

FNCE 926
EMPIRICAL METHODS IN CORPORATE FINANCE
FALL 2013

Instructor: Professor Todd Gormley

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Class Times: Wednesday, 9:00 – 11:50 AM at SHDH-116

Office Hours: Tuesdays, 1:30-3:00 p.m., or by appointment.
(*Outside of the classroom, this is the best way to interact with me.*)

Course Websites: <http://wharton.instructure.com>

Teaching Assistant: Christina Dobridge dobridge@wharton.upenn.edu

Course Description: This course will provide students with a toolbox and working knowledge of cross-sectional and panel data empirical methods for use in corporate finance research. This will be accomplished by exposing the students to a variety of methods commonly employed in empirical research. Because of time constraints, not all widely used empirical methods will be covered.

The course is designed to help you learn these methods via a three-pronged approach.

- (1) Lectures and light econometric readings will help you learn the econometric intuition behind each method. This is not a theory course; this is a course for end-users of econometric tools. Accordingly, I will teach you how to use each tool properly, not how to derive its asymptotic properties.
- (2) Course readings will expose you to examples of the methods being used in published and working papers. Seeing how the tools are actually used by other researchers is often far more useful in helping students understand the tools. I will rely on examples from corporate finance when possible, though I will also reference examples from other fields in economics including: labor, development, and public finance.
- (3) Course assignments will require you to use the methods analyzed in the course; i.e. you will learn by doing. There will be a number of exercises that will have you manipulate and analyze data using the various econometric techniques, and there will be assignments where you analyze and criticize other researchers' use of these tools. Since this is a finance course, the applications will typically be corporate finance related.

Reading Materials: I will teach from slides, which I will make available to you before each class on the course website, Canvas. I will be drawing from a variety of sources including various textbooks, journal articles, working papers, and other professors' lecture notes. As such, there is no required "textbook," but I will make note of the appropriate references for each lecture. The relevant methodology readings for each lecture are provided at the bottom of this syllabus, and students are expected to read these prior to the lecture. Additionally, most lectures will contain student presentations of three papers related to the previous week's lecture topic. A list of papers to be presented is given below.

Prerequisites: You should have taken a graduate sequence in econometrics. Practically speaking, you should be comfortable with econometrics at the level of William Greene's *Econometric Analysis* and Jeffrey Wooldridge's *Econometric Analysis of Cross-Section and Panel Data*.

Coursework: There will be three graded components to the course. These are designed to help you learn the econometric tools used in the literature while also preparing you for a successful career in academic research. The three assignments are as follows:

1. Empirical exercises

You will be asked to download data and write code to implement some of the tools taught in the course. The four exercises are designed to teach you how to actually use these tools. It's one thing to learn about a difference-in-difference-in-difference estimation and another thing to actually estimate one. The assignments will be completed in Stata, and to receive credit for the assignment, you will e-mail me your DO file, which I will run on a dataset to check whether your programming and regressions are correct.

2. In-class presentations/discussions

For many classes, there will be two to three papers assigned that students (regardless of whether you are just auditing) must read and present a discussion of in-class. Students will form groups of their own choosing, and we will assign each group their paper in the week ahead. E.g. If I give a lecture on instrumental variable estimations, then at the end of the lecture, I will assign three papers that make use of IV strategies. Students will present their discussions of these three papers in the second half of the next class. Each group will need to make a 10-12 minute PowerPoint presentation that discusses the paper, and each presentation will be followed by in-class discussion. The purpose of the assignment is twofold: (1) Presentations are one key way people in academia will come to know (and assess) you. So, it's a good idea to get some practice now. And (2), this will help you apply and think critically about the empirical tools discussed in the previous lecture.

To ensure participation following each presentation, each group must also type up one concern they had about each of the two papers their group did NOT present and hand these in at the start of class. Your group will state this concern at the start of the discussion. The comments should be very short [2-3 sentences] and designed to do one of two things: (1) isolate what your group

thought the biggest problem of the paper was, or (2) identify a concern you think the presenting group might overlook.

