

## F402 - Corporate Financial Strategy and Governance Spring 2012

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**Course Description:** This course explores the principles of corporate financial strategy and governance. Good knowledge of these subjects is important for anyone considering a career in consulting, corporate management, investment banking, trading, and academic economics or finance. The main areas of study are: valuation and capital budgeting, capital structure, payout policy, mergers and acquisitions, and advanced topics in corporate finance. We will emphasize the use of strategy in corporate decision making to maximize shareholder wealth. By the end of the course, you will validly be able to make each of the following statements:

- I can evaluate stocks, bonds, and other securities both qualitatively and quantitatively from a firm and investor perspective.
- I can implement techniques to decide which projects a firm should undertake, and I can address many of the common issues in capital budgeting.
- I can calculate a firm's cost of equity and debt capital and I know how to use the WACC appropriately in capital budgeting decisions.
- I know the steps involved and the costs and benefits of raising capital for a firm through venture capital funding, IPOs, private placements, and other forms of financing.
- I understand and can evaluate the factors that go into the debt versus equity decision of the firm.
- I know why firms might pay dividends, conduct stock splits, or undertake stock repurchases.
- I understand the benefits and common mistakes associated with mergers and acquisitions for companies, and I can evaluate the merits of a merger.
- I understand financial markets and Wall Street, and I am conversant in the language of finance (This is very important when you walk into an interview room).

In each topic, we will include a mix of theory, institutional facts, and empirical evidence. Financial economics is based on a few fundamental postulates and the application of analytical reasoning. The financial approach to understanding behavior is difficult to learn passively. Although the topics are by nature quantitative, we place as much emphasis on common sense, on the ability to know how to approach problems, and on the way of thinking, as we place on formulas and equations. If something appears not to make sense, just ask! A friendly inquiry or challenge, in a productive spirit, is always welcome.

The lectures and the exams will focus on examples. **Examples, instead of definitions, will help you learn.** An important part of your reading, but not the only part, is the questions at the end of assigned book chapters. Finance is learned through practice not through memorization. My personal experience has convinced me that working through these practice questions is essential for a superior performance in the exams. **Do the problems!**

**Prerequisites and background knowledge:** F303 and F305. This class will necessarily be easy for some students and difficult for other students. If you find the material very difficult, you need to (actually, must) take the initiative to keep up with the material. I am providing many sources of help, but you will likely fail if you wait until the week before the exams.

**Workload warning:** I am a believer in “learning by doing,” so do not assume this class is easy. The standard academic workload of KSB is 2 hours home preparation for each hour of class time. The suggested out-of-course workload is targeted for an average of 5 hours per week, sometimes more, sometimes less.

**Office hours:** my standard office hours are Tuesdays and Thursdays 4:00-5:00PM. In addition, whenever possible, I will try to remain present after class to immediately answer any student questions. In addition, every student can make a specific appointment to see me, which I will usually work within 48 hours. If you need to reach me outside of class and office hours, email is my preferred mode of communication.

**Course Material:**

- **Required:** “Corporate Finance” by Ross, Westerfield and Jaffe, McGraw-Hill Inc., 9<sup>th</sup> edition (RWJ).
- **Required:** Packet of cases and readings (hereafter, “Course Pack”), available from the Bookstore.
- **Recommended:** "Financial Markets and Corporate Strategy" by Grinblatt and Titman, McGraw-Hill Inc., 2<sup>nd</sup> edition (GT).
- Lecture notes, assignments, and other useful information will be posted on the course web page at <https://oncourse.iu.edu>. You are expected to download and print the required material before coming to the class. I expect you to read the required readings before class. You will not understand everything, but you should understand a good part of it. Having pre-read the material should help you to follow the discussion in class.
- Everyone in the class is highly recommended to subscribe to or at least read regularly *the Wall Street Journal*. You absolutely cannot walk into an interviewing situation without knowledge of (and/or an opinion about) current events. For example, when did LinkedIn go public and what happened during its first trading day? What is a Ponzi scheme? Why did S&P downgrade the U.S. debt? Similarly, you should not walk into a financial services or consulting interviewing situation if you are not tech-savvy. For example, what are the best financial websites and why?

