

Program: FPM

Course Title: Capital Structure and Valuation

Course Instructor: Prof. Ram Kumar Kakani

Course Objective: The objective of the course is to introduce research scholars to the issues that link capital structure decisions with the valuation of firms. After going through this course, research scholars are expected to develop a thorough understanding of the nature of the interaction between capital structure and valuation that have influenced researchers over past five decades.

Session Plan

Session 1

Valuation of Fixed Income Securities I

Reading: Modigliani, F. & Miller, M. 1961. Dividend policy, growth and the valuation of stocks. *The Journal of Business*. 34:4, pp.411-433.

Session 2

Valuation of Fixed Income Securities II

Reading: Lintner, J. 1965. The valuation of risk assets and the selection of risky investments in stock portfolios and capital budgets. *The Review of Economics and Statistics*. 47:1, pp. 13-37.

Session 3

Valuation of Stocks I

Reading: Ohlson, J.A. 1995. Earnings, book values, and dividends in equity valuation. *Contemporary Accounting Research*. 11:2, pp.661-687.

Session 4

Valuation of Stocks II

Reading: Welch, I. 2004. Capital structure and stock returns. *The Journal of Political Economy*. 112:1, pp.106-132.

Session 5

Valuation of Stocks III

Reading: Masulis, R.W.1983. The impact of capital structure change on firm value: Some estimates. *The Journal of Finance*.38:1, 107-126.

Session 6

PE and PEG Ratios

Reading: Easton, P.D. 2004. PE ratios, PEG ratios and estimating the implied expected return on equity capital. *The Accounting Review*.79:1, pp. 73-95.

Session 7

Capital Structure Question and the Pie Theory

Reading: Stewart, M.C.2001. *The Journal of Economic Perspectives*. 15:2, pp.81-102.

Session 7

Financial Leverage and Firm Value

Reading: Harris, M. & Raviv, Artur.1991. The theory of capital structure. *The Journal of Finance*. 46:1, pp.297-355.

Session 8

Propositions of Modigliani and Miller

Reading: Miller, M.H.1988. The Modigliani-Miller propositions after thirty years .*The Journal of Economic Perspectives*, 2: 4, pp. 99-120.

Session 9

Financial Distress

Reading: Scott, J.A.Jr. 1976. A theory of optimal capital structure. *The Bell Journal of Economics*. 7:1, pp.33-54.

Session 10

Tax Effects and Financial Distress Costs

Reading: Modigliani, F. & Miller. M.H. 1963. Corporate income taxes and the cost of capital: A correction. *The American Economic Review*, 53:3, pp. 433-443.

Session 11

Capital Structure and Signaling

Reading: Brennan, M.J. & Schwartz, E.S. 1978. Corporate income tax, valuation and the problem of optimal capital structure. *The Journal of Finance*.51:1, pp.103-114.

Session 12

Capital Structure and the Agency Theory

Reading: Leland, H.E. 1998. Agency costs, risk management, and capital structure. *The Journal of Finance*. 53:4, pp.1213-1243.

Session 13

The Pecking Order Theory

Reading: Morck, R., Shleifer, A & Vishny, R.W.1988. Management ownership and market valuation. *Journal of Financial Economics*. 20, pp.293-315

Session 14

Growth and the Debt-Equity Ratio

Reading: Chen, W.P., Chung, H., Hsu, T.L. &Wu, S. 2010. External financing needs, corporate governance and firm value. *Corporate Governance: An International Review*. 18:3, pp.234-249.

Session 15

Valuation and Capital Budgeting for the Levered Firm

Reading: Adsera, X. & Vinolas, P. 2003. FEVA : A financial and economic approach to valuation. *Financial Analysts Journal*. 59:2, pp.80-87.

Session 16

Adjusted Present Value Approach to Valuation

Reading: Frank, M.Z. & Goyal, V.K.2009. Capital structure decisions: Which factors are reliably important? *Financial Management*. Wiley Online Library.

Session 17

Flow to Equity Approach to Valuation

Reading: Sanders, W.G. & Boivie, S. 2004. Sorting things out: Valuation of new firms in uncertain markets. *Strategic Management Journal*. 25:2, pp.167-186.

Session 18

Weighted Average Cost of Capital Approach to Valuation

Reading: Rajan, R.G. & Zingales, L. 1995. What do you know about capital structure? : Some evidence from international data. *The Journal of Finance*. 50:5, pp. 1421-1460.

Session 19

Estimation of the Discount Rate

Reading: Vanderbilt University roundtable on the capital structure puzzle .1998. *The Journal of Applied Corporate Finance*, pp.8-24.

Session 20

Beta and Leverage

Reading: Barclay, M.J. & Smith, C.W. 2005. The capital structure puzzle: The evidence revisited. *The Journal of Applied Corporate Finance*, 17:1, pp. 8-17.

Evaluation:

50% on session-wise assignments.

50% on a written test at the end of the course.

Reference Books:

- 1) Ross, S.A., Westerfield, R.W., Jaffe., J. & Kakani, R.K. 2008. *Corporate Finance*, 8th Edition, Tata McGraw-Hill.
- 2) Brealey, R.A., Myers, S.C., Allen, F. & Mohanty, P.2007.Principles of Corporate Finance, 8th Edition, Tata McGraw-Hill.
- 3) Grinblatt, M., & Titman. S.2002. *Financial Markets and Corporate Strategy*, 2nd Edition, Irwin/McGraw-Hill.
- 4) Damodaran, A. 2006. *Damodaran on Valuation*, 2nd Edition, Wiley India
- 5) Koller, T., Goedhart, M. & Wessels, D. (McKinsey & Co). 2005. *Valuation*. 4th Edition, John Wiley & Sons.
