



Tuck School at Dartmouth

**ADVANCED CORPORATE FINANCE**

Spring 2009

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**DESCRIPTION**

This course surveys much of the scientific evidence in the field of corporate finance. The purpose is to help students develop a way of thinking about and quantitatively frame corporate finance decisions facing executives, management consultants, and investors. The readings and class discussions are largely non-technical, but students must have a good understanding of basic statistics and regression analysis. We discuss studies addressing (1) costs of alternative methods of raising capital, (2) capital structure choice and dividend policies, (3) costs associated with financial distress and bankruptcy, and (4) shareholder engagement policies and corporate control transactions. Working in groups of two, students are responsible for submitting weekly summaries of assigned readings, presenting individual articles to the class, as well as a final term project.

**GRADING**

- Class Participation – 60%, consisting of:
  - Individual participation in discussions
  - Six group submissions of a two-page memo on required readings
  - Two power point group presentations of a class topic.
- Group term project – 40%:

**TEXTBOOKS:**

The following two books should be purchased as a set. They contain comprehensive reviews of the latest empirical evidence in all the core areas of corporate finance, and they constitute the core reading for the course. They are available in the local Hanover bookstore and on the web, see e.g. [http://www.elsevier.com/wps/find/bookdescription.cws\\_home/714780/description#description](http://www.elsevier.com/wps/find/bookdescription.cws_home/714780/description#description)

Eckbo, B. Espen (ed.), 2007, *Handbook of Corporate Finance: Empirical Corporate Finance, Volume 1*, (Elsevier/North-Holland Handbook of Finance Series), ISBN-9780444508980

Eckbo, B. Espen (ed.), 2008, *Handbook of Corporate Finance: Empirical Corporate Finance, Volume 2*, (Elsevier/North-Holland Handbook of Finance Series), ISBN-9780444530905

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	<u>SESSION #</u>	<u>DATE</u>	<u>TOPIC</u>
<b>I.</b>	<b>INTRODUCTION</b>		
	1	Tue 3/24	The Banking Crisis (we're all Scandinavians now)
	2	Wed 3/25	Financial Contracts and Corporate Governance
	3	Mon 3/30	Executive Compensation - I
<b>II.</b>	<b>RAISING CAPITAL</b>		
	4	Tue 3/31	Security Offerings and the Rights Offer Paradox
	5	Mon 4/06	IPO Underpricing: Inefficient selling method?
	6	Tue 4/07	Do Corporate Insiders Time the Market?
<b>III.</b>	<b>FINANCIAL DISTRESS AND BANKRUPTCY</b>		
	7	Mon 4/13	Debt Renegotiations under Chapter 11
	8	Tue 4/14	Towards Auction Bankruptcy
<b>IV.</b>	<b>CAPITAL STRUCTURE AND DIVIDENDS</b>		
	9	Mon 4/20	Capital Structure Policy
	10	Tue 4/21	Taxes and Corporate Finance
	11	Mon 4/27	Dividend Policy
	12	Tues 4/28	Covenants and Optimal Security Design
<b>V.</b>	<b>SHAREHOLDER ENGAGEMENT AND CORPORATE CONTROL</b>		
	13	Mon 5/04	Executive Compensation - II (Stephen O'Byrne)
	14	Tue 5/05	The Norwegian Sovereign Wealth Fund (Runa Urheim)
	15	Mon 5/11	Takeover Bidding Strategies
	16	Tue 5/12	Hostile (Unsolicited) Takeovers
	17	Mon 5/18	Term project presentations
	18	Tue 5/19	Term project presentations

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**GROUP WRITE-UPS AND PRESENTATIONS**

The optimal is for students to form groups of two individuals. However, if someone wants to form “a group of one” then that’s possible – after consultation with Professor Eckbo.

Weekly group memos

Starting with Session 3, each group submits electronically to Professor Eckbo (email to the academic coordinator at [beth.perkins@dartmouth.edu](mailto:beth.perkins@dartmouth.edu)) a two-page memo answering a set of questions – listed below – based on the starred reading. The memo is due at the beginning of each class. There are a total of six memos, with the last memo due at the beginning of session 15.

Weekly group presentations

Each group will make two power-point presentations to the class over the term, addressing various class topics. These presentations may consist of an in-depth description of a single academic study, or a deeper analysis of some specific topic within the starred required reading. Each power point presentation is allocated 25 minutes of class time.

