

**The Ohio State University
Fisher College of Business**

Finance 8230: Corporate Finance

Professor Michael Weisbach
Spring 2023, First Half of Semester

The course will begin with the classic Modigliani/Miller arguments, and follow the literature in discussing the implications of violations of MM assumptions and capital structure more broadly. There will be classes devoted to areas in which theory has important insights in corporate finance, including the theory of the firm, financial intermediation, financial constraints, and takeover markets.

This is a Ph.D. level class, and will presume knowledge of Ph.D. level microeconomic theory and an understanding of how financial markets work. Most of the course will be devoted to formal models.

The class will cover of 7 main topics, each of which will take up about 2 class sessions. There will be a final exam, which will count for 70% of the course grade. Class participation counts for the remaining 30%. To earn full credit for the participation grade, it is important to read the articles and think about them prior to each session.

Auditors are always welcome to attend, and advanced students who have seen some but not all of this material are encouraged to attend the sessions covering material that they have not seen previously.

Course Materials:

The main focus of the course is on academic articles. I will hand out slides from which the lectures are based. From time to time, I will use material from Tirole's *The Theory of Corporate Finance*, which was published by Princeton University Press in 2006. I also will use some material from Hart's *Firms, Contracts, and Financial Structure*, which was published by Oxford University Press in 1995. I would highly recommend purchasing these two books.

I will also from time to time mention material from my book, entitled *The Economist's Craft: An Introduction to Research, Publishing, and Professional Development*, published by Princeton University Press in 2021. I would recommend purchasing a copy of this book as well.

Reading List

Note: Readings with a * will be emphasized in the class discussion. Unless noted in class, these articles should be read prior to the class discussing the relevant topic.

Topic 1: MM, Tradeoff Model, Stockholder/Bondholder Conflicts

* Modigliani, Franco and Merton H. Miller (1958), "The Cost of Capital, Corporation Finance, and the Theory of Investment," American Economic Review, 48, 261-297.

Miller, M., F. Modigliani, 1961, "Dividend Policy, Growth, and the Valuation of Shares," Journal of Business, 34, 411-433.

Brealey, R. and S. Myers, (1991) Principles of Corporate Finance, Chaps. 17-18. - This section of the textbook reviews M-M theory.

Harris, Raviv (1991), "The Theory of Capital Structure," Journal of Finance, 46, 297-355.

Graham, John (2003), "Taxes and Corporate Finance, A Review," Review of Financial Studies, 16, pp. 1074-1128.

* Miller, M. (1977), "Debt and Taxes," Journal of Finance, 32, pp. 261-275.

Mackie-Mason, J. (1991) "Do Taxes Affect Corporate Financing Decisions?" Journal of Finance, 45, pp. 1471-1493.

Rajan, R. and L. Zingales (1995) "What do we know about Capital Structure? Some Evidence from International Data," Journal of Finance, 50, 1421-1460.

Leary, Mark T. and Michael R. Roberts (2005) "Do Firms Rebalance Their Capital Structures," Journal of Finance, 60, pp. 2575-2619.

* Myers (1977) "Determinants of Corporate Borrowing" Journal of Financial Economics, 5, 147-175.

Fama, Eugene F. and Merton H. Miller, The Theory of Finance, Chapter 4 pages 179-181.

* Jensen, Michael C. and William H. Meckling (1976), "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure," Journal of Financial Economics 3: 305-360.

* Parrino, R. and M. Weisbach (1999) "Measuring Investment Distortions Arising from Stockholder-Bondholder Conflicts," Journal of Financial Economics, Vol. 53, pp. 3-42.

Topic 2: Capital Structure and Agency Problems

* Jensen, Michael C. and William H. Meckling (1976), "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure," *Journal of Financial Economics* 3: 305-360.

* Jensen, Michael C. (1986) "Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers," *American Economic Review*, 76, 323-329.

* Hart, Oliver and John Moore (1995) "Debt and Seniority: An Analysis of the Role of Hard Claims in Constraining Management," *American Economic Review*, 85, 567-585.

Townsend, Robert (1979) "Optimal Contracts and Competitive Markets with Costly State Verification" *Journal of Economic Theory*, 21, 265-293.

* Hart, Moore (1994) "A Theory of Debt Based on the Inalienability of Human Capital," *QJE*, 109, 841-879.

* Hart, O. (1995) *Firms, Contracts and Financial Structure*, Chapter 5.

Hart, Moore (1998) "Default and Renegotiation: A Dynamic Model of Debt," *Quarterly Journal of Economics*, 113, 1-41.

Stulz, R. (1988) "Managerial Control of Voting Rights: Financing Policies and the Market for Corporate Control," *Journal of Financial Economics*, 20, 25-54.

Stulz, R. (1990) "Managerial Discretion and Optimal Financing Policies," *Journal of Financial Economics*, 26, 3-27.

Topic 3: Capital Structure and Asymmetric Information

* Myers, S. (1984) "The Capital Structure Puzzle," *Journal of Finance*, 39, 575-592.

* Myers, S. and N. Majluf (1984) "Corporate Financing and Investment Decisions when Firms Have Information That Investors Do Not Have," *Journal of Financial Economics*, 13, 187-222.

Stein, J. (1992) "Convertible Bonds as Backdoor Equity Financing," *Journal of Financial Economics*, 32, 3-21.

