**UNIVERSITY OF PIRAEUS**

**DEPARTMENT OF BANKING AND FINANCE**

## Course Overview

The aim of this course is to provide an in-depth analysis of the key determinants of the investment and financing decisions of the firm.

The course will cover the following main topics:

- Capital Budgeting.
- The MM Propositions, the Effects of Taxes, Financial Distress/Bankruptcy Costs and the Static Trade-off Theory.
- Capital Structure under Asymmetric Information.
- Payout Policy: Dividends and Share Repurchases.
- Mergers and Takeovers.

## Background Readings

Brealey and Myers (**BM**), *Principles of Corporate Finance,* McGraw-Hill, 7th Edition, 2002.

Ross, Westerfield and Jaffe (**RWJ**), *Corporate Finance*, McGraw-Hill, 7th Edition, 2005.

## Recommended Textbooks

Copeland, Weston and Shastri (**CWS**), *Financial Theory and Corporate Policy*, Addison Wesley, 4th Edition, 2005.

De Matos (**DM**), *Theoretical Foundations for Corporate Finance,* Princeton University Press, 2001.

Tirole **(T)**, *The Theory of Corporate Finance,* Princeton University Press, 2006.

## Advanced/Supplementary Textbooks

Bolton and Dewatripont (**BD**), *Contract Theory*, MIT Press, 2005.

## Course Outline

**1. The Basics:** The Fisher Separation Theorem, the NPV Rule.

Readings: **BM**, Chs. 2, 3, 5
**CWS**, Chs. 1, 2
**DM**, Ch. 1
**RWJ**, Chs. 4, 6

**2. Capital Budgeting**

Readings: **BMA**, Chs. 6, 9, 11, 19
**DM**, Ch. 1
**RWJ**, Chs. 2, 7, 12, 17

M. Harris and A. Raviv (1996), "The Capital Budgeting Process: Incentives and Information", Journal of Finance, 51, pp. 1139-1174.

M. Harris and A. Raviv (1998), "Capital Budgeting and Delegation", Journal of Financial Economics, 50, pp. 259-289.

A. Bernardo, H. Cai and J. Luo (2004), "Capital Budgeting in Multidivision Firms: Information, Agency and Incentives", Review of Financial Studies, 17, pp. 739-767.

**3. Capital Structure I:** The MM Propositions, the Effects of Taxes, Financial Distress/Bankruptcy Costs and the Static Trade-off Theory.

Readings: **BM**, Chs. 14, 17, 18 (18.1 - 18.3), 20, 23
**CWS**, Chs. 15
**DM**, Ch. 2
**RWJ**, Chs. 14, 15, 16, (Sections 22.9, 22.10), 24

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

J. Graham (1996), "Debt and the Marginal Tax Rate", Journal of Financial Economics, 41, pp. 41-73.

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

J. Mackie-Mason (1990), "Do Taxes Affect Corporate Financing Decisions?" Journal of Finance, 45, pp. 1471-1495.

M. Miller (1977), "Debt and Taxes", Journal of Finance, 32, pp. 261-275.

M. Miller (1988), “The Modigliani-Miller Propositions After Thirty Years”, Journal of Economic Perspectives, 2, pp. 99-120.

R. Rajan and L. Zingales (1995), “What Do We Know about Capital Structure?” Some Evidence from International Data”, Journal of Finance, 50, pp. 1421-1460.

J. E. Stiglitz (1969), “A Re-Examination of the Modigliani-Miller Theorem”, American Economic Review, 59, pp. 784-793.

**4. Capital Structure II:** The Role of Asymmetric Information (Adverse Selection).

Readings: **CWS,** Ch. 12 (12.A)
**DM,** Ch. 3 (3.2)

S. Bharath, P. Pasquariello and G. Wu (2008), “Does Asymmetric Information Drive Capital Structure Decisions?”, forthcoming, Review of Financial Studies.

M. Brennan and A. Kraus (1987), “Efficient Financing under Asymmetric Information,” Journal of Finance, 42, pp. 1225-1244.

R. Chirinko and A. Singha (2000), “Testing Static Trade-off against Pecking Order Models of Capital Structure: A Critical Comment”, Journal of Financial Economics, 58, pp. 417-425.

I. Cho and D. Kreps (1987), Signalling games and stable equilibria, Quarterly Journal of Economics, 102, 179-221.

G. Constantinides and B. Grundy (1989), “Optimal Investment with Stock Repurchase and Financing as Signals”, Review of Financial Studies, 2, pp. 445-465.

