

## FINANCIAL ECONOMICS II

ECO 2504 - SPRING 2013

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This course deals with the following topics in financial economics:

- (1) Theoretical and empirical issues concerning the relevance of corporate financial structure.
- (2) Interactions between corporate investment and financing decisions.
- (3) Corporate Governance
- (4) The role of the financial system and the legal system in economic development and growth.

There is no required textbook. The course will rely extensively on readings of journal articles.

Recommended textbooks are:

T. Copeland, J. Weston, K. Shastri, **Financial Theory and Corporate Policy**, Addison-Wesley, 2003, fourth edition.

Ross, Westerfield, Jaffe and Roberts, **Corporate Finance**, McGraw-Hill Ryerson, 2011, 6<sup>th</sup> Canadian Edition.

You are not expected to read all the listed articles. I will indicate in class the central articles for the course; the rest should be useful to those pursuing the study of financial economics beyond this course.

Paper: Each Student will be assigned a paper(s) to summarize and critique. The last 4 lectures will be devoted to presentations of these papers by students in class. A four page write-up of the paper will be handed in by each student at the end of the course.

### **Grade Composition:**

Final examination	70%
Paper (to be assigned in class)	30%

#### **(i) FISHER SEPARATION THEOREM; CAPITAL STRUCTURE RELEVANCE**

E. Fama and M. Miller, The Theory of Finance, 1976 (Chapter 2)

J. Stiglitz, "A Re-Examination of the Modigliani-Miller Theorem", American Economic Review, 59, 1969.

J. Stiglitz, "On the Irrelevance of Corporate Financial Policy," American Economic Review, 1974.

F. Modigliani, "MM-Past, Present, and Future", Journal of Economic Perspectives, 2, 1988, 99-120.

M. Miller, "The Modigliani-Miller Propositions After Thirty Years", Journal of Economic Perspectives, 2, 1988.

J. Stiglitz, "Why Financial Structure Matters", Journal of Economic Perspectives, 2, 121-126, 1988.

S. Myers, "The Capital Structure Puzzle", Journal of Finance, July 1984.

Zingales, L., "In Search of New Foundations," Journal of Finance, 2000, 1623-1653.

**(ii) TAXATION AND CORPORATE FINANCIAL POLICY**

M. Miller, "Debt and Taxes", Journal of Finance, May 1977.

H. DeAngelo and R. Masulis, "Optimal Capital Structure Under Corporate and Personal Taxation", Journal of Financial Economics, March 1980.

V. Aivazian and J. Callen, "Miller's Irrelevance Mechanism: A Note", Journal of Finance, March 1987.

V. Aivazian and S. Turnbull, "Taxation and Capital Structure: A Selected Review", in The Impact of Taxation on Business Activity, 1987, J. Mintz and D. Purvis (ed.)

S. Benninga and E. Talmor, "The Interaction of Corporate and Government Financing in General Equilibrium", Journal of Business, 1988, vol. 61, no. 2.

R. Dammon and R. Green, "Tax Arbitrage and the Existence of Equilibrium Prices for Financial Assets", Journal of Finance, December 1987.

**(iii) BANKRUPTCY**

G. Andrade and S. Kaplan, "How Costly is Financial (Not Economic) Distress? Evidence from Highly Leveraged Transactions That Became Distressed," Journal of Finance, October 1998.

V. Maksimovic and G. Phillips, "Asset Efficiency and Reallocation Decision of Bankrupt Firm," Journal of Finance, October 1998.

M. White, "The Corporate Bankruptcy Decision", The Journal of Economic Perspectives, Spring 1989, p. 129-151.

E. Altman, "A Further Empirical Investigation of the Bankruptcy Cost Question", Journal of Finance, September 1984.

F. Easterbrook, "Is Corporate Bankruptcy Efficient?" Journal of Financial Economics, Vol. 27, 411-417.

K. Wruck, "Financial Distress, Reorganization and Organizational Efficiency", Journal of Financial Economics, 27, 419-440, 1990.

A. Shleifer and R. Vishny, "Liquidation Values and Debt Capacity: A Market Equilibrium Approach", Journal of Finance, September 1992.

