Sabanci Business School
PhD in Management Program
Spring 2022
FIN 619 – Empirical Corporate Finance

*****TENTATIVE*****
*****Course material may be revised until the semester starts*****

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Office Hours: By appointment

Type	Time	Days	Where
Class	10:40 – 13:30	Tuesdays	FASS G046 & Online

Course Objective:
The purpose of this course is to provide an overview of corporate finance at the graduate level. The covered topics include corporate financing, internal investment and external investment via takeovers. While covering these topics, we will first build the theoretical framework and then proceed to the empirical tests of these theories. After covering the key concepts, hypotheses and empirical regularities through seminal papers, we go over to more recent papers to explore the current state of the literature so that students can study cutting-edge novel research questions. The course is intended primarily for masters or doctoral students who are interested in corporate finance research. Students should have taken graduate-level microeconomics (equivalent of the ECON 501-502 sequence) and applied econometrics (equivalent of the ECON 505-506-604 sequence) classes prior to taking this course.

Course Material:
Tirole, J. (2010). *The Theory of Corporate Finance*. Princeton University Press.
Parts of the textbook will be used as course material throughout the semester. The textbook is available on the course reserve at the Information Center. Remaining reading material (i.e., papers and notes) can be accessed electronically via the IC.

Course Web:
All assignments should be submitted on the SuCourse+.

Grading:

Reflection Papers (8 papers in total)	: 20%
Paper presentations (4 presentations in total) & Participation	: 20% & 10%
Research Proposal	: 30%
Final Exam	: 20%

Requirements:
For every week, there will be a list of research articles, which may be updated throughout the semester, that provide crucial information about the topic in question. However, the lecture will focus primarily on several of those articles which will be chosen by the instructor and revealed to students a week prior to the lecture.

Reflection Papers
Students are expected to write weekly reflection papers covering the topic of the week. The reflection paper should provide a summary of the several papers that are picked by the instructor for that week. While summarizing specific empirical papers, students can discuss their primary research question, dataset, empirical design and identification strategies. For theory papers, the implications of the model, whether they capture key market dynamics, relevance of the key assumptions, and their empirical implications stand out. Please limit your reflections papers to a maximum of two pages (12-pt font, 1.5 spacing and 1-inch margins). The lowest two reflection paper grades (out of 8) will be dropped at the end of the semester.

Paper Presentations
Students are required to present a total of four papers during the semester. These should be 30 min presentations of one of the papers from the reading list. Each paper should come from one of the four main parts of the course content. The presentation should cover:

- What research questions are the authors asking? What is the contribution of the paper to the literature?
- Experimental design (empirical papers):
  - Data sources: is the data novel?
  - What econometric techniques are used and why?
  - Do they establish causal relationships clearly?
- Modelling (theory papers):
  - What are the critical assumptions of the model? How do the model implications depend on them?
  - Does the model capture the critical elements of the problem at hand?
  - Is there a novel modelling technique / approach?
  - What are the empirical implications of the model?
- Your own critique of the paper. What you like and what you find unconvincing about it. What would you do differently? Hint: Read the follow-up literature (and cite accordingly).

For the presentation week, the instructor will either assign a paper to each student or provide a list of possible papers from which the students can pick. Please submit your presentation slides in PDF.

Research Proposal
Students will write a research proposal on a topic related to empirical corporate finance. The proposal should have the following parts: (a) abstract, (b) introduction; (c) literature review; (d) data sources and variables construction; (e) empirical design. The proposal

should be in the format of a registered report: it should outline (i) key research questions and their relevance in the context of the extant literature and (ii) your proposed empirical approach for answering them. The proposals need not contain any analyses or results, but students will receive an extra bonus if they document preliminary empirical relationships. For students who want to follow this path, please request a WRDS and SDC account from us.

Students should share their proposal ideas with the instructors during the semester and present them in class on the 13th week of the semester. Research proposals are due right before the start of the presentations (please submit them through SuCourse). Please limit your proposal documents to a maximum of 15 pages (12-pt font, 1.5 spacing and 1-inch margins). Presentations should last for 45 minutes, followed by 15-minute Q&A sessions.

