Empirical Corporate Finance

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1 Course Objectives

The objective of this course is to present an introduction to the empirical analysis of modern corporate finance. Each part of the courses first discusses and reviews the rationale and ideas behind the theories and then focuses on testing the theory. The course will present a broad range of papers that cover the basic methodologies used in empirical corporate finance. The goal of the course is to provide a solid foundation so that the frontiers of research in corporate finance can be examined.

The main textbooks used for this course are:

1. Tirole, J., 2005, The Theory of Corporate Finance, *Princeton University Press*. (Tirole)
2. Eckbo, B.E., 2008, Handbook of Empirical Corporate Finance, Volume 2, *North Holland: Amsterdam*. (Eckbo)

2 Main Topics

2.1 Empirical Methods, Lectures 1-3

This section reviews the econometric issues surrounding the most popular technique in empirical corporate finance, event studies. Event studies aim to isolate the price impact of information content on corporate actions and are relevant for understanding corporate policy decisions. The section discuses measures of firm value (Tobins q) and how firm related 'events' affect this measure. The section also introduces the growing literature on behavioral corporate finance. The idea is to incorporate behavioral biases of CEO's and managers in the analysis of corporate policy decisions, in particular financing and investment patterns.

2.1.1 Event Studies

Main Readings:

- Eckbo: Chapter 1
- Campbell, J.Y., Lo, A.W. and MacKinlay, A.C., 1996 "*Econometrics of Financial Markets*", Chapter 4, pp. 150-178.

Supplementary Readings: Event Studies and Behavioral Corporate Finance:

- Fernando, C.S., May, A.D. and Megginson, W.L., 2012, "The Value of Investment Banking Relationships: Evidence from the Collapse of Lehman Brothers", *Journal of Finance*, Vol. 67(1).
- Abadie A. and Gardeazabal, J., 2003, "The Economic Costs of Conflict: A Case Study of the Basque Country", *American Economic Review*, Vol. 93, No. 1, pp. 113-132.

2.1.2 Selection Models

Main Readings:

- Eckbo: Chapter 2

Supplementary Readings: Event Studies and Behavioral Corporate Finance:

- Acharya, S., 1988. A generalized econometric model and tests of a signaling hypothesis with two discrete signals. *Journal of Finance* 43, 413Ű429.
- Acharya, S., 1993. Value of latent information: Alternative event study methods. *Journal of Finance* 48, 363Ű 385.
- Eckbo, B.E., 1992. Mergers and the value of antitrust deterrence. *Journal of Finance* 47, 1005Ű1029.
- Ljungqvist, A., Marston, F., Wilhelm Jr., W.J., 2006. Competing for securities underwriting mandates: Banking relationships and analyst recommendations. *Journal of Finance* 61, 301Ű340.
- Puri, M., 1994. The long-term default performance of bank underwritten securities issues. *Journal of Banking and Finance* 18, 397Ű418.

2.1.3 Auctions in Corporate Finance

Main Readings:

- Eckbo: Chapter 3

Supplementary Readings: Event Studies and Behavioral Corporate Finance:

- Andrade, G., Mitchell, M., Stafford, E., 2001. New evidence and perspectives on mergers. *Journal of Economic Perspectives* 15, 103Ű120.
- Betton, S., Eckbo, B.E., Thorburn, K.S., 2005. The toehold puzzle. Working Paper, Concordia University Dartmouth College.
- Boone, A., Mulherin, H. (2006a). How are firms sold? *Journal of Finance*, in press.
- Hartzell, J., Ofek, E., Yermack, D., 2004. WhatŠs in it for me? CEOs whose firms are acquired. *Review of Financial Studies* 17, 37Ű61.
- Kerins, F., Kutsuna, K., Smith, R., 2003. Why are IPO underpriced? Evidence from JapanŠs hybrid auction-method offerings. Working Paper, Claremont Graduate University.
- Thorburn, K., 2000. Bankruptcy auctions: Costs, debt recovery, and firm survival. *Journal of Financial Economics* 58, 337Ű368.