3. Write a research proposal

Basically, you will be asked to sketch out an outline for a possible empirical paper you could write using tools taught in the course. You'll need to come up with an interesting question, place your question in the relevant literature, sketch out an identification strategy for answering that question, and identify the necessary datasets to implement your identification strategy. If you want, you can think of this as a possible start to your eventual second year paper. You will also give a 10 minute presentation of your proposal in class towards the end of the semester. This presentation will help you gather feedback from classmates.

Presentation Groups: The class will be organized into three presentation groups, which will each give a presentation during lectures that include student presentations of related research papers. You are free to choose your own members. I just recommend that you split yourselves into three roughly equal-sized groups. We will choose our groups in the very first lecture, but students are free to change groups later on if needed.

Limitations: Time limitations impose certain restrictions on what we can accomplish in this course. For example, we will not cover all of the methods you might need or should know. We also will not cover each method in excruciating detail. Arguably, you could build an entire course (research agenda) around each method.

Canvas: Important course materials, such as lecture notes, required assignments, and other useful information will be available on the course web page at Canvas: <http://wharton.instructure.com>. You will also use this website to turn in all of your exercises & research proposals.

Questions: Please, just ask. I don't anticipate that everything I say in class or my lecture notes will be crystal clear. So, if something is confusing, please just ask me. I can't guarantee to always have an immediate answer, especially for questions of a more technical nature, but I promise to always find one and get back to you.

Participation: You will be graded on participation. Basically, I expect each student to give in-class presentations during the semester and help his/her group come up with comments on each paper. (You will be working in groups to write the presentation, but ultimately, only one of you gets up to give the presentation each week.) You should consider yourself likely to get "full participation credit" if you split the presentations equally among group members and are clearly reading the assigned papers and involved in class discussions. But, failure to do presentations or to be actively engaged in the discussions will result in a lower grade.

Final Exam: There will be a final exam in the last class period.

Grading: You should not be too worried about your grade; instead, you should focus on learning the tools taught in this course. Using these tools to write a solid job market paper and dissertation is far more important than your actual grade. When you're on the job market, no one will care what grade you got in your PhD courses. Instead, you should view your grade in this course as a signal of where I think you stand in terms of your understanding and ability to apply the tools of this course.

Your grade for the course will be determined by participation, research proposal, empirical exercises, and an exam. There will be a total of 150 points available, and the points are allocated as follows:

Empirical Exercises	20 points (i.e. 5 points each)
In-Class Discussions/Participation	20 points
Rough Draft of Research Proposal	15 points
Presentation of Research Proposal	10 points
Research Proposal	35 points
Final Exam	50 points

Grades are *non-negotiable*, and the quality of your work is a matter left to the course instructor's judgment. If you have a question about feedback or an assigned grade, please ask.

Code of Ethics: What follows is the boiler plate statement I give in my MBA and undergraduate students; I don't expect they need to be said for PhD students... "I take the matters of academic integrity seriously and expect that you do, too. Submitted assignments for grading should be your own work only. Failure to observe this rule, will at a minimum, result in receiving zero points on that assignment, and may result in an automatic failing grade for the course and referral to the Office of Student Conduct. Refer to the Code of Academic Integrity if you have any questions."

Office Hours and E-mail: If you have any questions or need assistance, please visit me during my office hours. If you are unable to make my office hours, just e-mail me so that we can arrange a mutually convenient time to meet in my office. You may also send me questions via e-mail.

Class Schedule: The tentative class schedule is below. The topics covered and the date in which they are covered may change, but if this occurs, I will notify you of any changes.

Gormley versus Roberts: I've had students ask me how my course will compare to the previous version of this course taught by Michael Roberts. (I assume they are trying to figure out whether to sit in on it or not). The courses will be similar; Michael was kind enough to share his notes with me, and I will be working off them. But, the courses will also be different. I'll give more focus to some issues and less to others. I will also be assigning a number of different papers for the in-class presentations than he did.

