UNIVERSITY OF BOLOGNA

CLAMDA-IM 2012/2013

CORPORATE FINANCE I.C.

CORPORATE GOVERNANCE EXAM

This is a closed books exam: you can use a calculator only. You are allowed 1h to complete the exam.

Name: ______________________________

ID number: ___________________________

Date: October 30th, 2012

MULTIPLE CHOICES (1 POINT EACH FOR A TOTAL OF 20 POINTS)

1) What is the right of withdrawal or right to step out?

a) the right to step out of a company if the company is taken over

b) the right of step out of the company and being paid out if one shareholder does not agree on a relevant extraordinary decision

c) the right to step out of the company before it goes bankruptcy

2)In Italian new regulation on related party transactions, major relevant transactions not approved by all independent directors must be approved by:

a) the majority of the board

b) the board of auditors

c) a standard shareholders' meeting

d) a shareholders' meeting without the vote of the related parties

3) Among others, the Market Abuse Directive has forbidden:

a) insiders to trade their shares in specific periods

b) banks to stabilize the market price of new listed firms' shares during IPOs

c) anyone to manipulate the security price by spreading false information

d) majority shareholders to trade their shares

4) The empirical evidence of the relationship between firm's performance or value and managerial ownership is the effect of:

a) the Jensen-Meckling alignment of interest theory

b) the entrenchment theory

c) both

5) The high leverage associated with LBO operation made by private equity investors before the subprime crisis, was favored by:

a) low credit spreads

b) high credit spreads

c) high priced paid in the acquisitions

6) If the quorum to approve proposals in an Extraordinary Shareholder Meeting (ESM) is 2/3, and the largest shareholder has a 25% stake, which is the minimum "hostile" stake (or blocking minority stake) that would allow a second shareholder to block any decision in the ESM?

a) 50%

b) 25%

b) 12.5%

7) *As far as stock options, the so called backdating fraud entails:*

a) the backdating of the strike date

b) the anticipation of the grant date

c) the backdating of the grant date

8) *Executive stock options should:*

a) Increase executives' risk aversion (referred to firm's assets)

b) Decrease executives' risk aversion (referred to firm's assets)

c) Not affect executive's risk aversion (referred to firm's assets)

9) In a stock option plan the so-called "vesting period" represents a period when the option:

a) Can be exercised at better conditions

b) Can't be either sold or exercised

c) Can be both sold and exercised

d) Can be exercised but not sold

10) Among others, the Sarbanes-Oxley Act has:

a) Forbidden the presence of more than 5 CEOs at the same time
b) Improved the disclosure of off-balance sheet transactions
c) Strongly decreased penalties for financial fraud

11) The Sarbanes-Oxley Act established a new agency (PCAOB) aimed to control:

a) Company's insiders
b) Investment banks
c) Financial Analysts
d) Auditors of US companies
e) CFOs

12) Among others, the Sarbanes-Oxley Act has:

a) Forbidden insiders to trade on their firm's shares
b) Substituted IAS accounting principles with GAAPs accounting principles
c) Introduced mandatory rotation for auditors

13) *Among other, the Sarbanes-Oxley Act has:*

a) Decreased SECc's powers
b) Decreased penal responsabilities for CEOs (*Chief Executive Officers*)
c) Increased penal responsabilities for CFOs (*Chief Financial Officers*)

14) A firm has 1 mln of voting shares and 1 mln of non-voting shares enjoying the same dividend payments. Assuming market prices are respectively equal to 5 euros for voting shares and 3 euros for non-voting shares. Which should be the approximate market reaction for the voting shares at the announcement of a 1:1 coercive dual class unification?

a) -25%
b) -20%
c) No reaction
d) +2%

15) According to the "Interest Group theory" on financial development:

a) Cross-countries difference in financial development do not change considerably over time
b) Opposition by incumbent will be weaker if an economy is opened only to capital flows
c) Opposition by incumbent will be weaker if an economy is opened to both capital and trade flows

16) According to the EU Takeover directive, if the bidder has already bought some shares of the target company, the offer price must be equal to:

a) The average market price in the pre-offer period and before the offer period is ended
b) The highest price paid in the pre-offer period
c) The highest price paid in the pre-offer period or before the offer period is ended
d) The highest market price in the pre-offer period

17) What is the "sell-out" right in takeover regulations?

a) The right of firing the management
b) The right of the holder of securities to sell all his shares to a third party outside the company
c) The right of the holder of the remaining securities to require the offeror to buy his securities
d) The right of the bidder who has acquired a very large part of the share capital to acquire the remaining outstanding shares

