

UNIVERSITY OF SOUTHERN CALIFORNIA
MARSHALL SCHOOL OF BUSINESS
Fall 2007

FBE 531 – Financial Policies and Corporate Control
Course Syllabus

1 Contact Information

Instructor: Ty Callahan
Office: ACC301D
Telephone: 213.740.6498
Email: Tyrone.Callahan@marshall.usc.edu
Office hours: Tuesday 5-6 pm or by appointment
Website: <https://blackboard.usc.edu/> (Blackboard)

2 Course Objective

Most business decisions have a financial dimension, be it of primary or secondary importance. This course will teach you a structured system of financial analysis that introduces a degree of objectivity to corporate financial decisions. The course has a corporate focus, but many of the skills you develop are relevant in an entrepreneurial or financial investment setting as well.

This course is best described as a secondary course in Corporate Finance. The focus is on developing a richer set of tools and an economic framework to analyze corporate investment and financing choices. Capital budgeting topics include robustness checking, certainty equivalent valuation, and real options. Understanding the usefulness of these more advanced methods will develop in students an appreciation for the implicit assumptions and potential shortcomings of the primary methods learned in introductory Corporate Finance.

Financing topics include issues arising from conflicts of interest between bondholders and shareholders and between shareholders and managers, and problems arising from information asymmetries between firms and the financial markets. We illustrate how financing choices influence, for better or worse, capital budgeting decisions and the interplay between financing and corporate control. Corporate control is discussed in the context of corporate governance mechanisms and security design considerations.

Prerequisites: GSBA 521/548 is the formal prerequisite. The course also relies on your knowledge of introductory financial accounting. You should be comfortable using a financial calculator and a spreadsheet program.

Course goal: Students will be able to apply fundamental financial tools to evaluate corporate investment and financing opportunities. Students will understand the relation between investments and financing and other aspects of corporate strategy.

Learning objectives: The primary learning objectives of the course are:

1. To understand when and why standard NPV analysis may fail or be difficult to implement and what valuation approaches might be useful alternatives.
2. To understand how financing interacts with value and other corporate objectives.
3. To understand how asymmetric information between firms and financial markets influences firms' investment and financing choices.
4. To understand the primary mechanisms of corporate governance.
5. To apply the theoretical approaches discussed to stylized textbook examples/problems and simple real world settings.

Course materials: We will use two texts in the class. The first you should already have:

Ross, Westerfield, and Jaffe, *Corporate Finance*, 1st ed., Pearson/Addison Wesley

The second text is available for free download:

I. Welch, *A First Course in Corporate Finance*, preview edition. The entire book is available by registering at <http://welch.econ.brown.edu/book/>.

You'll also need a calculator. Course notes, assignments, etc. will be posted on Blackboard, which can be accessed at <http://blackboard.usc.edu>. In addition, students are encouraged to read a periodical that covers events in the financial world. *The Wall Street Journal* is one good candidate; more global in outlook is the *Financial Times*.

Attendance and preparation: Announcements, lecture notes and all other additional course material will be posted on Blackboard. You will need to download them before each class. Please do the assigned reading prior to each lecture.

Academic integrity: *The use of unauthorized material, communication with fellow students during an exam, attempting to benefit from the work of another student, and similar behavior that defeats the intent of an examination or other class work is unacceptable to the University. It is often difficult to distinguish between a culpable act and inadvertent behavior resulting from the nervous tensions accompanying examinations. Where a clear violation occurs, however, the instructor may disqualify the student's work as unacceptable and assign a failing mark on the paper.*

Policy regarding returned graded work: *Returned paperwork, unclaimed by a student, will be discarded after 4 weeks and hence, will not be available should a grade appeal be pursued by a student following receipt of his/her course grade.*

Students with disabilities: *Any student requesting academic accommodations based on a disability is required to register with Disability Services and Programs (DSP) each semester. A letter of verification for approved accommodations can be obtained from DSP. Please be sure the letter is delivered to me (or my TA) as early in the semester as possible. DSP is located in STU 301 and is open 8:30 a.m. – 5:00 p.m., Monday through Friday. The phone number for DSP is (213) 740-0776.*

Grading: Your grade will be based on homework and three tests. Homework will count for 15% of your grade. Tests will count for 85% of your grade. Individual tests will have weights of 20/30/35. Your “best” test will receive the highest weight and your “worst” test will receive the lowest. (“Best” and “worst” are based on the class rank of your score.)

No letter grades will be assigned to individual tests or homework. The mean and standard deviation of each score will be available on Blackboard. Your overall course score will be calculated using the scheme that is most favorable to you. Grades will be awarded on a relative scale, based on the overall course score, in accordance with the Marshall School grading guidelines. Specifics regarding tests and homework follow.

→ **Homework:** All work is to be submitted in groups of 4 to 6 students. Assignments will be graded on a pass/fail basis. Assignments are due **at the beginning of class** on the due date. **Late homework will not be accepted.** To pass you do not need to get all the answers correct. The presentation and clarity of your work may also affect your homework grade.

→ **Tests:** There will be three tests during the semester. The tests are not cumulative. The test dates are: **September 25, November 6, and December 13 or 18 (or as designated by the University Finals Schedule)**. Attendance at all tests is mandatory. Tests are closed book. A formula sheet will be provided with the test. You will need a calculator. Laptop computers and programmable calculators with word

processing features are not permitted. By enrolling in the course you are committing to take the tests on the scheduled dates.

→ **Regrades:** Regrades must be requested within one week of the day the item was returned to the class. The student must submit a written and precise explanation of why he/she thinks the grade should be modified. The entire assignment will be regraded and the final mark may go up or down.

SCHEDULE and TOPICS
(tentative and subject to change)

| Week | Date | Topic |
|------|--------|---|
| 1 | 28-Aug | Introduction |
| | 30-Aug | Foundations review: Capital budgeting |
| 2 | 4-Sep | Refinement and Robustness methods: Sensitivity, Scenario, and Simulation analyses |
| | 6-Sep | Certainty Equivalent valuation |
| 3 | 11-Sep | Introduction to options |
| | 13-Sep | Options valuation |
| 4 | 18-Sep | Real options |
| | 20-Sep | Review |
| 5 | 25-Sep | Midterm exam 1 |
| | 27-Sep | Midterm recap |
| 6 | 2-Oct | Efficient vs Inefficient vs Perfect vs Imperfect markets |
| | 4-Oct | Foundations review: Capital structure and payout policy under M&M |
| 7 | 9-Oct | Credit rationing |
| | 11-Oct | Debt overhang and asset substitution |
| 8 | 16-Oct | Some determinants of borrowing capacity |
| | 18-Oct | Asymmetric information and the lemons problem |
| 9 | 23-Oct | Dissipative signals to eliminate asymmetric information |
| | 25-Oct | Corporate finance and product market interactions |
| 10 | 30-Oct | Speculative information and passive monitoring |
| | 1-Nov | Review |
| 11 | 6-Nov | Midterm exam 2 |
| | 8-Nov | Midterm recap |
| 12 | 13-Nov | Investor activism – the role of active monitors |
| | 15-Nov | Internal capital markets |
| 13 | 20-Nov | Corporate control rights |
| | 22-Nov | ----- Thanksgiving Holiday ----- |
| 14 | 27-Nov | Corporate governance and managerial compensation |
| | 29-Nov | Corporate takeovers – theoretical pros and cons |
| 15 | 4-Dec | Corporate takeovers – strategies and defenses |
| | 6-Dec | Wrap-up and review |
| | 13-Dec | Final Exam for daytime section |
| | 18-Dec | Final Exam for evening section |