This course covers the basic financial knowledge needed to run a firm—whether the firm is a multi-billion dollar international conglomerate or a three-person start up. In Finance 1, you learned how to value projects to help decide in which projects to invest. That investment decision, which is often called capital budgeting, is the first fundamental decision in corporate finance. In Finance 2, we will use a combination of lectures and business cases to examine the other two fundamental decisions in corporate finance: how firms fund their projects (capital structure) and how they allocate the return on their investments (payout policy). We will then apply the frameworks we develop to analyze applied corporate finance decisions, including corporate security design, mergers and acquisitions, and corporate risk management.

This is a challenging but rewarding class. The class does not require any knowledge of finance beyond Finance 1, but it does require hard work, extensive study, and diligent preparation outside of our class sessions. The class is designed both for managers who will initially specialize in a different functional area (e.g., marketing, operations) and for managers who will be directly involved in making or analyzing corporate finance decisions (e.g., future senior executives, general managers, investment bankers, consultants, securities analysts, money managers, investment advisors).

Textbook:


[If you already have the 3rd edition, use it. Note that although the chapter numbers below apply to both versions, the page numbers refer to the 4th edition and are different in the 3rd edition.]

Cases (included in course packet):

“Sampa Video, Inc.” (HBS 9-201-094)
“UST Inc.” (CaseNet)
“Facebook, Inc.: The Initial Public Offering (A)” (Ivey 9B12N031)
“Safeway, Inc.’s Leveraged Buyout (A)” (HBS 9-294-139)
“Dividend Policy at FPL Group, Inc. (A)” (HBS 9-295-059)
“Valuation of AirThread Connections” (HBS 4263)
“Stanley Black & Decker, Inc.” (HBS 9-211-067)
“United Grain Growers Limited (A)” (HBS 9-201-015)
“Liability Management at General Motors” (HBS 9-293-123)

The course is organized into three modules:

I. Capital Structure (Lectures 1-6; 4 cases)
II. Dividend Policy (Lecture 7; 1 case)
III. Applied Topics (Lectures 8-10; 4 cases)
I. Capital Structure

1. Introduction
   - Role and objectives of financial manager
   - How market efficiency affects financial decision making
     BD: Chapter 1.2 (pages 7-14) and Chapter 9.5 (pages 300-306)

2. Why Does Capital Structure Matter?
   - What is debt and equity?
   - MM irrelevance proposition
     BD: Chapter 14

3. Capital Structure: Taxes
   - Tax subsidies for corporate borrowing
   - Adjusted present value (APV) and weighted average cost of capital (WACC)
     BD: Chapters 15 and 18

Case application: “Sampa Video, Inc.”

   - Costs of financial distress
     BD: Chapter 16 and Chapter 24.3 (pages 876-877)

Case application: “UST Inc.”

5. Capital Structure: Security Mispricing
   - Signaling with capital structure
     BD: Chapter 16.8 (pages 577-584) and Chapter 23

Case application: “Facebook, Inc.: The Initial Public Offering (A)”

6. Capital Structure: Corporate Governance
   - Separation of ownership and control
   - Private equity
     BD: Chapter 16.6 (pages 571-575) and Chapter 29

Case application: “Safeway, Inc.’s Leveraged Buyout (A)”

II. Dividend Policy

7. Dividend Policy
   - MM irrelevance proposition
   - Dividends and taxes
   - Signaling with dividends
     BD: Chapter 17

Case application: “Dividend Policy at FPL Group, Inc. (A)”
III. Applied Topics

8. Security Design
   - Convertible securities
   - Callable/Exchangeable securities
   - Warrants
     BD: Chapter 24

9. Mergers & Acquisitions
   BD: Chapter 28

   Case application: “Valuation of AirThread Connections”

   Case application: “Stanley Black & Decker, Inc.”

10. Risk Management
    BD: Chapter 30

    Case application: “United Grain Growers Limited (A)”

    Case application: “Liability Management at General Motors”

LECTURES AND CLASS DISCUSSIONS

The lectures will be based on the outlines posted on Canvas. You should read the relevant lecture outlines carefully prior to class. I will encourage class participation and preparation is essential.

ASSIGNMENTS AND EXAMS

Deadlines for this class are non-negotiable. If you have a question about a deadline, you should resolve your question prior to the deadline. Under special circumstances, you may arrange to turn in assignments early. Assignments will not be accepted after the due date and exams may not be taken late. Turning in assignments after the due date or taking an exam later than the scheduled time is not allowed to avoid providing a student with an “unfair advantage over other students.” Students unable to complete the course assignments and exams by the due date will receive a zero and therefore may not pass this class.