2.2 Capital Structure: Lectures 4-6

Topics covered in this section include, Modigliani-Miller & firm financial structure, debt instruments & credit market, equity instruments & IPO's, payout policy. The empirical part of this section, discusses, first, the general determinants of firm capital structure (supplementary readings) and subsequently evidence that link firms' leverage policy to structural characteristics of product markets (Eckbo, Chapter 13). Solutions to endogeneity problems that commonly arise in this empirical investigation are also discussed.

2.2.1 Sources of Capital Financing

Main Readings:

- Eckbo: Chapter 5,6,7,9

Supplementary Readings:

- Graham, J. R. and C. R. Harvey, 2001, 'The Theory and Practice of Corporate Finance: Evidence from the Field', *Journal of Financial Economics*, 60, 187-243.
- Rajan, R.G. and L. Zingales, 1995, "What Do We Know about Capital Structure? Some Evidence from International Data", *Journal of Finance*, 50, 1421-1460.

2.2.2 Determinants of Capital Structure

Main Readings:

- Tirole: Chapter 2
- Eckbo: Chapter 11, 12, 13

Supplementary Readings:

- Titman, S. and Wessels, R., 1988, "The determinants of capital structure choice", *Journal of Finance*, vol. 43, pp. 1-19.
- McConnell, J.J. and H. Servaes, 1995, Equity ownership and the two faces of debt, *Journal of Financial Economics*, vol. 39, pp. 131-157.

2.3 Corporate Governance & Agency Costs: Lectures 7-8

Topics covered in this section include, ownership structure, managerial incentives, takeovers & buyouts, shareholder value, monitoring by board of directors, regulation. The empirical part of this section is divided in two parts. The first part surveys literature on firm organizational structure, examining the relevance of group/family ownership, shareholder protection & managerial 'entrenchment', and firm networks in affecting various firm policies. The second part discusses differences in incentive structure (compensation, stock options etc.) provided to managers and executives and the factors (risk aversion, productivity, information asymmetry etc.) that affect it.

2.3.1 Governance

MAIN READINGS:

- Tirole: Chapter 1

SUPPLEMENTARY READINGS: BOARD OF DIRECTORS:

- Baysinger, Barry, and Henry Butler, 1985, Corporate governance and the board of directors: performance effects of changes in board composition, *Journal of Law, Economics, and Organization* 1, 101-124.
- Hermalin, Benjamin E., and Michael S. Weisbach, 1988, The determinants of board composition, *Rand Journal of Economics* 19, 589-606.
- Rosenstein, Stuart, and Jeff Wyatt, 1997, Inside directors, board effectiveness and shareholder wealth, *Journal of Financial Economics* 44, 229-250.

INSTITUTIONAL INVESTORS, BLOCKHOLDERS, AND CORPORATE GOVERNANCE:

- Cremers, Martijn and Vinay Nair, 2004, Governance mechanisms and equity prices, Unpublished working paper, New York University.
- Gompers, Paul, Joy Ishii, and Andrew Metrick, 2003, Corporate governance and equity prices, *Quarterly Journal of Economics* 107-155.
- Gompers, Paul, and Andrew Metrick, 2000, Institutional Investors and Equity Prices, *Quarterly Journal of Economics* 114, 229-260. Grinblatt, Mark, Sheridan Titman, and Russ Wermers, 1995, Momentum investment strategies, portfolio performance, and herding: A study of mutual fund behavior, *American Economic Review* 85, 1088-1105.
- Berger, P. G., Ofek, E. and Yermack, D.L., 1997, "Managerial entrenchment and capital structure decisions", *Journal of Finance* 52, 1411-1438.
- La Porta, Rafael, Florencio Lopez de Silanes, Andrei Shleifer, and Robert W. Vishny, 2000, Investor protection and corporate governance, *Journal of Financial Economics* 58, 327.
- Fracassi, C. and Tate, G., 2012, "External networking and internal firm governance", *Journal of Finance*, Vol. 61(1).
- Fausto, P., Andrew, E. and Marco, P., 2010, "Inheritance Law and Investment in Family Firms", *American Economic Review*, 100.
- Rajan, R.G. and L. Zingales, 1995, "What Do We Know about Capital Structure? Some Evidence from International Data", *Journal of Finance*, 50, 1421-1460.
- Shleifer, A. and Vishny, R., 1997, "A Survey of Corporate Governance", *Journal of Finance*, Vol 52(2).

