12F004

Corporate Finance Theory

6 ECTS

Professor: Albert Banal-Estañol
Professor e-mail: albert.banalestanol@upf.edu
Office: 20.2E26

Introduction

Corporate Finance analyzes the two main challenges faced by the financial management of a company: the investment decision, concerning the use of company resources in productive projects, and the funding decision, or of capital structure, which examines how to obtain the money needed to finance the investments. This course will focus on the financing decisions.

Objectives

This course covers the theory and empirics of corporate finance. The starting point of the course is an introduction to the Modigliani-Miller irrelevance theorems, which describe a frictionless set-up in which capital structure is independent of the firms' characteristics or choices and is irrelevant for the valuation of the firm. A variety of deviations from this frictionless scenario are then studied. In these different cases we analyse optimal capital structure, corporate taxation, financial distress, the use of capital structure as a signalling device, and control allocation, amongst others, and how these affect the firm's valuation and investment decisions. In addition, we will also cover topics related to mergers and acquisitions, initial public offerings, project finance, and securitisation.

Required Background Knowledge

Basic notions of game theory and contract theory, and in particular of the problems of moral hazard and adverse selection, are useful but not strictly necessary.

Learning Outcomes

On successful completion of this programme, you will be expected to be able to:

Knowledge and understanding:
-Demonstrate a detailed understanding of the role of contract theory in the financing decisions, and how these decisions change under different informational settings
-Analyse financing decision-making and its implications for firm investment and value

Skills:
-Understand the role of moral hazard and adverse selection to explain financing decisions
-Undertake independent work on problem solving of corporate finance problems
-Apply concepts from microeconomic theory to real-world financing decisions
-Indepedently read corporate finance articles

Values and Attitudes
-Show respect for the efforts of other people working in a group
-Correctly reference the work of other people
-Understand the use of alternative assumptions and its implications for the basic corporate finance models

Methodology

There will be 30 hours devoted (mostly) to theoretical aspects, 10 hours to empirical issues and 10 hours to practical exercises. In the theory sessions we shall develop the concepts and methodologies that make up the items of the course list. These classes are based on textbooks and academic papers that support the course.
In the empirical sessions, students shall present and discuss academic empirical papers. Students should organize in pairs. Each group will present and discuss one paper. Presentations should last for about 25-30 minutes. A class discussion about the paper and related issues will follow the presentation. Therefore, all students should read the paper in advance and ask questions and make comments. A list of papers suitable for presentation will be made available at the beginning of the course but students are welcome to suggest other (relevant) papers outside of this list they may be interested in presenting instead.
Every week practice sessions will be held with exercises to be handed in regularly.

Evaluation

The final grade will be based on the final exam (65%) the grades from the practical exercises (15%) and the presentation of the empirical paper (15%). A final 5% will be based on active participation in class discussion following the presentations.

Course contents

1. The Modigliani and Miller Irrelevance Propositions, Taxes and Bankruptcy Costs
• The Modigliani-Miller Theorem
• Corporate Taxes – the debt tax shield
• Personal Taxes
• Bankruptcy Costs – The Static Trade-Off Theory

2. Agency problems and capital structure
• Moral hazard and the effort problem
• Asset Substitution or Risk shifting
• Underinvestment or debt overhang
• Capital Structure as a Control Mechanism
• Financial constraints

- Debt Capacity and the Role of Collateral
- Macroeconomic Implications of Financial Constraints

3. Adverse Selection and Capital Structure; signalling
- Adverse Selection
- The pecking order theory
- Market Timing
- Signalling
  Signalling through dividends
  Signalling through capital structure

4. Capital Structure and Product Market Competition

5. Security Design/The Structure of Corporate Liabilities

6. Mergers and Acquisitions
Mergers and acquisitions
Block trading
Disciplinary effect of M&A

7. Initial Public Offerings
Going public-The free rider problem
Going private-Leveraged buyouts
Motives to go public
Stylised facts
Theories on underpricing- Asymmetric information and others

8. Project finance (time permitting)

Session	Title
1-2	The Modigliani and Miller Irrelevance Propositions, Taxes and Bankruptcy Costs
3-8	Agency problems and capital structure
9-10	Adverse Selection and Capital Structure; signaling
11-12	Capital Structure and Product Market Competition
13-14	Security Design/The Structure of Corporate Liabilities
15-16	Mergers and Acquisitions
17-18	Initial Public Offerings
19	Project finance
20	Review

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Bibliography

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Brealey, R. A., Myers, S.C., and Allen F.: "Principles of Corporate Finance", 9th Edition, McGraw-Hill
Tirole, Jean (2006) "The Theory of Corporate Finance" Princeton University Press.

Professor's Biography

Albert Banal-Estanol is Associate Professor at the Universitat Pompeu Fabra, programme director of the MSc in Corporate Finance and Banking at the UPF-Barcelona School of Management, affiliated Professor at the Barcelona Graduate School of Economics (BGSE), affiliated Reader at City University London, visiting professor at the IFP-Energies Nouvelles in Paris and research fellow at the SP-SP Public-Private Sector Research Center at the IESE Business School. Previously, he has held teaching and research positions at the University of Western Ontario in Canada, Northwestern University in the US, University of Cambridge, UCL, and London Business School in the UK, and the University of Munich in Germany.
His main research interests are in the fields of corporate finance, competition and regulation, and innovation. His academic articles have been published in leading international peer-reviewed journals such as Management Science, Review of Financial Studies and Journal of Industrial Economics. He has also delivered executive training courses for government agencies such as the UK's Department of Trade and Industry, regulators such as the UK's Ofgem and private companies such as Gaz de France. Albert has also developed and delivered several training courses for regulators across Africa in collaboration with the World Bank and the African Forum for Utility Regulators.