

Applied Contract Theory – Corporate Finance

Swiss Finance Institute Ph.D Program, 2008-2009

This course offers a graduate level introduction to the theory of corporate finance with a focus on selected topics such as firms' capital structure and the allocation of corporate control. If time permits, we will also review the recent literature on institutional aspects of corporate finance.

Methodologically, this course use game-and contract-theoretic tools applied to corporate finance. The aim is to train students to use these tools for their own research. To this end, the course allocates time to the discussion of problem sets that the students are asked to solve in advance. Problem sets account for 30% of the final grade.

The main textbook for this course is

Jean Tirole (2006), *"The Theory of Corporate Finance"*, Princeton University Press.

It offers a unified framework to study the following topics

- Moral Hazard Models of Financial Contracting
- Liquidity and Risk Management
- Asymmetric Information Models of Financial Contracting
- Corporate Governance and Control
- Law and Finance

Other useful textbooks and survey papers are:

P. Bolton and M. Dewatripont, "Contract theory" MIT press.

D. Martimort and J-J. Laffont, "The theory of incentives", Princeton University Press

Shleifer, Andrei, and Robert W. Vishny (1997), "A survey of corporate governance", *Journal of Finance*, 52:737-783.

Stein, J. (2003) "Agency, information and corporate investment", *Handbook of Economics and Finance*, Amsterdam: North Holland.

Tirole J. (2001) "Corporate Governance", *Econometrica* 69 (1): 1-35.

A preliminary reading lists is:

Moral Hazard Models of Financial Contracting

Jensen, M. and W. Meckling (1976), "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure", *Journal of Financial Economics*, 3: 305-360.

Bolton, P. and D. Scharfstein (1990), "A Theory of Predation Based on Agency Problems in Financial Contracting", *American Economic Review*, 80: 94-106.

Diamond D, (1991), "Monitoring and reputation: the choice between bank loans and directly placed debt," *Journal of Political Economy* 99: 689-721

Hart, Oliver D., and John Moore (1994), "A Theory of Debt Based on the Inalienability of Human Capital," *Quarterly Journal of Economics*, 109:841-879.

Liquidity and Risk Management

Jensen M, (1986) "Agency costs of free cash flows, corporate finance and takeovers", *American Economic Review* 76: 323-339

Easterbrook, F (1984) "Two agency-cost explanations of dividends" *American Economic Review*, 74: 650-659.

Holmstrom, B. and J. Tirole (1998) "Private and public supply of liquidity", *Journal of Political Economy* 106 :1-40

Asymmetric Information Models of Financial Contracting

Myers, S. (1984), "The capital structure puzzle", *Journal of Finance*, 39: 575-592.

Myers, S. and M. Majluf (1984), "Corporate financing and investment decisions when firms have information that investors do not have", *Journal of Financial Economics*, 13: 187-221.

Frank, M.Z and V.K. Goyal, (2003) "Testing the pecking order theory," *Journal of Financial Economics* 67: 217-248

Corporate Governance and Control

Grossman, S. and O. Hart (1988), "One share one vote and the market for corporate control", *Journal of Financial Economics*, 20: 175-202.

Aghion, Ph. and P. Bolton (1992), "An incomplete contracts approach to financial contracting", *Review of Economic Studies*, 77: 388-401.

Bebchuk, L A. (1994), "Efficient and inefficient sales of corporate control", *Quarterly Journal of Economics*, 102: 957-993.

Zwiebel, Jeffrey (1996), "Dynamic capital structure under managerial entrenchment", *American Economic Review*, 86: 1197-1215.

Law and Finance

La Porta, Rafael, Florencio Lopez-de-Silanes, Andrei Shleifer, and Robert W. Vishny, (2000), "Investor protection and corporate governance", *Journal of Financial Economics*, 58: 3-27.

La Porta, Rafael, Florencio Lopez-de-Silanes, Andrei Shleifer, and Robert W. Vishny, (2002), "Investor protection and corporate valuation", *Journal of Finance*

La Porta, Rafael, Florencio Lopez-de-Silanes, Andrei Shleifer (2008) "The Economics consequences of legal origins" *Journal of Economic Literature*, June, 2008.