



Tuck School at Dartmouth

ADVANCED CORPORATE FINANCE

Winter 2011

B. ESPEN ECKBO

Tuck Centennial Professor of Finance and
Founding Director, Lindenauer Center for Corporate Governance
201 Woodbury Hall
(603) 646-3953
b.espen.eckbo@dartmouth.edu
www.tuck.dartmouth.edu/eckbo

KATI L. LEBRUN

Academic Coordinator
203 Woodbury
(603) 646-3412
kati.lebrun@tucknt.dartmouth.edu

DESCRIPTION

This advanced course surveys much of the scientific evidence in the field of corporate finance. It exposes students to the empirical research process and develops economic intuition about key corporate finance decisions in practice. The readings and class discussions are largely non-technical, but students must have a good understanding of basic statistics and regression analysis. Among the research topics are (1) investment banking and the capital acquisition process, (2) corporate capital structure choice and dividend policies, (3) bankruptcy resolution, (4) compensation policies and managerial incentives, and (5) corporate governance and control. 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

- 60% of the grade consist of the following three components:
 - Individual participation in discussions of the readings.
 - Group submissions of two-page memos on required readings
 - Group power point presentations of class reading.
- 40% of the grade: Term project (due and presented last week of class)

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 discussed in class, 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

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

ADVANCED CORPORATE FINANCE

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.

Two-page group memos

Each group submits electronically to Professor Eckbo (email to academic course coordinator Kati LeBrun at kati.lebrun@tucknt.dartmouth.edu) two-page memo answering the sets of questions listed below in this outline. Each memo is due at the beginning of each designated class.

Group paper presentations

Each group will make one or two (depending on class size) power-point presentations over the term, summarizing research papers as listed below. Each power point presentation is allocated around 40 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 double-spaced pages (plus 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 during the last week of the term.

(2) Objective

The objective of the term paper is to describe and analyze a case which you think raises interesting corporate financing issues 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 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 (Feb 8).

ADVANCED CORPORATE FINANCE
WINTER 2011
B. Espen Eckbo

<u>SESSION #</u>	<u>DATE</u>	<u>TOPIC</u>	<u>MEMO DUE</u>
I. CORPORATE FINANCE AND GOVERNANCE			
1	Tue	1/4 The Value Maximization Paradigm	
2	Wed	1/5 Corporate Governance: A Global perspective	
II. METHODOLOGICAL ISSUES			
3	Mon	1/10 Valuation and the “Bad Model” Problem	
4	Tue	1/11 “Rational” v. “Behavioral” Models	Memo #1
III. RAISING CAPITAL			
5	Tue	1/18 The New Issues Puzzle	
6	Wed	1/19 Why are IPOs Underpriced?	Memo #2
7	Mon	1/24 The Disappearing Rights Offer Phenomenon	
8	Tue	1/25 Security Offerings around the World	
IV. CAPITAL STRUCTURE CHOICE			
9	Mon	1/31 Debt Covenants and Security Design	
10	Tue	2/1 The Pecking Order Theory	Memo #3
11	Mon	2/7 Dividend Policy	
IV. BANKRUPTCY DESIGN			
12	Tues	2/8 Economics of Alternative Bankruptcy Systems	
13	Mon	2/14 What’s Different about Banks?	Memo #4
V. MANAGERIAL INCENTIVES AND RISK TAKING			
14	Tue	2/15 Structuring Executive Compensation	Memo #5
15	Mon	2/21 CEO Pay: A Compensation Consultant’s View	
16	Tue	2/22 Corporate Takeover Activity	
17	Mon	2/28 Term project presentations	
18	Tue	3/1 Term project presentations	

ADVANCED CORPORATE FINANCE READINGS

I. CORPORATE FINANCE AND GOVERNANCE

SESSION 1: The Value Maximization Paradigm

- *The firm as a nexus of contracts*
- *What should the firm maximize?*
- *The changing role of the board*
- *The government as shareholder*

Jensen, Michael C., 2001, "Value Maximization, Stakeholder Theory, and the Corporate Objective Function," Pre-published Working Paper, Tuck School of Business at Dartmouth.

Eckbo, B. Espen, 2009, "The Government as Active Shareholder," Testimony to the Congressional Domestic Policy Subcommittee of the Oversight and Governance Reform Committee (December 16).

