

# ECO359H1 S (L5201)

## Financial Economics II

### 2018 Winter

#### **Instructor Contact Information:**

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Name: Michael Ho  
Email: michaelhc.ho@utoronto.ca  
Class day/time: Wednesday 6–9pm (Tutorial 6–7pm & Lecture 7–9pm)  
Class location: SS 2135  
Course website: Blackboard

#### **Course Description:**

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Agency and incomplete information problems inherent in financial transactions; the role of contractual arrangements in overcoming them. Financial constraints on investment decisions of firms; the financial system in economic growth; the legal system in the functioning of financial markets. A look at theoretical and empirical literature covering these issues.

#### **Prerequisite & Exclusions:**

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Prerequisite: ECO358H1

Exclusion: ACT349H1, RSM333H1

#### **Required Textbook:**

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Corporate Finance (Seventh Canadian Edition) by Stephen Ross, Randolph Westerfield, Jeffrey Jaffe, and Gordon Roberts. McGraw-Hill Ryerson (2015).

#### **Course Materials:**

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Course outline and lecture outlines will be posted on Blackboard.

## **Evaluation and Grading:**

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<b>Assessment</b>	<b>If Mid-term is better than Final Examination</b>	<b>If Final Examination is better than Mid-term</b>
Group Project	20%	20%
Mid-term (1½ hours)	35%	25%
Final Examination (2 hours)	45%	55%

The Mid-term is scheduled to be written on February 16 in BA1160 at 4pm. The variable weights for the Mid-term and the Final Examination are designed to encourage students to improve upon their Final Examination. The Final Examination is cumulative and will be held during examination period.

Re-reads of the Mid-term will be granted if the test is written in pen and the request submitted to me within one week after the Mid-term has been returned in class (rather than one week the Mid-term has been picked up by the student) as students in this course need to know their relative position as early as possible before last day to drop S courses without academic penalty and have them removed from the transcript (March 14). In addition to this, you must include in writing and with specificity, your question or concern with the grading. Please be advised that re-read and re-mark may result in upward or downward revision. Addition errors will, of course, be corrected on the spot.

All groups must be formed with a maximum of 6 members. A hardcopy of the written group project (2,500 words) must be submitted during last class and no late submission (or electronic version) will be accepted.

## **Policy on Missed Mid-term:**

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Any student misses the Mid-term due to something outside his/her control, such as illness, accident or the death of a family member (see the Undergraduate Calendar for details), must submit a written request in person for special consideration within one week of the missed Mid-term explaining the reason for missing the Mid-term, and attaching appropriate documentation, such as Verification of Student Illness or Injury. If the request for special consideration has been accepted, then the student will have the weight on the Mid-term shifted to the Final Examination (80%).

## **Academic Misconduct:**

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Students should note that copying, plagiarizing, or other forms of academic misconduct (cheating in the mid-term or exam) will not be tolerated. Any student caught engaging in such activities will be subject to academic discipline ranging from a mark of zero on the assignment, test or examination to dismissal from the university as outlined in the academic handbook. Any student abetting or otherwise assisting in such misconduct will also be subject to academic penalties.

## **Important:**

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This course is constructed around the textbook (7<sup>th</sup> Canadian Edition) and the responsibility of the instructor is to specify the best source of information for the students to prepare for this course. It is totally up to the students to decide whether they would want to buy the textbook or not. This is a demanding course and there is a considerable amount of preliminary reading which should be done before each class. It would be difficult to do well if one falls behind in covering the required reading materials. Hence, students are expected to (i) read the relevant chapter(s) in the textbook before each class in order to follow the lecture discussion; and (ii) attend every lecture because a significant portion of the Mid-term and the Final Examination will be comprised of lecture discussion.

Communication in email must be done through UTOR email account for record-keeping and identification purposes as required by the University. Please put “*ECO359*” in the message title as this will help draw my attention to your email. Questions in any email should not require more than two sentences to answer. For any question that involves more than two sentences to answer, or requires equation or diagram, should be discussed in person either in class or office hours. Since there are limits to how much time can be devoted to answering email, questions already covered in the syllabus or announcements (in class or on Blackboard) will not get response. Students should not take email as a means to receive private tutorials or review material that was covered in class but they missed.

## **Assigned Articles**

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- [A1] Bhattacharya, S., 1979, Imperfect information, dividend policy, and the “bird in the hand” fallacy, *Bell Journal of Economics*, 10(1), pp. 259-270.
- [A2] Jensen, M.C., 1986, Agency costs of free cash flow, corporate finance, and takeovers, *American Economic Review*, 76 (2), pp. 323-329.
- [A3] Jensen, M.C. and W.H. Meckling, 1976, Theory of the firm: managerial behavior, agency costs and ownership structure, *Journal of Financial Economics*, 3(4), 305-360.
- [A4] Miller, M. and K. Rock, 1985, Dividends policy under asymmetric information, *Journal of Finance*, 40(4), pp. 1031-1051.
- [A5] Myers, S.C. and N. Majluf, 1984, Corporate financing and investment decisions when firms have information that investors do not have, *Journal of Financial Economics*, 13(2), pp. 187-221.
- [A6] Myers, S., 1977, Determinants of corporate borrowing, *Journal of Financial Economics*, 5(2), 147-175.
- [A7] Rock, K., 1986, Why new issues are underpriced? *Journal of Financial Economics*, 15(1), pp. 187-212.
- [A8] Ross, S.A., 1977, The determination of financial structure: the incentive-signalling approach, *Bell Journal of Economics*, 8(1), pp. 23-40.

## **Detailed Course Outline (Tentative):**

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<b>Topic</b>	<b>Materials</b>
Introduction, the Investment Decision	Chapters 1 & 4
Financial Statements, Cash Flow Analysis	Chapters 2 & 8
Risk and Capital Budgeting	Chapters 13 & 15
Capital Structure and the Cost of Capital	Chapter 16
Capital Structure: Limit to the Use of Capital	Chapter 17
Financial Leverage and Capital Structure Policy	Chapter 18
Capital Structure and Agency Costs	A2, A3, & A6
Capital Structure & Asymmetric Information	A5 & A8
Dividend Policy	Chapter 19, A1 & A4
Theories of IPO	Chapter 20 & A7
Mergers & Acquisitions, Takeovers	Chapter 30