



Marshall
School of Business

Note: this is not the final syllabus. While the topic coverage will be similar, the readings and course requirements may change. This document was prepared in conjunction with getting the course approved for offering.

**FBE 531: Corporate Financial Policy and Corporate Control
(1.5 units) class meets 3hrs/week for 8 weeks
Spring 2015**

Instructor: Mark Weinstein

Office: HOH713

Office Hours: TBD

Phone: 213-740-6499

[Email: mark.weinstein@marshall.usc.edu](mailto:mark.weinstein@marshall.usc.edu)

Course Description

In this course we examine the system of business finance. That set of institutions, laws, securities and traditions that allow business enterprises to raise needed funds and investors to invest. We start with what we view as the two fundamental problems of business finance:

1. How can a person raise money to finance a business opportunity when the funds needed exceed the amount the individual is willing and/or able to invest in the enterprise?
2. How can an investor, who has accumulated more wealth than they can, or desire to, invest in their own enterprise, feel comfortable investing in an enterprise that the investor will not personally control?

These problems have been the central issues in finance for millennia. We start by briefly tracing how these problems have been solved throughout history, leading up to the current day. It turns out that through history various legal forms, governance structures and financial instruments and markets have developed to attempt to meet these objectives in ways that are efficient, in the sense of low cost, and efficient, in the sense that the interests of managers and investors are aligned. Because the legal forms that are used to address these issues are the result of political processes, there are often public policy and political aspects to the way in which businesspeople address these matters. Those forms of organization that work also depend on the technologies that are available to control and discipline managers (e.g., the development double-entry bookkeeping and/or an inquisitive business press), and on other aspects of society. While this historical perspective is interesting in and itself (or at least, it is to *me*) understanding this process also helps us understand two important aspects of the relation between value and financial decisions. First, even today, legal and societal constraints, and the use of public debt and equity markets vary across countries. It is important to get a handle on how such variation may affect what financial decisions are appropriate in different geographic locations.

The current culmination of the evolution just discussed, at least in the Anglo-American world, is the dominance of the corporation with publicly traded equity (and perhaps debt). The form of business enterprise has been dominant since, roughly, the start of the 20th century, and much of finance has been devoted to understanding the governance and financial issues that attend the large corporation. However, as we shall see, the nature of the corporate form and attendant financial solutions to the basic problems, has been far from static. Rather, as technology develops, as academic thinking leads to new approaches, or at least lays bare the costs associated with then current practice, and as businesspersons learn from their mistakes, new financial markets, governance structures and security forms arise. Moreover, we now see a variety of different forms of organization that have, and are, becoming more and more important in conducting business. The money for startup companies often comes from venture capital partnerships (which are not themselves corporations). Many formerly public companies have “gone private” under the sponsorship of private equity firms which are not public corporations, though, ironically, some have developed structures and securities that let them tap public capital markets. Finally, many large projects around the world are now financed using structures commonly referred to as “project finance.” This structure often is used to address serious risks that the standard corporate form is not very good at handling.

The pace of change in business finance, and the increased likelihood that you will be doing business with and in countries other than the US make it important to understand not just where business finance is today, but what the underlying economic and social forces are that drive the efficacy and evolution of business finance decisions over time and across countries. We take the view that the value-maximizing financial policy depends not just on finance, but also on a myriad of societal, legal, and technological factors.

We finish the course by exploring how the businessperson can use this sort of analysis to design organizational, legal and financial structures, and security issues, that serve to align efficiently the needs of investors and managers today, and how these structures may change in the future.

Learning objectives

By the end of this course the student should understand relation between the financial decisions managers make and: (1) the historical evolution of corporate finance (2) the role of law and politics in limiting these choices. Using this knowledge, they should be able to adapt existing financial structures and policies to changing economic, political and social environments. They should be able to make appropriate financial decisions for their firms as they operate in economies with both developed and undeveloped capital markets, with strong and weak rule-of-law and anti-corruption regimes, with dispersed and concentrated shareholder communities, etc.

Pre-requisites

Knowledge of corporate finance consistent with completion of a course in corporate finance in a business or law school.

Relationship with other Courses

This course presumes some knowledge of corporate finance.

Textbook

None, though you will find it useful to refer to any textbook you have that covers corporate finance.

In lieu of a readings packet, I will post all readings on blackboard.

Format

Lecture and discussion. There will be assigned readings.

Grading

The grade will be based on an in class final examination (75%), 2 short problem sets (15%) and class participation (10%).

Notice on Academic Integrity

The use of unauthorized material, communication with fellow students during an examination, 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 has occurred, however, the instructor may disqualify the student's work as unacceptable and assign a failing mark on the paper. There may be additional penalties, including failing the course, in accordance to the university policies, as listed in the SCampus.

