



Course information 2020-21

FN2191 Principles of Corporate Finance

General information

COURSE LEVEL: 5

CREDIT: 30

NOTIONAL STUDY TIME: 300 hours

Summary

This course is aimed at students who are interested in understanding the principles of corporate finance. It provides a theoretical framework used to address issues in project appraisal and financing, payout policy, capital structure, mergers and acquisitions, equity offerings, and risk management. It provides students with the tools required for further studies in financial intermediation and investments.

Conditions

Prerequisite: If taken as part of a BSc degree, the following course(s) must be passed before this course may be attempted.

- EC1002 Introduction to economics **AND**
- **Either** MT105a Mathematics 1 **OR** MT105b Mathematics 2 **OR** MT1174 Calculus **OR** MT1186 Mathematical methods

Aims and objectives

This course provides a theoretical framework used to address issues in project appraisal and financing, payout policy, capital structure, mergers and acquisitions, equity offerings, and risk management. It provides students with the tools required for further studies in financial intermediation and investments.

Learning outcomes

At the end of the course and having completed the essential reading and activities students should be able to:

- explain how to value projects, and use key capital budgeting techniques (for example: NPV and IRR)
- understand and apply real option theory as an advanced technique of capital budgeting
- understand and explain the relevance, facts and role of the pay-out policy, and calculate how pay outs affect the valuation of securities
- understand the trade-off firms face between tax advantages of debt and various costs of debt
- calculate and apply different costs of capital in valuation
- understand and explain different capital structure theories, including information asymmetry and agency conflict

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- understand how companies issue new shares, and calculate related price impact in security offerings
- discuss why merger and acquisition activities exist, and calculate the related gains and losses
- understand risk, hedging, and numerous financial securities as tools to manage risk.

Essential reading

For full details, please refer to the reading list.

Brealey, Richard A., Stewart C. Myers, and Franklin Allen. Principles of Corporate Finance. (McGraw-Hill Education, 2019) thirteenth edition [ISBN 978-1260565553]

Assessment

This course is assessed by a three-hour unseen written examination.

Syllabus

Project evaluation: the NPV rule and IRR rules of investment appraisal; comparison of NPV and IRR; 'wrong' investment appraisal rules: payback and accounting rate of return.

Real options: understand what real options are and why they are important in project valuation; understand and calculate the source of option value; three types of real options: options to abandon/expand/wait.

Dividend theory: the Modigliani–Miller and dividend irrelevancy; Lintner's fact about dividend policy; dividends, taxes and clienteles; asymmetric information and signalling through dividend policy.

Capital structure: the Modigliani–Miller theorem: capital structure irrelevancy; taxation, bankruptcy costs and capital structure; weighted average cost of capital; Modigliani-Miller 2nd proposition; the Miller equilibrium; asymmetric information: 1) the under-investment problem, asymmetric information; 2) the risk-shifting problem, asymmetric information; 3) free cash-flow arguments; 4) the pecking order theory; 5) debt overhang.

Corporate governance: separation of ownership and control; management incentives; management shareholdings and firm value; corporate governance.

Mergers and acquisitions: motivations for merger activity; calculating the gains and losses from merger/takeover; the free-rider problem and takeover activity.

Equity offerings: understand venture capital and equity issuance in the public market; perform valuation with multiple financing rounds; initial public offerings and underpricing; winners' curse problem.

Risk management: understand why and how companies manage risk; cost of hedging; covered and uncovered interest rate parity.

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