Course Description

Finance 440 combines the material of Finance 430 and Finance 441 into an intensive one-quarter course that provides an introduction to the major topics in the field of finance, with an emphasis on valuation and corporate finance principles.

Texts and Supplementary Materials

Required:

Case Packet (contains Course Notes, articles, answers to recommended problems in BMA, and old exams.)

In addition to the Course Notes, a copy of the overhead slides for each lecture will be available on the course Web page. You should download these slides before each class, as they will greatly reduce the need to take notes.

Supplementary readings and other material also will be posted on the course Web page. You should bring your nameplate to each class, and have it out throughout the quarter.

Recommended:
There is a handout in the case packet entitled Using Financial Functions in Excel, by Prof. Korajczyk. It is important to learn how to do these financial calculations on a spreadsheet, such as Excel. If you have a financial calculator and know how to use it, this can also be helpful, but it is not required.

For newcomers to finance, an introduction (such as Kenneth Morris and Alan Siegel, The Wall Street Journal Guide to Understanding Money and Investing, Fireside, 1999) may provide a helpful overview of financial markets and instruments.

Office Hours

I will announce weekly office hours in class and on the web page when the term starts. If it is not possible for you to make this scheduled time, we can make an appointment. The best way to reach me is generally by email.

Review Sessions

The teaching assistant for this class is Joey Engelberg, who is a PhD student studying finance. Joey will run weekly review sessions on Wednesdays 1:30 – 3:00 pm to go over the problem sets and cover additional questions. These are optional and you should attend as you need to. There will be an additional review session before the midterm and the final.

Grading

There are two exams; the midterm is worth 30% of your grade and the final is worth 40% of your grade. The midterm is a free option -- if it doesn't help your grade, 70% of the grade will be based on the final, which is cumulative. Requests for reconsideration of grading must be submitted in writing within a week of when the exam is returned. If a regrade is requested, the entire exam will be re-evaluated. I cannot discuss an exam for which a regrade will be requested, since the regrade (like the exam) must be based entirely on your own work.

The Kellogg Honor Code strictly applies. Exams must be completed independently and within the allotted time. Only the specifically allowed materials may be used and nothing else. On the homework you can consult with any other class members and refer to class materials, except that answers to previous years’ problems are off limits.

There are five graded homework assignments (problem sets and cases), some requiring the use of a PC and spreadsheet program; each is worth 6 points (6% of your grade). The assignments may be submitted by groups of up to five; working on the homework in groups is highly recommended. Your answers should be clear and explanatory (the solution and how you obtained it); a spreadsheet is not considered a sufficient solution.

Assignment due dates are given on the course outline and are non-negotiable – in the interest of fairness and as required by the honor code, all students should face the same set of deadlines. If you foresee a problem, let me know immediately. To summarize:

\[
\text{final score} = \text{HW #1} + \text{HW #2} + \text{HW #3} + \text{HW #4} + \text{HW #5} + \max(\text{midterm} + \text{final}, \text{final} \times 1.75)
\]

Comment on homework and practice problems: The main objective of the homework is to help you learn by preparing for the class and thinking about the material. The recommended problems from Brealey, Myers and Allen are very helpful in absorbing the material and preparing for the exams (but they will not be graded). My advice is to do your best answering the homework and practice questions, but recognize that they are hard and meant to make you think. The best gauge is whether you understand the issues and the solutions that are handed out.
Course Outline and Assignments

This is the list of the topics that will be covered, readings, and recommended problems. This course moves very quickly. To keep up, it is essential that you complete the assigned readings prior to class, and that you work the practice problems along the way. Note that all the recommended problems refer to the "Practice Questions" section in Brealey, Myers, and Allen unless otherwise stated. Answers to the recommended problems are included in the case packet. Copies of the instructor's manual (with answers to all problems) and study guide for Brealey, Myers, and Allen are on reserve in the library. “*” denotes optional readings.

