

YLIOPISTOTENTTI - UNIVERSITY EXAM

Opiskelijan nimi / Student name:	Opiskelijanumero / Student number:
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Opettaja täyttää / Lecturer fills in:

Opintojakson koodi and nimi / The code and the name of the course:	
Koodi / Code	721963S
Tentin nimi / Exam name	Corporate Finance, Summer
Tiedekunta / Faculty:	OyKKK
Tentin pvm / Date of exam: 12.8.2019	Tentin kesto tunteina / Exam in hours: 3 h
Tentaattori(t) / Examiner(s): Markku Vieru	Opintopistemäärä / Credit units: 6 cr
	Sisäinen postios. / Internal address: OyKKK, Markku Vieru
Sallitut apuvälineet / The devices allowed in the exam:	
<input checked="" type="checkbox"/> Funktiolaskin / Scientific calculator	<input type="checkbox"/> Ohjelmoitava laskin / Programmable calculator
<input type="checkbox"/> Muu materiaali, tarkennettu alla / Other material, specified below:	
Tenttiin vastaaminen / Please answer the questions:	
<input checked="" type="checkbox"/> Suomeksi / in Finnish	<input checked="" type="checkbox"/> Englanniksi / in English
Suomenkielisessä tutkinto-ohjelmassa olevalla opiskelijalla on oikeus käyttää arvioitavassa opintosuorituksessa suomen kieltä, vaikka opintojakson opetuskieli olisi englanti. Tämä ei koske vieraan kielen opintoja. (Kts. <u>Koulutuksen johtosääntö 18 §</u>)	
In a Finnish degree programme a student has a right to use Finnish language for their study attainment, even though the language of instruction is English, (excluding language studies) even when the language of instruction is other than Finnish. (See <u>the Education Regulations 18 §</u>)	
Kysymyspaperi on palautettava / Paper with exam questions must be returned:	
<input type="checkbox"/> Kyllä / Yes	<input checked="" type="checkbox"/> Ei / No

INSTRUCTION for a student who have attended the 1st or 2nd Mid Term Exam (year 2019):

If you prefer that your points earned in the 1st Mid Term Exam are taken into account in course grading please answer **only** to questions 3 and 4. In this case, write in your answer sheet: *"I prefer that my points earned in the 1st Mid Term exam are taken into account"*.

Likewise, if you prefer that your points earned in the 2nd Mid Term Exam are taken into account in course grading please answer **only** to questions 1 and 2. In this case, write in your answer sheet *"I prefer that my points earned in the 2nd Mid Term exam are taken into account"*.

Good luck.

INSTRUCTION for the rest of the students:

Answer to all four questions. Please answer using full sentences. Good luck.

OHJE jos olet osallistunut 1. tai 2. välikokeeseen vuonna 2019:

Jos haluat, että 1. välikokeessa saamasi pisteet huomioidaan osana kurssiarvostelua, vastaa **vain** kysymyksiin 3 ja 4. Tässä tapauksessa kirjoita vastauspaperiisi *"Haluan, että arvostelussa huomioidaan 1. välikokeessa saamani pisteet"*.

Vastaavalla tavalla jos haluat, että 2. välikokeessa saamasi pisteet huomioidaan osana kurssiarvostelua, vastaa **vain** kysymyksiin 1 ja 2. Tässä tapauksessa kirjoita vastauspaperiisi *"Haluan, että arvostelussa huomioidaan 2. välikokeessa saamani pisteet"*.

Menestystä.

OHJE muille opiskelijoille. Vastaa kaikkiin neljään kysymykseen. Käytä vastauksissasi kokonaisia virkkeitä. Menestystä.

QUESTIONS

1. a) Describe what is meant by costly signaling in corporate finance and under which conditions costly signaling is beneficial for a firm. (1 p)
- b) In the text book and in the course material there are presented various ways how a firm can signal to outsiders. Describe i) how an entrepreneur can signal project's quality with investment (Leland & Pyle 1977), ii) how firm quality can be signalled with debt (Ross 1977), and iii) how expected cash flows can be signalled with dividends. Explain also what kind of message each signal is supposed to send to the market. (3 p)
- c) How the conflict between current and prospective shareholders can affect firm's investment decision according to Myers and Majluf (1984). Please explain the logic. (2 p)

2. There are theories which try to explain the capital structure of the firm.
 - a) Does the static trade-off theory (Myers 1984) predict that the firm has a target capital structure? Please explain. (2p)
 - b) Please explain the logic on how the agency costs of debt and agency costs of external equity can determine the capital structure of a firm? Please define also the key concepts. (2p)
 - c) Does the market timing theory (Baker and Wurgler 2002) predict that the firm has a target capital structure? Please explain and provide empirical evidence. (2p)

3.
 - a) Shefrin and Statman (1984) develops behavioural explanations for why some investors prefer the cash dividend over capital gains. Please explain why some investors perceive dividend attractive based on Shefrin and Statman (1984). (2p)
 - b) Let's suppose that you are manager of the firm. How would you take into account the clienteles when considering the firm's dividend policy? (2p)
 - c) Let's assume that marginal taxpayer (who set the price) is receiving dividends. Share price before the stock goes ex-dividend is 225€ and dividends per stock is 15€. The tax rate for dividends is 25% and for capital gains the marginal tax rate is 30%. When the share goes ex-dividend the expected share price decline is not the same as the size of dividend (Elton and Gruber, 1970). Please calculate a more reasonable prediction of new ex-dividend share price using tax preference ratio. (2p)

4. There are various reasons for M&A performance. CEO overconfidence may provide one explanation for poor M&A performance.
 - a) Describe what is meant by overconfidence and how CEO overconfidence is measured in the corporate finance literature. How overconfidence deviates from CEO's agency problem? (2p)
 - b) How Malmendier and Tate (2008) explain why it is likely that CEOs are overconfident? (2p)
 - c) Describe corporate governance implications of Malmendier and Tate (2008) related to evidence of CEO overconfidence. (2p)

