



Graduate School of Finance

Theoretical Corporate Finance, Part I: Agency Problems and Capital Structure

Spring 2024

Reading list (**subject to minor changes/updates during the course**)

Time: January 9 – February 21, 2024.

Place: Aalto University School of Business, Otaniemi

Lectures: GSF Director Mikko Leppämäki (Aalto University)

Exercises: Mr. Sina Ghavamabadi (Aalto University)

0. A Brief Introduction to Noncooperative Game Theory/Contracts

- Lecture notes (are sufficient for this course)
- You may consult *any advanced level Micro Theory/Game Theory book covering the same topics* that we go through in the introduction.

General Readings

This course is based on and uses materials from various chapters of Jean Tirole 2006: *The Theory of Corporate Finance*. Princeton University Press. In addition, some parts draw from Patrick Bolton and Mathias Dewatripont, 2005: *Contract Theory*. MIT Press, Bernard Salanié 2005: *The Economics of Contracts*. MIT Press and Oliver Hart 1995: *Firms, Contracts and Financial Structure*. Clarendon Press, Oxford.

- Tirole, Jean 2006: *The Theory of Corporate Finance*. Princeton University Press. Chapter 2 "Corporate Financing: Some Stylized Facts" pp. 75-109.
- Hart, Oliver 2001: Financial Contracting, *Journal of Economic Literature* 39, 1079-1100, <https://www.proquest.com/scholarly-journals/financial-contracting/docview/213157415/se-2?accountid=27468>
- Bolton, Patrick 2014: Corporate Finance, Incomplete Contracts, and Corporate Control, *Journal of Law, Economics, and Organization* 30, 64-81
- Allen, Franklin and Adelina Barbalau 2022: Security Design: A Review. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4258499 (Sections 1 and 2)
- Myers, Stewart 2003: "Financing of Corporations" in eds. *Handbook of the Economics of Finance*. Volume 1 A, Corporate Finance. Eds. George M. Constantinides, Milton Harris, and Rene M. Stulz, Elsevier, Amsterdam.

1. Corporate Financing under Moral Hazard

- Lecture notes
- Tirole, Jean 2006: *The Theory of Corporate Finance*. Princeton University Press, chapter 3: "Outside Financing Capacity", pages 113 – 156 and chapter 4 "Some Determinants of Borrowing Capacity", pages 157 – 197.
- Jensen, Michael and William Meckling 1976: "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure", *Journal of Financial Economics*, 3:305-360. Available at [Science Direct](#) database
- Nicolae Garleanu and Jeffrey Zwiebel 2009: "Design and Renegotiation of Debt Covenants", *The Review of Financial Studies* 22, Issue 2, 749–781, <https://www.jstor.org/stable/30226005>
- Thanassoulis, John 2013: Industry Structure Executive Pay and Short-Termism. *Management Science* 59. 402-419. <https://pubsonline.informs.org/doi/10.1287/mnsc.1120.1601>
- Bolton, P., H. Mehran and J. Shapiro 2015: "Executive Compensation and Risk Taking" *Review of Finance* 19. Issue 6, 2139 – 2181. <https://academic.oup.com/rof/article/19/6/2139/1575545>
- Innes, Robert D. 1990: "Limited Liability and Incentive Contracting with Ex-Ante Action Choices", *Journal of Economic Theory*, 52(1):45-67. Available at [Science Direct](#) database.
- Bhattacharya, Sudipto and Antoine Faure-Grimaud 2001: "The Debt Hangover. Renegotiation with noncontractible investment", *Economics Letters* 70. 413-419. Available at [Science Direct](#) database.
- Brunnermeier, Markus K., and Arvind Krishnamurthy 2020. "[Corporate Debt Overhang and Credit Policy](#)". *Brooking Papers of Economic Activity*, Summer, 447 – 488. https://www.brookings.edu/wp-content/uploads/2020/06/SU20_S6_Brunnermeier-Krishnamurthy_-final-paper.pdf
- Bolton, P. and Scharfstein, D. 1990: "A Theory of Predation Based on Agency Problems in Financial Contracting", *American Economic Review* 80, 93-106. Available at [JSTOR](#) database.
- Hart, O. and John Moore 1984: "A Theory of Debt Based on The Inalienability of Human Capital", *Quarterly Journal of Economics* 109. 841 – 880. Available at [JSTOR](#) database.
- Leppämäki, M., Mäkelä, P. and T. Takalo "Startup Financing and Entrepreneurial Spinoffs". (a handout will be distributed at the lectures)

