

Unit Plan

School of Accounting, Finance and Economics

ECF5106/4106: Corporate Finance

Semester 1, 2011

Lecturer/Unit Coordinator

Name	Room no	Contact number/s	eMail	Consultation times
Professor D.E. Allen	JO2.355	(08) 6304 5471	d.allen@ecu.edu.au	Friday 1:30 – 2:30pm

Lecture(s) and location

Day: Tuesday	Time: 13:30 – 16:30	Room no: JO 02.126
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Other staff contacts

Name	Role	Room no	Contact number	eMail

Corporate Finance 5106/4106

Professor D.E. Allen, Room number 2.355 (Joondalup)

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AIMS AND OBJECTIVES

The objective of this course is to provide a deeper understanding of corporate finance and the finance function. This includes corporate investment and financing decisions from both theoretical and empirical viewpoints. The course will proceed by first analysing corporate financial policy and investment decisions in perfect capital markets under conditions of certainty and then introducing uncertainty and applications of mean/variance analysis and the CAPM. Various market imperfections will then be introduced; such as taxation, agency costs and information asymmetries. The basic decision areas will then be re-evaluated in the light of the above considerations. Course participants will be encouraged to utilise the original papers as well as prescribed texts. This should build an awareness of both the strengths and limitations of the models and methods used currently in this branch of financial economics. The controversies, schisms, and contradictions in viewpoints should be evident. Nevertheless the tremendous advances in the scope of financial economics and the close marriage between theory and empirical work should become apparent.

COURSE OUTLINE

- Week 1** Introduction and overview. The change in perspective in financial economics in recent years.
- Week 2** Capital markets, consumption and investment, investment decisions.
- Week 3** Financing and dividend decisions under certainty. Corporate Valuation.
- Week 4** Special topics on capital budgeting: optimal duration, replacement rules and abandonment value. Constrained capital budgeting problems.
- Week 5** Valuation of assets and the firm. Capital structure decisions: certainty and uncertainty.
- Week 6** Corporate financing decisions in a mean/variance framework. Applications of the CAPM. CAPM in a multi-period context
- Week 7** Taxation and corporate financial policy decisions
- 25 April** No lecture MIDSEMESTER BREAK 25th -29th APRIL
- Week 8** Agency theory: implications for capital structure and dividend decisions.
- Week 9** Signalling models, information asymmetries and corporate financing decisions
- Week 10** Options pricing and contingent claims: applications to corporate financing decisions

- Week 11** Mergers and takeovers: theory and evidence.
- Week 12** Financial engineering: swaps, financial futures and various hedging techniques.
- Week 13** Corporate Finance in Japan: a contrast in practices.
Course review: Current issues and controversies

COURSE STRUCTURE

The first few weeks will consist of lectures, assigned readings and discussion of materials.

ASSESSMENT

2 Assignments/Essays	50 (25% each)
Examination	<u>50</u>
	<u>100</u>

All assignments must be typed. (Length should not be greater than 15-20 A5 pages.)

Marks will be deducted for work that is handed in late.

RECOMMENDED COURSE TEXTS:

Copeland, Weston, and Shastri, *Financial Theory and Corporate Policy*, 4th Edition, Addison Wesley, (2004).

TEXTBOOKS AND REFERENCES

Introductory:

Brealey and Myers, *Principles of Corporate Finance*, 3rd Edition

D.E. Allen, *Finance: A Theoretical Introduction*, Basil Blackwell, (1983).

More Advanced:

T.E. Copeland, J.F. Weston, and K. Shastri, *Financial Theory and Corporate Policy*, Addison Wesley, 4th Edition (2004).

E.F. Fama & M.H. Miller, *The Theory of Finance*, Holt, Rinehart & Winston, (1972).

