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How to choose a capital structure: Navigating the Debt-Equity Decision

Anil Shivdasani and Marc Zenner, *Journal of Applied Corporate Finance* [[view executive summary below](#)]

Creating value with M&A

Anil Shivdasani, Marc Zenner, and Todd Hazelkorn, forthcoming, *Journal of Applied Corporate Finance* [[view executive summary below](#)]

Best Practices in Corporate Governance

Anil Shivdasani and Marc Zenner, forthcoming, *Journal of Applied Corporate Finance* [[view executive summary below](#)]

"Treasury Bond and Note Futures: How the Delivery Option Affects the Contract's Pricing and Hedging Characteristics", Richard Rendleman, *The Journal of Fixed Income*, September 2004 [[view executive summary below](#)]

"A General Model for Hedging Swaps with Eurodollar Futures", Richard Rendleman, *The Journal of Fixed Income*, June 2004 [[view executive summary below](#)]

"Interpolating the Term Structure from Par Yield and Swap Curves", Richard Rendleman, *The Journal of Fixed Income*, March 2004 [[view executive summary below](#)]

How to choose a capital structure: Navigating the Debt-Equity Decision

Anil Shivdasani and Marc Zenner

Few financial decisions have as significant an impact on a company's equity value and future livelihood as the management of its capital structure and credit ratings. Companies manage capital structure through debt or equity issuance, debt or equity repurchases, dividend increases, acquisitions, new investments, and risk management. Since the Nobel Prize-winning work of Miller and Modigliani in the late 1950s, finance academics have spent considerable time and energy in identifying what does and does not matter in capital structure decisions. Yet today there is still significant debate about costs and benefits of a more or a less levered capital structure and the correspondent credit rating. Every day, highly rated companies wonder whether they should use their financial flexibility to lever up and buy back shares, and low-rated firms consider financing strategies to preserve or strengthen their credit rating.

Underlying the diversity of corporate credit ratings is a disparity of views among corporate executives and directors about the "right" credit rating. As a result, the capital structure decision can be a perplexing one for many companies. In this article, we summarize some of the views that are often advanced for a target credit rating and offer our own observations. Our views reflect both our familiarity with a large body of academic work as well as considerable experience addressing the practical considerations typically encountered by companies. We conclude by outlining a series of capital structure issues that many companies will want to consider in 2005.

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Creating Value with Mergers and Acquisitions

by Anil Shivdasani (UNC), Todd Hazelkorn and Marc Zenner (Citigroup)

A key issue in any M&A transaction is whether the transaction is likely to create value for the shareholders of the acquiring firm. What matters is whether the stock market reacts positively to the transaction in the short run and, more importantly, whether the acquirer's stock outperforms its peers in the long run. This article describes the track record of the U.S. acquirors over the past 12 years and the factors that have differentiated successful transactions from those judged unfavorably by equity investors.

Several studies have investigated whether acquisitions create value, and the prevailing view is that while the target shareholders generally fare pretty well, most acquisitions fail to create value for acquirors. For example, a *Business Week* report was tellingly entitled "The Merger Hangover: How Most Big Acquisitions Have Destroyed Shareholder Value" (October 12, 2002). But that report focused on equity-financed acquisitions of public companies. By ignoring cash-financed transactions and acquisitions of private companies (or business units of public companies), both of which are value-creating transactions on average, the *Business Week* report presented a distorted view of acquisition success. Further, there is huge variation in acquisition outcomes, from very positive to very negative, which suggests that acquisition execution can play a significant role in creating value.

Forthcoming in Journal of Applied Corporate Finance



Best Practices in Corporate Governance: What Two Decades of Research Reveals
by Anil Shivdasani (UNC), and Marc Zenner (Citigroup)

The quality of corporate governance can be an important driver of shareholder value. Companies with strong governance systems have outperformed peers in a wide range of settings. The composition and structure of corporate boards is instrumental in determining companies' ability to cope and react to CEO succession, the pursuit of acquisition opportunities, takeover bids, and declines in operating performance. The independence of the audit, compensation, and nominating committees significantly affects the quality of governance. Executive ownership in the form of common stock and/ or stock options enhances decision-making and increases shareholder value in most instances. Stock options have increasingly become a part of director compensation, and this trend has had a positive effect on value. Shareholder activists have frequently challenged antitakeover provisions, but these provisions do not necessarily reduce shareholder value.

Forthcoming in Journal of Applied Corporate Finance

***"Interpolating the Term Structure from Par Yield and Swap Curves"*, Richard Rendleman, The Journal of Fixed Income, March 2004**

The problem of valuing interest-dependent securities depends upon accurate estimation of the term structure of interest rates, especially when the cash flows of the securities being valued do not fall on the same dates as the cash flows of the instruments from which the term structure is estimated. Previously published interpolation methods smooth par yields of bonds (or swaps) and then employ the bootstrap method to estimate zero-coupon present value factors. With this approach, when the securities being valued are re-priced using the estimated present value factors, the security prices so obtained will not equal the original prices. By contrast, the interpolation methodology presented in this article operates directly on prices rather than par yields. The methodology guarantees that when the securities from which the present value factors are derived are re-priced using interpolated present value factors, the original set of security prices will be returned. The method is tested using hypothetical term structures and related bond prices generated by the Longstaff-Schwartz model and shown to be very accurate in returning present value factors that are almost identical to their theoretically correct values.

***"A General Model for Hedging Swaps with Eurodollar Futures"*, Richard Rendleman, The Journal of Fixed Income, June 2004**

This article presents a general model for hedging LIBOR-based swaps with Eurodollar futures. Drawing on the cubic spline interpolation methodology of Rendleman ([Journal of Fixed Income](#), March 2004), the hedging model automatically reflects timing differences between futures maturities and swap payment dates, the actual maturities of the three-month Eurodollar deposits that underlie each futures contract and the convexity bias defining the difference between Eurodollar futures and forward rates. The model also allows futures with overlapping maturities to be used in hedging rather than limiting hedging to contracts that are part of the regular March, June, September, December maturity cycle. Using daily futures prices and swap rates, the model is tested for calendar year 2001 for both a single swap and a swap book and is shown to be very effective in hedging the interest rate risk of LIBOR-based swaps.

***"Treasury Bond and Note Futures: How the Delivery Option Affects the Contract's Pricing and Hedging Characteristics"*, Richard Rendleman, forthcoming, The Journal of Fixed Income**

This article employs the Black, Derman and Toy model to determine the equilibrium Treasury Bond futures price in terms of the option to deliver one of many eligible bonds. The model is then used to determine the appropriate quantity of Treasury Bond futures required for hedging the bond identified initially as being cheapest-to-deliver. If interest rates are close to 6 percent (the rate employed for determining Treasury Bond futures conversion factors), the proper hedging quantity can differ significantly from a more standard duration-based quantity that ignores the option to switch delivery to a more optimal bond. On the other hand, if interest rates are significantly different than 6 percent, the option to switch will have little, if any, value, and hedging quantities that ignore the option to switch will be much more accurate.