18) According to the EU Takeover directive, what is the definition of "company control":

a) The ownership of at least 50 percent +1 of the total number of shares of each class
b) The ownership of at least 50 percent +1 of the total number of voting shares
d) The decision is left to each member state
e) The ownership of at least 30 percent of the total number of voting shares

19) Which of the following statements is true?

a) With the Equal Opp. Rule only inefficient control transfers take place
b) With the Equal Opp. Rule many efficient transactions cannot take place
c) Both

20) Which of the following statements is a goal of the Passivity Rule?

a) Increasing the welfare of the management
b) Facilitating takeover activity
c) Preventing the management from investing in bond of others companies
d) Increasing the price of being active in the market

Short exercises (2 points each)

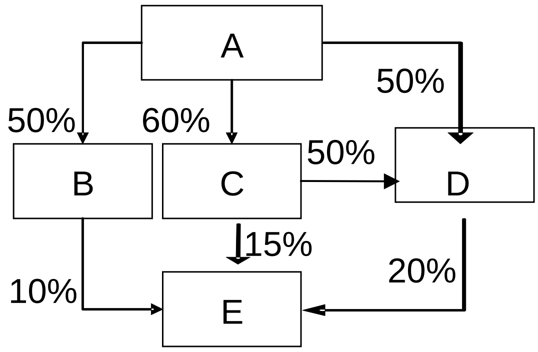
1) A EU-country's takeover regulation has set 30% of votes as the threshold for control definition which triggers the Equal Opportunity Rule. The majority shareholder of a listed company decides to sell his 33.3% controlling stake to a new owner for a price equal to 120 millions. 45 of the 120 mlns paid in the acquisition is the compensation for the private benefits enjoyed by the old owner and required to be paid to the new owner.
A) Which is the total value of the company (Mkt value and Private Benefits) under the old owner?
B) Which is the % of shares the new owner is obliged to make an offer for? And which is the total price of the acquisition for the new owner?

A) 120-45= 75 = mkt value of the 33.3% stake, hence Mkt value = 225 (75*3) and Total value = M +PB_{old} = 225+45=270
B) 100%, that is the remaining 66.7% The total value of the tender offer will be equal to 120x 3 = 360

2) Still referred to the previous case: a) How much will the new owner end up paying (overall) for the private benefits of the old owner? b) If the new owner will enjoy the same amount of private benefits, which is the absolute and percentage increase in the market value of the firm that he should be able to obtain thanks to a better managerial action in order to break even with the price paid?

a) 45 x 3 = 135
b) Delta W = $(1-\alpha)/\alpha \cdot PB_{old}$= 2· 45= 90;
% of total value = +90/270 = + 33.3%;
% of Mkt value = +90/225=40%

3) Assuming that the equity structure of all the firms below is always 1 share-1 vote: a) which is the percentage ownership of cash flows by firm A in firm E? b) Which is the value of control of voting right by firm A in firm E? c) Which is the value of the index for the separation of ownership from control (O/C) of firm A with respect to firm E? d) Which is the range of the possible values of the O/C separation index?



a) OWN= 50%*10%+ 60%*15%+ 50%*20% + 60%*50%*20%= 5%+9%+10%+6%=30%
b) CONTROL= 10% + 15%+ 20% = 45%
c) O/C= 30%/45%= 0,666
d) O/C varies between 0 and 1

4) A US public company wants to defend itself from a hostile takeover. The incumbent management holds 10% of the voting shares and proposes a dual class creation. Voting shareholders are offered to become non-voting shareholders by swapping voting shares with non-voting shares offering higher dividends. If the incumbent management does not adhere to the offer, which would be its stake after the dual class creation in case that:

a) 100% of the other voting shareholders adhere
b) 80% of the other shareholders adhere
c) 50% of the other shareholders adhere
d) 0% of the other shareholders adhere

a) 10%/10% surviving voting shares = 100%
b) 10%/[100% - (80%*90%)] surviving voting shares = 10%/28% = 35.71%
c) 10%/[100% - (50%*90%)] surviving voting shares = 10%/55%= 18.18%
d) 10%/100% surviving voting shares = 10%

5) A family controls 40% of the voting shares of company B which, on its turn, controls the 30% of the voting shares of company C. Please determine:
a) the ownership of the cash flows of the ultimate shareholder (the family) over company C and the ownership/Control ratio (O/C)
b) find the same results of point a) assuming also that both company B and company C are dual class firms and have their equity equally split between voting shares and non-voting shares (assuming that non-voting shares are held only by retail shareholders)

Ownership = 0.4x0.3= 0.12= 12%; O/C = 12%/30% = 0.40
Ownership = 0.4x0.5x0.3x0.5 = 0.03 = 3% O/C = 3%/30% = 0.10