

Department of Economics

ECON 5262

**Financial Economics II**

**3 Credit Hours**

Spring 2018

March 21, 2017 version

Days and Times of class meeting stated here.

Professor Michael Brandl

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**Course Description**

This course is a continuation of ECON 5261 Financial Economics I. The topics in this course reflect the current academic research in corporate finance. The course also examines alternative corporate financial structures such social finance and the economics of venture capital. These are topics which are not typically found in undergraduate or MBA finance level courses. This course will examine both theoretical and empirical academic research. In doing so we will investigate whether or not there is empirical support for the different theoretical approaches.

**Learning Outcomes**

At the end of the course the student is expected to know:

* The role of agency costs in corporate finance
* Macroeconomic implications of corporate finance decisions.
* The different types of investors and their impact on corporate finance decisions.
* The role consumers play in corporate finance decision making.

**Official Description:** Examination of academic literature and econometric analysis of topics involving financial markets, financial institutions, and financial market participants.

**Course Prerequisite:** ECON 5261

**Required Textbooks**

Tirole, Jean, *The Theory of Corporate Finance*, Princeton University Press, 2006. ISBN 9780691125565.

Note: Tirole, is currently chairman of the Foundation JJ Laffont-Toulouse School of Economics (TSE), and scientific director of the Institute for Industrial Economics (IDEI), University of Toulouse Capitole in France. He won the Nobel Prize in Economics in 2014. As you can imagine this text is written at a very high level but is suitable for this course.

As The Economist explained “This is far more than the mere textbook it purports to be; it has a plausible claim to be the first truly comprehensive overview of corporate finance by an economist.”

Nicholls, Alex and Rob Paton, *Social Finance*, Oxford University Press, 2015. ISBN 9780198703761. Referred to as N&P below.

Metrick, Andrew and Ayako Yasuda, *Venture Capital and the Finance of Innovation*, 2nd Edition, John Wiley & Sons, Inc., 2011. ISBN 9780470454701. Referred to as M&Y below.

**Grade Determination**

4 Homework Assignments: 20%

Midterm Exam: 40%

Cumulative Final Exam: 40%

Exams

Note the specific time and location of the cumulative final exam are determined by the University and cannot be changed to meet individual schedules. Taking an exam early to accommodate travel plans is NOT possible. Failure to show up for an exam does not warrant a make-up exam. If a medical emergency arises resulting in a student being unable to take an exam at its scheduled time the weight of that exam will be shifted to the final exam. Documented proof, including a signed letter of explanation for a non-relative health care provider must be provided for this exemption. Make-up final exams will be granted under only the most extreme circumstances such as the above described documented serious illness.

All of the exams will be a closed book, closed notes exam. No study sheets, crib notes or other aids will be allowed to be used during the exams. Students may expect time pressure on the exams. The exams will cover material covered in class, the assigned readings, and other material assigned.

The exams are designed to test students’ abilities to solve problems as well as recall and organize information rapidly. Exam questions will require one to solve mathematical problems, be able to explain theoretical concepts and models, require one to tie concepts together, expect one to be able to apply concepts and models to everyday situations, and require one to be familiar with historical occurrences relative to key concepts and models.

Homework Assignments

The Homework assignments are designed to help prepare students for the exams. The homework assignments will be made available through Carmen and will be collected on the dates announced ahead of time in class. Some of the questions on the homework will follow the material covered in class, while others will focus on results that extend material covered in class. The questions on the homework assignments are designed to mimic questions that will appear on the exam.

The Final Grade

The final grade assigned is an informed and final evaluation and not the beginning offer in a bargaining process. If an error occurs in the calculation of your grade, please notify Professor Brandl or his TA during the beginning of the following semester and actions will be taken to correct any errors. Please do NOT contact Professor Brandl or any TA to "lobby" for a higher grade. Any lobbying efforts (i.e. asking for a higher grade simply because you want one or need one) will not be tolerated.

*Make-up or extra work* to improve your grade is not possible. Your final letter grade is determined by the above stated method. Your general academic situation (For example, “I need a ‘C’ in this course to graduate.”) and/or personal problems cannot be considered. The final grade in the course, once assigned, will not be changed except in the event of a recording error.

*Religious Conflicts*. Students whose religious observations conflict with the assignment schedule will not be penalized in any way. If your religious observation conflict with the published schedule of assignments for the course, however, you must notify the instructor in writing no later than the third class period so that alternative arrangements can be made.

**Electronic Devices**

Electronic devices (e.g. laptops, smart phones, smart watches, etc.) are not to be used in class. They should be put away during class time. This includes the sending and receiving of text messages. Note: the use of laptops for taking of notes is strictly forbidden. The only except to this electronic devices rule is the use of a tablet ONLY for taking notes – it that case the tablet must remain flat on the writing surface during the course. Tablets are not allowed during quizzes and exams. Persistent violation of this rule will result in a final grade reduction of one full letter grade.

**Attendance Policy**

Attendance to each and every lecture is expected and assumed. Each lecture assumes that audience members have read the assigned readings and/or watched the assigned videos before the lecture. If you do not attend a lecture it is entirely your responsibility to determine what you have missed, including any administrative announcements that may have made.

**Disability Services**

 The University strives to make all learning experiences as accessible as possible. If you anticipate or experience academic barriers based on your disability (including mental health, chronic or temporary medical conditions), please let me know immediately so that we can privately discuss options.  To establish reasonable accommodations, I may request that you register with Student Life Disability Services.  After registration, make arrangements with me as soon as possible to discuss your accommodations so that they may be implemented in a timely fashion. **SLDS contact information:** slds@osu.edu; 614-292-3307; [slds.osu.edu](http://www.ods.ohio-state.edu/); 098 Baker Hall, 113 W. 12th Avenue.

