Introductory Finance

4th module, 2019-2020

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Course information

Course Website: TBA

Instructor's Office Hours: by request

Class Time: TBA

Room Number: TBA

TAs: TBA

Course description

This course introduces main concepts and approaches in finance: firm valuation, capital structure in perfect markets, financing capacity and agency costs (managerial incentives, credit rationing, liquidity and risk management, lemons problem and market freeze), security design. We will also discuss some macroeconomic implications of corporate finance such as liquidity problems.

Course requirements, grading, and attendance policies

Knowledge of basic game theory.

Course contents

1. Firm market value and capital structure.
    - CF chapter 2.
    - Modigliani, Miller (AER 1958) The Cost of Capital, Corporation Finance and The Theory of Investment.

2. Financing capacity and agency costs
    - CF chapter 3.
    - Jensen (AER 1986) Agency Costs of Free Cash Flow, Corporate Fianance, and Takeovers.
    - Stiglitz, Weiss (AER 1981) Credit Rationing in Markets with Imperfect Information.

3. Lemons problem, market freeze, pecking-order theory.

- CF chapters 6.1, 6.2.

4. Liquidity, accountability and risk management
    - CF chapters 4.4, 5.1, 5.2, 5.3.

5. Consumer liquidity demand.
    - CF chapter 12.
    - Diamond Dybvig (JPE 1983) Bank Runs, Deposit Insurance, and Liquidity.
    - Gorton, Pennacchi (JoF 1990) Financial Intermediaries and Liquidity Creation.

6. Self-fulfilling Liquidity Dry-ups.
    - Malherbe (JoF 2014) "Self-fulfilling Liquidity Dry-ups."

7. Credit squeeze and the net worth effects.
    - CF chapters 13.2, 13.3, 13,4.
    - Bernanke, Gertler (AER 1989) Agency Costs, Net Worth, and Business Fluctuations.
    - Gorton, Ordonez (AER 2014) Collateral Crises

8. Aggregate liquidity shortages and liquidity asset pricing. CF chapter 15.

Description of course methodology

Students are expected to actively participate in the discussion in the class, the goal is not only to learn standard methods and approaches in finance, but also to understand how and why the finance profession came up with these methods.

Sample tasks for course evaluation

The grade will be based on a written exam (70%) and a report on a paper (30%). Below you can find sample questions.

- According to classic Modigliani-Miller theorem what security the issuer should prefer: debt or equity?
- Suppose an individual who is likely to face a liquidity need in the future decides whether to invest his savings in bonds (debt) or stocks (equity). What would you advise him to do? Provide an argument.
- Provide the intuition behind the "bank runs" in the Diamond-Dybvig model.
- What policies can help to prevent bank runs?
- Based on the intuition from Malherbe (2014) "Self-fulfilling liquidity dry-ups" the secondary market for long-term assets is more likely to be illiquid: when firms hoard little liquidity or when firms hoard a lot of liquidity? Provide an argument.

Course materials

Required textbooks and materials

"Corporate Finance: 4th Edition" by Ivo Welch (can be found here http://book.ivo-welch.info/read/), "Corporate Finance", by Jonathan Berk and Peter DeMarzo, "The Theory of Corporate Finance", by Jean Tirole referred as CF.

Academic integrity policy

Cheating, plagiarism, and any other violations of academic ethics at NES are not tolerated.