SCHEDULE OF CLASSES

Class # (Date)	Lecture Topic (for first half of class on days with student presentations)	Student Presentation Topic (for second half of class)	Assignments due
1 (08/28)	Introduction Basics on Linear Regression		
2 (09/04)	Linear Regression continued...	Classics #1	
3 (09/11)	Causality	Classics #2	<i>Exercise #1 due</i>
4 (09/18)	Panel Data	Causality	
5 (09/25)	Instrumental Variables	Panel Data	<i>Exercise #2 due</i>
6 (10/02)	Natural Experiments #1	Instrumental Variables	
7 (10/09)	Natural Experiments #2	Natural Experiments #1	<i>Exercise #3 due</i>
8 (10/16)	Regression Discontinuity	Natural Experiments #2	
9 (10/23)	Common Limitations & Errors	Regression Discontinuity	<i>Rough draft of research proposal due</i>
10 (10/30)	Matching	Common Limitations & Errors	
11 (11/06)	Standard Errors & Clustering Limited Dependent Variables	Matching	<i>Exercise #4 due</i>
12 (11/15)	Structural Estimation <u>Special time: Friday, 1:30-4:30 p.m.,</u> Location = SHDH 1201 (Lecture given by Professor Taylor)	Review & Miscellaneous	
13 (11/20)	In-class student presentations of research proposals & review		<i>In-class presentations of preliminary proposals</i>
14 (12/04)	<u>In-Class Final Exam</u>		
15 (12/11)			<i>Final draft of research proposal due at noon</i>

IN-CLASS STUDENT PRESENTATION PAPERS

Below is the list of readings to be presented in class by students. All students are expected to read these papers, and groups will need to select one to present. Groups cannot choose the same paper to present. I've broken down the papers into "Topics". The "Topic" corresponds to the schedule of classes which week the papers will be presented. We will assign the groups to present each paper in the week prior to the lecture.

Classics #1

1. La Porta, Rafael, Florencio Lopez-de-Silanes, Andrei Shleifer, and Robert Vishny, 1998, "Law and finance," *Journal of Political Economy* 106, 1113-1155.
2. Berger, P., and Eli Ofek, 1995, "Diversification's Effect on Firm Value," *Journal of Financial Economics* 37, 39-65.
3. Kaplan, Steve, 1989, "The effects of management buyouts on operating performance and value," *Journal of Financial Economics* 24, 217-254.

Classics #2

4. Fazzari, Steven M., R. Glenn Hubbard and Bruce C. Petersen, 1988, "Financing Constraints and Corporate Investment," *Brookings Papers on Economic Activity*, 141-195.
5. Morck, Randal, Andrei Shleifer, and Robert Vishny, 1990, "The Stock Market and Investment: Is the Market a Sideshow?" *Brookings Papers on Economic Activity*, 157-215.
6. Opler, Timothy, Larry Pinkowitz, and Rene Stulz, 1999, "The determinants and implications of corporate cash holdings," *Journal of Financial Economics* 14, 1059-1082.

Causality

7. Rajan, Raghuram G., and Luigi Zingales, 1998, "Financial dependence and growth," *American Economic Review*, 88(3), 559-586.
8. Becker, Bo, Zoran Ivkovic, and Scott Weisbenner, 2011, "Local dividend clienteles," *Journal of Finance*, 66(2), 655-683.
9. Agarwal, Ashwini, and David A. Matsa, 2013, "Labor unemployment risk and corporate financing decision," *Journal of Financial Economics*, forthcoming.
<http://ssrn.com/abstract=1667035>

Panel Data

10. Khwaja, Asim Ijaz, and Atif Mian, 2008, "Tracing the Impact of Bank Liquidity Shocks: Evidence from an Emerging Market," *American Economic Review*, 98(4), 1413-1442.

11. Lemmon, Michael, Michael R. Roberts, and Jaime F. Zender, 2008, Back to the beginning: Persistence and the cross-section of corporate capital structure, *Journal of Finance* 63, 1575-1608.
12. Graham, John R., Si Li, and Jiaping Qiu, 2012, "Managerial attributes and executive compensation," *Review of Financial Studies*, 25, 144-186.