**Grading:** The grades for this course are determined on a relative basis, i.e., your grade will depend on where you stand with respect to the rest of the class (three sections combined). Grades will be determined as follows:

Group Case Write-ups (2 assignments, 50 points each)	100 points
In-class group assignments	20 points
Midterm 1	110 points
Midterm 2	110 points
Final Exam	110 points
<hr/> Total	<hr/> 450 points

Following the Finance Department policy, the average grade for the three sections combined will be a B- ~ B (2.7~3.0). In practical terms, this means that:

- 20%~25% of the class will get an A+, A or A-
- Close to 50% will get a B+, B, or B-
- Close to 25% will get a C+, C, or C-
- The median grade will be around a B- ~ B

As per the policy laid down by the Kelley School of Business, I will NOT offer an incomplete grade (I) once the final date for dropping the class is past.

**Cases:** We will discuss two cases during this course to illustrate the real-world applications of the various concepts discussed in class. You are expected to hand in two case write-ups. Case write-ups will be done in groups of 5 or 6 members (the maximum is 7). You may pick your own groups, but from within your section only. You must turn in your group requests to me on September 8<sup>th</sup> (i.e., the fourth class). Anyone not turning in a request by this date will be randomly assigned to a group for the entire semester. I reserve the right to redistribute groups and to make changes in order to ensure that all groups have 5 or 6 members. It is possible that some groups will end up with less than 5 members.

Case write-ups are to be handed in at the **beginning** of class on their due dates. **No credit will be given for late cases.**

Please note that I will not adjudicate any intra-group disputes. Learning to cope with intra-group conflicts is part of your training. Once groups are assigned, it is your responsibility to figure out who your group members are, how to contact them, etc. I will only grade one report submitted by the entire group, and will not accept multiple reports by factions within groups. Of course, at the end of the semester, you will get an opportunity to submit a confidential evaluation of your group members (specific guidelines for the evaluation will be provided later). Each student's case grade will be adjusted to reflect these evaluations.

Questions for case discussion and write-ups will be distributed in advance. Cases must be carefully type-written and proof-read. You may, however, write in any formulae or figures, etc., that are difficult to type in. Since class participation is essential for case discussion, I will feel free to call upon any student for any of the cases.

Task	Deadline
Submission of group requests	January 19 <sup>th</sup>
Submission of Case 1 write-up	February 28 <sup>th</sup>
Submission of Case 2 write-up	April 25 <sup>th</sup>

**In-class group assignments & participation:** There is only one way to learn finance concepts, and that is by repeatedly applying them to solve real-life problems faced by businesses. Every new concept we learn will be applied to a real-life example, which we will collectively solve in the class. You are expected to attend the class, actively participate in this exercise, and take down notes. I will not post any solutions to in-class examples on Oncourse.

Every now and then, I will assign one of these examples as an in-class group assignment, and will give each group 10-15 minutes to collectively solve the problem on a piece of paper. I will occasionally ask you to turn in your solutions and then grade your submissions, which will contribute to the “in-class group assignments and participation” component (4% weight) of your overall grade. It is, therefore, important that you turn in your group requests by September 8<sup>th</sup>, so that the groups can be in place when we meet on September 13<sup>th</sup>.

Note that the in-class assignment is not a surprise quiz; it is only meant to be an active participation exercise, and will be graded accordingly. Needless to say, if you miss a class, you will miss out on any in-class assignments assigned that day. Regardless of the reasons for your absence, there will be no make-up assignments.

### **Exams:**

You will be required to take three exams -- 2 mid-term exams and a final exam. All of these are closed-book, closed-notes exams, and will only focus on material covered in class since the last exam, i.e., all exams including the final exam are **non-cumulative**. You will be provided with a sheet containing the important formulas. You must bring your own calculators though. You should have a calculator that can calculate the internal rate of return (IRR) and the answer to  $y^x$  such as  $(1.103456)^{1.324}$ . It will make life easier if you buy a financial calculator like Texas Instruments BA II Plus or Hewlett Packard 12C (they are the only two types of calculators allowed on the CFA exam).

Following are the dates for the exams:

- Mid-term Exam 1: February 14<sup>th</sup>, Tuesday (regular class time)
- Mid-term Exam 2: March 29<sup>th</sup>, Thursday (regular class time)
- Final Exam: Finals Week, Time and Location TBA

If you anticipate any conflicts (for example: a religious holiday, 3 or more final exams on the date of final exam, etc.) with the exam times, you must inform me by the end of the second week of the course so that I can schedule an early exam for you. Do not make any travel plans or schedule job interviews that conflict with exam times, especially the final exam; I will not accept that as a legitimate conflict. You have to take the final exam at the designated time and place.