Turnitin Technologies

USC is committed to the general principles of academic honesty that include and incorporate the concept of respect for the intellectual property of others, the expectation that individual work will be submitted unless otherwise allowed by an instructor, and the obligations both to protect one's own academic work from misuse by others as well as to avoid using another's work as one's own. By taking this course, students are expected to understand and abide by these principles. All submitted work for this course may be subject to an originality review as performed by Turnitin technologies (<http://www.turnitin.com>) to find textual similarities with other Internet content or previously submitted student work. Students of this course retain the copyright of their own original work, and Turnitin is not permitted to use student-submitted work for any other purpose than (a) performing an originality review of the work, and (b) including that work in the database against which it checks other student-submitted work.

For 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 your instructor 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.

Emergency Preparedness/Course Continuity

In the event of an emergency, which limits access to campus for a period of more than a few days I will either (1) arrange an off-campus location for the class to meet or (2) arrange for the class to be taught on-line or via teleconference. I will contact you via Blackboard with information.

Topic Coverage:

(Week 1, 2) Topic 1: A brief overview of the current state of corporate finance.

Corporate Finance in a Perfect World (Modigliani –Miller)

Corporate Finance in an Imperfect World

Taxes

Information

Agency Issues

Will managers work hard?

Will managers (and other insiders) rip off outsiders?

Readings:

Miller, The Modigliani-Miller Propositions after 30 years, JEconPerspectives 1988

Miller, Debt and Taxes, JFin 1977

Ross, Determination of Financial Structure, BellJ, 1977

Myers and Majluf, Corporate Financing And Investment Decisions When Firms Have Information That Investors Do Not Have, JFE

Jensen and Meckling, “Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure” JFE 1976

(Week 2/3) Topic 2: A Historical Perspective on Finance

Finance in the preindustrial world

The rise of the corporate form

How important is limited liability?

The separation of ownership from control

Readings:

Baskin & Miranti, A HISTORY OF CORPORATE FINANCE, (Chapter 1, 2, 5 appendix)

Malmendier, Law and Finance at the Origin, JEconLit 2009

Berle & Means, The Modern Corporation and Private Property (excerpts posted)

Weinstein, Share Price Changes and the Arrival of Limited Liability in California, JLegalStud 2003

Weinstein, Limited Liability in California 1928 – 1931, AmLawEconRev 2005

Weinstein, Don’t Buy Shares Without It: Limited Liability Comes to American Express, JLegalStud, 2008

(Week 4)Topic 3: The role of Capital Markets

How and why different financial instruments evolved

The role of market efficiency

Readings:

Knoll, Put Call Parity and the Law, WP 1994

O’Rourke, Eat the Rich (Chapter 2), 1998

Shleifer, Are Markets Efficient?---No, Arbitrage Is Inherently Risky, Wall Street Journal (2000)

Malkiel, Are Markets Efficient?---Yes, Even if They Make Errors, Wall Street Journal (2000)

(Week 4 - 6) Topic 4: Ways to control insiders that let outsiders feel comfortable

- Monitoring technologies
 - Accounting/auditing
 - The press
- The legal system
 - Law and the corporation
 - Law and the securities markets
- Societal norms as control mechanisms
 - The role of religion
 - The role of family
 - Other societal norms
- The political system

Readings:

Morse, et. al. "Who Blows the Whistle on Corporate Fraud?" *JFin* 2010
LaPorta, et. al. "Law and Finance", *JPE*
Shleifer & Vishney, "A Survey of Corporate Governance" *JF*
Roe, Mark, *The Political Roots of American Corporate Finance*, *JAppliedCorpFin* 1997
Roe, Mark, "A Political Theory of Corporate Finance" *ColumLRev* 1991

(Week 7) Topic 5: Different corporate structures as solutions to the issues raised

- The publicly traded company
- Limited Liability Companies and Partnerships
- Project Finance
- Venture Capital
- Private Equity

Readings:

Collis, *The Scope of the Corporation*, 1995
Reiling, *Limited Liability Companies*, HBS Note 298-097 2010
Esty, *Overview of Project Finance* 2009
Lerner & Nicholas, *The Role of the Government in the Early Development of American Venture Capital*, 2012

(Week 8) Topic 6: Innovation in securities design

- Convertibles
- Tax advantaged securities
- Agency cost advantaged securities

Readings:

Chacko and Strick, *Convertible Securities*, HBS Note 202-129, 2002
Tufano, *Financial Engineering and Tax Risk*, HBS Case 297-056, 1996

Final exam on the last day of class