SESSION 2: Corporate Governance: A Global Perspective

- *Investor rights protection*
- *Strong insiders – weak outsiders*
- *Institutional investor activism*
- *Negative screening: The Wal-Mart case*

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

Eckbo, B. Espen, 2005, "Strong Insiders Invite Weak Governance", *Financial Times, Mastering Series* (May 19).

MiniCase: "Norway Sells Wal-Mart", HBS 9-308-019

II. METHODOLOGICAL ISSUES

SESSION 3: Valuation and the "Bad Model" Problem

- *Why do model prices differ from market prices?*
- *Risk factors and the cross-section of expected returns*
- *Extracting information from corporate news events*
- *Performance measurement using portfolio weights*

Khotari, S.P. and Jerold B. Warner, "Econometrics of Event Studies," *Handbook* Ch. 1.

MiniCase: COSL Drilling Europe

SESSION 4: “Rational” v. “Behavioral” Models

Two-Page Memorandum #1:

- (1) Try to give a concise definition of the term “behavioral” versus the term “rational”.
- (2) Suggest corporate actions that you believe are best explained by behavioral activities.
- (3) What empirical evidence supports your suggestions under (2)?
- (4) Discuss whether a “behavioral” perspective is useful for our understanding of corporate finance decisions.

Baker, Malcolm, Richard Ruback and Jeffrey Wurgler, “Behavioral Corporate Finance,” *Handbook* Ch. 4.

Student Presentations:

Morck, Randall, 2008, “Behavioral Finance in Corporate Governance: Economics and Ethics of the Devil’s Advocate,” *Journal of Management and Governance* 12, 179-200.

Driesprong, Gerben, Ben Jacobsen and Benjamin Maat, 2008, “Striking Oil: Another Puzzle?” *Journal of Financial Economics* 89, 2008, 307-327.

III. RAISING CAPITAL

SESSION 5: The New Issues Puzzle

- *SEOs, IPOs, and Debt Offerings*
- *Why are stock returns following security offerings low?*
- *Behavioral versus risk explanations*
- *Liquidity risk*

Eckbo, B. Espen, Ronald Masulis and Oyvind Norli, “Security Offerings,” *Handbook* Ch. 6, Section 5.

SESSION 6: Why are IPOs Underpriced?

Two-Page Memorandum #2:

- (1) Summarize main arguments for why issuers and banks rationally would agree to underpricing.
- (2) What are possible behavioral arguments for underpricing? Are these supported by evidence?
- (3) If you were the issuing firm, how would you try to minimize the underpricing cost?
- (4) In a one-page Appendix, report results of regressing underpricing on issue characteristics (data file in course folder).

Ljungqvist, Alexander, “IPO Underpricing”, *Handbook* Ch. 7.

Student Presentations:

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

Kerins, Frank, Kenji Kutsuna and Richard Smith, 2007, “Why are IPOs Underpriced? Evidence from Japan’s Hybrid Auction-Method Offerings,” *Journal of Financial Economics* 85, 637-666.

SESSION 7: The Disappearing Rights Offer Phenomenon

- *Alternative flotation methods and their costs*
- *How do information asymmetries affect flotation costs?*
- *Why have equity rights offers almost disappeared in the U.S?*
- *The equity rights offer as a last resort*

Eckbo, B. Espen, Ronald Masulis and Oyvind Norli, 2007, “Security Offerings,” *Handbook* Ch. 6, Sections 2 and 3.

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

MiniCase: Norsk Hydro

SESSION 8: Security Offerings Around the World

- *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?*
- *The equity rights offer as a last resort*

Student Presentations:

Henderson, Brian J., Narasimhan Jegadeesh, and Michael S. Weisbach, 2006, “World Markets for Raising New Capital,” *Journal of Financial Economics* 82, 63-101.

Kim, Woojin and Michael S. Weisbach, 2008, “Motivations for Public Equity Offers: An International Perspective,” *Journal of Financial Economics* 87, 281-307.

III. CAPITAL STRUCTURE CHOICE

SESSION 9: Debt Covenants and Security Design

- *Debt covenants as a commitment device*
- *Types of security design*
- *Addressing underinvestment incentives*
- *The role of convertible securities*

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

Holderness, Clifford G. and Dennis P. Sheehan, 1991, “Monitoring an Owner: The Case of Turner

Broadcasting”, *Journal of Financial Economics* 30, 325-346

MiniCase: “Black Box Technologies, Inc” Term Sheet for Convertible Preferred Shares

SESSION 10: The Pecking Order Theory

Two-Page Memorandum #3:

- (1) Briefly characterize the “tradeoff theory” and list what you think are its empirical implications.
- (2) Briefly characterize the “pecking order theory” and list what you think are its empirical implications
- (3) Which theory do you believe best characterizes actual corporate capital structure decisions? Explain.