2.3.2 Incentives

Main Readings:

- Eckbo: Chapter 17

Supplementary Readings: CEO Compensation & Incentives:

- Bertrand, M. and Mullainathan, S., 1999, "Is there discretion in wage setting? A test using takeover legislation". *RAND Journal of Economics*, Vol. 30(3).
- Bertrand, M. and Mullainathan, S., 1999, "Are CEOs rewarded for luck? The ones without principals are". *The Quarterly Journal of Economics*, Vol. 116(3).
- Hall, B. and Liebman, J., 1998, "Are CEOs really paid like bureaucrats?" *Quarterly Journal of Economics*, 63(3).
- Hayes, R.M. and Schaefer, S., 2009, "CEO pay and the Lake Wobegon effect", *Journal of Financial Economics*, Vol. 94(2).

2.4 Financial Distress: Bankruptcy, Re-organization and Liquidity: Lectures 9-10

Topics covered in this section include, default and bankruptcy in a perfect market, costs of bankruptcy and financial distress, financial distress and firm value, leverage, agency costs, asymmetric information. Empirical work on the costs and benefits of bankruptcy procedure is reviewed, with a discussion on optimal bankruptcy reorganization procedure – how different international bankruptcy law procedures affect firm liquidation.

2.4.1 Bankruptcy

Main Readings:

- Eckbo: Chapter 14

Supplementary Readings:

- Pulvino, T.C., 1998, "Bankruptcy, Boards, Banks and Blockholders: Evidence on Changes in Corporate Ownership and Control when Firms Default", *Journal of Financial Economics*, Vol. 27.
- White, M., 2007 "Economic Analysis of Corporate and Personal Bankruptcy Law". In Handbook of Law and Economics, Polinsky, A.M. and Shavell, S., Eds, Elsevier.

2.4.2 Takeovers and Restructuring

Main Readings:

- Eckbo: Chapter 15

2.5 Behavioural Corporate Finance: Lectures 11

The section introduces the growing literature on behavioral corporate finance. The idea is to incorporate behavioral biases of CEO's and managers in the analysis of corporate policy decisions, in particular financing and investment patterns.

MAIN READINGS:

- Eckbo: Chapter 4

SUPPLEMENTARY READINGS: EVENT STUDIES AND BEHAVIORAL CORPORATE FINANCE:

- Baker, M., Stein, J., Wurgler, J., 2003. When does the market matter? Stock prices and the investment of equity-dependent firms. *Quarterly Journal of Economics* 118, 969Ű1006.
- Bouwman, C., Fuller, K., Nain, A., 2006. The performance of stock-price driven acquisitions. *Review of Financial Studies*, in press.
- Cooper, M.J., Gulen, H., Rau, P.R., 2005. Changing names with style: Mutual fund name changes and their effects on fund flows. *Journal of Finance* 60, 2825Ű2858
- Ljungqvist, A.,Wilhelm,W., 2005. Does prospect theory explain IPO market behavior? *Journal of Finance* 60, 1759Ű1790.
- Polk, C., Sapienza, P., 2004. The real effects of investor sentiment. NBER Working Paper No. 10563.
- Pagano, M., Panetta, F., Zingales, L., 1998. Why do companies go public? An empirical analysis. *Journal of Finance* 53, 27Ű64.
- Bertrand, Marianne and Antionette Schoar, 2004, Managing with style: the effects of managers on firm policies, *Quarterly Journal of Economics* 118, 1169-1208.
- Malmendier, Ulrike and Geoffrey Tate, 2003, CEO overconfidence and corporate investments, *The Journal of Finance*, 2005