



FBE 631a. ADVANCED CORPORATE FINANCE

Professors John G. Matsusaka & Oguzhan Ozbas

Fall 2017

Tuesdays 1:30 – 4:20

SYLLABUS

Overview and Learning Objectives

This is part (a) of the second course in the corporate finance PhD sequence. It builds on core concepts in FBE 630 to explore a variety of current topics, including investment-cash flow sensitivity, internal capital markets, diversification, takeovers, and corporate governance, areas where recent research has significantly advanced our understanding and in some cases reversed what was previously believed. The goal of the course is to familiarize students with central ideas underpinning research in corporate finance, develop an ability to frame phenomena in terms of existing theory, and to bring students to the research frontier in select areas. 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 on the topics covered in the class.

Course Methods

Class meetings are organized around lectures that develop models and discuss empirical results. There are periodic homework assignments that focuses on modeling. Working through models has several benefits: it develops a deeper understanding of the underlying theory, prepares the student for independent theoretical research, and provides a foundation for empirical research.

Grades

Grades will be assigned on the following basis:

Homework	40%
Final exam (October 10, 1:30 – 3:30 pm)	60%

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, learn the lecture material.
2. Read the assigned papers.
3. Complete homework assignments. Each homework assignment consists of formulating and/or solving a theoretical or empirical model related to recent class content.
4. Attend the FBE department's weekly Finance Seminar that features an external speaker when the paper is in the area of corporate finance, and be prepared to discuss the paper the following class.

Teaching Assistant

The teaching assistant is Chong Shu: Chong.Shu.PhD@marshall.usc.edu. Chong is a doctoral student in finance who is working on his dissertation. He will be grading homework and going over the solutions at a time to be arranged.

Contact Information

Don't hesitate to contact the instructors if you have questions about the class. Email is convenient: matsusak@usc.edu or ozbas@usc.edu or drop by our offices if we are there.

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 non-commercial purposes that reasonably arise from the student's membership in the 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.

Support Systems

Student Counseling Services (SCS) - (213) 740-7711 – 24/7 on call. Free and confidential mental health treatment for students, including short-term psychotherapy, group counseling, stress fitness workshops, and crisis intervention. <https://engemannshc.usc.edu/counseling/>

National Suicide Prevention Lifeline - 1-800-273-8255. Provides free and confidential emotional support to people in suicidal crisis or emotional distress 24 hours a day, 7 days a week. <http://www.suicidepreventionlifeline.org>

Relationship & Sexual Violence Prevention Services (RSVP) - (213) 740-4900 - 24/7 on call. Free and confidential therapy services, workshops, and training for situations related to gender-based harm. <https://engemannshc.usc.edu/rsvp/>

Sexual Assault Resource Center. For more information about how to get help or help a survivor, rights, reporting options, and additional resources, visit the website: <http://sarc.usc.edu/>

Office of Equity and Diversity (OED)/Title IX compliance – (213) 740-5086. Works with faculty, staff, visitors, applicants, and students around issues of protected class. <https://equity.usc.edu/>

Bias Assessment Response and Support. Incidents of bias, hate crimes and microaggressions need to be reported allowing for appropriate investigation and response. <https://studentaffairs.usc.edu/bias-assessment-response-support/>

Student Support & Advocacy – (213) 821-4710. Assists students and families in resolving complex issues adversely affecting their success as a student EX: personal, financial, and academic. <https://studentaffairs.usc.edu/ssa/>

Diversity at USC – <https://diversity.usc.edu/>. Tabs for Events, Programs and Training, Task Force (including representatives for each school), Chronology, Participate, Resources for Students

Students with Disabilities

USC is committed to making reasonable accommodations to assist individuals with disabilities in reaching their academic potential. If you have a disability which may impact your performance, attendance, or grades in this course and require accommodations, you must first register with the Office of Disability Services and Programs (www.usc.edu/disability). DSP provides certification for students with disabilities and helps arrange the relevant accommodations. Any student requesting academic accommodations based on a disability is required to register with Disability Services and Programs (DSP) each semester. A letter of verification for approved accommodations can be obtained from DSP. Please be sure the letter is delivered to us during the first week. DSP is located in GFS (Grace Ford Salvatori Hall) 120 and is open 8:30 a.m.–5:00 p.m., Monday through Friday. The phone number for DSP is (213) 740-0776. Email: ability@usc.edu.

