



## FIRN Masterclass

### Recent topics in corporate finance: Agency problems inside and outside the firm

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#### Course description

This course will discuss several recent developments in corporate finance research, focusing on agency problems inside and outside the corporation. We will talk about the growing role of institutional investors in firms' ownership structures, highlighting the conflicts not just between managers and shareholders, but also among shareholders themselves. In particular, we will discuss the interactions between fund managers and fund investors, who are the ultimate owners of the firm, the rising heterogeneity in investors' preferences, and its effects on governance and shareholder voting. We will then explore how such differences in preferences can hinder effective information flows and lead to less informed decision-making, emphasizing the role of organizational structure, allocation of control, and board composition in alleviating these issues. We will also discuss the research on information design, which highlights how conflicted parties can strategically use information to advance their interests, and study the implications for topics such as corporate governance, stress testing, and capital regulation. Finally, we will cover recent developments in the literature on agency conflicts between shareholders and creditors: this new research emphasizes the role of reputation and commitment power, and their implications for the dynamics of capital structure decisions.

#### Summary of class schedule

Date	Instructor and time	Topic
July 15	<b>Nadya Malenko</b> 9:00-12:30 class 1:00-2:30 office hours	<b>Institutional investors' role in corporate governance</b> Two-layer agency problem Asset managers' incentives to be engaged The rise in indexing and implications for governance Differences in investors' ideologies and ESG preferences

<b>July 16</b>	<b>Nadya Malenko</b> 9:00-12:30 class 1:00-2:30 office hours	<b>Information, heterogeneous preferences, and the role of governance mechanisms</b> Shareholder voting: aggregation of preferences and information Allocation of control and its effect on corporate decisions Implications for organizational structure and board composition
<b>July 17</b>	<b>Andrey Malenko</b> 9:00-12:30 class 1:00-2:30 office hours	<b>Information design and applications</b> Introduction to information design Implications for corporate governance Implications for stress testing and capital regulation
<b>July 18</b>	<b>Andrey Malenko</b> 9:00-12:30 class 1:00-2:30 office hours	<b>Agency conflicts between shareholders and creditors: new developments</b> Leverage ratchet effect Dynamics of debt policies Role of commitment power and reputation in dynamic financing decisions

### Course requirements

1. Each student is expected to write two referee reports: one paper from the list “Papers for referee report #1” and one paper from the list “Papers for referee report #2”. Both lists are at the end of the syllabus, in the section “**Papers for referee reports**”. The guidelines for referee reports are also at the end of the syllabus.
2. In addition, we expect you to read the required papers (those with a check mark) in the section “**Reading list**” and actively participate in class discussions. At the minimum, for each paper marked with a check mark, you would carefully read the introduction and know the answers to the basic questions, such as the research question, key results, and contribution to the literature.

The overall grade will be based on these components according to the following weights:

- Participation 40%
- Referee report #1 30% Due date: July 23
- Referee report #2 30% Due date: July 26

## Reading list

Below is the reading list. The bullets indicate the importance of the readings:

- ✓ These papers will be covered in detail. You are expected to be prepared to answer basic questions on these papers, such as the research question, key results, and contribution to the literature (for papers that are not marked as literature reviews).
- These papers are recommended but will not be covered in detail. It is recommended that you read them if you are interested in the topic.