**Academic Misconduct**

Academic integrity is essential to maintaining an environment that fosters excellence in teaching, research, and other educational and scholarly activities. Thus, The Ohio State University and the Committee on Academic Misconduct (COAM) expect that all students have read and understand the University’s Code of Student Conduct, and that all students will complete all academic and scholarly assignments with fairness and honesty. Students must recognize that failure to follow the rules and guidelines established in the University’s Code of Student Conduct and this syllabus may constitute “Academic Misconduct.”

The Ohio State University’s Code of Student Conduct (Section 3335-23-04) defines academic misconduct as: “Any activity that tends to compromise the academic integrity of the University, or subvert the educational process.” Examples of academic misconduct include (but are not limited to) plagiarism, collusion (unauthorized collaboration), copying the work of another student, and possession of unauthorized materials during an examination. Ignorance of the University’s Code of Student Conduct is never considered an “excuse” for academic misconduct, so I recommend that you review the Code of Student Conduct and, specifically, the sections dealing with academic misconduct.

If I suspect that a student has committed academic misconduct in this course, I am obligated by University Rules to report my suspicions to the Committee on Academic Misconduct. If COAM determines that you have violated the University’s Code of Student Conduct (i.e., committed academic misconduct), the sanctions for the misconduct could include a failing grade in this course and suspension or dismissal from the University.

If you have any questions about the above policy or what constitutes academic misconduct in

this course, please contact me.

Other sources of information on academic misconduct (integrity) to which you can refer

include:

* The Committee on Academic Misconduct web pages

<http://oaa.osu.edu/coam.html>

**Tentative Course Outline** (subject to change – see Carmen for updates)

**Part A. Introduction and Overview**

Week 1: Introduction, Review & Corporate Governance

 Required Readings: Tirole Ch. 1

 Topics:

* Course overview
* Review of key concepts from microeconomics
* Corporate ownership
* Managerial incentives
* The Board of directors
* Investors
* Takeovers and Mergers

Week 2: Stylized facts

 Required Readings: Tirole Ch. 2

* Early corporate financing
* Corporate finance in the early 20th Century
* Corporate finance after WWII
* Corporate finance since 1980s
* Debt instrument facts
* Equity instrument facts
* Financing patterns
* The Five Cs of Credit analysis
* Loan covenants

**Part B. Corporate Finance and Agency Costs**

Week 3: Outside Financing

 Required Readings: Tirole Ch. 3

* Credit Rationing model
* Why we care about credit rationing
* Debt overhang
* The equity multiplier
* Overview of venture capital

Week 4: Expanding Borrowing Constraints

 Required Readings: Tirole Ch. 4

* Advantages and Disadvantages of Diversification
* Advantages and Disadvantages Collateralization
* Introduction to Microfinance and group lending

Week 5: Liquidity

 Required Readings: Tirole Ch. 5

* Financial statements
* Earnings per share
* Free cash flows
* Dividend policy

**Part C. Consumers and Corporate Finance**

Week 6: Consumer Liquidity Demand

 Required Readings: Tirole Ch. 12

* The Diamond-Dybvig Model of banks and liquidity provision
* How economists model bank runs
* Heterogeneous consumer horizons and securities
* Aggregate uncertainty among consumers

Week 7: More on Consumers and Finance

Required Readings: Inderst, Roman and Marco Ottaviani (2012) “Financial Advice” *Journal of Economic Literature*, 50:2, pp. 494-512. Provided on Carmen.

* The different types of “financial advisors.”
* Who follows what advice?
* Modelling advice and commissions
* The role of disclosures
* Commissions and naïve consumers
* Educating the naïve
* Can cancellation policies be effective?
* Irresponsible lending and minimum holding periods
* How should consumers be protected and informed?

**MidTerm Exam**

**Part D. Social Finance**

Week 8: Social Finance Overview

 Required Readings: N&P Ch. 1 & 2

* What social finance is and what it is not.
* Social finance v. “traditional” corporate finance.
* Life cycle of social finance
* Social Impact Bonds or SIBs
* Where should social finance investments be made?
* Social investments as a profit making venture

Week 9: Co-operative and Mutual Finance

 Required Readings: N&P Ch.5

* Mutual finance association over time.
* Credit union v. commercial banks.
* The membership debate in credit unions.
* Government regulation of credit unions.
* Should credit unions make more business loans.
* Mutual insurance organizations.

Week 10: Fair Trade and Corporate Finance

Required Reading: The Thousand Villages Annual Report. Available on Carmen

* How and why did the fair trade finance model develop?
* Goals of fair trade financial model.
* Fair trade stumbles and mistakes: bottom up v. top down
* Is Fair trade part of Social Finance or separate from it

**Part E. Venture Capital**

Week 11: Venture Capital Overview

 Required Reading: M&Y Ch. 1 & 2

* What is Venture Capital?
* What do VCs do?
* Historical evolution of the VC industry in the US.
* The VC market in Europe.
* VC Firms and Funds
* Limited Partners
* Limited Partnership Agreements

Week 12: The Economics of Venture Capital

 Required Reading: M&Y Ch. 3 & 4

* The VC industry reported returns
* Can industry reported returns be trusted?
* Fund reported returns.
* The Bi-model problem.
* Cost of capital for VCs.

Week 13: Venture Capital around the world

 Required Reading: M&Y Ch. 6

* The Global distribution of VC investing
* The cost of capital for international VCs
* Why VCs have so much trouble in developing countries.
* Why VCs have so much trouble in Europe.

Week 14: The merger of Venture Capital and Social Finance.

* Can the venture capital market be used to create economic develop in de-industrialized Ohio?

Week 15: Catch-up and summary