

Course Descriptions None 2015-2016

Course Title Capstone Assignment IBE Finance Topic 2
 Course Code CAP3007
 ECTS Credits 4,0
 Assessment None

Period	Start	End	Mon	Tue	Wed	Thu	Fri
3	11-1-2016	22-1-2016					

Level Intermediate

Coordinator Finance staff For more information:capstone-fin-sbe@maastrichtuniversity.nl

Language of instruction English

Goals For more information and regulations about the capstone assignment, please refer to EleUM>My SBE - Before and after graduation - Capstone assignment

Description Convertible debt: what is the role of the call provision?
 The use of convertible debt as a hybrid way to finance the company represents a way to control its capital structure contingent on its future borrowing needs. By writing off debt and issuing new equity upon conversion, the firm can regain financial flexibility when it needs additional funding for its expansion. Unfortunately, the optimal conversion policy for debtholders is usually to wait until the maturity of the issue to decide whether to convert or not. This makes it impossible for the company to control the timing of conversion, and reduces much of the attractiveness of such investment vehicles. This is the reason why, historically, many issuers have included a call provision (i.e. the option to call the issue before maturity) in the convertible package. As already recognized by Ingersoll in the seventies, based on a strict option valuation approach, the optimal behaviour of the firm is to call the issue as soon as the option to convert becomes valuable, and the optimal response of the bondholders is to voluntarily convert their claim as a consequence. Nevertheless, there is ample evidence that the timing of the call does not obey this rule, and in particular that convertible debt issues appear to be called much later than prescribed by the theory.
 For this capstone, briefly explain the mechanics of the callable convertible debt contract before answering the following question with respect to the relations between convertible debtholders and the company: What are the potential motivations for issuing convertible debt? What drives the firm's call policy and to what extent is it consistent with these motivations? How do the stock and bond markets typically react to a call, and how does this relate to asymmetric information issues? Do you think that, in general, convertibles are called too late? Answer these questions from a conceptual point of view based on corporate governance theory but also consider empirical evidence. In addition to the literature listed below, make sure that you review at least 5 additional articles of your own choice. For these, please provide correct references.

Literature Bühler, W. and Koziol, C., 2002. Valuation of convertible bonds with sequential conversion, Schmalenbach Business Review 54, 302-334.

Hennessy, C. and Tserlukevich, Y., 2008. Taxation, agency conflicts, and the choice between callable and convertible debt, Journal of Economic Theory 143, 374-404.

Ingersoll, J., 1977, An examination of corporate call policies on convertible securities, Journal of Finance 32, 463-478.

Korkeamaki, T. P. and Moore, W. T., 2004, Convertible bond design and capital investment: The role of call provisions, Journal of Finance 54, 391--405.

Prerequisites

Teaching methods

Assessment methods

Final Paper

Evaluation in previous academic year

For the complete evaluation of this course please click <http://iwio-sbe.maastrichtuniversity.nl/rapporten.asp?referrer=codeUM>

This course belongs to the following programme / specialisation

Bachelor Economics and Business Economics Capstone Assignment
 Specialisation International Business Economics