D. De Meza and D. Webb (1987), “Too much investment: A problem of asymmetric information”, Quarterly Journal of Economics, 102, pp. 281-292.

E. Fama and K. French (2002), “Testing Trade-off and Pecking Order Predictions About Dividends and Debt”, Review of Financial Studies, 15, pp. 1-33.

E. Fama and K. French (2005), “Financing Decisions: Who Issues Stock?” Journal of Financial Economics, 76, pp. 549-582.

M.Z. Frank and V.K.Goyal (2003), “Testing the Pecking Order Theory of Capital Stucture”, Journal of Financial Economics, 67, pp. 217-248.

M. Harris and A. Raviv (1991), “The Theory of Capital Structure”, Journal of Finance, 46, pp. 297-355.

R. Heinkel (1982), “A Theory of Capital Structure Relevance under Imperfect Information,” Journal of Finance, 37, pp. 1141-1150.

J. Helwege and N. Liang (1996), "Is There a Pecking Order? Evidence from a Panel of IPO Firms", Journal of Financial Economics, 40, pp. 429-458.

H. Leland and D. Pyle (1977), "Information Asymmetries, Financial Structure and Financial Intermediation", Journal of Finance, 32, pp. 371-388.

S. Myers (1984), "The Capital Structure Puzzle", Journal of Finance, 39, pp. 575-592.

S. Myers and N. Majluf (1984), "Corporate Financing and Investment Decisions when Firms Have Information that Investors Do Not Have", Journal of Financial Economics, 13, pp. 187-221.

L. Shyam-Sunder and S. Myers (1999), "Testing Static Trade-off against Pecking Order Models of Capital Structure", Journal of Financial Economics, 51, pp. 219-244.

J. Stein (1992), "Convertible Bonds as Backdoor Equity Financing", Journal of Financial Economics, 32, pp. 3-21.

J. Stiglitz and A. Weiss (1981), "Credit Rationing in Markets with Imperfect Information", American Economic Review, 71, pp. 393-410.

**5. Capital Structure and Incentives**

Readings: **CWS,** Ch 12 (12.C)
**DM,** Ch 3 (3.1)

B. Biais and C. Casamatta (1999), "Optimal Leverage and Aggregate Investment", Journal of Finance, 54, pp. 1291-1323.

R. Green (1984), "Investment Incentives, Debt, and Warrants", Journal of Financial Economics, 13, pp. 115-136.

R. Innes (1990), "Limited Liability and Incentive Contracting with ex ante Action Choices," Journal of Economic Theory, 52, pp. 45-67.

M. Jensen (1986), "Agency Cost of Free Cash Flow, Corporate Finance and Takeovers", American Economic Review, 76, pp. 323-329.

M. Jensen and W. Meckling (1976), "Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure", Journal of Financial Economics, 3, pp. 305360.

S. Myers (1977), "The Determinants of Corporate Borrowing", Journal of Financial Economics, 5, pp. 147-175.

R. Parrino and M. Weisbach (1999), "Measuring Investment Distortions Arising from Stockholder-Bondholder Conflicts", Journal of Financial Economics, 53, pp. 3-42.

## 6. Capital Structure under Adverse Selection and Moral Hazard

M. Darrough and N. Stoughton (1986), "Moral Hazard and Adverse Selection: The Question of Financial Structure", Journal of Finance, 41, pp. 501-513.

K. Koufopoulos (2007), "Managerial Compensation and Capital Structure under Asymmetric information", mimeo, University of Warwick.

K. Koufopoulos (2009), "Optimal Securities under Adverse Selection and Moral Hazard", Journal of Mathematical Economics, 45, pp. 341-360.

## 7. Payout Policy

Readings: **BM,** Ch. 16
**CWS,** Ch 16
**DM,** Ch. 4
**RWJ,** Ch. 18

J. Aharony and I. Swary (1980), "Quarterly Dividends and Earnings Announcements and Stockholders Returns: An Empirical Analysis", Journal of Finance, 35, pp. 1-22.

P. Asquith and D. Mullins (1983), "The Impact of Initiating Dividend Payments on Shareholder Wealth", Journal of Business, pp. 77-96.

R. Bali and G. Hite (1998), " Ex dividend Day Stock Price Behaviour: Discreteness or Tax-Induced Clienteles?", Journal of Financial Economics, 47, pp. 127-160.