K. Cuthbertson, *Quantitative Financial Economics*, John Wiley and Sons, New York, (1996).

Course reading and reference material
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Week beginning (Monday)

- Week 1** C.W. Smith, “*The Theory of Corporate Finance: a Historical Overview*”.
- (Lecture 1) R.M. Stulz, “*Merton Miller and Modern Finance, Financial Management*, (Winter 2000).
- L. Zingales, “In Search of New Foundations”, *Journal of Finance*”, (August 2000).
- Week 2** J. Hirshleifer, “*On the theory of the optimal investment decision*”, Journal of Political Economy, (August 1958).
- (Lecture 2)
- Week 3** M.H. Miller and F. Modigliani, “*Dividend Policy, Growth and the Valuation of Shares*”, Journal of Business, (October 1961).
- (Lecture 3)
- Week 4** Copeland and Weston, Financial Theory and Corporate Policy, Chapter 3.
- (Lecture 4) H.M. Weingartner, “*Capital Rationing: N-authors in Search of a Plot*”, The Journal of Finance, (December 1977), pp. 1403-1432.
- S.C. Myers, “*Finance Theory and Financial Strategy*”, Interfaces, (Jan-Feb 1984), pp. 126-137.
- J. Hirshleifer, “*Risk, the Discount Rate and Investment Decisions*”, American Economic Review, (1961), pp. 112-120.
- J.C. Van-Horne, “*A Note on the Biases in Capital Budgeting Introduced by Inflation*”.
- Week 5** Copeland and Weston, Chapter 3
- (Lecture 5) F. Modigliani and M.H. Miller, “*The Cost of Capital, Corporation Finance and the Theory of Investment*”, American Economic Review, (June 1958), pp. 261-297.
- W.F. Sharpe, “*Capital Asset Prices: a Theory of Market Equilibrium Under Conditions of Risk*”, Journal of Finance, (Sept 1964), pp. 425-442.
- E. F. Fama and K.R. French, “The Corporate Cost of Capital and the Return on Corporate Investment”, *Journal of Finance*, (December 1999).

- Week 6** Copeland and Weston, Chapters 7, 12 and 13.
- (Lecture 6) M.E. Rubinstein, “A Mean-Variance Synthesis of Corporate Financial Policy”, Journal of Finance, (March 1973), pp. 167-181.
- J.E. Stiglitz, “On the Irrelevance of Corporate Financial Policy”, American Economic Review, (Dec 1974), pp. 851-866.
- R.S. Hamada, “Portfolio Analysis, Market Equilibrium and Corporation Finance”, Journal of Finance, (1969), pp. 13-31.
- M.C. Bogue and R. Roll, “Capital Budgeting of Risky Projects with ‘Imperfect’ Markets for Physical Capital”, Journal of Finance, (May 1974), pp. 601-613.
- . E.F. Fama, “Risk-adjusted Discount Rates and Capital Budgeting Under Uncertainty”, Journal of Financial Economics, (1977), pp. 3-24.
- S.C. Myers and S.M. Turnbull, “Capital Budgeting and the Capital Asset Pricing Model: Good News and Bad News”, Journal of Finance, (May 1977), pp. 321-332
- Week 7**
- (Lecture 7) E.F. Fama and K.R. French, “Taxes, Financing Decisions, and Firm Value”, University of Chicago and Yale University.
- R.R. Officer, “A Note on the Cost of Capital and Investment Evaluation for Companies Under the Imputation Tax”, Accounting and Finance, Vol.27, (1988), pp. 65-71.
- D. Hamson and P. Ziegler, “The Impact of Dividend Imputation on Firm’s Financial Decisions”, Accounting and Finance, Vol.30, No.2, (1990).
- J.K. Mackie-Mason, “Do Taxes Affect Corporate Financing Decisions?”, Journal of Finance, Vol.45, No.5, (1990), pp. 1471-1493.
- R. Hamada and M. Scholes, “Taxes and Corporate Financial Management”, Chapter in Chapter in Recent Advances in Corporate Finance, Eds., E.I. Altmann and M.G. Subrahmanyam, Irwin (1985).
- F. Modigliani and M.H. Miller, “Corporate Income Taxes and the Cost of Capital: a Correction”, American Economic Review, Vol.53, No.3, (1963), pp. 433-443.
- M.H. Miller, “Debt and Taxes”, Journal of Finance, Vol.62, No.2, pp. 261-275.
- Week 8** Copeland and Weston, Chapters 13 and 14

