



GSBA 521B - CORPORATE FINANCE: Financial Policies and Applications
Term III 2017-2018

Instructor: Oguzhan Ozbas
Office: HOH 714
Office Hours: Mondays and Wednesdays, 2 - 3:30 p.m. or by appointment
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COURSE OBJECTIVES

This course is a rigorous introduction to the modern theory and practice of corporate finance. The course objective is for you to learn the tools, frameworks and concepts that are needed to develop and implement sound corporate financial policies. Through applications to real business decisions, an important emphasis of the course is on linking corporate financial strategy to other aspects of corporate strategy.

The design of financial policies can be viewed and understood through a simple principle; good financial policies add to firm value whereas bad ones destroy firm value. This simple principle is useful for understanding key concepts, including:

- capital market efficiency
- short-term financing
- long-term financing
- capital raising
- financial leverage
- dividends, share buybacks

By the end of the course, you should be able to:

- articulate the difference between efficient and inefficient capital markets
- evaluate the costs and benefits of alternative short-term and long-term financing options
- explain the mechanics of raising capital in the public markets
- assess and communicate the effect of various alternative capital structures on firm value
- state the benefits and costs of alternative payout policies

COURSE MATERIALS

Required: Ross, Stephen, Randolph Westerfield, Jeffrey Jaffe, and Bradford Jordan, Corporate Finance: Core Principles & Applications, 5th Edition, McGraw-Hill Education, 2018. ISBN 978-1-259-28990-3

Course reader containing business cases

Optional: *Wall Street Journal, Bloomberg Businessweek, Economist, Financial Times*

USC All information for this course, including announcements, assignments, solutions, and
 Blackboard other resources, will be posted on the USC Blackboard Course Pages under
 Course “<https://blackboard.usc.edu/>”. If you have any questions or need assistance with the
 Pages: Blackboard Course Pages, please contact the Marshall Help Desk at (213) 740-3000 or
 HelpDesk@marshall.usc.edu.

EXPECTATIONS

Each session will involve class discussion. In some instances, discussion will be centered on lectures; in others, it will be centered on a business case. Your participation is critical to the success of the course. You are expected to study all cases and readings, come to class, and participate in class discussion. You are also expected to work on end-of-chapter problems in the textbook. The course outline includes a list of recommended problems.

No audio or video recording is permitted. *All electronic devices, including laptops, tablets and cell phones, must be turned off during class meetings.*

GRADING

The final course grade will be assigned based on the combined score from your class participation, cases, quizzes, and a final exam. The final course grade will include such factors as the class mean, standard deviation, and rank, as well as other considerations. The target course GPA is 3.3. Grading will be based on:

	Points
Class Participation	5
2 Case Assignments (Team)	20
3 Quizzes (Best 2 of 3)	20
Final Exam	55
<i>TOTAL</i>	100

CLASS PARTICIPATION

The class participation grade will reflect both the quantity and quality of a student’s individual contribution to the classroom learning environment.

Be prepared for “cold-calling” in all class meetings. Note that regular attendance is necessary for class participation; however, it is not sufficient for a higher letter grade in this class.

CASE ASSIGNMENTS

Your team (the 4-6-member team assigned by the Marshall MBA Program Office) will be collectively responsible for completing two case assignments (see the course outline, “Debt Policy at UST Inc.” due on November 6, 2017 and “Radio One, Inc.” due on December 4, 2017). The case assignments will provide you with the opportunity to apply your newly-acquired expertise in corporate financial policy and capital structure. They will count for 20 points of your course grade. The detailed assignments will be posted on Blackboard.

Each team member is expected to make a contribution and be prepared to participate in class discussion. In addition, for each case assignment, your team will submit a hard-copy one-page single-spaced executive

summary describing your recommendation(s), followed by up to 5-page appendices of supporting calculations and analyses. The format should be as follows:

Date: November 6, 2017 / December 4, 2017
From: Team X (Bernanke, B., Draghi, M., Lagarde, C., Summers, L., and Yellen, J.)
To: The Board of Directors of Y Inc.
Cc: Oguzhan Ozbas
Re: Matter Z

Y Inc. is a leading company in ... Based on our analysis, we recommend that ...