Homework Assignments:

The homework assignments are designed to prepare you for the case assignments and exams. They are not graded and should be completed for your benefit by the dates posted on Canvas. The solutions to the homework assignments will be discussed in video-recorded TA sessions posted online, but I will not collect your answers. I strongly suggest you complete the assignments before you watch the TA session or look at my answers. Attempting the homework on your own—before looking at the solutions—will make the concepts much clearer and will help you immensely when it becomes time for the cases and exams.
Case Assignments:

A case memo (detailed written answer) is due at the beginning of class on the day that we discuss each of the following cases:

- **UST** ........................................... April 16
- **Facebook** ........................................ April 23
- **AirThread** ......................................... May 21
- **General Motors** .................................... June 4

Answers to a case poll (short online assignment) are due at 8 AM on the day we discuss each of the following cases:

- **Sampa Video** ........................................ April 11
- **Safeway** ........................................... April 30
- **FPL** ................................................ May 10
- **Stanley Black & Decker** ......................... May 24
- **United Grain Growers** ............................. May 31

The four case memos are worth 25 points each. While a formal write-up is not required for the remaining cases, I expect you to prepare them diligently. The five online assignments are worth 10 points each. I encourage you to discuss and solve the cases in groups, even for the cases for which formal memos are not turned in for credit. I will not handout answers for the cases.

Each memo should be 3-5 written pages plus tables. Case questions are on Canvas. Brevity is a virtue. Do not repeat the facts of the case – I have read it. You should turn in your memo at the beginning of class, but keep a copy as you will be expected to contribute to the class discussion based on your analysis. I expect the answers to be both well-reasoned and well presented. The cases are your opportunity to apply the concepts you have learned thus far to messy, real world situations. In the real world, understanding the ideas is important – being able to explain them to your boss and coworkers is equally important. Thus your case write ups will be graded on both your answers and how well you defend your proposed solution.

Your answers must not only be correct, but also must be clear. You will find spreadsheet software essential for preparing your answers, but handing in your spreadsheets is not considered a sufficient answer. It should be clear both what your answer is and how you arrived at it. With modern software, you are able to integrate the spreadsheets and graphs into the text of your answers. This doesn’t mean you should hand in elaborate presentations—these are homework assignments.

You may work in groups of up to 6 individuals to prepare the cases. It is sufficient to turn in 1 copy of the case memo per group, but each student should submit the online assignments individually. I strongly urge you to work in groups. In the past, groups have been more successful than individuals in preparing the cases.

Exams:

There will be two exams. The midterm exam will be given in class during the fifth week of the course. It will cover the first four weeks of material. The final exam will be given during exam week (the eleventh week of the course). It will cover the entire course. The midterm will count for 120 points, and the final exam will count for 240 points. Your midterm exam score can help your grade; the midterm
score will be automatically dropped and replaced by ½ of your final exam score, if you perform better on the final exam than on the midterm.

**GRADING**

Your total score for the class will be computed as follows:

<table>
<thead>
<tr>
<th>Assignment</th>
<th>Total Points</th>
</tr>
</thead>
<tbody>
<tr>
<td>Face card</td>
<td>10</td>
</tr>
<tr>
<td>Case memos (4)</td>
<td>25 each</td>
</tr>
<tr>
<td>Case polls (5)</td>
<td>10 each</td>
</tr>
<tr>
<td>Midterm</td>
<td>120</td>
</tr>
<tr>
<td>Final</td>
<td>240</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>520</strong></td>
</tr>
</tbody>
</table>

Total score = Face card + 4 cases memos + 5 case polls + max (midterm + final, 3/2 final)

**REGRADE POLICY**

If you feel that your homework assignments, cases, or exams have been graded incorrectly, you can submit a regrade request. I adhere to the Kellogg regrade policy. All requests must be made in writing within 10 working days after the exam or assignment has been graded and returned. They should consist of a short explanation of why you think the grading is incorrect. Upon submission of a regrade request, I will review your entire assignment/exam. Your final grade will be based on this complete review. Therefore, your grade can either be raised or lowered as a result of a regrade request.

**HONOR CODE**

The Kellogg honor code strictly applies to all aspects of this course, including class assignments, class participation, and exams. Exams are to be completed individually and are closed book. Solutions to previous year’s problems should not be used in solving homework or case assignments. The complete honor code can be found on the Office of Student Affairs website. Ask if there is any uncertainty as to how the honor code applies to this course.

**OTHER ADMINISTRATIVE DETAILS**

The class notes, homework assignments and answers, and past exams are the intellectual property of the instructor. You may not distribute class notes electronically or in any form to anyone outside the class or outside Kellogg. You may not duplicate these notes for use by your employers after graduating from Kellogg without my written consent.

Appointments to discuss anything related to the course may be made by e-mailing me at enrichetta.ravina@kellogg.northwestern.edu. Please make appointments a day in advance.