Graduate Program in Economics

IDEA

Course: Corporate Finance

Faculty: David Pérez-Castrillo

Term: First Semester

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Office Hours: upon request

Description: This course covers the theory (and some empiric facts) of corporate finance. Topics that will be analyzed include the optimal capital structure, financial distress, optimal financial contracts, the use of capital structure as a signaling device, control allocation, corporate governance, and venture capital contracts, amongst others. The main objective of this course is to provide students with a set of theoretical ideas and tools that are essential for the analysis of any problem related to corporate finance. At the same time, the tools will also enable the students to address other questions related to industrial organization and economics of information.

Outline:

1. **Corporate finance: An introduction and the Modigliani-Miller propositions**
   - 1.1. Brief introduction to Corporate Finance
   - 1.2. The Modigliani-Miller proposition
   - 1.3. Brief introduction to Economics of Information
2. **Corporate financing under Moral Hazard**
   - 2.1. Outside financing capacity
     - 2.1.1. Credit rationing in the fixed investment model
     - 2.1.2. The continuous investment model and the equity multiplier
   - 2.2. Determinants of borrowing capacity

        - 2.2.1. Diversification and cross-pledging
        - 2.2.2. Collateral and the redeployability of assets
        - 2.2.3. Group lending

3. Corporate financing under Asymmetric Information

- 3.1. The lemons problem and the market breakdown
    - 3.1.1. Privately-known prospects model
    - 3.1.2. Market breakdown and cross-subsidization
    - 3.1.3. Application: The negative stock price reaction to SEO's
- 3.2. Dissipative signals
    - 3.2.1. Application 1: Payout policy
    - 3.2.2. Application 2: Diversification and Incomplete Insurance
    - 3.2.3. Application 3: IPO underpricing

4. Product market interactions with corporate financing decisions

- 4.1. Interaction of financing and real decisions
- 4.2. M&M for competition and finance
- 4.3. Impact of competition on financial choices
    - 4.3.1. Profit destruction
    - 4.3.2. Benchmarking
- 4.4. The long purse story
- 4.5. Strategic security design
- 4.6. Financial contracts as strategic commitments
- 4.7. Anti-competitive financial contracting

5. Control rights and corporate governance

- 5.1. Control rights and pledgeable income
- 5.2. Contingent control rights
    - 5.2.1. Signals and pledgeable income
    - 5.2.2. Back to contingent control rights

6. Takeovers

- 6.1. The pure theory of takeovers
    - 6.1.1. Incumbent manager is not credit constraint
    - 6.1.2. Incumbent manager is credit constraint
- 6.2. The positive theory of takeovers
    - 6.2.1. The free rider problem
    - 6.2.2. The raider may make positive profits

7. Designing contracts for University Spin-offs

- 7.1. Introduction
- 7.2. Initial allocation of shares
- 7.3. Some financial instruments
- 7.4. Informational advantage of Technology Transfer Offices
- 7.5. The commercialization stage
- 7.6. The exit stage
- 7.7. Allocation of control rights

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Basic list of references:

Tirole, J. (2006), "*The Theory of Corporate Finance*," Princeton University Press.

Brealey, R.A. and Myers, S.C. (1997), "*Principles of Corporate Finance*," New York McGraw-Hill.

Kaplan, S. and Strömberg, P. (2003), "Financial Contracting Meets the Real World: An Empirical Study of Venture Capital Contracts," *Review of Economic Studies* 70: 281-315.

Macho-Stadler, I. and Pérez-Castrillo, D. (2010), "Incentives in University Technology Transfers", *International Journal of Industrial Organization* 28 : 362-367.

Grading:

Grading will be based on (i) a final exam, (ii) solving problem sets, (iii) the critical reading of relevant articles

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