Frank, Murray and Vidhan Goyal, “Tradeoff and Pecking Order Theories of Debt,” *Handbook* Ch. 12.

Student Presentations:

Lemmon, Michael L, Michael R. Roberts and Jamie F. Zender, 2008, “Back to the Beginning: Persistence and the Cross-Section of Corporate Capital Structures,” *Journal of Finance* 63, 1575 – 1608.

Kayhan, Avia and Sheridan Titman, 2007, “Firms’ Histories and their Capital Structures,” *Journal of Financial Economics* 83, 1-32.

SESSION 11: Dividend Policy

- *The puzzling demand for dividends*
- *What types of firms pay dividends?*
- *What theory best describes actual dividend policies?*

Kalay, Avner and Michael Lemon, “Payout Policy”, *Handbook* Ch. 10.

IV. BANKRUPTCY DESIGN

SESSION 12: Economics of Alternative Bankruptcy Systems

- *What is bankruptcy law trying to accomplish?*
- *How does Chapter 11 work, and what are the economic effects?*
- *Auction as a bankruptcy mechanism*
- *Do auctions cause “fire-sales”?*

Hotchkiss, Edith S., Kose John, Robert Mooradian, and Karin S. Thorburn, 2008, “Bankruptcy and the Resolution of Financial Distress,” *Handbook* Ch.14.

Eckbo, B. Espen and Karin S. Thorburn, 2009, “Bankruptcy as an Auction Process: Lessons from Sweden”, *Journal of Applied Corporate Finance* 21, 36-50.

SESSION 13: What's Different about Banks?

- *Banks and the too-big-to-fail doctrine*
- *Capital standards and the Basel Accords*
- *“Speed bankruptcy” – can it work?*
- *Reverse convertible debt and forced equity rights offers*

Two-Page Memorandum #4

- (1) Briefly state your favorite explanation for the banking crisis
- (2) Discuss the too-big-to-fail doctrine. Is it valid – and if so why?
- (3) How would you propose to regulate banks to avoid future crises?

Eckbo, B. Espen, 2010, “Banking System Bailout – Scandinavian Style,” *Journal of Applied Corporate Finance* 22 (3), 85-93.

Student presentations:

Duffie, Darrell, 2010, “The Failure Mechanisms of Dealer Banks,” *Journal of Economic Perspectives* 24, 51-72.

Admati, Anat R., Peter M. DeMarzo, Martin Hellwig and Paul Pfleiderer, 2010, “Fallacies, Irrelevant Facts, and Myths in the Discussion of Capital Regulation: Why Bank Equity is NOT Expensive,” Working paper, Stanford University.

V. MANAGERIAL INCENTIVES AND RISK TAKING

SESSION 14: Structuring Executive Compensation

- *How do you determine the pay level?*
- *Is CEO pay-performance sensitivity significant?*
- *Does option-based compensation induce excessive risk taking?*
- *Why “say on pay”?*

Two-Page Memorandum #5:

- (1) Discuss pros and cons of stock option programs
- (2) How would you determine the total size of CEO compensation (sum of all pay components)?
- (3) Do you think executive stock option programs influence corporate leverage strategies? Explain.
- (4) Do you think investor “say on pay” is useful? Why or why not?

Aggarwal, Rajesh, “Executive Compensation and Incentives”, *Handbook* Ch. 17.

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.

SESSION 15: CEO Pay: A Compensation Consultant's View

Class Visitor: Stephen O'Byrne, President, Shareholder Value Advisors, Inc.

O'Byrne, Stephen F. and S. David Young, 2005, "Top Management Incentives and Corporate Performance", *Journal of Applied Corporate Finance* 17, 105—114.

Fahlenbrach, Rudiger and Rene Stulz, 2009, "Bank CEO Incentives and the Credit Crisis," Working Paper, Ohio State University.

SESSION 16: Corporate Takeover Activity

- *Aggregate takeover activity*
- *Gains and losses from bidding*
- *Takeover financing*

Betton, Sandra, B. Espen Eckbo, and Karin S. Thorburn, "Corporate Takeovers," *Handbook* Ch. 15.

SESSIONS 17 and 18: Term paper presentations