Davison, Daniele Macciocchi, Roni Michaely, and Mathew CC Ringgenberg, "Does Socially Responsible Investing Chang Firm Behavior?," Review of Finance, 2023, 1-27.

Hartzmark, Samuel M., and Abigail B. Sussman. "Do investors value sustainability? A natural experiment examining ranking and fund flows." The Journal of Finance 74.6 (2019): 2789-2837.

Class Notes Policy

Notes or recordings made by students based on a university class or lecture may only be made for purposes of individual or group study, or for other usual noncommercial purposes that reasonably arise from the student's membership in the 3 class or attendance at the university. This restriction also applies to any information distributed, disseminated or in any way displayed for use in relationship to the class, whether obtained in class, via email or otherwise on the Internet, or via any other medium. Actions in violation of this policy constitute a violation of the Student Conduct Code, and may subject an individual or entity to university discipline and/or legal proceedings

University Policies

1. ***The Americans with Disabilities Act.*** The University of Utah seeks to provide equal access to its programs, services, and activities for people with disabilities. If you will need accommodations in this class, reasonable prior notice needs to be given to the Center for Disability Services, 162 Olpin Union Building, (801) 581-5020. CDS will work with you and the instructor to make arrangements for accommodations. All written information in this course can be made available in an alternative format with prior notification to the Center for Disability Services.

2. ***University Safety Statement.*** The University of Utah values the safety of all campus community members. To report suspicious activity or to request a courtesy escort, call campus police at 801-585-COPS (801-585-2677). You will receive important emergency alerts and safety messages regarding campus safety via text message. For more information regarding safety and to view available training resources, including helpful videos, visit safeu.utah.edu.

3. ***Addressing Sexual Misconduct***. Title IX makes it clear that violence and harassment based on sex and gender (which Includes sexual orientation and gender identity/expression) is a civil rights offense subject to the same kinds of accountability and the same kinds of support applied to offenses against other protected categories such as race, national origin, color, religion, age, status as a person with a disability, veteran's status or genetic information. If you or someone you know has been harassed or assaulted, you are encouraged to report it to the Title IX Coordinator in the Office of Equal Opportunity and Affirmative Action, 135 Park Building, 801-581-8365, or the Office of the Dean of Students, 270 Union Building, 801-581-7066. For support and confidential consultation, contact the Center for Student Wellness, 426 SSB, 801-581-7776. To report to the police, contact the Department of Public Safety, 801-585-2677(COPS).

4. **Academic Misconduct.** The Eccles School takes academic misconduct seriously. Here is an excerpt from our professional standards policy. "[P]rofessional or academic misconduct is not tolerated in the David Eccles School of Business. Students are expected to adhere to the standards of behavior outlined in the University of Utah Code of Student Rights and Responsibilities (Policy 6-400). Students engaging in behavioral misconduct could be subject to suspension or dismissal from the University."