Group term paper

*(1) Timeline and format*

The term paper is due for presentation to class in Sessions 17 and 18. You need to submit electronically to Professor Eckbo a paper of maximum 10 typewritten pages (including tables and references) as well as a power point presentation of the main results and conclusions. You will be given about 20 minutes to present your results to the class.

*(2) Objective*

The objective is to describe and analyze a case which you think raises interesting corporate financing issues and/or governance-related conflicts in some part of the world. If you are familiar with or interested in a country other than the U.S., you are encouraged to present a case from your own region and culture. You are completely free to select the topic and emphasis. Previous classes have presented term papers on cases addressing intricate financing solutions to investment problems, decisions to go public, corporate takeover bidding, target defenses to hostile bids, charges of insider trading, evidence of “excessive” compensation, self dealing and other forms of wealth expropriation of minority shareholders, conflicts in bankruptcy, institutional activism, etc.

*(3) Literature*

Include a brief summary of one or more academic study that you think is relevant for the case, either directly or as background. If you cannot find a suitable academic paper in the syllabus, consult with Professor Eckbo. Note that if you are dealing with a foreign country, you should include a brief description of key aspects of the country’s financial and governance systems as these may not be widely known to the class.

A proposal for the term paper should be emailed to Professor Eckbo by Session 11 at the latest (April 27).

## READINGS

- “Required”: must be read by all.
- “\*\* Required”: requires two-page written memo
- “Recommended”: relevant additional reading
- “Ch#”: chapter found in the textbook volumes.

## I. INTRODUCTION

### SESSION 1: The Banking Crisis (we’re all Scandinavians now)

- *Agency and mispricing as sources of the credit crisis*
- *Lessons from previous banking crises*
- *The” Scandinavian solution”*
- *Should the US Treasury demand voting stock in return for capital?*

#### Required Readings:

Allen, Franklin, 2008, “Market Illiquidity and Financial Instability”, Unpublished paper, University of Pennsylvania.

Eckbo, B. Espen, 2009, “Ghosts of Crises Past”, *Financial Times*, Mastering Management Series, January 23, pp. 6-8.

U.S. Department of the Treasury, “Capital Assistance Program: Mandatorily Convertible Preferred Stock and Warrants”, [http://www.ustreas.gov/press/releases/reports/tg40\\_captermsheet.pdf](http://www.ustreas.gov/press/releases/reports/tg40_captermsheet.pdf)

### SESSION 2: Financial Contracts and Corporate Governance

- *The firm as a nexus of contracts – with differing legal protection*
- *Implications for director fiduciary responsibility*
- *Law and finance around the world*
- *International trends in corporate governance reform*

#### Required:

Shleifer, Andrei and Robert W. Vishny, 1997, “A Survey of Corporate Governance”, *Journal of Finance* 52, 737-783.

Jensen, Michael C., 2001, “Value Maximization, Stakeholder Theory, and the Corporate Objective Function”, Working paper Tuck School of Business at Dartmouth (reprinted in *Journal of Applied Corporate Finance* 14 (Fall), 8-21, 2001).

### **SESSION 3: Executive Compensation - I**

- *What are pros and cons of bonus systems?*
- *What are pros and cons of executive option programs?*
- *Are executives overpaid? Why or why not?*
- *Do you support the “say on pay” movement? Why or why not?*

#### **\*\*Required:**

Jensen, Michael C. and Kevin J. Murphy, 2004, “Remuneration: Where We’ve Been, How we Got to Here, What are the Problems, and How to Fix them”, Working paper, HBS and USC.

## **II. RAISING CAPITAL**

### **SESSION 4: Security Offerings and the Rights Offer Paradox**

- *What are alternative financing instruments and their flotation costs?*
- *How do information asymmetries affect flotation costs?*
- *Why have equity rights offers almost disappeared in the U.S.*
- *Recent developments towards “accelerated underwriting”*

#### **Required:**

Sections 1-4 in Eckbo, B. Espen, Ronald Masulis and Oyvind Norli, 2007, “Security Offerings” Ch6.

#### **Recommended:**

Eckbo, B. Espen, 2008, “Equity Issues and the Disappearing Rights Offer Phenomenon”, *Journal of Applied Corporate Finance* 20 (4), 72-85.