V. Aivazian and S. Zhou, "Is Chapter 11 Efficient?" Financial Management, 2011.

(iv) **CORPORATE FINANCIAL POLICY AND AGENCY AND INCOMPLETE INFORMATION PROBLEMS**

M. Jensen and W. Meckling, "Theory of the Firm: Managerial Behavior, Agency Costs and Capital Structure", Journal of Financial Economics, 3, 1976.

S. Myers, "Determinants of Corporate Borrowing", Journal of Financial Economics, 5, 1977.

V. Aivazian and J. Callen, "Corporate Leverage and Growth: The Game-Theoretic Issues", Journal of Financial Economics, 8, 1980.

S. Grossman and O. Hart, "The Costs and Benefits of Ownership", Journal of Political Economy, 1986.

M. Jensen, "Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers", American Economic Review, May 1986.

R. Stulz, "Managerial Discretion and Optimal financial Policies," Journal of Financial Economics, 26, 1990.

S. Myers and N. Majluf, "Corporate Financing and Investment Decisions When Firms Have Information Investors Do Not Have", Journal of Financial Economics, 1984.

P. Viswanath, "Strategic Considerations, the Pecking Order Hypothesis, and Market Reactions to Equity Financing," Journal of Financial and Quantitative Analysis, June 1993.

Hart, O., "Financial Contracting," Journal of Economic Literature, 39, 1079-1100.

(v) **INTERACTION BETWEEN PRODUCTION AND FINANCING DECISIONS**

A. Dotan and S. Ravid, "On the Interaction of Real and Financial Decisions of the Firm Under Uncertainty", Journal of Finance, June 1985.

R. Dammon and L. Senbet, "The Effect of Taxes and Depreciation on Corporate Investment and Financial Leverage", The Journal of Finance, June 1988.

V. Aivazian and M. Berkowitz, "Precommitment and Financial Structure: An Analysis of the Effects of Taxes", Economica, 1992.

V. Aivazian and M. Berkowitz, "Ex Post Production Flexibility, Asset Specificity and Financial Structure", Journal of Accounting, Auditing, and Finance, Winter 1998.

D. Mauer and A. Triantis, "Interactions of Corporate Financing and Investment Decisions: A Dynamic Framework", The Journal of Finance, September 1994.

A. Abel, A. Dixit, J. Eberly, R. Pindyck, "Options, the Value of Capital, and Investment," Quarterly Journal of Economics, August 1996.

Brander, J.A. and T. R. Lewis, "Oligopoly and Financial Structure: The Limited Liability Effect", American Economic Review 76:956-970, 1986.

R. G. Hubbard, "Capital-Market Imperfections and Investment", Journal of Economic Literature, March 1998.

**(vi) EMPIRICAL STUDIES OF CORPORATE FINANCIAL POLICY**

Bradley, Jarrell and Kim, "On the Existence of an Optimal Capital Structure: Theory and Evidence", Journal of Finance, July 1985.

L. Shyam-Sunder and S. Myers, "Testing Static-Tradeoff Against Pecking Order Models of Capital Structure," Journal of Financial Economics, 1999.

S. Titman and R. Wessels, "The Determinants of Capital Structure Choice", The Journal of Finance, March 1988.

R. Rajan and L. Zingales, "What do we know about capital structure? Some Evidence from International Data," Journal of Finance, 1995.

L. Booth, V. Aivazian, A. Demircug-Kunt, and V. Maksimovic "Capital Structure in Developing Countries", Journal of Finance, February 2001.

L. Lang, E. Ofek, and R. Stulz, "Leverage, Investment, and Firm Growth," Journal of Financial Economics, 40, 1996.

V. Aivazian, Y. Ge, and J. Qiu, "The Impact of Leverage on Firm Investment: Canadian Evidence," Journal of Corporate Finance, 2005.

S. Fazzari, R. Hubbard, and B. Petersen, "Financing Constraints and Corporate Investment," Brookings Papers on Economic Activity, 1988.

V. Aivazian, J. Callen, D. Gelb, "Corporate Leverage and Unanticipated Industry Growth: A Test of the Myers Conjecture" 2012.