Final Exam
The final exam covers the course material, including theoretical and empirical papers. Questions may include literature assessment and/or critique, specific contributions of seminal papers to the literature, extensions of the theoretical models covered in class, or empirical modelling techniques. The exam will take place in the final week of the semester.

Academic Honesty:
Learning is enhanced through cooperation and as such you are encouraged to work in groups, ask for and give help freely in all appropriate settings. At the same time, as a matter of personal integrity, you should only represent your own work as yours. Any work that is submitted to be evaluated in this class should be an original piece of writing, presenting your ideas in your own words. Everything you borrow from books, articles, or web sites (including those in the syllabus) should be properly cited. Although you are encouraged to discuss your ideas with others (including your friends in the class), it is important that you do not share your writing (slides, MS Excel files, reports, etc.) with anyone. Using ideas, text and other intellectual property developed by someone else while claiming it is your original work is *plagiarism*. Copying from others or providing answers or information, written or oral, to others is *cheating*. Unauthorized help from another person or having someone else write one's paper or assignment is *collusion*. Cheating, plagiarism and collusion are serious offenses that could result in an F grade and disciplinary action. Please pay utmost attention to avoid such accusations.

Course Outline

(T) Theory Paper **(P)** Paper can be chosen for Presentation

Part 1 – Financing of Corporations (Evrim Akdoğu)

Week 1: Capital Structure: Theoretical Foundations and Determinants of Leverage

<u>Determinants of Leverage and Payouts: Theoretical Foundations</u>

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

(T) Miller, Merton H., 1977, "Debt and Taxes," *Journal of Finance* 32, 261-275.

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

(T) Miller, Merton H. and Franco Modigliani 1961, "Dividend Policy, Growth and the Valuation of Shares," *Journal of Business* 34, 411-433.

(T) Miller, Merton H. and Kevin Rock 1985, "Dividend Policy Under Information Asymmetry," *Journal of Finance* 40, 1031-1051.

<u>Determinants of Leverage: Empirical</u>

Titman, Sheridan, and Roberto Wessels, 1988, The Determinants of Capital Structure Choice, *Journal of Finance*, 1-19.

Rajan, Raghuram, and Luigi Zingales, 1995, What Do We Know About Capital Structure: Some Evidence from International Data, *Journal of Finance* 50, 1421-1460.

Welch, Ivo, 2004, Capital Structure and Stock Returns, *Journal of Political Economy* 112, 106-131.

Faulkender, Michael, and Mitchell A. Petersen, 2006, Does the Source of Capital Affect Capital Structure? *Review of Financial Studies* 19, 45-79.

Week 2: Capital Structure: Empirical Tests of Proposed Theories

<u>Pecking Order vs Trade Off Theories</u>

Shyam-Sunder, Lakshmi, and Stewart Myers, 1999, Testing Static Tradeoff Against Pecking Order Models of Capital Structure, *Journal of Financial Economics* 51, 219-244.

Fama, Eugene, and Kenneth R. French, 2002, Testing Trade-off and Pecking Order Predictions about Dividends and Debt, *Review of Financial Studies* 15, 1–33.

Frank, Murray and Vidham Goyal, 2003, Testing the pecking order theory of capital structure, *Journal of Financial Economics* 67, 217-248.

Fama, Eugene, and Kenneth R. French, 2005, Financing Decisions: Who Issues Stock? *Journal of Financial Economics* 76, 549-582.

New Issues, Dividends, Repurchases

Asquith, Paul and David Mullins, 1986, "Equity Issues and Offering Dilution," *Journal of Financial Economics* 15, 61-89.

Jay Ritter, 1991, "The long-run performance of initial public offerings," *Journal of Finance* 42, 365-394.

Loughran, Tim and Jay Ritter, 1995, "The New Issues Puzzle," *Journal of Finance* 50, 23-51.

LaPorta, Rafael, Florencio Lopez-de-Silanes, Andrei Shleifer and Robert Vishny, 2000, "Agency Problems and Dividend Policies Around the World," *Journal of Finance* 55, 1-33.

Alon Brav, John R. Graham, Campbell R. Harvey, and Roni Michaely, 2005, "Payout Policy in the 21st Century," *Journal of Financial Economics* 77, 483-527.