A peer evaluation form will be used to assess individual member's contributions. *The peer evaluation form will be posted on Blackboard and is to be completed and submitted in class on December 4, 2017.* Any team member who does not submit a hard copy of his/her evaluation of team members will be deemed to have given the maximum score to each member of the team.

There are four other case studies in the course reader for class discussion.

QUIZZES/EXAMS

There will be three in-class quizzes. Each quiz will include four questions worth 2.5 points each.

The quizzes and final exam will be closed book, but you will be supplied with the appropriate mathematical formulae. No electronic device other than a calculator is permitted during a quiz or exam. You may not store any course-related material on your calculator.

You are required to take at least two out of the three quizzes and the final exam administered in this course. Neither the quizzes nor the final exam may be made up; any missed quiz or exam will be recorded as a zero.

STATEMENT OF ACADEMIC CONDUCT AND SUPPORT SYSTEMS
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USC seeks to maintain an optimal learning environment. Students are expected to submit original work. They have an obligation both to protect their own work from misuse and to avoid using another's work as their own. All students are expected to understand and abide by the principles of academic honesty outlined in the University Student Conduct Code (see University Governance, Section 11.00) of SCampus (www.usc.edu/scampus or <http://scampus.usc.edu>). The recommended sanctions for academic integrity violations can be found in Appendix A of the Student Conduct Code.

Students with Disabilities:

USC is committed to making reasonable accommodations to assist individuals with disabilities in reaching their academic potential. If you have a disability which may impact your performance, attendance, or grades in this course and require accommodations, you must first register with the Office of Disability Services and Programs (www.usc.edu/disability). DSP provides certification for students with disabilities and helps arrange the relevant accommodations. 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 no later than the end of Week 1. DSP is located in GFS (Grace Ford Salvatori Hall) 120 and is open 8:30 a.m.–5:00 p.m., Monday through Friday. The phone number for DSP is (213) 740-0776. Email: ability@usc.edu.

Support Systems:

Student Counseling Services (SCS) - (213) 740-7711 – 24/7 on call

Free and confidential mental health treatment for students, including short-term psychotherapy, group counseling, stress fitness workshops, and crisis intervention. <https://engemannshc.usc.edu/counseling/>

National Suicide Prevention Lifeline - 1-800-273-8255

Provides free and confidential emotional support to people in suicidal crisis or emotional distress 24 hours a day, 7 days a week. <http://www.suicidepreventionlifeline.org>

Relationship & Sexual Violence Prevention Services (RSVP) - (213) 740-4900 - 24/7 on call

Free and confidential therapy services, workshops, and training for situations related to gender-based harm. <https://engemannshc.usc.edu/rsvp/>

Sexual Assault Resource Center

For more information about how to get help or help a survivor, rights, reporting options, and additional resources, visit the website: <http://sarc.usc.edu/>

Office of Equity and Diversity (OED)/Title IX compliance – (213) 740-5086

Works with faculty, staff, visitors, applicants, and students around issues of protected class. <https://equity.usc.edu/>

Bias Assessment Response and Support

Incidents of bias, hate crimes and microaggressions need to be reported allowing for appropriate investigation and response. <https://studentaffairs.usc.edu/bias-assessment-response-support/>

Student Support & Advocacy – (213) 821-4710

Assists students and families in resolving complex issues adversely affecting their success as a student EX: personal, financial, and academic. <https://studentaffairs.usc.edu/ssa/>

Diversity at USC – <https://diversity.usc.edu/>

Tabs for Events, Programs and Training, Task Force (including representatives for each school), Chronology, Participate, Resources for Students

Emergency Preparations

In case of an emergency if travel to campus is not feasible, the USC Emergency Information web site (<http://emergency.usc.edu/>) will provide relevant information, such as the electronic means the instructors might use to conduct their lectures through a combination of USC's Blackboard learning management system (blackboard.usc.edu), teleconferencing, and other technologies.

INSTRUCTOR

Oguzhan Ozbas, Associate Professor of Finance and Business Economics & Co-Director of Doctoral Program in Finance

Education

B.S. Industrial Engineering, Boğaziçi University
M.S. Industrial Administration, Carnegie Mellon University
Ph.D. Financial Economics, Massachusetts Institute of Technology

Professional Experience

Treasury Associate, Ford Motor Company
Consultant to the Organisation for Economic Co-operation and Development

Research in Corporate Finance and Governance

“Can Shareholder Proposals Hurt Shareholders? Evidence from SEC No-Action Letters,” with J. Matsusaka and I. Yi, working paper, 2017.

