

THE OPEN UNIVERSITY OF TANZANIA
FACULTY OF BUSINESS MANAGEMENT

DEPARTMENT OF ACCOUNTING AND FINANCE

OFN 453 Topics in Corporate Finance

COURSE OUTLINE

Introduction

This course is designed to cover contemporary issues in corporate finance taking into account their applicability in the Tanzania's young corporate sector. It will cover issues in long term finance that would not have been covered in the earlier courses in corporate finance or financial management, corporate restructuring for growth (mergers and acquisitions) and business failures (reorganisation and liquidation), as well and corporate risk management using the products of financial engineering and innovations – derivative securities.

Topic One: Corporate Financing -Venture Capital

A large segment of the Tanzania's corporate sector is comprised of small and medium enterprises (SMEs) whose major problem, among others, is related to limited sources of long-term financing. This topic will introduce you to one of the potential, but seldom talked about, source of long term finance for young, high risk, high growth small and medium enterprises – venture capital.

After completing this topic you should be able to:

- Develop an understanding of the venture capital as a source of long term finance and identify the key roles that venture capital funding play in corporate financing;
- Discuss the venture capital process and identify the key sources of funding for venture capital investments;
- Discuss the key issues in selecting a venture capitalist and some of the realities involved;
- Identify some of the key rules for successful venture capital investments and the circumstances under which venture capitalists cash out on their investments; and
- Develop an overview of venture capital financing market in Tanzania.

Sub topics

- Sources of finance for small, high-growth companies
- Venture capital market and its role in corporate financing
- Target firms for venture capital financing
- The venture capital process
- Sources of funds for venture capital investments

- Attracting venture capital finance and choosing a venture capitalist
- Realities in venture capital financing
- Rules for successful venture capital investments
- When do venture capitalists cash out?
- Venture capital market in Tanzania.

References

Brealey, R. A. and Myers, S. C. (2003) *Principles of Corporate Finance* (7th edn), McGraw-Hill, Irwin, Boston

Joseph, G. C. (2002) *Analysis of Factors Affecting Accessibility of Small and Medium Enterprises to Venture Capital in Tanzania*, Unpublished MBA Dissertation, University of Dar es Salaam, Dar es Salaam.

Moyer, R. C., McGuigan, J. R., and Kretlow, W. J. (1995) *Contemporary Financial Management*, (6th edn), St. Paul, West Publishing Company.

Pandey, I. M. (1995) *Financial Management*, (Revised 6th edn), New Delhi, Vikas Publishing House Pvt Ltd.

Topic Two: Corporate Financing – Hybrid Securities

As corporation's growth continues, venture capitalist may cash out by allowing the enterprise to raise funds from the wider public – through equity (initial public offerings and seasoned equity offering e.g. via rights issues) or by issuing corporate debt. These issues were covered in an earlier course in corporate finance. Corporations wanting to raise funds through debt securities may also choose to use hybrid debt securities instead of simply using straight debt. This topic will introduce you to two of the most commonly used hybrid debt securities – convertible debt and warrants.

After you have completed this topic you should be able to:

- Understand how convertible debt and warrant securities work and their key features;
- Establish the theoretical value of convertible debt and warrant securities;
- Explain the relationship between the convertible debt's market value, investment value and conversion value;
- Identify the reason behind corporations' decision to issue hybrid securities instead of straight debt; and
- Compare convertible debt and warrants securities.

Sub-topics

Convertible debt

- The workings of convertible securities
- Key features of convertible securities
 - Conversion value
 - Conversion ratio

- Conversion premium
- Investment value
- Valuation of convertible debt securities
- Why do companies issue convertible debt securities

Warrants

- Key Features of Warrants
 - Exercise price
 - Exercise ratio
 - Expiration date
 - Detachability
 - Rights
- Valuation of warrants
- Why do companies issue warrants

Convertible debt securities vs. warrants

References

Brealey, R. A. and Myers, S. C. (2003) *Principles of Corporate Finance* (7th edn), McGraw-Hill, Irwin, Boston

Moyer, R. C., McGuigan, J. R., and Kretlow, W. J. (1995) *Contemporary Financial Management*, (6th edn), St. Paul, West Publishing Company.

