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 course 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:

Note: If you already have the 3rd edition, use it. The chapter numbers listed below apply to both versions, but 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)
“RJR Nabisco” (HBS 9-289-056)

Additional reading materials will be posted on Canvas.

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

Lecture 1. Introduction
- Course description
- 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)

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

Lecture 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.”

- Signaling with capital structure
  BD: Chapter 16.8 (pages 577-584) and Chapter 23

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

Lecture 6. Capital Structure: Conflicts of Interest
- 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

Lecture 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

**Lecture 8. Mergers & Acquisitions**
BD: Chapter 28

*Case application:* “Valuation of AirThread Connections”

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

**Lecture 9. Security Design**
- Convertible securities
  BD: Chapter 24

**Lecture 10. Risk Management**
BD: Chapter 30

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

**Wrap up Case:** “RJR Nabisco”

IV. Final exam

**Review in class for final exam**

**Final Exam** (Date and time TBD)

**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.

**TA AND REVIEW SESSIONS**

A video of pre-recorded review “sessions” solving homework assignments, as well as written solutions, will be made available on Canvas. These provide guidance in solving problems and applying the concepts covered in lectures.

For further feedback or addressing remaining questions on homework assignments, the TA for the course, Menaka Hampole, will be available for virtual office hours using Blue Jeans, available on the course website on Canvas. You can contact Menaka over email: menaka.hampole@kellogg.northwestern.edu.

Professor Frydman will also hold review sessions before the midterm and final exams. Dates and times will be announced in class and on Canvas.

**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 may provide a student with an unfair advantage over other students. Students unable to complete the course assignments and exams by the due date will receive zero credit.

Homework Assignments (Ungraded):

There are eight homework assignments. These assignments are not graded, but should be completed for your benefit. Doing 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 exams.

I will post answers online by the due date. I will not collect or grade your answers.

Homework assignments are “due” on the following dates:

Homework 1 .................................................... January 10
Homework 2 .................................................... January 17
Homework 3 .................................................... January 24
Homework 4 .................................................... January 31
Homework 5 .................................................. February 14
Homework 6 .................................................. February 21
Homework 7 .................................................. February 28
Homework 8 .................................................... March 7

The TA will be available for virtual office hours (time TBD, by request). The times for the TA’s office hours will be posted on the class calendar on Canvas.

Case Assignments:

There are nine case assignments; four requiring case memos and five requiring short responses to an online questionnaire.

The case memos are worth 25 points each. You may work in groups of up to 6 individuals to prepare the cases. In the past, groups have been more successful than individuals in preparing the cases, so I strongly urge you to work in groups. Please turn in one memo per group, but keep a copy of your answers for class; you will be expected to contribute to the class discussion based on your written answers.

The memos should be 3-5 written pages plus tables. Brevity is a virtue. Do not repeat the facts of the case – I have read it. I will provide case questions on Canvas to guide your discussion. Your case grade will depend not only on your final answer, but also on how well you reason through your proposed solution. The goal of the cases is to apply the concepts that we learn in class to messy, real world situations, and to explain your ideas concisely and clearly—as you would do in a board presentation. I will return the graded cases with written comments, but I will not hand out a solution key.

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.

Case memos are due at the **beginning** of class on the day that we discuss the following cases:

- UST ................................................................. January 24
- Facebook ......................................................... January 31
- AirThread ...................................................... February 28
- United Grain Growers ................................. March 7

For the remaining four cases, I will assign a short web-based questionnaire requiring short responses (worth 10 points each). Though I am not assigning a case memo, I still expect you to prepare these cases diligently. I encourage you to discuss and solve the cases in groups, but each student is responsible for completing the web-based questions on her or his own.

Answers to the case short online assignments are due by **8 AM** on the day we discuss the following cases:

- Sampa Video ................................................... January 17
- Safeway ........................................................... February 7
- FPL ................................................................. February 21
- Stanley Black & Decker ............................. March 7
- RJR Nabisco ................................................. March 14

**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.

**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 = 4 cases memos + 4 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 any one 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 c-frydman@kellogg.northwestern.edu. Please make appointments a day in advance.