

Fall 2020 PhD Course

Financial Theory II, Part 2 (1.5 credits)

Instructor: Viral V Acharya, Department of Finance, NYU Stern

Timings: 12 noon to 2:45 PM (November 2, 16, and 30)

Timings: 12 noon to 3:15 PM (November 9, 23, and December 7)

Tentative Outline (a few papers to be discussed and related literature may be updated)

The focus of the course will be on theoretical models of corporate liquidity management (cash and lines of credit) in normal times and under stress; information frictions (corporate disclosures, income smoothing, risk-shifting, etc.), corporate governance (internal and external) and governance externalities; and, the role of funding problems (agency issues, market freezes) in financial crises. Some relevant empirical evidence will also be discussed as motivating facts.

Format: Each class will consist of presentations by me with expectation that students would read the key papers before the class and be able to engage in informed conversations about the topic and the models being presented.

Evaluation: Each student will be required to write **three referee reports** during the course. The six candidate papers as options for writing referee reports that provide **critical and objective evaluation** are marked with (*) below. Referee reports can focus on just the theoretical aspects of the paper, i.e., the model, although students are free to also comment on the empirical parts if they wish. **The first report will be due by Nov 16, the second by Nov 30, and the third by Dec 14.** The final grade of each student will be based on the assessment of the three referee reports (30% weight each) and the quality of class participation (10% weight). Referee report expectations will be discussed in first class.

Week by week course plan

1. Corporate liquidity management in normal times and under stress:

Week 1 (November 2: 12 noon to 2:45 PM):

- **“The Cash Flow Sensitivity of Cash” by Heitor Almeida, Murillo Campello and Michael S. Weisbach**, *The Journal of Finance*, [Vol. 59, No. 4 \(Aug., 2004\)](#), pp. 1777-1804
- **"Is Cash Negative Debt? - A Hedging Perspective on Corporate Financial Policies"** *Journal of Financial Intermediation*, 16(4), 2007, 515-554 (Viral V Acharya, Heitor Almeida and Murillo Campello)
[Download PDF](#) (May 2006 version)

- (*) **"The Sensitivity of Cash Savings to the Cost of Capital"** (Viral V Acharya, Soku Byoun and Zhaoxia Xu), Working Paper, NYU Stern, June 2020
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Week 2 (November 9: 12 noon to 3:15 PM):

- **"Aggregate Risk and the Choice between Cash and Lines of Credit"** (Viral V Acharya, Heitor Almeida and Murillo Campello), *Journal of Finance*, 2013, 68, 2059-2116.
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- **"Credit Lines as Monitored Liquidity Insurance: Theory and Evidence"** (Viral V Acharya, Heitor Almeida, Filippo Ippollito and Ander Perez), *Journal of Financial Economics*, 2014, 112, 287-319.
[Download PDF](#)
- **"Banks as Liquidity Providers: An Explanation for the Coexistence of Lending and Deposit-taking"** by [Anil K. Kashyap](#), [Raghuram Rajan](#) and [Jeremy C. Stein](#), *Journal of Finance*, 2002, <https://doi.org/10.1111/1540-6261.00415>

Week 3 (November 16: 12 noon to 2:45 PM):

- **"Cash Holdings and Credit Risk,"** (Viral V Acharya, Sergei Davydenko and Ilya Strebulaev), 2012, *Review of Financial Studies*, 25(12), 3572-3609
[Download PDF](#)
- (*) **"Efficiency or Resiliency? Choosing between Operational and Financial Hedging"** (Viral V Acharya, Heitor Almeida, Yakov Amihud and Ping Liu) – Work in Progress

Related readings for Weeks 1-3:

- (*) **"Leverage Dynamics and Financial Flexibility,"** Patrick Bolton, Neng Wang and Jinqiang Yang, Working Paper, Columbia University
- **"Credit Lines and the Liquidity Insurance Channel"** (Viral V Acharya, Heitor Almeida, Filippo Ippolito and Ander Perez), *forthcoming, Journal of Money, Credit and Banking*.
[Download PDF](#)
- **"Bank Lines of Credit as Contingent Liquidity: Covenant Violations and their Implications"** (Viral V Acharya, Heitor Almeida, Filippo Ippolito and Ander Perez), *forthcoming, Journal of Financial Intermediation*.
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2. Information-theoretic issues:

Week 4 (November 23: 12 noon to 3:15 PM):

- [EFFICIENT CAPITAL MARKETS, INEFFICIENT FIRMS: A MODEL OF MYOPIC CORPORATE BEHAVIOR](#) by JEREMY C. STEIN, Quarterly Journal of Economics, 1989
- "A Theory of Income Smoothing when Insiders Know More than Outsiders" (Viral V Acharya, Bart Lambrecht), *Review of Financial Studies*, 2015, 28: 2534-2574.
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- "Seeking Alpha: Excess Risk Taking and Competition for Managerial Talent" (Viral V Acharya, Marco Pagano and Paolo Volpin), *Review of Financial Studies*, 2016, 2565-2599 (lead article)
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Related readings:

- "Endogenous Information Flows and the Clustering of Announcements" *American Economic Review*, 2011, 101(7), 2955-79 (Viral V Acharya, Peter DeMarzo and Ilan Kremer)
[Download PDF](#)
- "Counterparty risk externality: Centralized versus over-the-counter markets" (Viral V Acharya, Alberto Bisin), *Journal of Economic Theory*, 2014, 149, 153-182.
[Download PDF \(March 2013 version\)](#)
- (*) "[Commitment in Organizations and the Competition for Talent](#)" by Thomas Cooley, Ramon Marimon and Vincenzo Quadrini, forthcoming, *Review of Economic Studies*

3. Internal governance and governance externalities:

Week 5 (November 30: 12 noon to 2:45 PM):

- "The Internal Governance of Firms," *Journal of Finance*, 66(3), 2011, 689-720 (lead article) (Viral V Acharya, Stew Myers and Raghuram Rajan)
[Download PDF](#) (September 2010 version) [Online Appendix](#)
- "Corporate Governance Externalities" *Review of Finance*, 14(1), 2010, 1-33 (lead article, Viral V Acharya and Paolo Volpin)
[Download PDF](#) (August 2008 version)

Related readings:

- (*) **"A Model of Infrastructure Financing"** (Viral V Acharya, Cecilia Parlato and Suresh Sundaresan), September 2020
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- **"Competition for Managers and Corporate Governance"** (Viral V Acharya, Marc Gabarro and Paolo Volpin), Working Paper, NYU Stern, May 2018

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4. The Role of Funding Problems in Financial Crises

Week 6 (December 7: 12 noon to 3:15 PM):

- **"Rollover Risk and Market Freezes"**
Journal of Finance, 66, 2011, 1175-1207 (Viral V Acharya, Douglas Gale and Tanju Yorulmazer)
[Download PDF](#) (October 2010 version)
- **"Leverage, Moral Hazard and Liquidity"**
Journal of Finance, 66, 2011, 99-138 (Viral V Acharya, S. Viswanathan)
[Download PDF](#) (Mar 2010 version)
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Related readings:

- (*) **"Bankruptcy Exemption of Repo Markets: Too Much Now for Too Little Tomorrow?"** (Viral V Acharya, Ravi Anshuman and S. Viswanathan), Work in Progress, NYU Stern
- **"A Model of Liquidity Hoarding and Term Premia in Inter-Bank Markets,"** (Viral V Acharya, David Skeie), *presented at the Carnegie Rochester Conference Series on Public Policy, November 2010, and published in the Journal of Monetary Economics*, 2011, 58(5), 436-447.
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