



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 / Name	Corporate Finance	
Tiedekunta / Faculty: OyKKK		
Tentin pvm / Date of exam: 4.5.2017	Tentin kesto tunteina / Exam in hours: 3	
Tentin nro / No. of the exam: 2. Retake (esim. Tentti, 1. uusinta, 2. uusinta / e.g. Exam, 1. retake, 2. retake)	Opintopistemäärä / Credit units: 6 cr	
Tentaattori(t) / Examiner(s): Markku Vieru	Sisäinen postios. / Internal address: OyKKK, Markku Vieru	
Sallitut apuvälineet / The devices allowed in the exam:		
<input checked="" type="checkbox"/> Nelilaskin / Standard calculator	<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	
Kysymyspaperi on palautettava / Paper with exam questions must be returned:		
<input type="checkbox"/> Kyllä / Yes	<input checked="" type="checkbox"/> Ei / No	

Vastaa kaikkiin neljään kysymykseen. Käytä vastauksissasi kokonaisia virkkeitä. Menestystä.

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

1. a) In the text book and in the course material there are presented various ways how a firm can signal to outsiders. Describe i) how entrepreneur can signal project 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 what kind of message each signal is supposed to send to the market.
b) How conflict between current and prospective shareholders can affect firm's investment decision according to Myers and Majluf (1984). Please explain.
2. There are different theories which try to explain capital structure of the firm.
a) Please explain how agency costs of debt and agency costs of external equity can effect capital structure decision? Please explain how debtholders and equityholders try to mitigate their agency costs.
b) How equity market timing theory (Baker and Wurgler, 2002) explains firm's capital structure? Explain how Baker and Wurgler (2002) tested the theory using initial public offerings (IPOs).
- 3 a) Koch and Sun (JF, 2004) tested the following model (using the confirmation sample):

$$CAR_{it} = a + b_1 \Delta QEARN_{it} + b_2 \Delta FUTURE_{it} + \varepsilon_{it}$$

where CAR is sum of daily abnormal returns beginning 2 days before the announced dividend and ending 2 days after the announced dividend change; $\Delta EARN$ is the seasonal random walk change for quarter earnings prior to the dividend announcement (deflated by the market value); $\Delta FUTURE$ is future $EARN$ surprises (deflated by the market value). Please open up the point of the model and the results.

- b) Let's assume that marginal taxpayer (who set the price) is receiving dividends. Share price before the stock goes ex-dividend is 20 and dividends per stock is 2. The tax rate for dividends is 20% 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 more reasonable prediction of new ex-dividend share price using tax preference ratio.
4. Should investors be worried about large cash reserves of a company? Please explain (based on research findings) i) how large cash reserved can be motivated and ii) conditions why it can destroy the value of the company.