### **SESSION 5: IPO Underpricing: Inefficient selling method?**

- *The marketing process for IPOs*
- *Theories for IPO underpricing: Why do issuers leave money on the table?*
- *Why does the amount of under pricing change over time?*
- *What are cross-sectional determinants of underpricing?*

#### **\*\*Required:**

Ljungqvist, Alexander, 2007, “IPO Underpricing”, Ch7.

#### **Three Group Presentations:**

Loughran, Tim and Jay Ritter, 2004, “Why has IPO Underpricing Changed over Time?”, *Financial Management* (Autumn), 5-37.

Derrien, Francois and Kent L. Womack, 2003, “Auction vs. Bookbuilding and the Control of Underpricing in Hot IPO Markets”, *Review of Financial Studies* 16, 31-61.

Degeorge, Francois, Francois Derrien, and Ket L. Womack, 2007, “Analyst Hype in IPOs: Explaining the Popularity of Bookbuilding”, *Review of Financial Studies* 20, 1021-1058

### **SESSION 6: Do Corporate Insiders Time the Market?**

- *Performance measurement: Econometric issues*
- *Are stock returns following security issues abnormally low?*
- *Behavioral vs. risk explanations*
- *Do corporate insiders trade on inside information?*

#### Required:

Section 5 in Eckbo, B. Espen, Ronald W. Masulis, and Oyvind Norli, 2007, “Security Offerings” Ch6

#### Recommended:

Sections 1-2.2 and 2.4 in Baker, Malcolm, Richard S. Ruback and Jeffrey Wurgler, 2007, “Behavioral Corporate Finance”, Ch4.

Eckbo, B. Espen and David C. Smith, 1998, “The Conditional Performance of Insider Trades”, *Journal of Finance* 53, 467-498.

## **III. FINANCIAL DISTRESS AND BANKRUPTCY**

### **SESSION 7: Debt Renegotiations under Chapter 11**

- *What are different sources of distress costs?*
- *What do firms do to stave off bankruptcy?*
- *How does Chapter 11 work, and what are the economic effects?*
- *The Detroit bailout: what are pros and cons of invoking Chapter 11?*

#### \*\*Required:

Sections 1-7 in Hotchkiss, Edith S., Kose John, Robert Mooradian, and Karin S. Thorburn, 2008, “Bankruptcy and the Resolution of Financial Distress”, Ch14.

#### Recommended:

Baird, Douglas G. and Robert K. Rasmussen, 2003, “The End of Bankruptcy”, Working Paper Chicago Law School.

## **SESSION 8: Towards Auction Bankruptcy**

- *The U.S. trend towards using market-based mechanisms for resolving bankruptcy*
- *What are the pros and cons of an auction bankruptcy system versus Chapter 11*
- *Do bankruptcy auctions result in “fire sales”?*
- *The TWA bankruptcy: Anatomy of a failed U.S. bankruptcy auction*

### Required:

Section 8 in Hotchkiss, Edith S., Kose John, Robert Mooradian, and Karin S. Thorburn, 2008, “Bankruptcy and the Resolution of Financial Distress”, Ch14.

Eckbo, B. Espen and Karin S. Thorburn, 2008, “Automatic Bankruptcy Auctions and Fire-Sales”, *Journal of Financial Economics* 89, 404-422.

### Recommended:

Eckbo, B. Espen and Karin S. Thorburn, 2009, “Bankruptcy Auction”, *Journal of Applied Corporate Finance*, forthcoming.

## **IV. CAPITAL STRUCTURE AND DIVIDENDS**

### **SESSION 9: Capital Structure Policy**

- *What is the trade-off theory of capital structure choice?*
- *Do firms have capital structure targets?*
- *What is meant by the capital structure “pecking order” and why does it exist?*
- *What do cash holdings imply for capital structure theories?*

### \*\*Required:

Frank, Murray and Vidhan Goyal, 2008, “Tradeoff and Pecking Order Theories of Debt”, Ch12.

### Recommended:

Parsons, Chris and Sheridan Titman, 2008, “Capital Structure and Corporate Strategy”, Ch13

Bates, Thomas W., Kathleen M. Kahle, and Rene M. Stulz, 2009, “Why Do U.S. Firms Hold so Much More Cash than They Used to?”, *Journal of Finance*, forthcoming.

Chang, Xin and Sudipto Dasgupta, 2009, “Target Behavior and Financing: How Conclusive is the Evidence?”, *Journal of Finance*, forthcoming.