Exams will be graded in a timely fashion. Re-grading requests must be submitted to me, in writing, within a week of the grade being distributed.

### **FAQ:** What if you miss an exam?

- I do not offer make-up exams. If you miss either of the mid-term exams because of a valid reason (described below), the credit for that exam will be redistributed over the **exams that follow** (i.e., there won't be any re-distribution over exams that you have already taken). Please understand that I am not offering you an option to miss a mid-term exam that you can exercise at will. You may miss a mid-term only for a valid reason: family or health emergency, backed by documentary evidence. At a minimum, a signed note from the doctor/nurse on an official letterhead attesting that you were advised a

day's rest. It is not enough to show me a slip providing that you visited a clinic and phone calls from parent(s) will not suffice, either.

- If you miss a mid-term exam, you must notify me immediately (by email) and provide the necessary documentation within a week's time. If you fail to do so or if you miss a mid-term for non-valid reasons, you will get a score of 0 on it, without any grade redistributions.
- Missing the final exam or missing more than one exam will automatically result in an **F** (and not an incomplete).

Even if some medical/family problem does arise, you should try and resist the temptation of missing a mid-term exam because:

- You diversify your risks better if you take all 3 exams.
- We cover more and more difficult topics as we progress through the semester. It is possible that you might find Mid-Term 2 and the Final more difficult in comparison with Mid-Term 1.
- The feedback from exams is very useful (especially for those facing difficulties) in preparing for other exams, deciding whether or not to drop the course, etc.

**Academic Honesty:** All students enrolled in a course taught through the Kelley School of Business are expected to uphold the KSB Undergraduate Program Student Honor Code (visit <http://www.kelley.iu.edu/ugrad/honorCode.cfm>), regardless of whether or not they are business majors, and the IU Honor Code (visit <http://www.dsa.indiana.edu/Code>). The attempt of any student to present the work of another as his or her own, or to present any work not honestly performed, or to pass any examination by improper means is a most serious offense and will be treated with extreme prejudice. Using homework assignment and/or exam solutions from a previous semester is a clear case of cheating. The aiding and abetting of a student in any dishonesty is likewise held to be a great breach of discipline. Activities violating these codes will result in an **F**. **I take cheating very, repeat, very seriously.**

**Disability Services:** If you need any special accommodations on account of any disabilities, you must obtain a "Testing/ Classroom Modifications Memo" from the Disability Services for Students (visit <http://www.indiana.edu/~iubdss/> for details). Please bring this memo to me at least 2 weeks before Mid-Term Exam 1 so that I can make the appropriate arrangements for you.

### Schedule of Classes:

- The class schedule is tentative. I will make every effort to maintain the class schedule that follows. However, it may be necessary to make adjustments as the class proceeds.
- “RWJ” refers to the Ross, Westerfield and Jaffe text, “GT” refers to the Grinblatt and Titman text, “CP” refers to the course pack, and “PS” refers to the problem sets.

Class Number	Topics Covered	Required Readings	Recommended Readings
1 (Jan 10)	Introduction <ul style="list-style-type: none"> <li>• Syllabus</li> <li>• Goals of Financial Managers</li> </ul> Review: Tools (I) <ul style="list-style-type: none"> <li>• Time Value of Money</li> <li>• Multi-period</li> </ul>	RWJ Ch 1; RWJ Ch 4.1-4.3	
2 (Jan 12)	Review: Tools (II) <ul style="list-style-type: none"> <li>• Compounding Periods</li> <li>• Perpetuities and Annuities</li> <li>• Statistics</li> </ul>	RWJ Ch 4.1-4.4	PS 1
3 (Jan 17)	Fixed Income Valuation <ul style="list-style-type: none"> <li>• Bond Pricing</li> <li>• Credit Analysis and Interest Rate Risk</li> </ul>	RWJ Ch 8;	GT Ch 2.4; PS 2
4 (Jan 19)	Equity Valuation <ul style="list-style-type: none"> <li>• Stock Valuation</li> <li>• DGM and NPVGO</li> <li>• P/E ratio</li> </ul>	RWJ Ch 9	GT Ch 3.1; PS 3
5 (Jan 24)	Risk Evaluation (I) <ul style="list-style-type: none"> <li>• Returns</li> <li>• Risk Premium and Variance</li> </ul>	RWJ Ch 10	GT Ch 4
6 (Jan 26)	Risk Evaluation (II) <ul style="list-style-type: none"> <li>• Diversification</li> <li>• CAPM</li> </ul>	RWJ Ch 10; The Nobel Prize; About Regressions (CP)	GT Ch 4, Ch 5; PS 4
7 (Jan 31)	Risk Evaluation (III) <ul style="list-style-type: none"> <li>• APT</li> <li>• Cost of Capital</li> </ul>	RWJ Ch 11 12; About Factor Methods (CP)	Topic Notes; PS 5
8 (Feb 2)	Capital Budgeting (I) <ul style="list-style-type: none"> <li>• NPV</li> <li>• IRR</li> </ul>	RWJ Ch 6.1, Ch 6.5-6.6	
9 (Feb 7)	Capital Budgeting (II) <ul style="list-style-type: none"> <li>• Payback and Other Methods</li> <li>• Efficient Market Hypothesis</li> </ul>	RWJ Ch 6.3, 6.7-6.8, Ch. 14.1-14.5	RWJ Ch 7; PS 6

