

Economics 1720 Corporate Finance
Fall 2008
Syllabus

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- Section A (S01): TuTh 10:30 – 11:50, MacMillan Hall 115
- Section B (S02): TuTh 13:00 – 14:20, Wilson Hall 102

- Course website: <http://mycourses.brown.edu>
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Office Hours:

- Instructor: My regular office hours are 14:30 to 15:00 on Tuesdays and 14:30 to 15:45 on Thursdays. I'm also available for appointments outside these hours. If you need to contact me outside office hours the best method is through email.
- Teaching Assistants: Kien Yoon Andy Chong, Ji-Hee Shin and Amit Vyas.
Office hours to be announced. (Check for announcements on mycourses.)

Course Materials:

1. Lecture notes: Available at the course website.
The notes that I post at the website are not complete. They contain many blank spaces that you should fill in during class. You should thus download the relevant course notes and bring them to class. Depending on the nature of the material, I expect that we will cover between 10 and 25 pages of notes each class period. I expect to have lecture notes posted at least one week in advance. I recommend that you not print off notes more than one week ahead of schedule; I often do last minute revisions.
2. Textbook: *A First Course in Corporate Finance*, First edition, 2008, Ivo Welch.
This is a new textbook and the printing is a bit behind schedule. The book is expected to be available in the bookstore in October. The first ten chapters of the text will be made available as a course packet.
The material presented in the course will follow the textbook very closely. The book also contains most of the homework assignments.

Subject Matter: Economics 1720 teaches the foundations of finance. While the focus is on corporate finance, the knowledge that you acquire and the skills that you develop will also be applicable to personal finance. The material covered fits into the following areas:

- Basics: rates of return.
- Valuation: How should a manager decide whether to take on a project? How does financial valuation differ from accounting valuation? Do taxes matter?
- Investments: An abbreviated version to cover what we need in corporate finance. How should an investor choose an investment portfolio?
- Corporate finance: How can a manager finance projects? What is a good capital structure/issuance policy?

Basics and Investments overlap with Econ 1710. Econ 1710 is not a prerequisite for this class. I will cover in this class all of the finance that you need to know for this class. However, for those of you who have not taken 1710 this material may go by a bit quickly.

Course Objectives: My objective is that by the end of this semester you will have a basic knowledge of the subject matter *and* you will be able to apply that knowledge. You should be able to engage in basic financial decision making, both for your personal life and in a business context.

Knowledge of the subjects covered in this course is important for anyone considering a career in economics or finance, whether as an academic or in consulting, investment banking or corporate management. This course is similar to an introductory finance course taught at a business school. This course, together with 1710, is a prerequisite for other finance courses and strategy courses.

Prerequisites:

- Algebra. I know that all of you have passed an algebra course or two, or you wouldn't be here. The math used in this course is not particularly fancy, but there are a lot of formulas and equations. Math aptitude is useful. You need to be comfortable using algebra to figure things out.
- Computer skills: Basic Excel or advanced calculator knowledge. Email and web use.
- The ability to pick up an accounting and a statistical intro textbook, and read what is necessary.

What I expect of you/How to do well in this class:

Class Preparation:

- Read the relevant book chapter before class. Don't worry if you don't understand everything. What you don't understand should become clear in the lecture. If not, then you are prepared to ask questions. You will also be prepared for "cold calling".
- Print and glance at the lecture notes.
- Bring to class: the lecture notes (for that class and the one before and the one after), a calculator, your name card.
- After class read through your notes.
- *Do all of the assignments!* Assignments will be graded, but not in detail. You may talk with other students in the process of preparing the assignments. But, the final write-up must be yours. The real benefit of the assignments is that they are preparation for the exams. Because they are not graded in detail there is no advantage to copying someone else's work to make sure that you have things right. The benefit to you will be in the process of doing the work. For those of you who are athletes or performers you can think of the difference between preparing for competition or performance by watching someone else perform, or by going through the exercises yourself.

Class Etiquette:

I will in many ways treat this like a business school class. You should always bring your name card and have it set up so that I and other students can read it.

Proper business etiquette includes arriving on time. If you must arrive late, then you should go quickly to an outside seat at the back of the class.

I will call on students to answer questions. (As described below, participation does play a role, albeit very small, in grading.) I expect all students to show respect for each other, and for the material.

Use of computers is not permitted in class. You should print the classnotes before class and write your notes on them. I have found that having computers open during class is very distracting for everyone.

Rules for exams:

Exams will be closed book. You may bring a "cheat card": a 3" X 5" index card on which you may write anything, front and back. You may also bring a calculator, but not a computer.

Honor code: Brown has an honor code. This prohibits cheating and plagiarism. You are also required to inform me if you observe other students cheating. While it may be tempting to glance at someone else's solutions in an exam, don't – the penalties far outweigh the benefit.

Additional readings and skills: What I list here goes beyond the required materials listed on the first page of this syllabus.

1. Professional readings: I recommend that you read the Wall Street Journal on a regular basis. The WSJ makes a lot of their material freely available at wsj.com. However, by subscribing you will gain access to more indepth material.

2. Vocabulary and accounting basics:

Accounting is the language of business. We will not get into any advanced accounting in this class, but you will need, by about two-thirds through the semester, to be fluent in the basics. Accounting basics are covered in Chapter 13 of your textbook. This material will be covered in lecture. You may, however, wish to supplement this with a basic primer. A relatively inexpensive book that covers the basics is Thomas Ittelson, 1998, *Financial Statements: A step-by-step guide to understanding and creating financial reports*. (A new edition is due in October of this year.) There are in addition many introductory accounting textbooks that would serve as good references.