2. Corporate Financing under Asymmetric Information

- Lecture notes
- Tirole, Jean 2006: *The Theory of Corporate Finance*. Princeton University Press, chapter 6: "Corporate Financing under Asymmetric Information", pages 237-282.
- Myers, Stewart C. and Nicholas Majluf 1984: "Corporate Financing and Investment Decisions When Firms Have Information That Investors Do Not Have," *Journal of Financial Economics*, 13:187-221. [https://doi.org/10.1016/0304-405X\(84\)90023-0](https://doi.org/10.1016/0304-405X(84)90023-0)

- Murray, Frank Z. and Vidhan K. Goyal (2008): Trade-off and pecking order theories of debt. Espen Eckbo (editor) *The Handbook of Empirical Corporate Finance*, Elsevier Science. Chapter 12, 135-197.
- Landier, A. and David Thesmar 2008: "Financial Contracting with Optimistic Entrepreneurs", *Review of Financial Studies* 22. 116 – 150. Available at [EBSCO](#) database.
- Leppämäki, M, "Firm Formation and Talent Allocation under Uninformed and Informed Finance". (a handout will be distributed at the lectures)

3. Signaling in Corporate Finance

- Lecture notes
- Tirole, Jean (2006) *The Theory of Corporate Finance*. Princeton University Press, pages 249-264.
- Spence, Michael 1973: "Job Market Signaling" *Quarterly Journal of Economics*, 87. 355-74. Available at [JSTOR](#) database
- Riley, J. 2001: "Silver Signals: Twenty-Five Years of Screening and Signaling". *Journal of Economic Literature*, 39:432- 478. <https://www.proquest.com/scholarly-journals/silver-signals-twenty-five-years-screening/docview/213192679/se-2?accountid=27468>
- Ross, Steven 1977: "The Determination of Financial Structure: The Incentive Signaling Approach", *Bell Journal of Economics*, 8:23-40. Available at [JSTOR](#) database
- Leland, Hayne and David Pyle 1977: "Information Asymmetries, Financial Structure and Financial Intermediation", *Journal of Finance*, 32(2):371-388. <https://doi.org/10.1111/j.1540-6261.1977.tb03277.x>
- Gertner R., Gibbons R., Scharfstein D. 1988: "Simultaneous signaling to the capital and product markets", *Rand Journal of Economics* 19: 173-190. Available at [JSTOR](#) database.
- Allen, F. and Fauhlhaber, G.R. 1989: "Signalling by underpricing in the IPO market", *Journal of Financial Economics* 23: 303-323. Available at [Science Direct](#).
- Leppämäki, M. and M. Mustonen 2009: "Skill Signaling with Product Market Externality", *Economic Journal*, 119:1130-1142. Available at <http://onlinelibrary.wiley.com/doi/10.1111/j.1468-0297.2009.02258.x/epdf>

4. Debt, Managerial Incentives and Entrenchment

- Lecture notes
- Jensen, Michael C. (1986), "Agency Costs of Free Cash Flow, Corporate Finance and Takeovers", *American Economic Review*, 76:323-329. Available at [JSTOR](#) database
- Hart, Oliver D., and John Moore (1995), "Debt and Seniority: An Analysis of the Role of Hard Claims in Constraining Management," *American Economic Review*, 85: 567-585. Available at [JSTOR](#)
- Zwiebel, Jeffrey (1996), "Dynamic Capital Structure Under Managerial Entrenchment," *American Economic Review*, 86: 1197-1215. Available at [JSTOR](#) database.
- Benmelech, Efraim "Managerial Entrenchment and Debt Maturity: Theory and Evidence" Harvard University and NBER. Available at: <http://scholar.harvard.edu/files/benmelech/files/entrenchment.pdf>

Access to the articles is subject to your home institutions' subscriptions of journals. Hard copies of all readings are available for consultation at the GSF secretary's office, Aalto University School of Business, Ekonominaukio 1, Room T317 (3rd floor) or by e-mail reetta.ali-alha@aalto.fi