### **Session 1 (July 15): Institutional investors' role in corporate governance**

- ✓ Appel, I. R., T. A., Gormley, and D. A. Keim, 2016. Passive investors, not passive owners. *Journal of Financial Economics* 121, 111-141.
- ✓ Corum, A. A., A. Malenko, and N. Malenko, 2023. Corporate governance in the presence of active and passive delegated investment. Working paper.
- ✓ Heath, D., D. Macciocchi, R. Michaely, and M. C. Ringgenberg, 2022. Do index funds monitor? *Review of Financial Studies* 35, 91-131.
- ✓ Lewellen, J., and K. Lewellen, 2022. Institutional investors and corporate governance: The incentives to be engaged. *Journal of Finance* 77, 213-264.
- Bebchuk, L. A., and S. Hirst, 2019. Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy. *Columbia Law Review* 119, 2029-2146.
- Bolton, P., T. Li, E. Ravina, and H. Rosenthal, 2020. Investor ideology. *Journal of Financial Economics* 137, 320-352.
- Brav, A., W. Jiang, T. Li, and J. Pinnington, 2024. Shareholder monitoring through voting: New evidence from proxy contests. *Review of Financial Studies* 37, 591-638.
- Brav, A., A. Malenko, and N. Malenko, 2023. Corporate governance implications of the growth in indexing. *Oxford Research Encyclopedia of Economics and Finance* (literature review).
- Bubb, R., and E. Catan, 2022. The party structure of mutual funds. *Review of Financial Studies* 35, 2839-2878.
- Dasgupta, A., V. Fos, and Z. Sautner, 2021. Institutional investors and corporate governance. *Foundations and Trends in Finance* 12, 276-394 (literature review).
- Malenko, A., and N. Malenko, 2024, Voting Choice. Working paper.
- McCahery, J. A., Z. Sautner, and L. T. Starks, 2016. Behind the Scenes: The Corporate Governance Preferences of Institutional Investors. *Journal of Finance* 71, 2905-2932.

## **Session 2 (July 16): Information, heterogeneous preferences, and the role of governance mechanisms**

- ✓ Iliev, P., and M. Lowry, 2015. Are mutual funds active voters? *Review of Financial Studies* 28, 446–485.
- ✓ Malenko, A., and N. Malenko, 2019. Proxy advisory firms: The economics of selling information to voters. *Journal of Finance* 74, 2441-2490.
- Adams, R. B. and D. Ferreira, 2007. A theory of friendly boards. *Journal of Finance* 62, 217-250.
- Aghion, P., and J. Tirole, 1997. Formal and real authority in organizations. *Journal of Political Economy* 105, 1-29.
- Dessein, W., 2002. Authority and communication in organizations. *Review of Economic Studies* 69, 811-838.
- Donaldson, J. R., N. Malenko, and G. Piacentino, 2020. Deadlock on the board. *Review of Financial Studies* 33, 4445-4488.
- Harris, M., and A. Raviv, 2008. A theory of board control and size. *Review of Financial Studies* 21, 1797-1832.
- Iliev, P., J. Kalodimos, and M. Lowry, 2021. Investors' Attention to Corporate Governance. *Review of Financial Studies* 34, 5581-5628.
- Levit, D., N. Malenko, and E. Maug, 2024. Trading and shareholder democracy. *Journal of Finance* 79, 257-304.
- Malenko, N., 2023, Information flows, organizational structure, and corporate governance (literature review). *Handbook of Corporate Finance*, 511-547.
- Schwartz-Ziv, M., and M. Weisbach, 2016. What do boards really do? Evidence from minutes of board meetings. *Journal of Financial Economics* 108, 349-366.

## **Session 3 (July 17): Information design and applications**

- ✓ Goldstein, I., and Y. Leitner, 2018. Stress Tests and Information Disclosure. *Journal of Economic Theory* 177, 34-69.
- ✓ Kamenica, E., and M. Gentzkow, 2011. Bayesian Persuasion. *American Economic Review* 101, 2590-2615.
- ✓ Malenko, A., N. Malenko, and C. Spatt, 2023. Creating Controversy in Proxy Voting Advice. Working paper.
- Bergemann, D., and S. Morris, 2019. Information Design: A Unified Perspective. *Journal of Economic Literature* 57, 1-57.
- Chang, B., and M. Szydlowski, 2020. The Market for Conflicted Advice. *Journal of Finance* 75, 867-903.
- Dworzak, P., and G. Martini, 2019. The Simple Economics of Optimal Persuasion. *Journal of Political Economy* 127, 1993-2048.

- Faria-e-Castro, M., J. Martinez, and T. Philippon, 2017. Runs versus Lemons: Information Disclosure and Fiscal Capacity. *Review of Economic Studies* 84, 1683-1707.
- Inostroza, N., and A. Pavan, 2020. Persuasion in Global Games with Application to Stress Testing. Working Paper.
- Leitner, Y., and B. Williams, 2023. Model Secrecy and Stress Tests, *Journal of Finance* 78, 1055-1095.
- Malenko, N., and Y. Shen, 2016, The Role of Proxy Advisory Firms: Evidence from a Regression-Discontinuity Design. *Review of Financial Studies* 29, 3394-3427.
- Orlov, D., P. Zryumov, and A. Skrzypacz, 2023, The Design of Macroprudential Stress Tests. *Review of Financial Studies* 36, 4460-4501.