Statement on Academic Integrity

USC seeks to maintain an optimal learning environment. General principles of academic honesty include the concept of respect for the intellectual property of others, the expectation that individual work will be submitted unless otherwise allowed by an instructor, and the obligations both to protect one's own academic work from misuse by others as well as to avoid using another's work as one's own. All students are expected to understand and abide by these principles. *SCampus*, the Student Guidebook, contains the Student Conduct Code in Section 11.00, while the recommended sanctions are located in Appendix A. Students will be referred to the Office of Student Judicial Affairs and Community Standards for further review, should there be any suspicion of academic dishonesty. The Review process can be found at: <http://www.usc.edu/student-affairs/SJACS/>. Failure to adhere to the academic conduct standards set forth by these guidelines and our programs will not be tolerated by the USC Marshall community and can lead to dismissal.

Plagiarism – presenting someone else's ideas as your own, either verbatim or recast in your own words – is a serious academic offense with serious consequences. Please familiarize yourself with the discussion of plagiarism in *SCampus* in Part B, Section 11, "Behavior Violating University Standards" <https://policy.usc.edu/scampus-part-b/>. Other forms of academic dishonesty are equally unacceptable. See additional information in *SCampus* and university policies on scientific misconduct, <http://policy.usc.edu/scientific-misconduct>.

Discrimination, sexual assault, and harassment are not tolerated by the university. You are encouraged to report any incidents to the *Office of Equity and Diversity* <http://equity.usc.edu/> or to the *Department of Public Safety* <http://capsnet.usc.edu/department/department-public-safety/online-forms/contact-us>. This is important for the safety of the whole USC community. Another member of the university community – such as a friend, classmate, advisor, or faculty member – can help initiate the report or can initiate the report on behalf of another person. *Relationship and Sexual Violence Prevention and Services (RSVP)* <https://engemannshc.usc.edu/rsvp/> provides 24/7 confidential support, and the sexual assault resource center webpage <https://sarc.usc.edu/reporting-options/> describes reporting options and other resources.

SCHEDULE AND READINGS

The following schedule is provisional and may be modified as the class progresses:

Class	Topic	Due
Aug. 22	Takeovers, M&A	
Aug. 29	Internal capital markets 1	HW 1
Sep. 5	Internal capital markets 2	HW 2
Sep. 12	Diversification	
Sep. 19	Investment-cash flow sensitivity	HW 3
Sep. 26	Governance 1	
Oct. 3	Governance 2	HW 4
Oct. 10	FINAL EXAM	

A reading list will be distributed before each class. The following list is provisional and may be modified as the semester progresses. Required readings will be identified as we go. Asterisks indicate readings that will be discussed in class.

1. Takeovers and M&A

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

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.]

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. Internal Capital Markets

Williamson, *Markets and Hierarchies: Analysis and Antitrust Implications* (The Free Press, 1975) [Chapters 8-9]. [Benefits of internal capital markets and winner picking]

Gertner, Scharfstein, and Stein, "Internal versus External Capital Markets," *Quarterly Journal of Economics*, November 1994. [Centrality of control rights]

Stein, "Internal Capital Markets and the Competition for Corporate Resources," *Journal of Finance*, March 1997. [§§ I-II] [Information advantages]

Matsusaka and Nanda, "Internal Capital Markets and Corporate Refocusing," *Journal of Financial Intermediation*, April 2002. [§§ 1-3] [Option to avoid external finance]

Lewellen, "A Pure Financial Rationale for the Conglomerate Merger," *Journal of Finance*, May 1971. [Coinsurance]

Faure-Grimaud and Inderst, "Conglomerate Entrenchment under Optimal Financial Contracting," *American Economic Review*, June 2005. [Tougher competitor]

Scharfstein and Stein, "The Dark Side of Internal Capital Markets: Divisional Rent-Seeking and Inefficient Investment," *Journal of Finance*, December 2000 [§ I]. [Rent seeking]

Ozbas, "Integration, Organizational Processes, and Allocation of Resources," *Journal of Financial Economics*, Jan. 2005 [§§ 1-4]. [Information distortion]

Rajan, Servaes, and Zingales, "The Cost of Diversity: The Diversification Discount and Inefficient Investment," *Journal of Finance*, February 2000. [§ III]

Maksimovic and Phillips, "Do Conglomerate Firms Allocate Resources Inefficiently Across Industries? Theory and Evidence," *Journal of Finance*, April 2002. [§§ II-III]

Shin and Stulz, "Are Internal Capital Markets Efficient?," *Quarterly Journal of Economics*, May 1998.