Adhikari, B. K. and A. Agrawal, 2018, "Peer Influence on Payout Policies", *Journal of Corporate Finance* 48, 615-637.

Week 3: Capital Structure: Presentations (Pick one from below, first come first served)

(P) Frank, Murray Z., and Vidhan K. Goyal, 2007, Capital structure decisions: Which factors are reliably important? *Financial Management* 38-1, 1-37.

(P) Lemmon, Michael L., Michael R. Roberts, and Jaime F. Zender, 2007, Back to the Beginning: Persistence and the Cross-Section of Corporate Capital Structure, *Journal of Finance* 63-4, 1575-1608.

(P) Lemmon, Michael, and Jamie F. Zender, 2010, Debt Capacity and Tests of Capital Structure Theories, *Journal of Financial and Quantitative Analysis* 45-5, 1161-1187.

(P) Fama, Eugene and Kenneth R. French (2001), "Disappearing Dividends: Changing Firm Characteristics or Lower Propensity to Pay?" *Journal of Financial Economics* 60, 3-43.

(P) Leary, Mark T., and Michael R. Roberts, 2010, The Pecking Order, Debt Capacity, and Information Asymmetry, *Journal of Financial Economics* 95, 332-355.

Part 2 – Corporate Investment (Şerif Aziz Şimşir)

Stein, J. C. (2003). Agency, information and corporate investment. *Handbook of the Economics of Finance*, *1*, 111-165.

Week 4: Theoretical Foundations of Corporate Investment / Financing
Asymmetric information between the firm and outsiders:
(T) Myers, S.C., and N.C. Majluf (1984), "Corporate financing and investment decisions when firms have information that investors do not have", *Journal of Financial Economics* 13:187−222.

Debt Overhang:
(T) Myers, S.C. (1977), "Determinants of corporate borrowing", *Journal of Financial Economics* 5:147−175.

(T) Tirole, J. (2010). *The theory of corporate finance*. Chapter 3.3. Princeton University Press.

Agency problem between managers and shareholders:
Jensen, M.C. (1986), "Agency costs of free cash flow, corporate finance, and takeovers", *American Economic Review* 76:323−329.

(T) Stulz, R.M. (1990), "Managerial discretion and optimal financing policies", *Journal of Financial Economics* 26:3−27.

(T) Hart, O., and J. Moore (1995), "Debt and seniority: an analysis of the role of hard claims in constraining management", *American Economic Review* 85:567−585.

Week 5: Corporate Investment Behavior: Empirics
Cash Flow – Investment Sensitivity
Blanchard, O.J., F. Lopez-de-Silanes and A. Shleifer (1994), "What do firms do with cash windfalls?", *Journal of Financial Economics* 36:337−360.

Lamont, O. "Cash Flow and Investment: Evidence from Internal Capital Markets." *Journal of Finance*, 52 (1997), 83–109.

Faulkender, M., and M. Petersen. "Investment and Capital Constraints: Repatriations under the American Jobs Creation Act." *Review of Financial Studies*, 25 (2012), 3351–3388.

Lewellen, J., & Lewellen, K. (2016). Investment and cash flow: New evidence. *Journal of Financial and Quantitative Analysis*, 1135-1164.

Financing Constraints
Fazzari, S. M., R. G. Hubbard and B.C. Petersen (1988), "Financing Constraints and Corporate Investment," *Brookings Papers on Economics Activity*, pp. 141-195.

Kaplan, S. N., & Zingales, L. (1997). Do investment-cash flow sensitivities provide useful measures of financing constraints? *The Quarterly Journal of Economics*, *112*(1), 169-215.

Farre-Mensa, J., & Ljungqvist, A. (2016). Do measures of financial constraints measure financial constraints? *The Review of Financial Studies*, *29*(2), 271-308.

Buehlmaier, M. M., & Whited, T. M. (2018). Are financial constraints priced? Evidence from textual analysis. *The Review of Financial Studies*, *31*(7), 2693-2728.

Week 6: Topics in Corporate Investment

Behavioral Factors

Malmendier, U., & Tate, G. (2005). CEO overconfidence and corporate investment. *The Journal of Finance*, *60*(6), 2661-2700.