S. Bernartzi, R. Michaely and R. Thaler (1997), "Do Changes in Dividends Signal the Future or the Past?", Journal of Finance, 52, pp. 1007-1034.

D. Bernheim and A. Wantz (1995), "A Tax-Based Test of the Dividend Signalling Hypothesis", American Economic Review, 85, pp. 532-551.

S. Bhattacharya (1979), "Imperfect Information, Dividend Policy, and "the bird in the hand" Fallacy", Bell Journal of Economics, 10, pp. 259-270.

R. Comment and G. Jarrell (1991), "The Relative Signalling Power of Dutch-Auction and Fixed-Price Tender Offers and Open Market Share Repurchases", Journal of Finance, 46, pp. 1243-1271.

L. Dann (1981), "Common Stock Repurchases: An Analysis of Returns to Bondholders and Stockholders", Journal of Financial Economics, 9, pp. 113-128.

H. DeAngelo, L. DeAngelo and D. Skinner (2004), "Are Dividends Disappearing? Dividend Concentration and the Consolidation of Earnings", Journal of Financial Economics, 72, pp. 425-456.

E. Elton and M. Gruber (1970), "Marginal Stockholders' Tax Rates and the Clientele Effect", Review of Economics and Statistics, pp. 68-74.

E. Fama and K. French (1998), “Taxes, Financing Decisions, and Firm Values”, Journal of Finance, 53, pp. 819-843.

E. Fama and K. French (2001), “Disappearing Dividends: Changing Firm Characteristics or Lower Propensity to Pay?”, Journal of Financial Economics, 60, pp. 3-43.

G. Fenn and N. Liang (2001), “Corporate Payout Policy and Managerial Stock Incentives”, Journal of Financial Economics, 60, pp. 45-72.

G. Grullon and R. Michaely (2004), “The Information Content of Share Repurchase Programs”, Journal of Finance, 59, pp. 651-680.

A. Koch and A. Sun (2004), “Dividend Changes and Persistence of Past Earnings Changes”, Journal of Finance, 59, pp. 2093-2116.

R. Michaely, R Thaler and K. Womack (1995), “Price Reactions to Dividend Initiations and Omissions: Overreactions or Drift”, Journal of Finance, 50, pp. 573608.

M. Miller and K. Rock (1985), “Dividend Policy under Asymmetric Information”, Journal of Finance, 40, pp. 1031-1051.

A. Ofer and A. Thakor (1987), “A Theory of Stock Price Responses to Alternative Corporate Cash Disbursement Methods: Stock Repurchases and Dividends”, Journal of Finance, 42, pp. 365-394.

**8. The Market for Corporate Control:** Mergers and Takeovers

Readings: **BMA**, Chs. 33, 34
**CWS,** Ch 18 **RWJ**, Ch. 29

G. Gorton, M. Kahl and R. Rosen (2003), “Eat or Be Eaten: A Theory of Mergers and Merger Waves”, Working Paper, University of Pennsylvania.

S. Grossman and O. Hart (1980), “Takeover Bids, the Free-Rider Problem and the Theory of the Corporation”, Bell Journal of Economics, 11, pp. 42-64.

S. Grossman and O. Hart (1988), “One Share - One Vote and the Market for Corporate Control”, Journal of Financial Economics, 20, pp. 175-202.

O. Hart, *Firms, Contracts and Financial Structure*, Oxford University Press, 1995 (Chapter 8).

B. Holmstrom and S. Kaplan (2001), “Corporate Governance and Mergers Activity in the United States: Making Sense of the 1980s and 1990s”, Journal of Economic Perspectives, 15, pp. 121-144.

J. Harford (2005), “What Drives Merger Waves?”, Journal of Financial Economics, 77, pp. 529-560.

B. Jovanovic and P. Rousseau (2002), “The Q-Theory of Mergers”, American Economic Review, 92, pp. 198-204.

A. Kyle and J-L. Vila (1991), “Noise Trading and Takeovers”, RAND Journal of Economics, 22, pp. 54-71.

B. Lambrecht (2004), “The timing and Terms of Mergers Motivated by Economies of Scale”, Journal of Financial Economics, 72, pp. 41-62.

M. Rhodes-Kropf and S. Viswanathan (2004), “Market Valuation and Merger Waves”, Journal of Finance, 59, pp. 2685-2718.

M. Rhodes-Kropf, D. Robinson and S. Viswanathan (2005), “Market Valuations and Merger Activity: The Empirical Evidence”, Journal of Financial Economics, 77, pp. 561-603.