Course Overview: The aim of this part of the course is to expose you to important papers that emphasize the theoretical foundations of corporate finance. My objective is to give you a working understanding of key papers and to expose you to solution techniques to be applied in your own research. At the end of the semester we will consider some empirical topics and will discuss how to bridge a gap between theoretical and empirical research.

The W.P. Carey School of Business has established the following learning goals for its graduate students: Critical Thinking, Communication, Discipline Specific Knowledge, and Research Methods.

Textbooks: There are no required textbooks for this class. However, you can find helpful:
1. The theory of corporate finance, by Jean Tirole (Tirole’s aim is to simplify models; hence the text is more comprehensive than the papers themselves that we will cover).

Grading Policy: Your grade will be calculated as follows:

Problem Sets (5): 35%
Paper Critique & Presentation (1): 10%
Research Idea Assignments (2): 10%
Class Participation: 5%
Research Proposal Presentation (1) 10%: (Due Apr 28, in-class)
Final Exam: 30% (May 5, 4:30 PM-6:30 PM)

Student learning outcomes:
On completion of this course, students will be able to:
1. Understand the theoretical and conceptual underpinnings of the tradeoff and pecking order models of capital structure.
2. Compare and contrast contracting models that build on unverifiable, semi-verifiable or fully verifiable income framework and be able to explain why debt arises as optimal contract in each framework.
3. Interpret the existing empirical evidence on the magnitude of financing constraints faced by firms in the U.S.
4. Identify the main benefits and disadvantages for the firm to have large blockholders.
5. Identify and analyze different agency costs of debt and equity. Explain the nature of the conflict and be able to offer the mechanisms to mitigate the conflict.
6. List the possible signaling mechanisms explored by the signaling literature and identify the empirical predictions stipulated by signaling models.

Assignments:
There will be 5 problems sets that students need to work out individually, aimed at practicing the standard techniques in theoretical corporate finance literature and contracting.

Students will also need to complete a paper critique review. The critique has to summarize the main contribution of the paper and place it in the literature, explain the major necessary assumptions made by the paper and discuss their validity, offer possible extensions or modifications to the model, assess whether the model captures the key elements of the real world and the main tradeoffs and whether it is tractable, and assess the strength and importance of the empirical work (if any is done in the paper). The critique will be presented in class.

Students will also have to submit two original research ideas that have not been implemented elsewhere in the literature. The ideas should be pertinent to research in theoretical or empirical corporate finance, economics, or accounting. The idea should briefly summarize what the student plans to do and explain the economic importance of studying this question (1-2 pages).

A research proposal along with the presentation is due in the last class. The proposal has to contain original research by a student. It should be accompanied by an abstract of less than 100 words, and contain literature review section, motivation of the research question, and the proposed methodology. The actual solution of the model (if the proposal is mainly theoretical) or the actual empirical tests (if the proposal is empirical) are not necessary, but would be a plus.

Academic Integrity: Any student caught cheating will receive a grade of zero for that exam/assignment and/or an F for the course. Please familiarize yourself with ASU’s academic integrity policies:
https://provost.asu.edu/sites/default/files/AcademicIntegrityPolicyPDF.pdf

Outline of lecture schedule (tentative)

Lecture 1. Optimal capital structure and agency theory, Jan 13 and Jan 20


**Lecture 2. The information content of financial decisions, Jan 27, Tirole Ch 6, PS 1 DUE Jan 27**
1) (13,537) Myers, Stewart, and Nicholas Majluf, 1984, Corporate financing and investment decisions when firms have information that investors do not have, *Journal of Financial Economics* 13, 187-221. (**)

**Lecture 3. Theories of debt and credit rationing, Feb 3 and Feb 10, Tirole Ch 3, PS 2 DUE Feb 3**


*Lecture 4. Theories of corporate control, Feb 17, Research Idea 1 DUE Feb 17*


*Lecture 5. Theories of debt structure, Feb 24*


*Lecture 6. Capital structure and corporate strategy, product markets, Mar 3, Tirole Ch 7, PS 3 DUE Mar 3*


**Lecture 7. Internal vs. external finance and corporate investment, Mar 17, Research Idea 2 DUE**


**Lecture 8: Theories of liquidity, Mar 24, PS 4 DUE**


**Lecture 9. Trade-off theory of capital structure, Mar 31, PARER CRITIQUE DUE**


Lecture 10. Trade-off, pecking order, and market timing theories of capital structure, Apr 7, PS 5 DUE


Lecture 11. Executive compensation, Apr 14 and Apr 21


April 28 (Student Proposal Presentations)