V. Aivazian and E. Santor, "Financial Constraints and Investment: Assessing the Impact of a World Bank Credit Program on Small and Medium Enterprises in Sri Lanka", Canadian Journal of Economics, 2008.

**(vii) DIVIDEND POLICY**

F. Black, "The Dividend Puzzle," Journal of Portfolio Management, 2, 5-8, 1976.

E. Fama and K. French, "Disappearing Dividends: Changing Firm Characteristics or Lower Propensity to Pay?" Journal of Financial Economics, 60, 2001, pp. 3-43.

M. Baker and J. Wurgler, "Why Are Dividends Disappearing? An Empirical Analysis," Working Paper, NYU, 2002.

K. Dewenter and V. Warther, "Dividends, Asymmetric Information, and Agency Conflicts: Evidence from a Comparison of the Dividend Policies of Japanese and U.S. Firms", Journal of Finance, 1998.

V. Aivazian, L. Booth, S. Cleary, "Do Emerging market Firms Follow Different Dividend Policies From U.S. Firms?" Journal of Financial Research, Fall 2003.

R. La Porta, F. Loopez-de-Silanes, A. Shleifer, and R. Vishny, "Agency Problems and Dividend Policies Around the World," Journal of Finance, 55, 1-33, 2000.

V. Aivazian, L. Booth, S. Cleary. "Why Some Firms Smooth Dividends and Other Firms Do Not," Journal of Financial and Quantitative Analysis, 2006.

H. DeAngelo, L. DeAngelo, and D. Skinner, "Are Dividends Disappearing? Dividend Concentration and the Consolidation of Earnings," Journal of Financial Economics, 2003.

**(viii) CORPORATE GOVERNANCE**

R. La Porta, F. Lopez-de-Silanes, A. Shleifer, "Corporate Ownership Around the World," Journal of Finance, 54, 471-517.

Oliver Williamson, "Corporate Finance and Corporate Governance", Journal of Finance, July 1988.

R. Posner, Economic Analysis of Law, Chapters 14 & 15.

R. La Porta, F. Lopez-de-Silanes, A. Shleifer, and R. Vishny, "Investor Protection and Corporate Governance," Journal of Financial Economics, 58, 1-27, 2000.

A. Shleifer and R. Vishny, "A Survey of Corporate Governance," Journal of Finance, 1997.

R. La Porta, F. Lopez-de-Silanes, A. Shleifer, and R. Vishny, "Investor Protection and Corporate Governance," Journal of Financial Economics, 58, 3-27, 2000.

M. King and D. Segal, "Corporate Governance, International Cross Listing, and Home Bias," Canadian Investment Review, Volume 16, No. 4, Winter 2003.

**(ix) FINANCIAL SYSTEM, LEGAL SYSTEM, AND ECONOMIC GROWTH**

R. Levine, "Financial Development and Economic Growth: Views and Agenda," Journal of Economic Literature, 35, 1997.

F. Modigliani and E. Perotti, "The Rules of the Game and the Development of Security Markets," Pacific-Basin Capital Markets Research, volume II, S. Rhee and R. Change (eds.), 1991, North Holland.