## **SESSION 10: Taxes and Corporate Finance**

- *Empirically, how large is the tax advantage of debt relative to equity?*
- *Yield spread between taxable corporate debt and tax-free municipal bonds of similar risk*
- *Do gains from LBO transactions largely emanate from tax savings?*
- *Taxes and the ex-dividend day price drop*

### Required:

Graham, John R., 2008, "Taxes and Corporate Finance", Ch11.

### Recommended:

Fama, Eugene F. and Kenneth R. French, 1998, "Taxes, Financing Decisions, and Firm Value", *Journal of Finance* 53, 819-843.

## **SESSION 11: Dividend Policy**

- *Why do investors demand dividends?*
- *What types of firms pay dividends and how much?*
- *Does the tax disadvantage of cash dividends affect stock returns?*
- *What explains the positive market reaction to surprise dividends?*

### \*\*Required:

Kalay, Avner and Michael Lemmon, 2008, "Payout Policy", Ch10.

### Recommended:

DeAngelo, Harry, Linda DeAngelo and Douglas J. Skinner, 2004, "Are Dividends Disappearing? Dividend Concentration and the Consolidation of Earnings", *Journal of Financial Economics* 72, 425-456.

## **SESSION 12: Covenants and Optimal Security Design**

- *The value of debt covenants as commitment device*
- *Types of security design*
- *Debt covenants aiming to resolve underinvestment incentives*
- *Covenants as a corporate control device*

### Required:

Smith, Clifford W. and Jerold B. Warner, 1979, "On Financial Contracting", *Journal of Financial Economics* 7, 117-161.

### Recommended:

Kaplan, Steven N. and Per Stromberg, 2003, "Financial Contracting Meets the Real World: An Empirical Analysis of Venture Capital Contracts", *Review of Financial Studies* 70, 2003, 281-315.

## V. SHAREHOLDER ENGAGEMENT AND CORPORATE CONTROL

### SESSION 13: Executive Compensation - I (Stephen O'Byrne)

- *Incentive effects of option programs*
- *Optimal compensation*

Required:

Aggarwal, Rajesh K., 2008, "Executive Compensation and Incentives", Ch17.

### SESSION 14: The Norwegian Sovereign Wealth Fund (Runa Urheim)

- *Investment policy of the Norwegian SWF*
- *The fund's governance objectives*
- *Are "socially responsible" investments policies socially responsible?*
- *What are pros and cons of investor activism?*

Required:

Del Guercio, Diane and Jennifer Hawkins, 1999, "The Motivation and Impact of Pension Fund Activism", *Journal of Financial Economics* 52, 291-340.

"The Norwegian Government Pension Fund: The Divestiture of Wal-Mart Stores Inc.", Columbia CaseWorks, ID#080301

Recommended:

Masulis, Ronald W., Cong Wang, and Fei Xie, 2009, "Agency Problems at Dual-class Companies", *Journal of Finance*, forthcoming.

### SESSION 15: Takeover Bidding Strategies

- *The costs of alternative mechanisms for acquiring corporate control*
- *What are elements of optimal bidding strategies?*
- *Why are bidder ownership stakes in the target (toeholds) so rare?*
- *Why are bidder gains small on average and often negative?*

\*\*Required:

Sections 1-5 in Betton, Sandra, B. Espen Eckbo and Karin Thorburn, 2008, "Corporate Takeovers", Ch15

Recommended:

Betton, Sandra, B. Espen Eckbo and Karin S. Thorburn, 2009, "Merger Negotiations and the Toehold Puzzle", *Journal of Financial Economics* 91, 158-178,

## **SESSION 16: Hostile (Unsolicited) Takeovers**

- *What is the legal basis for target defenses against a takeover bid?*
- *What are director fiduciary responsibilities when facing a takeover bid?*
- *Is society better off banning “poison pills” and other “draconian” takeover defenses?*
- *Empirically, what is the effect of poison pills on expected offer premiums?*

### Required:

Sections 2.3 and 5.2 in Betton, Sandra, B. Espen Eckbo and Karin Thorburn, 2008, “Corporate Takeovers”, Ch15

Comment, Robert and G. William Schwert, 1995, “Poison or Placebo? Evidence on the Deterrence and Wealth Effects of Modern Antitakeover Measures,” *Journal of Financial Economics* 39, 3-43.

### Recommended:

Danielson, Morris and Jonathan Karpoff, 1998, “On the Uses of Corporate Governance Provisions”, *Journal of Corporate Finance* 4, 347-371.

## **SESSIONS 17 and 18: Term paper presentations**