

School of Economics and Finance

MOFI 402: CORPORATE FINANCE

Trimester Two 2007

COURSE OUTLINE

Contact Details

The course co-ordinator and lecturer is Martin Lally, RH 301, Ph 463-5998, martin.lally@vuw.ac.nz.

Class Times and Room Numbers

Thursday, 3.40pm – 6.30pm, RLWY 125.

There will be a final exam during the examination period October 19-November 11.

Course Objectives

The course intensively examines selected aspects of corporate financial theory and empirical evidence. Classes will comprise weekly 2-3 hour seminars at which student contribution is anticipated. Prescribed reading should be done prior to the relevant class. Assignments will be prescribed weekly, for submission at the commencement of the following week's class.

Expected Workload

A minimum of 15 hours per week, comprising 3 hrs for the class, 3 hrs in preparing the assignment, 5 hrs in undertaking the background reading, and 4 hrs in researching and writing the essay.

Materials and Equipment

Electronic calculators may be used in examinations. Calculators must be non-programmable and without a full set of alphabetic keys.

Assessment Requirements

The final mark for the course will be based upon the following approximate weights

Weekly assignments	25%
Essay (see below)	25%
Final Exam	50%

Essay

The essay comprises a critical review of the estimates for the market risk premium and the equity beta in the *Electricity Distribution Price Review 2006-2010 Final Decision Volume 1, Chapter 9*, pp. 345-365 (www.esc.vic.gov.au). It must be typed, 1.5 spaced A4, font 12, with a maximum of 18 pages at 25 lines per page, excluding the bibliography (c. 6000 words). Pages must be **numbered**. Students should consult a book on essay style and may also wish

to examine the following example of a critical review: *Investing in New Zealand: A Review* (www.nzsuperfund.co.nz). An Executive Summary is not required. The due date is **October 12** (5.00pm).

Penalties

Late essays will suffer a penalty of 5% per business day (i.e. marked out of 95, 90, etc.) unless an extension has been granted in advance for significant medical or personal problems. Essay material in excess of the limit prescribed above will **not** be evaluated.

Mandatory Course Requirements

There are no mandatory requirements for passing the course other than obtaining at least a C grade.

Communication of Additional Information

Any additional information will be conveyed to students during classes.

Course Content

The following topics will be examined.

1. The Wealth Maximisation Goal: July 12
2. Capital Structure
 - (a) Non debt Tax Shields: July 19
 - (b) Constant Market Value Leverage: July 26
3. Cost of Capital
 - (a) Estimation of the market risk premium: Aug 2, 9, 16
 - (b) Estimation of beta: Sept 6, 13, 20
4. Capital Budgeting:
 - (a) Multiperiod discounting in a CAPM world: Sept 27
 - (b) Determination of pure security prices by CAPM and OPM: Oct 4
5. Dividend Policy:
 - (a) Equilibrium Dividend Policy Under Personal Taxation: Oct 11

Readings

Students should first be familiar with the mathematics in

Copeland, T. and Weston, J., *Financial theory and Corporate Policy*, 4th edition, Pearson Addison-Wesley, 1988, Appendix D.

Spiegel, M., *Advanced Calculus*, McGraw-Hill, 1974, Ch. 1-6.

and the statistics in

Wonnacott, R. and Wonnacott, T., *Introductory Statistics*, 3rd edition, Wiley, 1977, Ch 1-13.

Where appropriate reference should also be made to

Mood, A., Graybill, F. and Boes, D., *Introduction To The Theory of Statistics*, 3rd edition, McGraw-Hill, 1974.

Prescribed reading for the seminar topics is as follows :

1. Wealth Maximisation Goal:

Copeland, T., Weston, J. and Shastri, K., *Financial Theory and Corporate Policy*, 4th edition, Pearson Addison-Wesley, 2005, Ch. 1, Ch 2 A-B.

De Angelo, H., "Competition and Unanimity", *American Economic Review*, 1981, pp 18-27.

2. Capital Structure:

Copeland, T., Weston, J. and Shastri, K., *Financial Theory and Corporate Policy*, 4th edition, Pearson Addison-Wesley, 2005, Ch. 15, A-B, F-H.

De Angelo, H. and Masulis, R., "Optimal Capital Structure Under Corporate And Personal Taxation", *Journal of Financial Economics* 8 (1980), pp 3-29.

Miles, J. and Ezzell, J., "Reformulating Tax Shield Valuation: A Note", *Journal of Finance* 40, (1985), pp 1485-1492.

3. Cost of Capital:

Copeland, T., Weston, J. and Shastri, K., *Financial Theory and Corporate Policy*, 4th ed., Pearson Addison-Wesley 2005, Ch 15, C-D.

Siegel, J., "The Equity Premium: Stock and Bond Returns Since 1802", *Financial Analysts Journal* (Jan-Feb 1992), pp 28-38.

Dimson, E., Marsh, P. and Staunton, M. "Global Evidence on the Market Risk Premium", *Journal of Applied Corporate Finance*, vol. 15 (4), Fall 2003, pp. 27-38.

Lally, M., "Time-Varying Market Leverage, the Market Risk Premium and the Cost of Capital", *Journal of Business Finance and Accounting* 29 (Nov/Dec 2002), pp. 1301-1318.