There are a couple of decent primers on financial vocabulary written by Virginia Morris and Kenneth Morris: *Standard & Poor's Guide to Money and Investing*, 2007 and *Standard & Poor's Dictionary of Financial Terms*, 2007. The *Wall Street Journal Complete Money & Investing Guidebook* by Dave Kansas also provides a lot of useful background financial information, as well as lists of many useful websites.

3. There are a number of other corporate finance textbooks that may complement the textbook used in the class: Berk-DeMarzo *Corporate Finance*, Brealey-Myers *Fundamentals of Corporate Finance*, Ross-Westerfield-Jaffe *Corporate Finance*, and Grinblatt-Titman *Financial Markets and Corporate Strategy*. The last of these is a bit more advanced than the others.
4. If you wish to go beyond the basics of valuation taught in this course you may find the following books useful: Copeland, Koller, Murrin *Valuation*. Bradford Cornell *Corporate Valuation*.
5. There are other skills beyond what you will obtain in this class, but that you will find very useful if you wish to pursue a career in business or finance, either professionally or academically.

Communication: Take a course in public speaking or acting. Take courses that require you to write.

Data manipulation: Take a computer programming course.

Grading:

Midterms, 30%: I will give two in-class midterms, but I will count only the one on which you receive a higher score. If you miss a midterm, then you give up the option to drop a score. Midterm questions will be similar to homework questions.

Final Exam, 40%: The final exam will be similar to the midterms in format, but longer and cumulative in material.

Homework, Project and Discretion/participation, 30%:

- Homeworks will count for 5 to 10% of the grade. They will be assigned in class at the end of each topic. Thus, the homework schedule will depend on the pace that we keep in lecture. Homeworks will be graded on a “check”, “check-minus” or “zero” basis. I will drop the grade for your two worst homeworks.

You are permitted, and even encouraged, to discuss homeworks with other students or with the TAs. But, you must write up the solutions on your own.

Typically every student who makes a serious effort on homework receives a top score. As such, there is very little dispersion in homework grades. Homework can significantly affect your grade in two ways: i) If you use the homework to learn the material and enhance your skills, then you will do better on the exams. (There is typically lots of grade dispersion on exams.) ii) If you don't do the homework, then the loss of 5 to 10% on your final score will hurt you. (That said, if you do very well on the exams, then I will deduct less for not doing the homeworks. The homework grade is really intended to help you.)

When handing in homework, please keep a copy for yourself. Also make sure that your work is readable and organized.

- A team project will count for 15%. The project will consist of an analyst report, including a pro forma valuation, of a company. I don't expect that grade dispersion will be high for this project. The importance of the project for your final grade will be similar to that for the homework. I may even include a question on the exam that will favor those students who put in the effort to really understand what was done on the project.

Each team must consist of 3-5 students (not more; not fewer).

More details on the project will be posted on the course website later in the semester.

- My discretion counts for 5-10%. You should attend class, bring your name card, and participate. But, don't participate just to make noise.

I also use this discretion to make allowances for single bad days. But, you need to have been present and performed well on other days in order to convince me that your bad day was out of character.

Additional Incentives: In the previous semester the top 5 students in the class were invited to be TA's this semester. This is great experience and also looks good on a resume. I plan to do the same this semester and pass on the names of the top students to the professor who teaches the course in the Spring.

TOPICS and CLASS SCHEDULE

The timing listed below for the topics is only approximate. The dates for the exams are fixed. If we do not finish a particular topic before an exam, then I will adjust the exam material accordingly.

Lecture #		Date	Topic	Chapter
1	Thurs	Sept 4	course intro	1
2	Tues	Sept 9	basics: returns, time value of money	2
3	Thurs	Sept 11	basics, cont'd	2
4	Tues	Sept 16	perpetuities and annuities	3
5	Thurs	Sept 18	capital budgeting	4
6	Tues	Sept 23	capital budgeting, cont'd	4/5
7	Thurs	Sept 25	time-varying rates of return	5
8	Tues	Sept 30	uncertainty, corporate bonds and stocks	6
	Thurs	Oct 2	Midterm 1	
9	Tues	Oct 7	intro to investments & institutions	7
10	Thurs	Oct 9	risk and reward	8
11	Tues	Oct 14	CAPM	9
12	Thurs	Oct 16	CAPM, cont'd	9
13	Tues	Oct 21	market imperfections	10
14	Thurs	Oct 23	efficient markets	11
15	Tues	Oct 28	capital budgeting applications	12
16	Thurs	Oct 30	capital budgeting applications, cont'd	12
	Tues	Nov 4	Midterm 2	
17	Thurs	Nov 6	financial statements to cash flows	13
18	Tues	Nov 11	fin'l statements and ratios	13/14
19	Thurs	Nov 13	ratios and comparables	14
20	Tues	Nov 18	corporate claims	15
21	Thurs	Nov 20	capital structure	16
22	Tues	Nov 25	weighted average cost of capital and APV	17
	Thurs	Nov 27	Thanksgiving	
23	Tues	Dec 2	market imperfections & capital structure	18
24	Thurs	Dec 4	cont'd	18/19

Final exam dates: The official university schedule is:

Section A (S01): Wednesday, December 17

Section B (S02): Saturday, December 13, 9 am

Students from Section A may take the Saturday December 13 exam, and in fact are strongly encouraged to do so. Students from Section B may *not* take the Wednesday exam without a valid, verifiable excuse for missing the earlier exam. Also, any Section A student who wishes to take the exam on Wednesday must let us know by September 30 (the last add date).