



## CORPORATE FINANCE

B40.2302  
Spring 2009

Professor: **JUAN-PEDRO GÓMEZ**

### Short Bio

I currently work as full time assistant professor at Instituto de Empresa (IE) Business School in Madrid, Spain. Previously, I have worked at Universidad Carlos III in Madrid, ITAM in Mexico City, BI in Oslo and UPF in Barcelona.

My teaching interests include **Corporate Finance** and **Portfolio Management**.

The focus of my research is on the role of institutional investors in equity trading. Within this topic, I have work in **Asset Pricing** and **Management Compensation**, my two fields of specialization. More concretely, I employ contract theory to study the micro-economic foundations of manager's compensation schemes and to analyze how different schemes affect the managers' optimal portfolio decisions and their performance. In a general equilibrium context, I derive the theoretical and empirical asset pricing implications of equity trading carried out by institutional investors, both domestically and overseas.

My work has been published in the European Journal of Finance, Economic Theory a Finance Research Letters. I'm a referee for the Journal of Economic Dynamics and Control, the Journal of Banking and Finance, and the Journal of International Money and Finance.

Copies of my current research projects can be downloaded from  
<http://juanpedrogomez.profesores.ie.edu/>

### Course Description

This course is an introduction to the main concepts and issues in modern financial management. After a brief introduction to corporate finance and financial markets, we will concentrate on the two main decision financial managers face everyday: capital budgeting and capital structure decisions. In other words, what the firm "does" with the money and where the firm "gets" the money from.

As for the first type of decisions, capital budgeting, we will study two main concepts: the time-value-of-money and how to create value for shareholders. Free cash-flow analysis is the main instrument here. We will value investment projects using alternative methods like real options. With respect to the second type of decisions, we can distinguish between short-term financial planning (estimating the cash needs for the firms in the short run) and long term capital structure decisions (how the firm chooses the right balance among different sources of financing, mainly long-term debt and equity). We pay special attention to the company's payout policies. Dividends, share buybacks...

Obviously, both types of decisions are interconnected. We close the course analysing the link between capital budgeting and structure: the cost of capital. The key concept here is risk and how it affects the cost of capital.

An important aspect of the financial decisions nowadays is given by its social impact. In this sense we will explore what we understand by a "true" socially responsible company in relation to

its different stakeholders: share and bond holders, clients, workers, the community,... In this regard, Free Cash Flows will be proved to be the most transparent measure of the project's profitability versus other accounting or "book" measures. Value creation and agency problems (between the managers and shareholders and between the later and bondholders) will be analysed. Is the Net Present Value rule good enough to make sure that managers do really create value for shareholders?

## Course Objectives

The course has been designed for an audience not familiarized with finance issues. For this reason, the main emphasis is in the concepts rather than in the techniques. By the end of the course, the student should feel "comfortable" enough to understand and discuss the firm's financial decisions presented in the Course Description.

I assume all of you attended the Foundations of Finance course and are familiar with such basic concepts as beta or the Capital Asset Pricing Model (CAPM). Many of these concepts will be reviewed briefly in class but not in sufficient depth to learn them from scratch.

## Course Material

Lecture notes are the main source for the theory. Additional material (like exercises and reading handouts) will be updated periodically in Blackboard. We will use this tool as the main interface for communication. Please, check it regularly.

For those of you interested in a deeper coverage of specific topic, a good reference is

Principles of Corporate Finance, R. Brealey, S. Myers and F. Allen (BMA). Irving McGraw-Hill, 8<sup>th</sup> edition (2006)

Analysis for Financial Management, R. C. Higgins (H), 8<sup>th</sup> edition (2007)

Of course, you are most encouraged to read the financial newspapers:

Wall Street Journal.  
The Economist  
Financial Times

## Class Dynamic

Every session will typically contain 2 of the following 3 elements: Presentation and discussion of a reading handout, case presentation and discussion and lecturing (theory concepts) The recommended dynamic for the student is to work on the readings handout or case before the lecture, attend the lecture and participate actively in the readings or case discussion. Then read the corresponding references and work on the suggested problems after the lecture.

The Course Schedule below includes a detailed list of all the cases, readings and lecture topics that will be covered through the course. The reading handouts will be updated periodically on Campus Online or distributed in hand during class. In what follows you will find a description of each of these elements, the class dynamic and the grading criterion.