Merton, R., "On Estimating The Expected Return on the Market", *Journal of Financial Economics* 8 (1980), pp 323-361.

Cornell, B., *The Equity Risk Premium*, John Wiley & Sons Inc (1999), Ch 3.

Bernstein, P. and Arnott, R. "Earnings Growth: The Two Percent Dilution", *Financial Analysts Journal*, Sept-Oct 2003, pp. 47-55.

Cooper, I., "Arithmetic Versus Geometric Mean Estimators: Setting Discount Rates for Capital Budgeting", *European Financial Management* 2, (1996), pp. 157-67.

Conine, T., "Corporate Debt and Corporate Taxes: An Extension", *Journal of Finance* (1980), pp 1033-1036.

Cornell, B. and Green, K., "The Investment Performance of Low-Grade Bond Funds", *Journal of Finance* (1991), pp. 29-48.

Ehrhardt, E. and Shrieves, R., "The Impact of Warrants and Convertible Securities on the Systematic Risk of Common Equity", *The Financial Review* 30 (1995), pp 843-856.

Lally, M., "An Examination of Blume and Vasicek Betas", *The Financial Review* 33, (1998), pp 183-198.

_____ "Correcting Betas for Changes in Firm and Market Leverage", *Pacific Accounting Review* 10, (1998), pp. 97-115.

_____ "Betas and Market Leverage", *Accounting Research Journal* 15(1), (2002), pp. 91-97.

Chung, K. and Charoenwong, C. "Investment Options, Assets in Place and the Risk of Stocks", *Financial Management*, Autumn 1991, pp. 21-33.

4. Capital Budgeting:

Copeland, T. and Weston, J., *Financial Theory and Corporate Policy*, 3rd edition, Addison-Wesley, 1988, Ch. 12, A-C.

Fama, E., "Risk-Adjusted Discount Rates and Capital Budgeting Under Uncertainty", *Journal of Financial Economics* 5 (1977), pp 3-24.

Myers, S. and Turnbull, S., "Capital Budgeting and the Capital Asset Pricing Model: Good News and Bad News", *Journal of Finance* 32 (1977), pp 321-33.

Haley, C. and Schall, L., "The Theory of Financial Decisions", 2nd edition, pp 255-261.

Banz, R. and Miller, M., "Prices For State Contingent Claims: Some Estimates and Applications", *Journal of Business* 51 (1978), pp 653-672.

5. Dividend Policy:

Copeland, T., Weston, J. and Shastri, K., *Financial Theory and Corporate Policy*, 4th edition, Pearson Addison-Wesley, 2005, Chapter 16, A-B.

DeAngelo, H. and Masulis, R., "Leverage and Dividend Irrelevancy Under Corporate and Personal Taxation", *Journal of Finance* 35 (1980), pp. 453-467.

Faculty of Commerce and Administration Offices

Railway West Wing (RWW) - FCA Student and Academic Services Office

The Faculty's Student and Academic Services Office is located on the ground and first floors of the Railway West Wing. The ground floor counter is the first point of contact for general enquiries and FCA forms. Student Administration Advisers are available to discuss course status and give further advice about FCA qualifications. To check for opening hours call the Student and Academic Services Office on (04) 463 5376.

Easterfield (EA) - FCA/Education/Law Kelburn Office

The Kelburn Campus Office for the Faculties of Commerce and Administration, Education and Law is situated in the Easterfield Building - it includes the ground floor reception desk (EA005) and offices 125a to 131 (Level 1). The office is available for the following:

- Duty tutors for student contact and advice.
- Information concerning administrative and academic matters.
- Forms for FCA Student and Academic Services (e.g. application for academic transcripts, requests for degree audit, COP requests).
- Examinations-related information during the examination period.

To check for opening hours call the Student and Academic Services Office on (04) 463 5376.

General University Policies and Statutes

Students should familiarise themselves with the University's policies and statutes, particularly the Assessment Statute, the Personal Courses of Study Statute, the Statute on Student Conduct and any statutes relating to the particular qualifications being studied; see the Victoria University Calendar or go to www.vuw.ac.nz/policy.

For information on the following topics, go to the Faculty's website www.vuw.ac.nz/fca under Important Information for Students:

- Academic Grievances
- Academic Integrity and Plagiarism
- Student and Staff Conduct
- Meeting the Needs of Students with Impairments
- Student Support

Manaaki Pihipihinga Programme

Manaaki Pihipihinga is an academic mentoring programme for undergraduate Māori and Pacific students in the Faculties of Commerce and Administration, and Humanities and Social Sciences. Sessions are held at the Kelburn and Pipitea Campuses in the Mentoring Rooms, 14 Kelburn Parade (back courtyard), Room 109D, and Room 210, Level 2, Railway West Wing. There is also a Pacific Support Coordinator who assists Pacific students by linking them to the services and support they need while studying at Victoria. Another feature of the programme is a support network for Postgraduate students with links to Postgraduate workshops and activities around Campus.

For further information, or to register with the programme, email manaaki-pihipihinga-programme@vuw.ac.nz or phone (04) 463 5233 ext. 8977. To contact the Pacific Support Coordinator, email pacific-support-coord@vuw.ac.nz or phone (04) 463 5842.