**Topic 1: Introduction to Present Value Concepts and Value Maximization**

*Week 1*  
**Reading:** BMA 1, 2, 3  
**Course Notes #1**  
**Practice Questions:** Ch. 2: 1, 3, 4; Ch. 3: 1, 2, 3, 7-11, 16, 17, 23

**Topic 2: Using Present Value for Capital Budgeting and Security Valuation**

*Week 1-2*  
**Reading:** BMA 4, 5, 6, 12.4  
**Course Notes #2**  
"The Real Key to Creating Wealth," *Fortune*  
“AT&T Uses Shareholder Wealth as a Guide to Strategy” *Planning Review*  
**Practice Questions:** Ch. 4: 8, 11, 16; Ch. 5: 1, 3, 4, 5; Ch. 6: 10, 11, 13, 14, 16, 17, 19

**Topic 3: Risk and Return I: Diversification and Portfolio Choice**

*Week 2-3*  
**Reading:** BMA 7, 8  
**Course Notes #3**  
“Great Expectations” *The Economist*  
**Practice Questions:** Ch. 7: 3-5, 8, 10; Quiz 4 & 7, plus Challenge Question #1  
Ch. 8: 1, 3, 8, 11

**Topic 4: Risk and Return II: The CAPM and Valuation Under Uncertainty**

*Week 3-4*  
**Reading:** BMA 9  
**Course Notes #4**  
“How High a Hurdle?” *The Economist*  
**Optional Reading:** BMA 10*, 11*  
**Practice Questions:** Ch. 9: 2, 7, 10, and Challenge Question #2

**Topic 5: Market Efficiency**

*Week 4*  
**Reading:** BMA 13  
“Teaching Note on Market Efficiency”  
“Are Markets Efficient?” *The Wall Street Journal*  
**Optional Reading:** “The Motives and Consequences of Debt-Equity Swaps and Defeasances: more evidence that it does not pay to manipulate earnings” *Journal of Applied Corporate Finance*  
“Behavioral Finance” (forthcoming in the Handbook of Judgment and Decision Making)*  
**Practice Questions:** Ch. 13: 3, 5-8 and Challenge Question #1
Topic 6: Derivative Securities  
Week 5  Reading:  BMA 20, 21, 22  
Course Notes #6  
Teaching note on “Valuing Loan Guarantees”  
Optional Reading: “The Options Approach to Capital Investment”* (Harvard Business Review)  
Practice Questions: Ch. 20: 2, 9, 12, 16; Ch. 21: 2; Ch. 22: 1  

Topic 7: Fixed Income Securities and the Yield Curve  
Week 6  Reading:  BMA 23, 24.1, 27.1 - 27.3  
Course Notes #7  
“A Guide to Investing in U.S. Treasury STRIPS” (AAII Journal)  
Optional Reading: BMA 28.1 – 28.2*  
Practice Questions: Ch. 27: 5-6; Ch. 23: 4, 6-8, 10, Quiz #5;  

Topic 8: Financing in Perfect Markets: Modigliani-Miller  
Week 6  Reading:  BMA 16 (focus on 16.5, perfect markets, for now), Ch. 17  
Course Notes #8  
Practice Questions: Ch. 16: 3, 5, 7; Ch. 17: 1, 5, 7, 11-12, Challenge Question #2  

Topic 9: Capital Structure in Imperfect Markets I  
Week 7  Taxes and Financial Distress: Static Trade-off Theory  
Reading:  BMA 18  
Course Notes #9  
“Debt and Taxes” (The Journal of Finance)  
Case  Dixon Corporation (read with this material, to be turned in later)  
Practice Questions: Ch. 18: 1, 8-9  

Topic 10: Capital Structure in Imperfect Markets II  
Week 8  Valuation Techniques for Investment and Financing Decisions  
Reading:  BMA 19  
Course Notes #10  
Case  Sampa Video, Inc. (read with this material, to be turned in later)  
Optional Reading: BMA 26*  
Practice Questions: Ch. 19: 4, 6-8, 11
Topic 11: Dividends and Payout Policy
Week 9  Reading:  BMA 16
        Course Notes #11
        Optional Reading:  “Using Capital Structure to Communicate with Investors:  The Case of CUC International” (Journal of Applied Corporate Finance) *
        “Payout Policy in the 21st Century”, Brav, Graham, Harvey, & Michaely 2004*
        Practice Questions:  Ch. 16: 8, 11, 13

Topic 12: Raising Capital and Issuing Securities
Week 10  Reading:  BMA 14
        Course Notes #12
        Optional Reading: BMA 15*, 25*  

rev. 21-Aug-06