- (Lecture 8) M.C. Jensen and W.H. Meckling, “*The Nature of Man*”, Journal of Applied Corporate Finance, (1994)
- M.C. Jensen and W. H. Meckling, “*Theory of the Firm; Managerial Behaviour, Agency Costs and Ownership structure*”, Journal of Financial Economics, (1976), pp. 305-360.
- F.H. Easterbrook, “*Two Agency Costs Explanations of Dividends*”, American Economic Review, (1986).
- D.E. Allen, “*The Determinants of the Capital Structure of Listed Australian Companies: the Financial Managers’ Perspective*”, Australian Journal of Management, (1991).
- Schleifer and R.W. Vishny, “*A Survey of Corporate Governance*”, The Journal of Finance, Vol. LII, No.2, (June 1997).
- S. Myers, “*Outside Equity*”, *The Journal of Finance* (2000)
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- Week 9**
(Lecture 9) C. James, “*Some Evidence on the Uniqueness of Bank Loans*”, Journal of Financial Economics, (1987), pp. 217-235.
- S. Bhattacharya, “*Nondissipative Signalling Structures and Dividend Policies*”, Quarterly Journal of Economics, (1980), pp. 1-24.
- S.A. Ross, “*The Determination of Financial Structure: the Incentive Signalling Approach*”, Bell Journal of Economics, (1977), pp. 23-40.
- S.C. Meyers, “*Still Searching for Optimal Capital Structure*”, New England Economic Review, Federal Reserve Bank of Boston, (March/April 1990), pp. 80-105.
- D.E. Allen, “*The Pecking Order Hypothesis: Australian Evidence*”, Applied Financial Economics, (1993).
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- Week 10**
(Lecture 10) Copeland and Weston, Chapter 8.
- F. Black and M. Scholes, “*The Pricing of Options and Corporate Liabilities*”, Journal of Political Economy, (1973), pp. 637-654.
- D. Galai and R.W. Masulis, “*The Option Pricing Model and the Risk Factor of the Stock*”, Journal of Financial Economics, (1976), pp. 53-81.
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- Week 11**
Copeland and Weston, Chapters 19 and 20.

- (Lecture 11) R. Da Silva Rosa, “*An Investigation of the Size Effect Anomaly on the Abnormal Returns to Firms Involved in Corporate Takeovers*”.
- P. Dodd and R.R. Officer, “*Takeovers: the Australian Evidence*”, Chapter in Share Markets and Portfolio Theory, ed. Ball, Brown, Finn and Officer.
- M.C. Jensen and R.S. Ruback, “*The Market for Corporate Control*”, Journal of Financial Economics, (1983).
- Week 12** T. Arnold, “*How to do Interest Rate Swaps*”, Harvard Business Review,
(Lecture 12) (1984).
- J. Bicksler and A.H. Chen, “*An Economic Analysis of Interest Rate Swaps*”, Journal of Finance, (1986).
- R.H. Litzenberger, “*Swaps: Plain and Fanciful*”, Journal of Finance, (1992).
- Week 13** S.D. Prowse, “*The Structure of Corporate Ownership in Japan*”, Journal of
(Lecture 11) Finance, (1992).
- D.E. Allen, “*Some Features of Dividend Policy in Japan*”, Managerial Finance, (1992).
- P. Sheard, “*Japanese Corporate Finance and Behaviour: Recent Developments and the Impact of Deregulation*”, Chapter 4 in Japanese Financial Markets and the Role of the Yen, Ed., C. McKenzie and M. Stutchbury, Allen and Unwin, (1992).