## Reading handouts

When appropriate, reading handouts based on press articles, mainly from The Economist and The Wall Street Journal or Financial Times will be distributed among students. These readings are meant to motivate the main topics in the lecture. All the students are expected to read the articles in order to contribute to the class discussion. This will be graded through class participation.

## Cases

Some lectures include a “Case Discussion.” The cases are meant to summarize and exercise the concepts studied in the previous lecture/s. As a guideline to the case resolution, a set of questions will accompany each case. You can find these questions on Blackboard. All the students are expected to read the cases with the questions in mind in order to contribute to the class discussion. This will be graded through class participation.

Every case will be assigned to a group/s of students (see the Course Schedule below) who will be in charge of:

1. Handing in an executive summary before the session addressing the questions for the case (synthesis will be rewarded).
2. Presenting the topic in front of the class.
3. Leading the discussion (extra material, complementary questions, ...)

The 3 tasks will be graded. The average will constitute the homework grade for the particular group (all the students in a group will obtain the same grade except the group *unanimously* decides otherwise). I expect the material from the presenting group/s (executive summary + material for the presentation) to be sent to me by email the day before the presentation.

## Lecturing

Class slides (when used) will cover the main aspects of every topic. Slides will be available on Global Campus before every session. The objective is to make lectures as participative and dynamic as possible. Therefore, students are encouraged to intervene with clarifying and constructive questions or remarks anytime during the lecture. Remember that class participation is graded.

## Course Outline

### MODULE 1 Introduction

#### SESSION 1

BMA 1.1-4

#### **Introduction to Corporate Finance: Course Overview**

Financial Markets

### MODULE 2 Capital Budgeting and Financial Planning

#### SESSION 2

BMA 2.1, 5.2-3

#### **The Time-Value-of-Money Concept**

#### **The Net Present Value (NPV) and Alternative Investment Rules**

#### SESSION 3

BMA 29.1-3

#### **Accounting Statements and Cash Flows**

#### SESSION 4

BMA 29.4-5

#### **Capital Budgeting in Practice. Incremental Cash Flows**

#### **Models of Financial Planning**

#### **Case discussion: The Super Project (HBS 9-112-034)**

#### SESSION 5

**Financial planning in practice  
MID-TERM REVIEW**

**Case discussion: Butler Lumber Company (HBS 9-292-013)**

MODULE 3 Capital Structure and Payout Policy

*SESSION 6*

BMA 8.3-4

**MID-TERM EXAM**

**Review: The cost of capital: CAPM and alternative risk models**

*SESSION 7*

BMA 17

**Weighted Average Cost of Capital, Risk and the Cost of Capital.  
Debt or Capital: Deciding The Company's Financial Structure**

*SESSION 8*

BMA 18.3-4

H 6

**Optimal Capital Structure Theories: beyond Modigliani and Miller**

**Case discussion: American Chemical Corporation (HBS 9-280-102)**

*SESSION 9*

BMA 22

**Valuing Investment Projects with Real Options**

*SESSION 10*

BMA 16.2-5

**Payout Policy: Dividends and buybacks**

**Case discussion: Diageo (HBS 9-201-033)**

*SESSION 11*

**FINAL REVIEW**

**Debt Advisory Report**

**Case Discussion: Dividend Policy at FPL Group, Inc. (HBS 9-295-059)**

*SESSION 12*

**FINAL EXAM**

### Grading Policy

The grade will be based on homework (cases), class participation (discussion of readings and cases and general class intervention), and the final exam. The grade will be assigned according to the following distribution:

Homework:	30%
Class participation:	20%
Final exam:	50%

The final exam will take place during the last session.

At Stern, we want to ensure fair and consistent grading across courses. As such, grades for this course will be distributed following the Stern Grading Guidelines for Core Graduate Courses

A	10
A-	10 to 15
B+	10
B and B-	50 to 60
C+, C, C-, D and F	10 to 15
IP and IF	<i>No more than 5</i>

## Office Hours

To be determined

## Honor Code

This course will be conducted according to the rules specified in the "Stern Honor Code", which mandates zero tolerance for academic dishonesty. You are expected to be familiar with the School's Honor Code and to follow the procedures outlined therein. All discussions about case assignments are to be limited to your group. Materials like case reports from other students, previous years or other courses or other publicized information on cases are not to be consulted. All work handed in for grading has to be your own or your group's, and all sources of information used have to be accounted for. Each assignment should include a signed statement indicating adherence to the Stern Honor Code.