* Leland, H. and D. Pyle (1977) "Informational asymmetries, financial structure, and financial intermediation," *Journal of Finance*, 32, 371-387.

* Ross, S. (1977) "The Determination of Financial Structure: The Incentive Signaling Approach," *Bell Journal of Economics*, 8, 23-40.

Miller, M. and K. Rock (1985) "Dividend Policy under Information Asymmetry," *Journal of Finance*, 40, 1031-1051.

* Rock, K (1986) "Why New Issues are Underpriced?" Journal of Financial Economics, 15, 187-212.

Fama, E. and K. French (2002) "Testing Tradeoff and Pecking Order Predictions about Dividends and Debt," Review of Financial Studies, 15, 1-33

Topic 4: Theory of the Firm, Contracting, Learning Models of Incentives.

* Coase, R. (1937), "The Nature of the Firm", Economica, 386-405.

Alchian, A. and H. Demsetz (1972) "Production, Information Costs and Economic Organization," American Economic Review, 62, 777-705.

* Klein, B., Crawford, and Alchian, A. (1978), "Vertical Integration, Appropriable Rents and the Competitive Contracting Process", Journal of Law and Economics, 297-326.

* Grossman, S. and O. Hart (1986) "The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration," Journal of Political Economy, 94, 691-719.

O. Hart and J. Moore (1990) "Property Rights and the Nature of the Firm," Journal of Political Economy, 98, 1119-1158.

Rajan, R. and L. Zingales, (1998), "Power in a Theory of the Firm", Quarterly Journal of Economics, 387-432.

Holmstrom, B. (1979) "Moral Hazard and Observability," Bell Journal of Economics, 10, 74-91.

* Holmstrom, B. (1999) "Managerial Incentive Problems - A Dynamic Perspective," Review of Economic Studies, 66, 169-182.

* Stein, J. (1989) "Efficient capital markets, inefficient firms: A model of myopic corporate behavior," Quarterly Journal of Economics, 104, 655-669.

* Chung, J., B. Sensoy, L. Stern and M. Weisbach (2012) "Pay for Performance from Future Fund Flows: The Case of Private Equity," Review of Financial Studies, 25, 3259-3304.

* Hermalin, B. and M. Weisbach (2017) "Assessing Managerial Ability: Implications for Corporate Governance," Chapter 3 of *The Handbook of the Economics of Corporate Governance*, B. Hermalin and M. Weisbach editors.

Pan, Y., T. Wang, and M. Weisbach (2015) "Learning about CEO Ability and Stock Return Volatility," Review of Financial Studies, 28, 1623-1666.

Topic 5. Financial Distress

A. Theory

* Gertner, R. and D. Scharfstein (1991) "A Theory of Workouts and the Effects of Reorganization Law," *Journal of Finance*, 46, 1189-1222.

* Shleifer, A. and R. Vishny (1992) "Liquidation Values and Debt Capacity: A Market Equilibrium Approach," *Journal of Finance*, 47, 1343-1366.

Almeida, H. and T. Philippon (2007) "The Risk-Adjusted cost of Financial Distress".

B. Empirical Evidence

* Pulvino, T. (1998) "Do Asset Fire Sales Exist? An Empirical Investigation of Commercial Aircraft Transactions," *Journal of Finance*, 53, 939-978.

* Benmelech, Efraim (2007) "Asset Salability and Debt Maturity: Evidence from 19th Century American Railroads," *Review of Financial Studies*.

* Andrade, Gregor and Steven N. Kaplan (1998) "How Costly is Financial (not Economic) Distress? Evidence from Highly Leveraged Transactions," *Journal of Finance*, 53, pp. 1443-1493.

Benmelech, Efraim, Mark Garmaise and Tobias Moskowitz (2005), "Do Liquidation Values Affect Financial Contracts? Evidence from Commercial Loan Contracts and Zoning Regulation," *Quarterly Journal of Economics*, 120, 1121-1154.

Warner, J. (1977) "Bankruptcy Costs: Some Evidence," *Journal of Finance*, 32, 337-348.

* Cutler, D. and L. Summers (1988) "The Costs of Conflict Resolution and Financial Distress: Evidence from Texaco-Pennzoil Legislation," *RAND Journal of Economics*.

Weiss, L (1990) "Bankruptcy Resolution: Direct Costs and Violation of Priority of Claims," *Journal of Financial Economics*, 27, 419-444.

* Hartzscu, Ali, Gregor Matvos, Chad Syverson and Siriam Venkataraman (2011) "Indirect Costs of Financial Distress in Durable Goods Industries: The Case of Auto Manufacturers," *Review of Financial Studies*, forthcoming.

Lim, Jongha, (2014) "The Role of Activist Hedge Funds in Distressed Firms," *Journal of Financial and Quantitative Analysis*.

Topic 6: Takeover Markets and Free Rider Issues

* Grossman, S. and O. Hart (1980), "Takeover Bids, the Free Rider Problem, and the Theory of the Corporation," *Bell Journal of Economics*, 11, 42-64.

* Shleifer, A. and R. Vishny (1986), "Large Shareholders and Corporate Control," Journal of Political Economy, 94, 461-88.

Grossman, S. and O. Hart (1988), "One Share, One Vote and the Market for Corporate Control," Journal of Financial Economics, 20, 175-202.