**CORPORATE FINANCE**

**Syllabus**

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| Prepared by | Pavel Malyshev, Associate Professor of the School of Finance,  Faculty of Economic Sciences |
| Lectures and classes (hours) | 24 |
| Self-study (hours) | 24 |
| Study format | Online |

1. **Abstract**

The course aims to develop the theoretical framework of the major financial decisions in a public company (corporation) operating in market environment. Corporate Finance covers capital budgeting issues, capital structure theory, payout policy, risk management and M&A. The course is intended to provide the basic skills in evaluating financing and investment decisions as well as their influence on corporate performance and value. We use the real cases of Russian and global companies. Students will have a chance to apply their knowledge in a group activity, estimating the economic efficiency of an investment project undertaken by the company of their choice.

Having successfully completed the course, students are expected to:

* Understand the principles of modern financial analysis and apply capital budgeting techniques in making investment decisions;
* Evaluate capital structure decisions and understand how market imperfections influence capital structure decisions;
* Discuss different stakeholders’ goals as a source of agency conflicts;
* Explain corporate payout decisions and discuss the market reaction to the changes of dividend policy;
* Analyze risk management decisions and the sources to increase company value;
* Discuss M&A motives and value creation via restructuring.

There are no specific prerequisites for the course, however, students should be familiar with the fundamentals of Financial Economics, Microeconomics (basic level) and Accounting.

1. **Structure**

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| --- | --- | --- | --- | --- | --- |
| **#** | **Topic** | **Total hours** | **Lectures** | **Classes** | **Self-study** |
|
| 1 | Investment decisions: capital budgeting | 6 | 2 | 2 | 2 |
| 2 | Capital structure choice, corporate value and the cost of capital | 8 | 2 | 2 | 4 |
| 3 | Agency cost and asymmetric information | 6 | 2 | 2 | 2 |
| 4 | Payout policy | 6 | 2 | 2 | 2 |
| 5 | Risk management policy | 4 | 2 | 0 | 2 |
| 6 | M&A and corporate restructuring | 4 | 2 | 0 | 2 |
| 7 | Advanced valuation with debt | 4 | 0 | 2 | 2 |
| 8 | Group project presentations | 10 | 0 | 2 | 8 |
| **Total hours** | | **48** | **12** | **12** | **24** |

*1. Investment decisions: capital budgeting*

Investment opportunities of a corporation. Cash flows of an investment project. Project risk, cost of capital and discounted cash flows. Applying net present value (NPV) methodology in capital budgeting. Mutually exclusive projects. Profitability index (PI) as a relative measure of present value. Internal rate of return (IRR): methodology and limitations. Time constraints: discounted payback method. Value creation with efficient investment projects.

*2. Capital structure choice, corporate value and the cost of capital*

Modigliani and Miller theorem (MM) on capital structure, perfect capital market assumptions and basic MM irrelevance propositions. Weighted average cost of capital (WACC): a portfolio approach to determine the overall opportunity cost of capital. Competing definitions of WACC. Cost of debt, cost of equity and WACC under pure MM. Shareholder reaction to changes in capital structure. MM propositions with corporate income taxes. Income tax shield as motivation to take debt. Motivation of WACC behavior. The effect of personal taxes on capital structure. Miller equilibrium model. Tradeoff theory as a model of optimal capital structure: tax shield vs financial distress costs. Firm value vs WACC under tradeoff theory.

*3. Agency cost and asymmetric information*

A debtholder – shareholder conflict: asset substitution problem, debt overhang problem, debt covenants and monitoring opportunities as means to agency costs. A shareholder – manager conflict: overinvestment problem, deficient management efforts, aligning the conflicting interests with capital structure. Minimizing the total cost of two agency conflicts with capital structure choice. The pecking order of financing theory. The information conveyed by capital structure decisions.

*4. Payout policy*

Types of dividends: cash dividend, stock dividend, share repurchase. Payout policy as a financing problem. The Modigliani-Miller payout irrelevance theorem. Neither dividend size nor means of delivery matters under MM. The effect of investor taxes: a preference for capital gains compared to cash distributions. The dividend puzzle. Static clientele theory. Lintner’s stylized empirical facts. Signaling role of dividends. Payout decisions as means to align the interests of managers and shareholders.

*5. Risk management policy*

Risk and the M&M theorem. The motivation to hedge: decrease tax payments, decrease costs of financial distress, improve planning for capital needs. The methods of interest rate risk management. Foreign exchange risk management. Application of risk management to industrial firms.