Chevalier, "What Do We Know About Cross-Subsidization? Evidence from Merging Firms," *Advances in Economic Analysis & Policy*, 2004, Article 3.

Ozbas and Scharfstein, "Evidence on the Dark Side of Internal Capital Markets," *Review of Financial Studies*, February 2010. [§§ 1-3]

3. 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]

Amihud and Lev, "Risk reduction as a managerial motive for conglomerate mergers," *Bell Journal*, 1981. [Managerial risk aversion]

Lewellen, "A pure financial rationale for conglomerate mergers," *Journal of Finance*, May 1971. ["Coinsurance" argument, not quite correct]

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]

Akbulut and Matsusaka, "50+ Years of Diversification Announcements," *Financial Review*, 2010. [Comprehensive event-study evidence]

Berger and Ofek, "Diversification's effect on firm value," *Journal of Financial Economics*, 1995.

Campa and Kedia, "Explaining the diversification discount," *Journal of Finance*, August 2002. [Evidence the discount causes diversification]

Chandler, *Scale and Scope: The Dynamics of Industrial Capitalism*, 1990. [History]

Custodio, Claudia, "Mergers and Acquisitions Accounting and the Diversification Discount," *Journal of Finance*, February 2014.

Graham, Lemmon, and Wolf, "Does corporate diversification destroy value?," *Journal of Finance*, April 2002. [Hardwired discount]

Hann, Ogneva, Ozbas, "Corporate Diversification and the Cost of Capital," *Journal of Finance*, 2013.

Hubbard and Palia, "A re-examination of the conglomerate merger wave in the 1960s: An internal capital markets view," *Journal of Finance*, December 1988.

Hyland and Diltz, "Why firms diversify: An empirical examination," *Financial Management*, Spring 2002. [Announcement returns]

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]

Lins and Servaes, "Is corporate diversification beneficial in emerging markets?," *Financial Management*, 2002. [Discount in some emerging markets]

Matsusaka, "Takeover Motives during the Conglomerate Merger Wave," *RAND Journal of Economics*, 1993. [Announcement returns]

Morck, Shleifer, and Vishny, "Do managerial objectives drive bad acquisitions?," *JF*, 1990.

Natividad, "Financial Capacity and Discontinuous Investment: Evidence from Emerging Market Multibusiness Firms," *Review of Financial Studies*, September 2013. [Identified]

Schoar, "Effects of corporate diversification on productivity," *Journal of Finance*, Dec. 2002.

Servaes, "The value of diversification during the conglomerate merger wave," *Journal of Finance*, September 1996. [Diversification discount in 1960s and 1970s]

Villalonga, "Does diversification cause the 'diversification discount'?, " *Financial Management*, 2004. [More on endogeneity]

Villalonga, "Diversification discount or premium? New evidence from BITS establishment-level data," *JF*, 2004. [Diversification discount statistical artifact?]

Yan, "Value of Conglomerates and Capital Market Conditions," *Financial Management*, 2006.

4. 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.

Chaney, Sraer, and Thesmar, "The Collateral Channel: How Real Estate Shocks Affect Corporate Investment," *American Economic Review*, 2012.

Duchin, Ozbas, and Sensoy, "Costly External Finance, Corporate Investment, and the Subprime Mortgage Credit Crisis," *Journal of Financial Economics*, 2010.

Ivashina and Scharfstein, "Bank Lending During the Financial Crisis of 2008," *Journal of Financial Economics*, 2010.

5. Corporate Governance

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.

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

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.