#### **Session 4 (July 18): Agency conflicts between shareholders and creditors: new developments**

- ✓ Admati, A. R., P. M. DeMarzo, M. F. Hellwig, and P. Pfleiderer, 2018. The Leverage Ratchet Effect. *Journal of Finance* 73, 145-198.
- ✓ DeMarzo, P. M., and Z. He, 2021. Leverage Dynamics without Commitment. *Journal of Finance* 76, 1195-1250.
- ✓ Goldstein, R., N. Ju, and H. Leland, 2001. An EBIT-Based Model of Dynamic Capital Structure. *Journal of Business* 74, 483-512.
- ✓ Malenko, A., and A. Tsoy, 2024. Optimal Time-Consistent Debt Policies. Working paper.
- Abel, A. B., 2018. Optimal Debt and Profitability in the Trade-Off Theory. *Journal of Finance* 73, 95-143.
- DeMarzo, P. M., 2019. Presidential Address: Collateral and Commitment. *Journal of Finance* 74, 1587-1619.
- DeMarzo, P. M., Z. He, and F. Tourre, 2023. Sovereign Debt Ratchets and Welfare Destruction. *Journal of Political Economy* 131, 2825-2892.
- Donaldson, J. R., D. Gromb, and G. Piacentino, 2020. The Paradox of Pledgeability. *Journal of Financial Economics* 137, 591-605.
- Fischer, E. O., R. Heinkel, and J. Zechner, 1989. Dynamic Capital Structure Choice: Theory and Tests. *Journal of Finance* 44, 19-40.
- Hu, Y., F. Varas, and C. Ying, 2023. Debt Maturity Management. Working paper.
- Leland, H. E., 1994. Corporate Debt Value, Bond Covenants, and Optimal Capital Structure. *Journal of Finance* 49, 1213-1252.
- Leland, H. E., and K. B. Toft, 1996. Optimal Capital Structure, Endogenous Bankruptcy, and the Term Structure of Credit Spreads. *Journal of Finance* 51, 987-1019.
- Strebulaev, I., 2007. Do tests of capital structure theory mean what they say? *Journal of Finance* 62, 1747-1787.

## Papers for referee reports

For each of the two lists below, please pick one paper and submit (for each of the two papers) a referee report, which briefly summarizes the paper and contains the following discussions:

- the main contributions to the literature;
- any potential limitations (e.g., modeling assumptions or methodological problems);
- how one could extend the paper by identifying unanswered questions.

Papers for referee report #1 (due date July 23). Please pick one paper from the following list:

- Carlson, M., A. Fischer, and A. Lazrak, 2023, Why Divest? The Political and Informational Roles of Institutions in Asset Stranding. Working paper.
- Dottling, R., D. Levit, N. Malenko, and M. Rola-Janicka, 2024. Voting on Public Goods: Citizens vs. Shareholders. Working paper.
- Fahlenbrach, R., N. Rudolf, and A. Wegerich, 2024. Leading by Example: Can One Universal Shareholder's Voting Pre-Disclosure Influence Voting. Working paper.
- Landier, A., and S. Lovo, 2023. ESG Investing: How to Optimize Impact? Working paper.
- Li, T., and Q. Zhu, 2024. (Re)call of Duty: Mutual Fund Securities Lending and Proxy Voting. Working paper.
- Hu, E., N. Malenko, and J. Zytneck, 2024. Custom Proxy Voting Advice. Working paper.

Papers for referee report #2 (due date July 26). Please pick one paper from the following list:

- Blonien, P., A. D. Crane, K. Crotty, D. De Angelis, 2023. Errors in Shareholder Voting. Working Paper.
- D'Avernas, A., V. Maurin, and Q. Vandeweyer, 2022. Can Stablecoins Be Stable? Working Paper.
- Fuchs, W., S. Fukuda, and D. Neuhann, 2024. Rules versus Discretion: Prudential Regulation and Market Discipline, 2024. Working Paper.
- Gamba, A., and A. Saretto, 2023. Debt Maturity and Commitment to Firm Policies. Working Paper.
- Malenko, A., and A. Tsoy, 2024. Optimal Time-Consistent Debt Policies. Working Paper.