10 (Feb 9)	Review of Mid-Term Exam 1	Preparation Guide	
11 (Feb 14)	<b>Midterm Exam 1</b>		
12 (Feb 16)	Raising Capital (I) <ul style="list-style-type: none"> <li>• IPOs</li> <li>• Private Equity Market</li> </ul>	RWJ Ch 20; HBS Case: IPO Process (CP)	GT Ch 3
13 (Feb 21)	Raising Capital (II) <ul style="list-style-type: none"> <li>• Rights</li> <li>• Corporate Bond</li> </ul>	RWJ Ch 20	GT Ch 2; PS 7
14 (Feb 23)	Capital Structure (I) <ul style="list-style-type: none"> <li>• MM Theorem</li> <li>• Proposition I (no taxes)</li> </ul>	RWJ Ch 16	GT Ch 14
15 (Feb 28)	Case Discussion: Google's IPO <b>Google Case Write-up Due</b>	Google Case (CP)	
16 (Mar 1)	Capital Structure (II) <ul style="list-style-type: none"> <li>• Proposition II (no taxes)</li> </ul>	RWJ Ch 16	GT 14; PS 8
17 (Mar 6)	Capital Structure (III) <ul style="list-style-type: none"> <li>• Proposition I and II with taxes</li> <li>• Financial Distress</li> </ul>	RWJ 17	GT 19.5
18 (Mar 8)	Capital Structure (IV) <ul style="list-style-type: none"> <li>• Agency Costs of Debt</li> <li>• Signaling</li> <li>• Trade-off Theory and Pecking-Order Theory</li> </ul>	RWJ 17	GT 19.5; PS 9
19-20 (Mar 13, 15) No Class: Spring Break			
21 (Mar 20)	Payout Policy (I) <ul style="list-style-type: none"> <li>• Cash Dividends, Stock Dividends, Stock Splits, and Share Repurchases</li> <li>• MM Theorem</li> <li>• Taxes</li> </ul>	RWJ Ch 19	GT Ch 15.1-15.3
22 (Mar 22)	Payout Policy (II) <ul style="list-style-type: none"> <li>• Signaling</li> <li>• Dividends and Investment Decisions</li> </ul>	RWJ Ch 19	PS 10
23 (Mar 27)	Review for Mid-term Exam 2	Preparation Guide	
24 (Mar 29)	<b>Midterm Exam 2</b>		
25 (Apr 3)	Case Discussion: Linear Technology <b>Linear Technology Case Write-up Due</b>	HBS Case: Linear Technology (CP)	
26 (Apr 5)	Mergers and Acquisitions (I) <ul style="list-style-type: none"> <li>• Forms of Acquisitions</li> <li>• Synergy and Coinsurance Effect</li> </ul>	RWJ Ch 29	
27 (Apr 10)	Mergers and Acquisitions (II) <ul style="list-style-type: none"> <li>• Financing Acquisitions</li> </ul>	RWJ Ch 29.11	GT 20.9-20.11 PS 11

