

Course Description: FINA 7A30, “Advanced Corporate Finance” [temporarily listed as FINA 7A97]

Prerequisite: FINA 7A10, “Intermediate Corporate Finance: Valuation” [temporarily listed as FINA 7A97].

Building on the core finance class (FINA 6A35) and the Valuation course (FINA 7A10), we examine the financial decisions that managers make: What sort of financing is optimal for a given type of firm? How much debt should a firm have? What are the benefits of using debt or equity to finance operations or investments, and what are possible drawbacks? What payout policy should a firm follow? When should shareholders expect dividends, or share repurchases? Ever wondered what determines the weighted average cost of capital (WACC) that you used in the earlier courses? In this course, you will learn what determines this cost of capital.

The goal of the course is to help you understand optimal capital structure and payout policy choices for different businesses. We will discuss how corporate strategy affects a firm’s optimal capital structure, and how capital structure affects corporate strategy. These are decisions that a CEO and CFO make, but managers of those corporations benefit from understanding what determines “their” cost of capital, and so do investors, analysts, investment bankers, etc., when analyzing or valuing a firm.

Specific issues covered include:

- The Modigliani-Miller "Irrelevance Results"
- The role of corporate income taxes
- Costs of financial distress, including conflicts between different investor groups
- Effects of financing decisions on managerial incentives
- The cost of issuing equity (including IPOs) or other securities
- Dividends and share repurchases

Throughout the course, our primary viewpoint is that of a corporate financial manager; however, since corporations get funds from investors, we will often look at issues from an investor’s point of view and then examine the implications for managers. Managers who understand the issues will anticipate their investors’ reaction and therefore make decisions that maximize value for all investors.

You will notice that valuation is a central theme in this course: In order to make or understand financial decisions, you need to examine what consequences they have and how to compare the alternatives. You need to practice the proper approach to valuation: the expected future cash flows matter! For that reason, the Valuation course is a prerequisite for this course.

You will also be surprised to learn that while we deal with numbers a lot, I will rarely insist that one particular answer or point of view is “correct”, and all others are “wrong”. You will learn to use tools that improve your decisions, but they do not automatically or mechanically produce easy answers. Experience and common sense will remain essential, and these tools will allow you to make better-informed decisions (and to avoid certain types of mistakes).

This course is essential for anyone planning a career in finance, whether at a corporation or a financial institution. It is recommended for all business students, since any decision made in corporations may add or destroy value, and this course will improve your ability to judge whether value is being added or destroyed.