

The Hong Kong University of Science & Technology
Department of Finance
FINA 321: Advanced Financial Management
Spring 2008

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Schedule:

L1: Monday & Wednesday 14:00–15:20, LT H

L2: Monday & Wednesday 15:30–16:50, LT H

Course Objective

The objective of this course is to provide students the tools necessary to answer the key corporate finance questions:

1. What are good investments and,
2. How should the firm finance its investments?

Topics covered in the course: capital budgeting decisions, the variety of securities firms can issue to finance their investments, the process of issuing securities, the affect of taxes, transactions costs, and information costs on firm value, the relation between the choice of financial structure and the cost of capital, dividend policy, and applications of valuation techniques to mergers and acquisitions.

Prerequisites:

FINA 111 and FINA221

Required Textbook

(BD) Jonathan Berk and Peter Demarzo, *Corporate Finance*, Pearson Education. 2007.

Grading

Your grade in this course will be based on your performance on:

- | | |
|-------------------------------------|-----|
| 1. Class discussions | 10% |
| 2. Three (group) Case reports | 30% |
| 3. Two (group) homework assignments | 10% |
| 4. Mid-term examination (March 12) | 20% |
| 5. Final examination (TBA) | 30% |

The midterm will cover the first 2 topics on the course outline below. Specific details will be issued one week before the midterm. The final exam covers the entire course and will last 3 hours. You may bring to the exams a calculator and an A4-size data sheet, on which you can write anything you like on both sides, but everything has to be hand-written.

Cheating will not be tolerated. Any student caught cheating in the exams will receive zero credit and may face further disciplinary actions.

In the case reports and homework assignments, all group members will receive the same basic grade to begin with. The basic grade will then be adjusted according to peer evaluation. The peer evaluation will be confidential and will be done at the time of the final exam.

In the peer evaluation, each member of your group will be asked to rank every other member on a scale of 1 to 5 indicating his/her evaluation of each member's relative contribution to the group's efforts (excluding himself/herself). A rank of 5 is the best possible, and 1 is the lowest possible. If the average rank for an individual is x (a number between 1 and 5), that individual's eventual grade in case reports is:

$$\text{Grade in Case Reports} = \text{Basic Grade} \times [90\% + 10\% \times (x - 3)/2]$$

If the group size is less than 6, the formula will be adjusted accordingly. For example, suppose that a group has 5 members. The best possible rank is 4. The formula becomes:

$$\text{Grade in Case Reports} = \text{Basic Grade} \times [90\% + 10\% \times (x - 2.5)/1.5]$$

Note you are not allowed to give the same rank to any two people in your group. If you do or you do not rank someone in your group, those individuals will be assigned a rank of 3 (for group of size 6) or 2.5 (for group of size 5) from you. As a penalty, your average rank will be lowered to 1.

Here is an example of how the grade for the entire course will be computed. Suppose your group has six members and gets the following grades in case reports:

Case 1: 80
Case 2: 85
Case 3: 90
Case 4: 85

$$\text{Basic Grade} = (80 + 85 + 90 + 85)/4 = 85$$

Your Average Rank in the Peer Evaluation: 4

$$\text{Your Grade in Case Reports} = 85 \times [90\% + 10\% \times (4-3)/2] = 81$$

Your Grade in Mid-term Exam: 90
Your Grade in Final Exam: 80

$$\text{Total Grade} = 81 \times 30\% + 90 \times 30\% + 80 \times 40\% = 83$$

Case groups and write-ups

The assigned cases and homework should be prepared in groups of no more than 6 members. You are required to form groups in the first week of classes. Each group will consist of 6 members. The names of group members must be handed in by February 18. Students who are not in any group of size 6 will be combined in groups in an arbitrary manner. One group of size smaller than 6 may be necessary if the number of students enrolled in your session is not divisible by 6.

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

Each case counts equally (10%) towards the final grade. Answer to the discussion questions should not exceed 4 pages, (plus exhibits, if required) 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 the answer.
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.
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.....

Homework assignments

There are 2 group homework assignments, each counting equally (5%) towards the final grade. Homework assignments 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.

Course Outline and Reading Assignments

Topic	Readings	Problems
1. Introduction and review: 1.1. The objective of the firm 1.2. Capital budgeting under certainty 1.3. Capital budgeting under uncertainty 1.4. Introduction to derivative pricing	Chapter 1 Chapters 6, 7 Chapters 10 Chapter 20	
2. Real options	Chapter 22	
3. The choice of capital structure 3.1. Financing decisions and market efficiency 3.2. Sources of financing 3.3. Capital structure in a perfect market 3.4. The effect of taxes 3.5. The effect of transaction costs 3.6. The effect of information costs	Chapter 9.5 Chapters 8, 9, 24 Chapter 14 Chapter 15 Chapter 16	
4. The relation between capital structure and the cost of capital	Chapter 18	
5. Dividend policy 5.1. Cash dividends 5.2. Share repurchase 5.3. Stock dividends	Chapter 17	
6. Capital acquisition 6.1. The Capital acquisition process 6.2. The impact of Capital acquisition on the price of the firm's securities	Chapter 23	
7. Mergers, acquisitions, and changes in corporate control	Chapter 28	

Important dates:

February 18	Name cards and Group members names due
February 25	Case1 due
March 10	Homework 1 due
March 12	Mid-term examination
April 9	Case 2 due
April 23	Homework 2 due
May 7	Case 3 due