Instrumental Variables

13. Gormley, Todd A., 2010, "The impact of foreign bank entry in emerging markets: evidence from India," *Journal of Financial Intermediation*, 19(1), 26-51.
14. Bennedsen, M., K Nielsen, F. Perez-Gonzalez, and D. Wolfenzon, 2007, Inside the family firm: The role of families in succession decisions and performance, *Quarterly Journal of Economics*, 122, 647-691.
15. Giroud, Xavier, Holger M. Mueller, Alex Stomper, and Arne Westerkamp, 2012, "Snow and leverage," *Review of Financial Studies*, 25, 680-710.

Natural Experiments #1

16. Jayaratne, Jith, and Philip Strahan, 1996, "The finance-growth nexus evidence from bank branch deregulation," *Quarterly Journal of Economics*, 111(3), 639-670.
17. Bertrand, Marianne, and Sendhil Mullainathan, 2003 "Enjoying the quiet life? Corporate governance and managerial preferences," *Journal of Political Economy*, 111(5), 1043-75.
18. Hayes, Rachel M., Michael Lemmon, and Mingming Qiu, 2012, "Stock options and managerial incentives for risk taking: evidence from FAS 123R," *Journal of Financial Economics*, 105, 174-190.

Natural Experiments #2

19. Gormley, Todd A., and David Matsa, 2011, "Growing Out of Trouble? Corporate Responses to Liability Risk," *Review of Financial Studies*, 24(8), 2781-2821.
20. Becker, Bo, and Per Stromberg, 2012, "Fiduciary Duties and Equity-Debtholder Conflicts." *Review of Financial Studies* 25(6), 1931-1969.
21. Agrawal, Ashwini, 2013, "The impact of investor protection law on corporate policy and performance: evidence from the blue sky laws," *Journal of Financial Economics*, 107, 417-35.

Regression Discontinuity

22. Crane, Alan, Sebastien Michenaud, and James P. Weston, 2012, "The Effect of Institutional Ownership on Payout Policy: A Regression Discontinuity Design Approach," working paper. <http://ssrn.com/abstract=2102822>

23. Keys, Benjamin, Ranmoy Mukherjee, Amit Seru, and Vikrant Vig, 2010, Did securitization lead to lax screening? Evidence from subprime loans, *Quarterly Journal of Economics* 125, 307-362.
24. Fracassi, Cesare, Mark J. Garmaise, Shimon Kogan, and Gabriel Natividad, 2013, “How much does credit matter for small business success in the United States?” working paper, <http://ssrn.com/abstract=2157707>.

Common Limitations & Errors

25. Giroud, Xavier, and Holger Mueller, 2010, “Does corporate governance matter in competitive industries?” *Journal of Financial Economics*, 95, 312-331.
26. Ljungqvist, Alexander, Christopher Malloy, and Felicia Marston, 2009, “Rewriting history,” *Journal of Finance*, 64(4), 1935-1960.
27. Bennedsen, Morten, Francisco Perez-Gonzalez, and Daniel Wolfenzon, 2012, “Evaluating the Impact of the Boss: Evidence from CEO Hospitalization Events”, working paper, <http://www.stanford.edu/~fperezg/valueboss.pdf>

Matching

28. Morse, Adair, 2011, “Payday lenders: heroes or villains?” *Journal of Financial Economics*, 102, 28-44.
29. Colak, Gonul and Toni Whited, 2007, Spin-offs, divestitures, and conglomerate investment, *Review of Financial Studies* 20, 557-595.
30. Lemmon, Michael and Michael R. Roberts, 2010, “The response of corporate financing and investment to changes in the supply of credit,” *Journal of Financial and Quantitative Analysis*, 45(3), 555-587.

Review & Miscellaneous

31. Heider, Florian and Alexander Ljungqvist, 2012, “As certain as debt and taxes: Estimating the tax sensitivity of leverage from exogenous state tax changes,” working paper, <http://ssrn.com/abstract=2024200>
32. Ponticelli, Jacopo, 2013, “Court enforcement and firm productivity: Evidence from bankruptcy reform in Brazil,” working paper, <http://ssrn.com/abstract=2179022>.
33. Campello, Murillo, Antonio F. Galvao, and Ted Juhl, 2013, “Policy heterogeneity in empirical corporate finance,” working paper, <http://ssrn.com/abstract=2250772>.

