

The Hong Kong University of Science & Technology  
Department of Finance  
FINA 514: Advanced Topics in Financial Management  
Fall 2008

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## Course Objective

The objective of this course is to introduce the students to the long term financing decision of the firm and to the interaction between the firm's investment and financing decisions. Emphasis is placed on financial theory and its empirical implications. Scientific evidence relating theory and practice will be presented and discussed.

Firms can choose to finance their investments from internal or external sources. External financing requires selling claims against the future cash flows of the firm to individuals and institutions. We consider first the affect of taxes, transactions costs, and information costs on the firm's choice of financial structure. We then turn to the affect of financing on the cost of capital and the valuation of the firm's future cash flows. We also discuss an alternative approach to value the firm's future cash flows with the use of option pricing techniques.

The use of internal financing together with the use of external financing and the investment requirements of the firm affect the firm's ability to pay dividends to its shareholders. Thus, the firm's dividend policy is an integral part of its financing decisions. We will discuss cash dividends and share repurchase as alternative ways firms use to distribute cash to shareholders and the factors affecting the choice of dividend policy.

Topics covered in the course: The choice of capital structure, the cost of capital, the valuation of real options, and dividend policy.

## Prerequisites

ACCT515 and FINA521 (or ACCT510 and FINA512)

Students should be familiar with the material in chapters 4-12 in the course text book.

## Readings

1. [BD] Jonathan Berk and Peter Demarzo, *Corporate Finance*, Pearson Education. 2007 (course text book)

2. [GT] Mark Grinblatt and Sheridan Titman, *Financial Markets and Corporate Strategy*, McGraw Hill, 2<sup>nd</sup> edition, 2004

Required readings of journal articles will be assigned in class. Students are also expected to read The Asian Wall Street Journal or a similar publication on a regular basis since the topics covered in this course are discussed daily in the business press. We will allocate some of the class time to the discussion of current events.

## Grading

Your grade in this course will be based on

Problem Sets (2)	20%
Case analysis (2)	20%
Class participation	10%
Final exam	50%

## Case write-ups

The assigned cases and homework should be prepared in groups of no more than 5 members. The names of group members must be handed in by the end of the second class. Students who are not in any group of size 5 will be combined in groups in an arbitrary manner. One group of size smaller than 5 may be necessary if the number of students enrolled in your session is not divisible by 5.

Group members are required to sit together in class, work together on problem sets and case reports, and have with them a copy of the case and the report for class discussion.

Each case counts equally (10%) towards the final grade. Answer to the discussion questions should not exceed 3 pages, (plus exhibits, if required), font 12, 1" margin on the left and right hand side of the page, and handed in at the beginning of the class on due dates. No late assignment are accepted, except under extraordinary conditions, and agreement from me is required before the stated due date.

For each case, I will provide you a set of questions to guide your analysis.

Please pay attention to the following points when you prepare a case report.

1. You need to turn in a hardcopy of the report. Softcopies (disk or email-attachments) will not be graded.
2. Mark clearly the number of the question you are referring to.
3. When necessary, you should have a section called "Key Assumptions" where you list the important assumptions you have made throughout a specific answer (not for the entire case). You have to emphasize where these assumptions are necessary in your analysis.
4. Charts or tables do not constitute an answer – they are considered as supporting material for your analysis.

5. All tables and charts should have a descriptive title, should be numbered and appear at the end of the report. There must be “Explanatory Notes” following each table or chart where the calculations in the table or chart are explained in details.
6. The analysis in the report should make clear reference to the charts and tables. Including table or chart number, and the main result taken from the table or chart to support you answer.
7. The best advice for a good report is that each member of the team reads the report **before** submitting it. If you have time read it again, and if you have more time read it again and again and again.....

## **Problem Sets**

There are 2 group homework sets, each counting equally (10%) towards the final grade. A hard copy of the group's solution should be handed in at the beginning of the class on due dates. Late assignments will not be accepted. Group members are required to have with them a copy of the assignment for class discussion. Solutions will be available after due dates.

In addition, a list of recommended end-of-chapter problems is attached to this outline. The book's solutions will be made available to you and will be discussed during review sessions. These problems provide a good preparation for the final exam and you are strongly encouraged to attempt to solve them individually.

## **Final Exam**

The final exam will take place in our last meeting. You are allowed 1 page (front and back) of hand written notes and a calculator.

## **Schedule**

The schedule below is based on my understanding of the background of the people registered for the class. Please let me know during the first class if you have any reservations regarding this schedule.

Due dates of the cases also appear in the schedule.

The reading assignments refer to the course text book

**Week 1** (September 13)

1. Introduction and review of corporate financing decisions
2. Financing decisions and market efficiency
3. Financing instruments

Readings: [BD] Chapter 1, 8, 9, 24

**Week 2** (September 20)

4. The choice of capital structure
  - 4.1. Capital structure in a perfect market
  - 4.2. The effect of taxes
  - 4.3. The effect of transaction costs
  - 4.4. The effect of information costs

Readings: [BD] Chapter 14, 15, 16

**Week 3** (September 27)

Case I due

5. The relation between capital structure and the cost of capital

Readings: [BD] Chapter 18

**Week 4** (October 4)

Problem set I due

6. Capital acquisition
  - 6.1. The Capital acquisition process
  - 6.2. The impact of Capital acquisition on the price of the firm's securities

Readings: [BD] Chapter 23

**Week 5** (October 11)

7. Dividend policy
  - 7.1. Cash dividends
  - 7.2. Share repurchase
  - 7.3. Stock dividends and stock splits

Readings: [BD] Chapter 17

**Week 6** (October 18)

Case II Due

- 8. An introduction to real options
  - 8.1. Timing option
  - 8.2. Growth options
  - 8.3. Abandonment option

Readings: [BD] Chapter (20), 22

**Week 7** (October 25)

Problem set II due

- 9. Course review

**Week 8** (October 26)

Final Examination

**Important dates:**

September 20	Group members names due
September 27	Case 1 due
October 4	Problem set 1 due
October 18	Case 2 due
October 25	Problem set 2 due
October 26	Final Examination