Pandey, I. M. (1995) *Financial Management*, (Revised 6th edn), New Delhi, Vikas Publishing House Pvt Ltd.

Topic Three: Mergers, Acquisitions and market for Corporate Control

One of the most dramatic and controversial activity in corporate finance is the acquisition of one firm by another or the merger of two or more firms. These activities raise such questions as to what reasons are behind mergers and acquisitions and how do companies determine whether such acquisitions and or mergers are worthwhile. This topic is designed to introduce you to issues surrounding mergers and acquisition. It will also explore some defence tactics that shareholders or the target firms may use should they feel unhappy with the offer of the pursuing company

After your have learned this topic you should be able to:

- Develop an understanding of what mergers and acquisitions are and discuss their various forms;
- Identify the real motives for merger and acquisitions;
- Illustrate the methodology for evaluating costs and benefits of mergers and acquisitions;
- Understand the various defence tactics the targeted firms may use to fight approaching firms; and

- Reflect on some mergers and acquisition cases in Tanzania in the recent years.

Sub-topics

- Different forms of mergers and acquisitions
- Reasons (sensible and dubious) for Mergers and acquisitions
- Evaluating merger gains and costs
 - Mergers financed by cash
 - Mergers financed by shares
- Costs of and Gains from acquisition
- Takeovers and Defensive tactics
- Markets for Corporate Control
- Proxy contest
- Mergers and acquisition
- Divestitures and spin-offs
- Leveraged buyouts
- Some mergers and acquisition experiences in Tanzania

References

Brealey, R. A., Myers, S. C. and Marcus, A.J. (2001) *Fundamentals of Corporate Finance* (3rd edn), McGraw-Hill, Irwin, Boston, pages 567-596

Brealey, R. A. and Myers, S. C. (2003) *Principles of Corporate Finance* (7th edn), McGraw-Hill, Irwin, Boston, Chapter 33, pages 928-961

Firer, Colin; Stephen A. Ross; Randolph W Westerfield and Bradford D. Jordan (2005) *Fundamentals of Corporate Finance*, (3rd South African Edition) McGraw-Hill Companies, Berkshire UK., Chapter 24 pages 758 - 803

Ross, Stephen A.; Randolph W Westerfield and Bradford D. Jordan (2006) *Fundamentals of Corporate Finance*, 7th edition, McGraw-Hill – Irwin, Boston.

Topic Four: Corporate Restructuring, Business Failures and Reorganisation

As the firm grows, it may find it necessary to restructure. This can be done through a broad array of activities that include changes in ownership, asset structure, capital structure, etc. For example the preceding topic has focussed at mergers and acquisition as one of the ways in which corporations can restructure (growth cases). However, some businesses may experience severe and extended problems that might cause failure. This topic therefore provides an overview of business failures and the alternatives that are available to a failing business firm.

At the end of this topic you should be able to:

- Distinguish different forms of business failures (technically insolvent, legally insolvent and bankruptcy);
- Identify and describe the primary causes of business failures;
- Discuss the alternatives for a failing business; and
- Develop and understanding of how the reorganize vs. liquidate decisions are taken.

Sub topics

- What is business failure?
- Causes of Business Failures
- Alternatives (formal and informal) for failing businesses
- Corporate Reorganization
- Corporate liquidation
- Reorganize vs liquidate decisions

Moyer, Charles R. James R McGuigan and William J Kretlow (2001) *Contemporary Financial Management* (8th Edition), South-Western College Publishing

Topic Five: Risk Management: an Introduction to Financial Engineering and Derivative Securities

Prices of goods and services have become increasingly volatile in the recent years. Sudden and unexpected shifts in prices can create expensive disruptions in operating activities irrespective of how well the organisations are run. How then can firms shield themselves from price volatility? What financial products are there on the market that these firms can use to achieve such an objective? How do such products work? These questions and several related others are what this topic will try to tackle; aiming at introducing you to some of the basics of financial risk management using derivative instruments