“Opportunistic Proposals by Union Shareholders,” with J. Matsusaka and I. Yi, working paper, 2017.

“A Theory of Shareholder Approval and Proposal Rights” with J. Matsusaka, *Journal of Law, Economics, and Organization*, 2017.

“Corporate Diversification and the Cost of Capital,” with R. Hann and M. Ogneva, *Journal of Finance*, 2013.

“Evidence on the Dark Side of Internal Capital Markets,” with D. Scharfstein, *Review of Financial Studies*, 2010.

“Costly External Finance, Corporate Investment, and the Subprime Mortgage Credit Crisis,” with R. Duchin and B. Sensoy, *Journal of Financial Economics*, 2010.

“When Are Outside Directors Effective?,” with R. Duchin and J. Matsusaka, *Journal of Financial Economics*, 2010.

“Club Deals in Leveraged Buyouts,” with M. Officer and B. Sensoy, *Journal of Financial Economics*, 2010.

“Integration, Organizational Processes, and Allocation of Resources,” *Journal of Financial Economics*, 2005.

COURSE OUTLINE AND ASSIGNMENTS

Session-Date (Day)	Topic
1-October 16, 2017 (M)	Overview of the Course Efficient Capital Markets and Behavioral Challenges Assignment: • Required Reading: Chapter 13 Efficient Capital Markets and Behavioral Challenges • Recommended text problems: 2, 3, 4 Key Questions: • What is the definition of capital market efficiency? ◦ What conditions generally lead to market efficiency? ◦ What are the three forms of market efficiency? • What are the implications of market efficiency for corporate finance? • What are the empirical challenges to market efficiency?
2-October 18, 2017 (W)	Efficient Capital Markets and Behavioral Challenges (Cont'd) Short-Term Financing Assignment: • Required Reading: Chapter 18 Short-Term Finance and Planning • Recommended text problems: 1, 4, 6, 11, 17 Key Questions: • What are the components of the cash cycle and what are some characteristics of a firm with a long cash cycle? • What should be considered in setting a firm's short-term financial policy?

Session-Date (Day)	Topic
3-October 23, 2017 (M)	<i>Quiz 1</i> Long-Term Financing Assignment: • Required Reading: Chapters 5.2, 5.4-5.5 and 6.5-6.6 • Recommended text problems: 5.29, Example 6.6 (p.180) for the case of 20,000 shares outstanding Key Questions: • What are the basic characteristics of common and preferred stock? ○ What is the difference between cumulative voting and straight voting? ○ What are the rights of shareholders? • What are characteristics of corporate long-term debt? ○ What is an indenture, call provision, sinking fund? ○ What are some different types of bonds?
4-October 25, 2017 (W)	<i>Tombstones (Case Discussion)</i> The case contains brief descriptions and summary terms – “tombstones” – for six securities issued by U.S. firms during 2009-2010. Learning objective: take a tour of the securities “zoo.”
5-October 30, 2017 (M)	Raising Capital from the Public Guest Speaker—Vinay V. Prabhu, Managing Director, Jefferies Investment Banking, on “IPOs and Other Forms of Capital Raising.” Assignment: • Required Reading: Chapter 19.2-19.12 • Recommended text problems: 1,4, 6, 8, 14 Key Questions: • What are the basic methods of raising capital? • What are the basic procedures in a new public security issue? • What is a general cash offer (IPO and seasoned new issues)? Why go public? What are the basic procedures in an IPO? ○ Negotiated offer and Dutch Auction • What are the costs of issuing securities? • What is a rights offer, a shelf registration, and a private placement?

