

UNIVERSITY OF MARYLAND
The Robert H Smith School of Business
BMGT 808C
Doctoral Seminar: Public Policy Perspectives of Finance

Focus: Issues in Corporate Governance and Financial Reforms

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Seminar Methodology and Approach

This seminar focuses on issues in corporate governance and financial reforms with specific attention to the reforms of governance/executive compensation practices, linkage between finance and development, financial crisis, and corporate tax policy. *Journal articles* and recent working papers constitute the primary material for the seminar.

The readings list is by no means intended to be exhaustive. The list mentions important background or related articles, where applicable. The last section of the list includes recent survey articles and syntheses of some mainstream issues. Please note that the references in the papers presented are considered an integral part of the reading list. Articles can be retrieved or downloaded from *JSTOR* and various *websites*.

Grading for the course is determined by:

- (a) Oral presentations of articles and the corresponding written reports,
- (b) Class participation,
- (c) Report on recent corporate scandals: Incentives and Solution Mechanisms
- (d) Term project

The requirement for the **term project** may be satisfied by any of the following:*

- (a) A critique of an article on a significant issue
- (b) A replication of a significant empirical study
- (c) A literature survey on a specific topic, leading to a thesis proposal
- (d) An original piece of work

* *A two-page proposal for the term project is due on September 26.*

Seminar Outline

Foundation: Paradigms in Agency and Corporate Finance

1. The Firms as a nexus of contracts
2. Investment distortions and value destruction
 - Underinvestment/Overinvestment
 - Risk Incentives: Undue conservatism/Undue aggressiveness
3. Managerial agency and “stealing”

Background readings:

A. Barnea, R. Haugen, and L. Senbet. Agency Problems and Financial Contracting (Prentice-Hall, 1985)

M. Jensen . “Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers”, *American Economic Review* 76 (1986).

M. Jensen and W. Meckling. “Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure”, *Journal of Financial Economics* (October 1976)

Corporate Governance and Executive Compensation

1. Pay for Performance: Overview

M. Jensen and K. Murphy. “Performance pay and top-management incentives, “ *Journal of Political Economy*, Vol. 98, No. 2 (April 1990).

B. Holmstrom and S. Kaplan. “The State of US corporate governance: What is right and what’s wrong?” *Journal of Applied Corporate Finance* (Spring 2003).

2. Incentive Effects of Stock Options

D. Yermack. “Do corporations award CEO stock options effectively?” *Journal of Financial Economics*, Volume 39 (1995).

B. Hall and K. Murphy. “The trouble with stock options”, NBER working paper, forthcoming, *Journal of Economic Perspectives*.

[*Supplementary and background readings:* R. Haugen and L. Senbet, “Resolving the Agency Problems of External Capital Through Options”, *Journal of Finance* (June 1981);; W. Guay, S.P. Kothari, and R. Sloan “Accounting for employee stock options”, *American Economic Review* 93 (2003)]

3. Risk and Executive Compensation

R. Aggarwal and A. Samwick. “The Other Side of the Tradeoff: The Impact of Risk on Executive Compensation”, *Journal of Political Economy* (1999), pp.65-105.

L. Meulbroek. “The efficiency of equity-linked compensation: Understanding the full cost of awarding executive stock options”, *Financial Management* 30 (2001), No. 2

B. Hall K.Murphy. “Stock options for undiversified executives”, *Journal of Accounting & Economics* 33 (2002), No.1.

S. Ross. “Compensation, Incentives, and the Duality of Risk Aversion and Riskiness”, *Journal of Finance* (February 2004).

N. Ju, H. Leland, and L. Senbet. “Options and Option Repricing: Their Effects of Corporate Investment Risk”, Maryland- Berkeley working paper, 2005.

4. Governance and board effectiveness

B. Hermalin and M. Weisbach. “Endogenously Chosen Boards of Directors and Their Monitoring of Management”, *American Economic Review* (March 1998)

Gompers, Paul A., Joy L. Ishii, and Andrew Metrick. “Corporate Governance and Equity Prices”, *Quarterly Journal of Economics* (February 2003).

Core, John, Wayne Guay, and Tjomme Rusticus. “Does Weak Governance Cause Weak Stock Returns? An Examination of Firm Operating Performance and Analysts’ Expectations”, forthcoming, *Journal of Finance* [Maryland Finance Symposium]

Cremers, Martijn and V. Nair. “Corporate Governance and Equity Prices”, Yale working paper, forthcoming, *Journal of Finance*

[See alternative view: J.Chi, “Understanding the Endogeneity between Firm Value and Shareholder Rights”, forthcoming, *Financial Management*]

B. Hermalin. “Recent Trends in Corporate Governance”, forthcoming, *Journal of Finance*.

Enter: The Sarbanes – Oxley Act of 2002 (SOX): *John-Senbet (FER Background piece on reform proposals; also C. Leuz, A. Triantis, T. Wang on voluntary SEC deregistration*

M. Jensen. “Agency Costs of Overvalued Equity”, *Financial Management* (Spring 2005)

5. Stakeholder perspective: extensions into bank incentives and regulation

R. La Porta, F. Lopez-de-Silanes, and A. Shleifer, and R. Vishny. "Law and Finance," *Journal of Political Economy* 106 (1998)

K. John, A. Saunders, and L. Senbet. "A Theory of Bank Regulation and Management Compensation", *Review of Financial Studies* 13 (2000).

