

**University of California, San Diego**  
**School of International Relations and Pacific Studies**

Professor Bruce N. Lehmann  
Corporate Finance

Spring 2005  
IRGN 424

Office: 1415 Robinson Building  
Phone: 534-0945  
Class Hours: 9:30-10:50 P. M., Monday and Wednesday  
Office Hours: 11:00-12:30, Wednesday and by appointment

Required Text: Brealey, Richard A. and Stewart C. Myers, *Principles of Corporate Finance* (New York: McGraw-Hill, 2003)

**COURSE DESCRIPTION**

This course provides an overview of corporate financial policy. In part, the course is a natural extension of the core finance course in that it continues with the impact of taxation on valuation. In part, it broadens the investigation by moving onto other topics such as the evaluation of strategic options and the use of securities to help corporations and investors manage risk and incentive problems. Four examples include:

- The impact of taxation on financial and investment policy.
- The incentive problems engendered by the separation of ownership and control in the modern corporation.
- Mitigating agency problems with financial policy and by carefully crafted security issuance.
- Evaluating projects with embedded options.

I make no pretense of trying to provide a comprehensive and thorough treatment of any of these topics in ten weeks. However, I will provide an introduction to several interesting problems that arise in actual capital markets, the light that financial theory can shed on them along with the limitations of any such insight, and some of the policy consequences of these problems, both for private market participants and for governments.

The Brealey and Myers book is, of course, the one that you used in the core finance course. I will cover only 7.5 chapters this quarter in an effort to spend more time on some of the more difficult material. In particular, the real options component of the course requires a nontrivial detour into option pricing but the payoff in terms of understanding should make the effort worthwhile.

There are a few course mechanics that require some elaboration. I will post my slides on my remarkably generic web site: <http://www-irps.ucsd.edu/academics/f-lehmann-t.php>. I will give you the end-of chapter problem solutions and I encourage you to do all of them as this is the

best way to master the material. There will be a midterm and a final exam, each of which will count for half of your grade. The exams will be closed book but a calculator is allowed (actually, it is a virtual necessity). All questions on the examinations will be taken from either Stulz or the in-class examples.

Finally, I will miss class on Wednesday, May 18 and probably on Monday, May 16 as well due to conference obligations. I will endeavor to reschedule all classes at the Benthamite time (the greatest good for the greatest number if my failing memory serves), probably toward the end of the quarter. Perusal of the IR/PS course schedule suggests that possible slots include 11 to 12:30 or 12:30-2 on Mondays and Wednesdays, and, of course, the less popular evening times.

### **Course Outline**

<b>Week</b>	<b>Topic</b>	<b>Readings</b>
1	Debt Policy	Chapter 17
2	Debt and Taxes	Chapter 18
3	The Costs and Risks of Financial Distress	Chapter 18
4	Capital Budgeting and Risk	Chapter 9
5	A Project is Not a Black Box	Chapter 10
	Midterm Examination	
6	An Introduction to Options and the Option-like Nature of Corporate Liabilities	Chapters 20 and 23
7	Understanding Options	Chapter 20
8	Valuing Options	Chapter 21
9	Real Options	Chapter 22
10	Real Options, Continued	Chapter 22