*6. M&A and corporate restructuring*

Types of M&A. Reasons to acquire: economies of scale, vertical integration, financing side motivation. Hubris hypothesis by Roll. Empirical evidence of inefficient M&As. Value creation via restructuring. Divestitures and bankruptcy as types of corporate restructuring. The sources for synergy in restructuring.

*7. Advanced valuation with debt*

Adjustments to capital budgeting techniques when evaluating a project under certain financing plan. Adjusted present value (APV), weighted average cost of capital (WACC) approach and free cash flow to equity (FCFE): three classical approaches to account for side effects.

1. **Evaluation criteria**

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| --- | --- | --- | --- |
| **#** | **Activity** | **Marking** | **Weight** |
|
| 1 | Quiz 1 | 0-10 (integer number) | 5% |
| 2 | Quiz 2 | 0-10 (integer number) | 5% |
| 3 | Class participation | 0-10 (integer number) | 10% |
| 4 | Written test | 0-10 (integer number) | 30% |
| 5 | Group project | 0-10 (integer number) | 50% |
| **Final mark (0-10), weighted average** | | **0-10 (integer number)** | **100%** |

* Quiz is a brief test (10 minutes) run during the class using an online platform covering the topics discussed during the previous classes;
* Class participation includes answering questions, participation in the group discussion and problem solving.
* Written test includes essay-type theoretical questions and problem solving;
* Group project includes work with real company and market data. A group of maximum 3 students is supposed to describe and evaluation an investment decision in a real company. This work is limited to publicly available data. Students are expected to present their results at the final class.

Linear system applies. No part of the total mark is blocking. Final mark is rounded according to general mathematic rules.

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| --- | --- | --- |
| **From** | **To** | **Mark** |
| 0 | 3 | Fail |
| 4 | 5 | Satisfactory |
| 6 | 7 | Good |
| 8 | 10 | Excellent |

1. **Recommended reading**

**Essential reading**

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| --- | --- |
| **#** | **Title** |
|  |  |
| 1 | Jonathan Berk, Peter DeMarzo (B&D). Corporate Finance. Pearson: 5th edition, 2020 |
| 2 | Pierre Vernimmen, Pascal Quiry, Maurizio Dallocchio, Yann Le Fur, and Antonio Salvi (V&Q). Corporate Finance: Theory and Practice. Wiley: 5th edition, 2017 |

**Supplementary reading**

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| --- | --- |
| **#** | **Title** |
|  |  |
| 1 | Black, F., and Scholes, M. The Effects of Dividend Yield and Dividend Policy on Common Stock Prices and Returns. Journal of Financial Economics 1 (1974), pp. 1–22. |
| 2 | Richard Brealey, Stuart Myers (B&M). Principles of Corporate Finance. McGraw Hill. 6th Edition. |
| 3 | Grossman, S., and Hart, O. Takeover bids, the free rider problem, and the theory of the corporation, Bell Journal of Economics 11 (1980), 42-64. |
| 4 | Jensen, M., and Meckling, W. Theory of the firm: Managerial behavior, agency costs and ownership structure, Journal of Financial Economics, (1976), 305-360. |
| 5 | Litzenberger, R., and Ramaswamy, K. The Effects of Dividends on Common Stock Prices: Tax Effects or Information Effects? Journal of Finance, no. 2 (1982), pp. 429–437. |
| 6 | Modigliani, F., and Miller, M. The cost of capital, corporation finance and the theory of investment, American Economic Review, (1958), 261-297. |
| 7 | Modigliani, F., and Miller, M. Corporate income taxes and the cost of capital, American Economic Review, 53 (June 1963), 433-443. |
| 8 | Miller, M. Debt and Taxes, Journal of Finance, (1977), 261-275. |
| 9 | Myers, S. The capital structure puzzle, Journal of Finance, 39 (1984), 575-592. |
| 10 | Myers, S., and Majluf, N. Corporate financing and investment decisions when firms have information that investors do not have, Journal of Financial Economics, 13, (1984), 187-221. |
| 11 | Pettit, J. Is a Share Buyback Right for Your Company? Harvard Business Review, April 2001. |
| 12 | Roll, R. The Hubris Hypothesis of Corporate Takeovers, Journal of Business, 59 (1986), 197-216. |
| 13 | Ross, S. The determination of financial structure: The incentive signalling approach, Bell Journal of Economics 8 (Spring 1977), 23-40. |