METHODOLOGY READINGS FOR EACH TOPIC

For each lecture, I've listed some readings that will be helpful with understanding the methodology being discussed. My lectures will be largely based off of these readings, and students are expected to read these papers prior to the lecture. The lectures primarily draw from the four below sources, and I've provided abbreviations that will be used to refer to each.

1. Wooldridge, Jeffrey M., 2010, *Econometric Analysis of Cross-Section and Panel Data*, MIT Press, Massachusetts, Second Edition [**Wooldridge**]
2. Greene, William H., 2011, *Econometric Analysis*, Prentice Hall, N.J., Seventh Edition. [**Greene**]
3. Angrist, Joshua D., and Jorn-Steffen Pischke, 2009, *Mostly Harmless Econometrics*, Princeton University Press, New Jersey. [**Angrist-Pischke**]
4. Roberts, Michael R., and Toni M. Whited, 2011, "Endogeneity in Empirical Corporate Finance," University of Rochester, working paper, <http://ssrn.com/abstract=1748604> [**Roberts-Whited**]

Linear Regression

1. Angrist-Pischke, Sections 3.1-3.2, 3.4.1
2. Wooldridge, Sections 4.1-4.2
3. Greene, Chapter 3 & Sections 4.1-4.4, 5.7-5.9, 6.1-6.2

Causality

1. Roberts-Whited, Section 2
2. Angrist-Pischke, Section 3.2
3. Greene, Sections 5.8-5.9
4. Wooldridge, Sections 4.3, 4.4

Panel Data

1. Angrist-Pischke, Sections 5.1, 5.3
2. Greene, Chapter 11
3. Wooldridge, Chapter 10
4. McKinnish, T. 2008. *Panel Data Models and Transitory Fluctuations in the Explanatory Variable In Modeling and Evaluating Treatment Effects in Econometrics*, eds. Daniel L. Millimet, Jeffrey A. Smith, and Edward J. Vytalacil, 335–58. Amsterdam: Elsevier.

Instrumental Variables

1. Roberts-Whited, Section 3
2. Angrist-Pischke, Sections 4.1, 4.4, 4.6
3. Greene, Sections 8.2-8.5
4. Wooldridge, Chapter 5

Natural Experiments

1. Roberts-Whited, Sections 2.2 and 4
2. Angrist-Pischke, Section 5.2
3. Bertrand, M., E. Duflo, and S. Mullainathan. 2004. How Much Should We Trust Differences-in-Differences Estimates? *Quarterly Journal of Economics* 119:249–75.

Regression Discontinuity

1. Roberts-Whited, Section 5
2. Angrist-Pischke, Chapter 6

Common Limitations & Errors

1. Ali, A., S. Klasa, and E. Yeung, 2009, “The limitations of industry concentration measures constructed with Compustat Data: Implications for finance research,” *Review of Financial Studies*, 22(10), 3839-71
2. Gormley, Todd A., and David A. Matsa, 2013, “Common Errors: How to (and Not to) Control for Unobserved Heterogeneity,” *Review of Financial Studies*, forthcoming.
<http://ssrn.com/abstract=2023868>

Matching

1. Roberts-Whited, Section 6
2. Angrist-Pischke, Sections 3.3.1-3.3.3
3. Wooldridge, Section 21.3.5

Standard Errors, Limited Dependent Variables

1. Angrist-Pischke, Chapter 8 and Sections 3.4.2, 4.6.3
2. Petersen, M. A. 2009. Estimating Standard Errors in Finance Panel Data Sets: Comparing Approaches. *Review of Financial Studies* 22:435–80.
3. Bertrand, M., E. Duflo, and S. Mullainathan. 2004. How much should we trust differences-in-differences estimates? *Quarterly Journal of Economics*, 119(1): 249-275.
4. Greene, Section 17.3

Structural Estimation

1. Strebulaev, Ilya A., and Toni M. Whited, 2012, “Dynamic Models and Structural Estimation in Corporate Finance,” working paper, <http://ssrn.com/abstract=2091854>