Instructor Profile

John G. Matsusaka

Education

B.A. Economics, University of Washington
M.A., Ph.D. Economics, University of Chicago

Professional

Charles F. Sexton Chair in American Enterprise, 2009-
Professor of Finance and Business Economics, USC Marshall School, 1991-
Professor of Business and Law, USC Law School, 2004-
Professor of Political Science, USC, 2005-
Executive Director, Initiative & Referendum Institute at USC, 2004-
Vice Dean for Faculty and Academic Affairs, USC Marshall School, 2007-2013
John M. Olin Visiting Professor of Economics, GSB, University of Chicago, 2001
Visiting Associate in Economics, California Institute of Technology, 2000
Visiting Scholar, Anderson School, UCLA, 1996
National Fellow, Hoover Institution, Stanford University, 1994-1995

Other Professional

Consultant on corporate governance, Council of Economic Advisors, Executive Office
of the President, Washington D.C., 2002

Research in Finance and Governance

"Can Shareholder Proposals Hurt Shareholders? Evidence from SEC No-Action Letters,"
with O. Ozbas and I. Yi, WP, 2017.

"Opportunistic Proposals by Union Shareholders," with O. Ozbas and I. Yi, WP, 2017.

"A Theory of Shareholder Approval and Proposal Rights," with O. Ozbas, *Journal of Law,
Economics, and Organization*, 2017.

"When Are Outside Directors Effective?," with R. Duchin and O. Ozbas, *Journal of
Financial Economics*, 2010.

"50+ Years of Diversification Announcements," with M. Akbulut, *Financial Review*, 2010.

"From Families to Formal Contracts: An Approach to Development," with K. Kumar,
Journal of Development Economics, 2009.

"Decision Processes, Agency Problems, and Incomplete Information: An Economic
Analysis of Capital Budgeting," with A. M. Marino, *Review of Financial Studies*, 2005.

"Internal Capital Markets and Corporate Refocusing," with V. Nanda, *Journal of Financial
Intermediation*, 2002.

"Corporate Diversification, Value Maximization, and Organizational Capabilities," *Journal
of Business*, 2001 [Merton Miller Prize for "most significant paper."]

Instructor Profile

Oguzhan Ozbas

Education

B.S. Industrial Engineering, Boğaziçi University
M.S. Industrial Administration, Carnegie Mellon University
Ph.D. Financial Economics, Massachusetts Institute of Technology

Professional

Associate Professor of Finance and Business Economics, USC Marshall, 2002-
Visiting Associate Professor of Finance, Koç University, 2011-2012, 2013-2015
Treasury Associate, Ford Motor Company, Dearborn, MI, 1995-1998

Other Professional

Consultant to the Corporate Affairs Division, Organisation for Economic Co-operation
and Development on the proxy advisory industry, Paris, France, 2014-15

Research in Corporate Finance and Governance

“Can Shareholder Proposals Hurt Shareholders? Evidence from SEC No-Action Letters,”
with J. Matsusaka and I. Yi, WP, 2017.

“Opportunistic Proposals by Union Shareholders,” with J. Matsusaka and I. Yi, WP, 2017.

“A Theory of Shareholder Approval and Proposal Rights,” with J. Matsusaka, *Journal of
Law, Economics, and Organization*, 2017.

“Disclosure of Status in an Agency Setting,” with A. Marino, *Journal of Economic Behavior
and Organization*, 2014.

“Corporate Diversification and the Cost of Capital,” with R. Hann and M. Ogneva, *Journal
of Finance*, 2013.

“Club Deals in Leveraged Buyouts,” with M. Officer and B. Sensoy, *Journal of Financial
Economics*, 2010.

“Costly External Finance, Corporate Investment, and the Subprime Mortgage Credit
Crisis,” with R. Duchin and B. Sensoy, *Journal of Financial Economics*, 2010.

“Evidence on the Dark Side of Internal Capital Markets,” with D. Scharfstein, *Review of
Financial Studies*, 2010.

“When Are Outside Directors Effective?,” with R. Duchin and J. Matsusaka, *Journal of
Financial Economics*, 2010.

“Integration, Organizational Processes, and Allocation of Resources,” *Journal of Financial
Economics*, 2005.