- V. Aivazian, "Microeconomic Elements of Financial Liberalization: Perspectives From Finance Theory," in J. Fanelli and R. Medhora, eds., Financial Reform in Developing Countries, London, MacMillan, 1998.
- R. King and R. Levine, "Finance and Growth: Schumpeter Might be Right," Quarterly Journal of Economics, August 1993.
- B. Mayer, "Financial Systems, Corporate Finance and Economic Development," in R. Hubbard, Asymmetric Information, Corporation, and Investment, (1990).
- G. Caprio, Jr. and L. Summers, Finance and Its Reform: Beyond Laissez-Faire, Working Paper No. 1171, World Bank, August 1993.
- J. Stiglitz, The Role of the State in Financial Markets, The Institute of Economics, Academia Sinica, Taiwan, April 1993.
- V. Aivazian, W. Hejazi, J.D. Han, "How Much does Finance Matter in East Asia?" in Fiscal Frameworks and Financial Systems in East Asia: How Much do They Matter? W. Dobson (ed.), University of Toronto Press, 1998, p. 91-183.
- La Porta, Lopez-de-Silanes, Shleifer, Vishny, "Legal Determinants of External Finance," Journal of Finance, 1997, p. 1131-1150.
- La Porta, Lopez-de-Silanes, Shleifer, Vishny, "Law and Finance," Journal of Political Economy, 1998.
- R. La Porta, F. Lopez-de-Silanes, A. Shleifer, and R. Vishny, "Investor Protection and Corporate Governance," Journal of Financial Economics, 58, 1-27, 2000.
- R. La Porta, F. Lopez-de-Silanes, A. Shleifer, and R. Vishny, "Investor Protection and Corporate Valuation," Journal of Finance, 57, 1147-1170, 2002.
- C. Doidge, A. Karolyi, and R. Stulz, "Why Are Foreign Firms Listed in the U.S. Worth More?" Journal of Financial Economics, Vol. 71, No. 2, February, 2004.
- T. Beck, and R. Levine, "Industry Growth and Capital Allocation: Does Having a Market or Bank-based System Matter," Journal of Financial Economics, 64, 147-180, 2000.
- A. Demirguc-Kunt, and V. Maksimovic, "Funding Growth in Bank-based and Market-based Financial Systems: Evidence from Firm-level Data," Journal of Financial Economics, 65, 337-363, 2002.
- R. Rajan and L. Zingales, "Financial Dependence and Growth," American Economic Review, 1998.
- A. Demirguc-Kunt and V. Maksimovic, "Law, Finance, and Firm Growth", Journal of Finance, December 1998.
- T. Beck, R. Levine, and N. Loayza, "Finance and the Sources of Growth," Journal of Financial Economics, 58 261-300, 2000.

- R. Stulz, and R. Williamson, "Culture, Openness, and Finance," Journal of Financial Economics, 70, 313-349, 2003.
- T. Beck, A. Demirguc-Kunt, and R. Levine, "Law, Endowments, and Finance," Journal of Financial Economics, 70, 137-181, 2003.
- R. Rajan, and L. Zingales, "The Great Reversals: the Politics of Financial Development in the Twentieth Century," Journal of Financial Economics, 69, 5-50, 2003.
- W. Carlin, and C. Mayer, "Finance, Investment, and Growth," Journal of Financial Economics, 69, 191-226, 2003.
- D. Denis, and V. Mihov, "The Choice Among Bank Debt, Non-bank Private Debt, and Public Debt: Evidence From New Corporate Borrowings," Journal of Financial Economics, 70, 3-28, 2003.
- S. Claessens, and L. Laeven, "Financial Development, Property Rights, and Growth," The Journal of Finance, Vol. LVIII, No. 6, Dec., 2003.
- J. S. Ang, R.A. Cole and J. Wuh Lin, "Agency Costs and Ownership Structure," Journal of Finance, Vol. LV. No1., February 2000.
- H. Demsetz, B. Villalonga, "Ownership structure and corporate performance," Journal of Corporate Finance, 7, 209-233, 2001.
- B. Villalonga, "Does Diversification cause the Diversification Discount?," Financial Management, Summer 2004.
- M. A. Desai, C. F. Foley and J.R. Hines Jr., "A Multinational Perspective on Capital Structure Choice and Internal Capital Markets," The Journal of Finance, Vol. LIX, No. 6, December 2004.
- T. Beck, A. Demirguc-Kunt and V. Maksimovic, "Financial and Legal Constraints to Growth: Does Firm Size Matter?" The Journal of Finance, Vol. LX, No. 1, February 2005.
- M.C. Jensen, W. H. Meckling, "Specific and General Knowledge, and Organizational Structure," Journal of Applied Corporate Finance, Fall 1995.
- M. Braun, B. Larrain, "Finance and the Business Cycle: International, Inter-Industry Evidence," The Journal of Finance, Vol. LX, No.3, June 2005.
- R. M. Stulz, "The Limits of Financial Globalization," Journal of Finance, 60(4), pp. 1595-638, 2005.
- V. Aivazian, M. Rahaman, L. Sun, "Financial Shocks and Firm Performance: Evidence from Systemic Banking Crisis," Work paper, 2011.