

PhD400: Theoretical Corporate Finance

Jan Starmans*

Spring 2020

Course Summary

The objective of this course is to undertake a rigorous study of the theory of corporate finance. A wide variety of topics will be discussed. To set the stage, the course will begin with an economic overview of corporate institutions. As the semester progresses, we will discuss corporate financing and agency costs and security design.

We will talk about a number of topics including the determinants of outside financing capacity and the implications of credit rationing, liquidity, free cash flow, and long-term finance, corporate financing under asymmetric information, the allocation of control rights, and takeovers.

The course focuses in depth on selected topics rather than attempting to give a complete overview of the field of corporate finance theory. The course is necessarily theoretically oriented. The material consists of game- and contract-theoretic tools applied to corporate finance. However, the focus is on gaining economic intuition and the math is kept at a minimum.

Learning Outcomes

The course has four aims. The first aim is that students understand the key theoretical ideas in corporate finance theory discussed in the course. Second, the aim is to teach students the standard

*Department of Finance, Stockholm School of Economics, Drottninggatan 98, 111 60 Stockholm, Sweden. Email: jan.starmans@hhs.se. Phone: +46 8 736 9181.

terminology of the field of corporate finance, such as debt capacity, costly state verification etc. The third aim is to improve students' general ability to think and reason as an economist. Fourth, the aim is to advance students' ability to develop and communicate their own research ideas.

Reading List

The course offers a graduate level introduction to corporate finance theory. It is based on the textbook *The Theory of Corporate Finance* by Jean Tirole. The course focuses in depth on selected chapters of the book, in particular firms' financing choices and the allocation of corporate control. The textbook has an extensive list of references, which students are referred to.

In addition to the textbook for this course, there are excellent textbooks on contract theory, including Laffont and Martimort (2002) and Bolton and Dewatripont (2005).

References:

Bolton, Patrick, and Mathias Dewatripont, 2005, *Contract Theory* (MIT Press).

Laffont, Jean-Jacques, and David Martimort, 2002, *The Theory of Incentives: The Principal-Agent Model* (Princeton University Press).

Tirole, Jean, 2006, *The Theory of Corporate Finance* (Princeton University Press).

Course Structure

Below is a list of topics I plan to cover.

1. An Economic Overview of Corporate Institutions
2. Outside Financing Capacity
3. Credit Rationing and Economic Activity
4. Some Determinants of Borrowing Capacity

5. Liquidity, Free Cash Flow, and Long-Term Finance
6. Corporate Financing under Asymmetric Information
7. Control Rights and Corporate Governance
8. Takeovers

Homework Assignments

Homework assignments will be distributed as the course progresses. The assignments are intended to deepen the students' understanding of the material of the course and are not graded. A subset of the homework assignments will be discussed in class.

Assessment

Assessment will be based on class participation and a research project. The weighting for the course grade is as follows: class participation 50%; research project 50%.

For the research project, students are allowed to work in groups of up to two. The research project is a short research paper, which presents and discusses a model related to the topics discussed in the lecture. It should be written in the style of a working paper and should not exceed 20 pages (double-spaced). It should be self-contained and include an abstract, an introduction, a complete description of the model, and all proofs. The model should either be a simple extension of a model discussed in class or a new model, which addresses a question in the area of corporate finance (broadly defined). As a guide towards finding a possible extension, students can refer to the exercises of the textbook. The group should consult with me at least once, and the meetings are to be arranged personally between the group and me. The topic of the research project should be agreed with me. The deadline for submitting the research project is Tuesday, June 9, 2020. The final presentation of the research projects will take place after the submission deadline on a mutually agreed date.

Office Hours

Please get in touch with me to arrange a mutually convenient time.

Schedule

All lectures take place 8:00-12:00 at the Swedish House of Finance, Drottninggatan 98, 111 60 Stockholm, and are scheduled as follows:

1. Tuesday, April 14, 2020,
2. Wednesday, April 15, 2020
3. Tuesday, April 28, 2020
4. Wednesday, April 29, 2020
5. Tuesday, May 5, 2020
6. Wednesday, May 6, 2020
7. Tuesday, May 12, 2020
8. Wednesday, May 13, 2020