After completing this topic you should be able to

- Understand what financial engineering and financial innovations are;
- Understand the role of financial engineering in corporate finance;
- Identify the factors that contributes to the growth of financial engineering;
- Define risk and price volatility;
- Identify some of the most common corporate risk exposures;
- Understand derivatives instruments, their features and payoffs; and
- Demonstrate an understanding of how some hedging strategies can be developed using derivative instruments

Sub-topics

- Financial engineering and innovations

- Growth of Financial engineering
- The role of financial engineering and innovation
- Derivative instruments (forward contracts, futures contracts, options and swaps)
- Price and rate volatility
- Risk and risk exposures
- Managing (hedging) risk with financial derivatives (forward contracts, futures contracts and option contracts)

References

Brealey, R. A. and Myers, S. C. (2003) Principles of Corporate Finance (7th edn), Boston, McGraw-Hill, Irwin, Chapter 1, p.3-9.

Brealey, R. A., Myers, S. C. and Marcus, A.J. (2007) Fundamentals of Corporate Finance (5th edn), Boston, McGraw-Hill, Irwin,

Kolb, Robert W., (2000): Futures, Options and Swaps, (3rd Edition) Blackwell Publishing Ltd, Oxford UK

Marshall, J. F. and Bansal V. K. (1992) Financial Engineering: A Complete Guide to Financial Innovation, Prentice Hall of India Private Limited, New Delhi

Ross, Stephen A.; Randolph W Westerfield and Bradford D. Jordan (2006) Fundamentals of Corporate Finance, 7th edition, McGraw-Hill – Irwin, Boston.

Winstone, D. (1995) Financial Derivatives: Hedging with Futures, Forwards, Options, and Swaps, 1st Edition, Chapman and Hall, London.

Course Evaluation

The course shall be evaluated as follows

Course work

• Two assignments	@ 7.5%	15%	
• Two timed tests	@12.5%	<u>25%</u>	
Total course work			40%
Final Examination	@60%		<u>60%</u>
Total			<u>100%</u>

Pass mark shall be 40% and no candidate shall be allowed to pass with coursework or final examination alone.

KEY RECOMMENDED READING LIST

Brealey, R. A. and Myers, S. C. (2003) Principles of Corporate Finance (7th edn), Boston, McGraw-Hill, Irwin, Chapter 1, p.3-9.

Brealey, R. A., Myers, S. C. and Marcus, A.J. (2001) *Fundamentals of Corporate Finance* (3rd edn), Boston, McGraw-Hill, Irwin, Chapter 1, p. 3-31.

Firer, Colin; Stephen A. Ross; Randolph W Westerfield and Bradford D. Jordan (2005) *Fundamentals of Corporate Finance*, (3rd South African Edition) McGraw-Hill Companies, Berkshire UK

Joseph, G. C. (2002) *Analysis of Factors Affecting Accessibility of Small and Medium Enterprises to Venture Capital in Tanzania*, Unpublished MBA Dissertation, University of Dar es Salaam, Dar es Salaam.

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Marshall, J. F. and Bansal V. K. (1992) *Financial Engineering: A Complete Guide to Financial Innovation*, Prentice Hall of India Private Limited, New Delhi

McMenamin, Jim (1999) *Financial Management: An Introduction*, Routledge, New York.

Moyer, R. C., McGuigan, J. R., and Kretlow, W. J. (1995) *Contemporary Financial Management*, (6th edn), St. Paul, West Publishing Company.

Pandey, I. M. (1995) *Financial Management*, (Revised 6th edn), New Delhi, Vikas Publishing House Pvt Ltd.

Ross, S. A., Westerfield, R. W. and Jaffe, J. F. (2002) *Corporate Finance*, (International 6th edn), New York, McGraw-Hill, Chapter 1, p. 2-19.

Ross, Stephen A.; Randolph W Westerfield and Bradford D. Jordan (2001) *Essentials of Corporate Finance*, McGraw-Hill Higher Education, New York, US

Van-Horne, J. (2002) *Financial Management and Policy*, (12th edn), Upper Saddle River, New Jersey, Prentice-Hall, Chapter 1, p. 2-19.

Winstone, D. (1995) *Financial Derivatives: Hedging with Futures, Forwards, Options, and Swaps*, 1st Edition, Chapman and Hall, London.