Session-Date (Day)	Topic
6-November 1, 2017 (W)	Capital Structure: Basic Concepts Assignment: • Required Reading: Chapter 14 Capital Structure: Basic Concepts • Recommended text problems: 1, 4, 14, 15, 24 Key Questions: • What is the effect of financial leverage on EPS and ROE? • When does capital structure matter? ○ Under what conditions will a firm's value and WACC not change with the use of debt? ○ Why does the cost of equity increase with the use of debt? • What is the quirk in the tax code that makes a levered firm more valuable than an otherwise identical unlevered firm?
7-November 6, 2017 (M)	<i>Debt Policy at UST Inc. (Case Assignment Due)</i> UST Inc. is a very profitable smokeless tobacco firm with low debt compared to other firms in the tobacco industry. The setting for the case is UST's decision to substantially alter its debt policy by borrowing \$1 billion to finance its stock repurchase program. Learning objective: quantify the value of debt tax shields.
8-November 8, 2017 (W)	<i>Quiz 2</i> Capital Structure: Limits to the Use of Debt Assignment: • Required Reading: Chapter 15 Capital Structure: Limits to the Use of Debt • Recommended text problems: 1, 2, 8 Key Questions: • What are stockholders inclined to do when a firm is under financial distress? • What are the direct and indirect costs of bankruptcy? ○ Why and how do taxes and bankruptcy costs generate a "target" capital structure? • What is the pecking order theory? • What do we know about empirical capital structure? What factors do we consider in setting a target capital structure? • Why do some firms use a lot of debt and others use very little?

Session-Date (Day)	Topic
9-November 13, 2017 (M)	<i>Restructuring JAL (Case Discussion)</i> JAL has become highly levered and is quickly running out of liquidity following a series of extreme events. The company's financial condition has started to have a negative effect on operations, further eroding profitability. Learning objective: understand the difference between costs of financial distress and costs of economic distress, and the economic rationales behind bankruptcy laws.
10-November 15, 2017 (W)	Dividends and Other Payouts Assignment: • Required Reading: Chapter 16 Dividends and Other Payouts • Recommended text problems: 1, 3, 5, 6, 17 Key Questions: • What are the characteristics of regular cash dividends? ○ What is the procedure for cash dividend payment? ○ What is the stock price behavior around the ex-dividend date? • When does dividend policy matter? ○ What are some factors that might motivate a firm to pay more (or less) dividends than implied by free cash flow? ○ Why don't some firms pay any dividends? • What are some of the issues in considering share repurchases as an alternative to cash dividend payouts? • What is a sensible payout policy? • Why do firms undergo stock splits and reverse stock splits?
11-November 20, 2017 (M)	<i>Apple, Einhorn, and iPrefs (Case Discussion)</i> Apple Inc. has a very large cash balance and is under pressure to return cash to shareholders. Hedge fund manager David Einhorn thinks Apple can "unlock value" by issuing perpetual preferred stock, dubbed iPrefs. Learning objective: discuss real and financial frictions that make payout policy and liquidity management relevant for firm value.

Session-Date (Day)	Topic
12-November 27, 2017 (M)	Quiz 3 Options and Corporate Finance Assignment: • Required Reading: Chapter 17 Options and Corporate Finance • Recommended text problems: 1, 2, 7, 8, 30 Key Questions: • Why are options widely used? ○ What is a call option? A covered call strategy? ○ What is a put option? A protected put strategy? ○ What are the payoffs and bounds of an option? • What are the factors that determine the price of an option? • How do you price a call option with the Black-Scholes Model? • How can stockholders view bonds as owning put options? • Why do firms issue option-embedded securities?
13-November 29, 2017 (W)	<i>Molycorp: Financing the Production of Rare Earth Minerals (Case Discussion)</i> With plummeting prices for rare earth minerals in the middle of a major capital expenditure project, Molycorp's management team is faced with a serious funding shortfall. Management has to decide: how much capital to raise, what kind to raise, and when to raise it. Learning objective: design a financing strategy that enables the firm to implement its business strategy while not exposing it to excessive financial risk.
14-December 4, 2017 (M)	<i>Radio One, Inc. (Case Assignment Due)</i> Radio One, the largest radio group targeting African-Americans in the country, had the opportunity to acquire 12 urban stations in the top 50 markets from Clear Channel Communications, Inc. in the winter of 2000. Radio One was also negotiating the acquisition of nine additional stations. The proposed acquisitions would double the size of Radio One. Learning objective: forecast the cash flows associated with the proposed acquisitions and value them using discounted cash flows as well as transaction and trading multiples.
December 11, 2017 (M) 8:00 – 10:50 AM	FINAL EXAM Core A — JKP 112 Core B — JKP 210 Core C — JKP 212