5th Seminar assignment in ECON 4245, week 42 (15-19 Oct)

A. Brander and Lewis' model

1. Show that: (you need Leibniz' formula)

$$V^i_{iD_i} = V^i_{i\hat{z}_i} \frac{d\hat{z}_i}{dD_i}$$

2. What are the key elements/reasons for why some debt is good in Cournot duopoly?
   a. First explain thoroughly in words.
   b. Then show the most important equations/algebra.
   c. In particular, discuss and explain:

$$Y^i_{D_i} = \left[\int_{\underline{z}}^{\hat{z}_i} R^i_i(q_i, q_j, z_i) f(z_i) dz_i \right] \frac{dq_i}{dD_i}$$

$$+ \left[\int_{\hat{z}_i}^{\overline{z}} R^i_i(q_i, q_j, z_i) f(z_i) dz_i \right] \frac{dq_i}{dD_i}$$

$$+ \left[\int_{\underline{z}}^{\overline{z}} R^i_j(q_i, q_j, z_i) f(z_i) dz_i \right] \frac{dq_j}{dD_i}$$

B. Benchmarking

1. Why might competition in product market reduce agency costs?
2. How can competitors be useful when investors design the wage scheme of their manager?

C. Signal

1. If a firm has a high debt/equity ratio, what does that tell you about the firm? (First think on your own, then have a look in e.g. Harris and Raviv.)

D. Behavioral corporate finance

1. Discuss pro et contra for behavioral assumptions in corporate finance.
2. Discuss weaknesses and strengths of the model by Landier and Thesmar.
    a. which real-life phenomena does it capture and not capture?
    b. find weird elements/assumptions/results in their model.
        i. There is one crucial difference between Hart&Moore and L&T about verifiability, which?
        ii. Does the human capital of the entrepreneur matter in the joint business of investor and entrepreneur in this model?
3. L&T say that entrepreneurs (on average) are more optimistic than the population average, due to self-selection. Explain what they mean by that.
4. The separating equilibrium, or separating menu of debt contracts if you like, is better (than pooling eq.) for all types of actors (given their subjective beliefs), why?