[Background: K. John and T. John. "Top-management compensation and capital structure", *Journal of Finance*, 48 (1993)]

M. Desai, A. Dyck, and L. Zingales. "Theft and Taxes", Chicago working paper, 2005.

K. John, V. Nair, and L. Senbet. "Law, Taxes and Organizational Form: A Stakeholder Perspective", Wharton/Maryland/NYU working paper, 2005.

A. Durnev and E. Kim. "To Steal or Not to Steal: Firm Attributes, Legal Environment, and Valuation", *Journal of Finance* 60 (2005).

Finance and Development

R. Levine and S. Zervos. "Stock Markets, Banks, and Economic Growth," *American Economic Review* 88 (1998)..

R. Rajan and L. Zingales. "Financial Dependence and Growth," *American Economic Review* 88 (1999).

P. Henry. "Stock Market Liberalization, Economic Reform, and Emerging Market Equity Prices", *Journal of Finance* 55 (2000).

S. Claessens and L. Laeven. "Financial Development, Property Rights, and Growth," *Journal of Finance* 58 (2003).

S. Tadesse. "The Allocation and Monitoring Role of Capital Markets: Theory and International Evidence", *Journal of Financial and Quantitative Analysis* (Dec 2004)

G. Bekaert, C. Harvey, and C. Lundblad. "Does Financial Liberalization Spur Growth," *Journal of Financial Economics* (July 2005).

China puzzle: Apparent counter-example to linkage between financial development-growth nexus

F. Allen, J. Qian, and M. Qian, "Law, Finance, and Economic Growth in China," *Journal of Financial Economics* (July 2005).

[See Also: K. Murphy and R. Vishny. "The Transition to a Market Economy: Pitfalls of Partial Reform", *Quarterly Journal of Economics* (August 1992)].

Financial Crisis

S. Johnson, P. Boone, A. Breach, and E. Friedman. "Corporate Governance in the Asian Financial Crisis", *Journal of Financial Economics* (October/November 2000).

A. Bris and Y. Koskinen. "Corporate Leverage and Currency Crises", *Journal of Financial Economics* (February 2002).

R. Cull, L. Senbet, and M. Sorge. "Deposit Insurance and Financial Development", *Journal of Money, Credit, and Banking* 37 (2005).

A. Gande, K. John, and L. Senbet. "Bank Incentives, Economic Specialization, and the Financial Crises in Emerging Economies", Maryland/NYU working paper, Aug 2005.

Synthesis and Survey

K. John and L. Senbet. "Corporate Governance and Board Effectiveness," *Journal of Banking and Finance* 22 (1998).

Abowd, J.M., and D.S. Kaplan. "Executive compensation: Six questions that need answering", *Journal of Economic Perspectives* (Fall 1999).

Core, John E., W. Guay, and D. Larcker. "Executive Equity Compensation and Incentives: A Survey", *Economic Policy Review* (April 2003).

K. John and L. Senbet, "Executive Compensation: Issues and Reform Proposals", background piece for the Financial Economists Roundtable (July 2003).

M. Jensen, K. Murphy, and E. Wruck. "Remuneration: Where We've Been, How We Got to Here, What are the Problems, and How to Fix Them", Harvard working paper (July 2004).

R. Levine. "Financial Development and Economic Growth: Views and Agenda", *Journal of Economic Literature* 35 (1997), 688-726.

R. Rajan and L. Zingales. "Which Capitalism? Lessons from the East Asian Crisis," *Journal of Applied Corporate Finance* 11 (1998).

R. Rajan and L. Zingales. "The Great Reversals: The Politics of Financial Development in the Twentieth Century", *Journal of Financial Economics* 69 (2003).

R. Stulz. "The Limits of Financial Globalization", *Journal of Finance* (August 2005).

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Journal References and Databases

JSTOR

Google Scholar

ScienceDirect (Elsevier)

Beck, T., A. Demirguc-Kunt, R. Levine, 2000. "A New Database on Financial Development and Structure", World Bank Economic Review 14, 597-605.

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Academic Integrity, Honor Pledge, and Special Needs

Academic Integrity: The University's *Code of Academic Integrity* is designed to ensure that the principles of academic honesty and integrity are upheld. All students are expected to adhere to this Code. The Smith School does not tolerate academic dishonesty. All acts of academic dishonesty will be dealt with in accordance with the provisions of this code. Please visit the following website for more information on the University's Code of Academic Integrity: http://www.inform.umd.edu/CampusInfo/Departments/JPO/AcInteg/code_acinteg2a.html

Honor Pledge: On each assignment you will be asked to write out and sign the following pledge. "*I pledge on my honor that I have not given or received any unauthorized assistance on this exam/assignment.*"

Special Needs: Any student with special needs should bring this to the attention of the instructor as soon as possible, but not later than the second week of class