	<ul style="list-style-type: none"> <li>• Empirical Evidence</li> </ul>		
28 (Apr 12 )	<i>No Class</i>		
29 (Apr 17)	Advanced Topics: Agency cost and Information Asymmetry (I) <ul style="list-style-type: none"> <li>• Debt Holder-Equity Holder Conflicts</li> <li>• Equity Holder-Manager</li> </ul>	Lecture Slides	GT Ch 16, 18;
30 (Apr 19)	Advanced Topics: Agency cost and Information Asymmetry (II) <ul style="list-style-type: none"> <li>• Convertibles</li> <li>• Capital Structure</li> <li>• Payout Policy</li> </ul>	Lecture Slides	GT Ch 19; PS 12;
31 (Apr 24)	Advanced Topics: Introduction to Venture Capital and Private Equity <ul style="list-style-type: none"> <li>• Fund Structure</li> <li>• Geography of VC/PE</li> <li>• Financial Contracting</li> <li>• Exit Strategy</li> </ul>	Lecture Slides	
32 (Apr 26)	Review for Final Exam	Preparation Guide	
	<b>Final Exam</b>		

## **APPENDIX**

### **Undergraduate Program Learning Goals**

#### ***Learning Goal 1: An Integrative Point of View***

*Graduates of the Kelley School of Business Undergraduate Program will be able to evaluate and make business decisions from an integrative point of view, one that reflects an understanding of mutually interdependent relationships among competitive and environmental conditions, organizational resources, and the major functional areas of a business enterprise.*

#### ***Learning Goal 2: Ethical Reasoning***

*Graduates of the Kelley School of Business Undergraduate Program will be able to recognize ethical issues, demonstrate familiarity with alternative frameworks for ethical reasoning, and discern tradeoffs and implications of employing different ethical frames of reference when making business decisions.*

#### ***Learning Goals 3: Critical Thinking & Decision Making***

*Graduates of the Kelley School of Business Undergraduate Program will be able to use a variety of research methodologies to identify and critically evaluate implications of business decisions for organizational stakeholders (e.g., customers, colleagues, employees, stockholders, suppliers, foreign governments, communities, cultures, regulatory agencies) and the natural environment.*

#### ***Learning Goal 4: Communication***

*Graduates of the Kelley School of Business Undergraduate Program will be able to communicate effectively in a wide variety of business settings (e.g., live, virtual, synchronous and asynchronous), employing multiple mediums of communications (e.g., written, oral and visual).*

#### ***Learning Goal 5: Quantitative Analysis and Modeling***

*Graduates of the Kelley School of Business Undergraduate Program will be able systematically apply tools of quantitative analysis and modeling to make recommendations and business decisions.*

#### ***Learning Goals 6: Team Membership & Leadership***

*Graduates of the Kelley School of Business Undergraduate Program will be able to collaborate productively with others, functioning effectively as both members and leaders of teams.*

#### ***Learning Goal 7: Respect, Inclusiveness & Valuing People***

*Graduates of the Kelley School of Business Undergraduate Program will be able to create and sustain personal and work environments that are respectful and inclusive, valuing the contributions of all persons.*

#### ***Learning Goal 8: Personal and Professional Development***

*Graduates of the Kelley School of Business Undergraduate Program will be prepared to become the “authors” of their own futures, make informed and deliberate choices about personal and professional development, assume responsibility for their decisions, take pride in excellence, contribute to community, and demonstrate college-level mastery of the skills needed for pursuing and managing a career as a business professional.*

#### ***Learning Goal 9: Global Awareness***

*Graduates of the Kelley School of Business Undergraduate Program will be conversant with major economic, social, political, and technological trends and conditions influencing foreign investment and development of the global economy and demonstrate an understanding of the cultural, interpersonal and analytical competencies required for engaging in global business activities.*

#### ***Learning Goal 10: Innovation and Creativity***

*Graduates of the Kelley School of Business Undergraduate Program will know how to respond to the need for innovation or creativity by engaging in ongoing learning, broadening their points of view, exploring cross-contextual links, and consulting with others.*

This course helps you achieve the learning objectives set by the school wide program. Specifically:

1. Team Membership and Leadership – There are two group projects and a few in-class group assignments that make up 24% of your grade for the course.
2. Quantitative Analysis and Modeling – The course will have a heavy emphasis on developing quantitative as well as qualitative analysis skills. We will do this by in-class demonstrations and two group projects.
3. Global Awareness – The in-class case requires a breakdown of domestic and international growth analysis. Additionally, other class examples and current events will draw on international firms and themes.
4. Ethics – This is not explicitly taught in the course, but obviously, you are expected to abide by the honor code.