

ECONOMICS 855: FINANCIAL ECONOMICS SYLLABUS & OUTLINE

Instructors:

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General: This course will be team-taught by Prof's Maloney and Kirby. Rotthoff will grade assignments and be available for tutoring as needed. We will exchange material in this class using e-mail and the internet. Old lectures are posted on Maloney's web site. Assignments, selected reading material, and addenda to the notes will be sent to you via e-mail. The written material that you do should be sent to all three of us by e-mail as well.

Materials: There are two texts that are very useful in this class. One is *Financial Theory and Corporate Policy*, by Copeland, Weston, and Shastri. The other is *Takeovers, Restructuring, and Corporate Governance*, 4th edition, Weston, Mitchell and Mulherin, Prentice-Hall. The former is a very good, all around corporate finance book. The 4th edition has a lot of the more recent literature. However, you can buy an old edition and then get the new corporate finance literature from the Weston, Mitchell, & Mulherin book. This text is a good reference book on corporate control issues. In addition, you will find that a basic corporate finance text that covers basic discounting, capital budgeting, and asset pricing is helpful.¹ Other reading material will be taken from journal articles, from material on the internet, and from material that I will provide.

We will do a lot of computer work. You will be expected to excel at Excel. Learn it. Learn how to use SAS. The computer center puts on a lot of short courses. There will be some lectures on these points, but the most important thing for you all to do is to work together to learn about computers programs.

We will use various financial databases. Many of these are available over the internet. You will be expected to search for public sources on your own, but we will instruct you on some of the proprietary ones.

Grades: There will be 6-10 short papers and assignments and one longer essay. There will also be a final examination comprised of short essays. The short papers should be in the range of 500-1500 words depending on the topic. One of these will be a mid-term exam comprised of several short questions. The longer paper should be around 5000 words. The short papers and mid-term

¹ Brealey and Myers, *Principles of Corporate Finance*, any edition is perfect.

cumulatively count 50% of your grade. The longer paper and the final each count 25%. Up to one-half of the credit received on the papers will be depend on your class presentation and discussion of your ideas.

Attendance: There is no formal attendance policy. However, you should come to class. Courtesy requires that you inform me when you are not coming. An e-mail is sufficient. Much of the grade is based on class participation as described above.

Office Hours: By appointment—we are all around a lot. Email or call to set up a specific time.

Outline:

1. Consumption, Saving, and Productive Investment in 2 Period Setting. [Two Bond problem; review math stat on expected value operators.]
2. Overview of the Behavior and Structure of the Firm—Introduction to Corporate Securities and Capital Structure.
3. Utility in mean/variance setting. Risk aversion. [Readings on risk aversion; problems on risk aversion]
4. Risk-Return Frontier: The Bullet. [Derive the Bullet in spreadsheet application]
5. Capital Asset Pricing Model. [Estimate betas; start readings from book; also M&M and Sharpe]
6. Other Pricing Models
7. Option Pricing [Applications to managerial compensation and to bond futures]
8. Market Return and Market Performance: Is the equity risk premium too high?
9. Efficient Markets—Challenger Crash
10. Rules for Project Evaluation and Managerial Decision Making. [Start collecting data from VL to do valuation / Compustat]
11. Valuation and the Choice of the Proper Discount Rate.
12. Leverage and the Value of Tax Shields. [Valuation of firms from VL; compare to market value.]
13. Event Study Methodology and Practice.
14. Agency Costs and the Theory of the Firm.
15. Agency Costs and Leverage: Bankruptcy.
16. Issues in Corporate Control: Tender Offers, Takeovers, Proxy Contests.
17. Other Issues in Corporate Control: Poison Pills, Golden Parachutes.
18. Special Topics [Interest Rate Swaps, etc.]

Selected Readings:

Franco Modigliani and Merton Miller, “The Cost of Capital, Corporate Finance, and the Theory of Investment,” *AER*, 6/58.

William F. Sharpe, “Capital Asset Prices: A Theory of Market Equilibrium Under Conditions of Risk,” *Journal of Finance*, 1964, 425-22.

Michael Jensen and William Meckling, “Theory of the Firm: Managerial Behavior, Agency Cost and Ownership Structure,” *Journal of Financial Economics*, 1976.

Daigle, Katherine, and M.T. Maloney. "Residual Claims in Bankruptcy: An Agency Theory Explanation," *Journal of Law & Economics*, April 1994.

Mitchell, Mark, and Ken Lehn, "Do Bad Bidders Become Good Targets?" *Journal of Political Economy*, 1990, 98, 372-397.

Maloney, Michael T., Robert E. McCormick, and Mark Mitchell, "Managerial Decision Making and Capital Structure," *Journal of Business*, 1993.