Benmelech, E., & Frydman, C. (2015). Military CEOs. *Journal of Financial Economics*, *117*(1), 43-59.

Financial Crises

Duchin, R., Ozbas, O., & Sensoy, B. A. (2010). Costly external finance, corporate investment, and the subprime mortgage credit crisis. *Journal of Financial Economics*, *97*(3), 418-435.

Kahle, K. M., & Stulz, R. M. (2013). Access to capital, investment, and the financial crisis. *Journal of Financial Economics*, *110*(2), 280-299.

Corporate Innovation

Seru, A. (2014). Firm boundaries matter: Evidence from conglomerates and R&D activity. *Journal of Financial Economics*, *111*(2), 381-405.

Cornaggia, J., Mao, Y., Tian, X., & Wolfe, B. (2015). Does banking competition affect innovation? *Journal of Financial Economics*, *115*(1), 189-209.

Policy Uncertainty

Gulen, H., & Ion, M. (2016). Policy uncertainty and corporate investment. *The Review of Financial Studies*, *29*(3), 523-564.

Kim, H., & Kung, H. (2017). The asset redeployability channel: How uncertainty affects corporate investment. *The Review of Financial Studies*, *30*(1), 245-280.

Part 3 – External Investment: Mergers and Acquisitions (Evrim Akdoğu)

Week 7: Mergers and Acquisitions: Determinants of M&A Returns and Overbidding

(T) Grossman, Sanford and Oliver Hart, 1980, "Takeover Bids, the Free Rider Problem and the Theory of the Corporation," *Bell Journal of Economics* 11, 42-69.

(T) Roll, Richard, 1986, "The Hubris Hypothesis of Corporate Takeovers," *Journal of Business* 59, 197-216.

(T) Burkart, M., 1995, "Initial Shareholdings and Overbidding in Takeover Contests." *Journal of Finance*, 50, 1491–1515.

(T) Akdoğu, E., 2011, "Value-Maximizing Managers, Value-Increasing Mergers, and Overbidding", *Journal of Financial and Quantitative Analysis*, 46-1, 83-110.

Shleifer, Andrei and Robert Vishny (2003), "Stock Market Driven Acquisitions," *Journal of Financial Economics* 70, 295-311.

Morck, Randall, Andrei Shleifer and Robert Vishny (1990), "Do Managerial Objectives Drive Bad Acquisitions?" *Journal of Finance* 45, 31-48.

Betton S., Eckbo E., Thorburn K., 2008. Corporate takeovers. Handbook of Corporate Finance: Empirical Corporate Finance, Volume 2, Chapter 15.

Akdoğu, E., 2009, "Gaining a Competitive Edge through Acquisitions: Evidence from the Telecommunications Industry", *Journal of Corporate Finance* 15, 99-112.

Week 8: Mergers and Acquisitions: M&A Waves and Other empirical regularities

M&A Waves

(T) Toxvaerd, F., 2008, Strategic Merger Waves: A Theory of Musical Chairs, *Journal of Economic Theory*, 140(1), 1-26

(T) Morellec, E., and A. Zhdanov., 2005, "The Dynamics of Mergers and Acquisitions." *Journal of Financial Economics*, 77, 649–672.

Mitchell M. L., Mulherin J. H., 1996. The impact of industry shocks on takeover and restructuring activity. *Journal of Financial Economics* 41, 193-229.

Harford J., 2005. What drives merger waves? *Journal of Financial Economics* 77, 529-560.

Diversification, Private Target, Serial Acquirers

(T) Shleifer and Vishny, "Large Shareholders and Corporate Control," *Journal of Political Economy*, June 1986.

(T) V. Maksimovic, G. Phillips, 2002, Do conglomerate firms allocate resources inefficiently across industries? Theory and Evidence, *Journal of Finance* 57 (2) 721–767.

(T) Boyan Jovanovich and Serguey Braguinsky, "Bidder Discounts and Target Premia in Takeovers," *American Economic Review*, March 2004.

Rajan, Servaes, and Zingales, "The Cost of Diversity: The Diversification Discount and Inefficient Investment," *Journal of Finance*, February 2000.

Fuller, K.; J. Netter; and M. Stegemoller, 2002, "What Do Returns to Acquiring Firms Tell Us? Evidence from Firms That Make Many Acquisitions." *Journal of Finance*, 57, 1763–1793.

Week 9: Mergers and Acquisitions: Presentations

(P) Moeller S. B., Schlingemann F. P., Stulz R. M., 2004. Firm size and the gains from acquisitions. *Journal of Financial Economics* 73, 201-228.

(P) Rhodes-Kropf M., Robinson D. T., Viswanathan S., 2005. Valuation waves and merger activity: The empirical evidence. *Journal of Financial Economics* 77, 561-603.

Part 4 – Topics in M&As (Serif Aziz Simsir)

Week 10: Corporate Governance and Takeovers
Becht, M., Bolton, P., & Röell, A. (2003). Corporate governance and control. In *Handbook of the Economics of Finance* (Vol. 1, pp. 1-109). Elsevier.

Aktas, N., Croci, E., & Simsir, S. A. (2016). Corporate Governance and Takeover Outcomes. *Corporate Governance: An International Review*, *24*(3), 242-252.

Takeovers as External Disciplining Mechanisms
(T) Tirole, J. (2010). *The theory of corporate finance*. Chapter 11. Princeton University Press.

(T) Grossman, S. J., & Hart, O. D. (1980). Takeover bids, the free-rider problem, and the theory of the corporation. *The Bell Journal of Economics*, 42-64.

(T) Scharfstein, D. (1988). The disciplinary role of takeovers. *The Review of Economic Studies*, *55*(2), 185-199.

Internal Governance Quality and Takeover Performance
Masulis, R. W., Wang, C., & Xie, F. (2007). Corporate governance and acquirer returns. *The Journal of Finance*, *62*(4), 1851-1889.

Fracassi, C., & Tate, G. (2012). External networking and internal firm governance. *The Journal of Finance*, *67*(1), 153-194.

Faleye, O., Hoitash, R., & Hoitash, U. (2011). The costs of intense board monitoring. *Journal of Financial Economics*, *101*(1), 160-181.

Week 11: CEO Incentives and Takeovers

Grinstein, Y., & Hribar, P. (2004). CEO compensation and incentives: Evidence from M&A bonuses. *Journal of Financial Economics*, *73*(1), 119-143.

Datta, S., Iskandar-Datta, M., & Raman, K. (2001). Executive compensation and corporate acquisition decisions. *The Journal of Finance*, *56*(6), 2299-2336.

Hartzell J. C., Ofek E., Yermack D., (2004). What's in it for me? CEOs whose firms are acquired. *The Review of Financial Studies* 17, 37-61.

Harford, J., & Li, K. (2007). Decoupling CEO wealth and firm performance: The case of acquiring CEOs. *The Journal of Finance*, *62*(2), 917-949.

Jenter, D., & Lewellen, K. (2015). CEO preferences and acquisitions. *The Journal of Finance*, *70*(6), 2813-2852.

Yim, S. (2013). The acquisitiveness of youth: CEO age and acquisition behavior. *Journal of Financial Economics*, *108*(1), 250-273.

Week 12: Behavioral Factors in M&As / Corporate Investments

Guenzel, M., & Malmendier, U. (2020). *Behavioral corporate finance: The life cycle of a CEO career* (No. w27635). National Bureau of Economic Research.

Malmendier, U., & Tate, G. (2008). Who makes acquisitions? CEO overconfidence and the market's reaction. *Journal of Financial Economics*, *89*(1), 20-43.

Baker, M., Pan, X., & Wurgler, J. (2012). The effect of reference point prices on mergers and acquisitions. *Journal of Financial Economics*, *106*(1), 49-71.

Ma, Q., Whidbee, D. A., & Zhang, W. (2019). Acquirer reference prices and acquisition performance. *Journal of Financial Economics*, *132*(1), 175-199.

Ye, P. (2014). Does the disposition effect matter in corporate takeovers? Evidence from institutional investors of target companies. *Journal of Financial and Quantitative Analysis*, 221-248.

Guenzel, M. (2020). In Too Deep: The Effect of Sunk Costs on Corporate Investment. Wharton Working Paper.

Week 13: Research Paper Presentations

Week 14: Final Exam