UNIVERSITY OF BOLOGNA

LMEC 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: April 9th, 2013

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

1) The disciplining role of debt for reducing agency costs is more effective in:

a) firms in mature industries producing high cash flows
b) firms in new industries which are burning cash
c) firms controlled by families

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

a) the Jensen-Meckling alignment of interest theory
b) the entrenchment theory
c) both

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

a) the backdating of the exercise date
b) the posticipation of the grant date
c) the backdating of the grant date

4) 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

5) 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

6) If the quorum to approve proposals in an Extraordinary Shareholder Meeting (ESM) is 2/3, and the largest shareholder has a 20% stake, which is the "hostile" stake that would allow a second shareholder to block any decision in the ESM?

a) 50%
b) 20%
c) 10%

7) A firm has 1 mln of voting shares and 1 mln of non-voting shares. Assuming the market prices are respectively 3 euros for voting shares and 1 euro for non-voting shares. Which should be the approximate market reaction for the voting shares to the announcement of a 1:1 coercive dual class unification?

a) -25%
b) -33%
c) No reaction
d) +2%

8) Company A owns 50% of Company B cash flows. Company B acquires another company (company C) and pays 10 millions more than its fair value. The ultimate controlling shareholder (which owns 20% of A's cash flows) is expecting to extract an amount of private benefits equal to 6 millions. What is the overall gain or loss for the ultimate shareholder?

a) +6 millions
b) +1 millions
c) -5 millions
d) 5 millions
e) +6 millions

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

a) Cross-countries differences in financial development do not change considerably over time
b) The "Legal family" theory by La Porta et al. is not able to explain cross-country variation of relative financial market development
c) The "Legal family" theory by La Porta et al. is not able to explain cross-time variation of relative financial market development

10) Which of the following non-legal tools may help investors' protection:

a) the cross listing in whichever stock market
b) the cross-listing in a stock market with high levels of investor protection and enforcement
c) possibility of a class-action

11) Which Italian law has introduced the requirement that at least one director must be reserved to the minority shareholders' list who has collected the greatest number of votes

a) the 1998 TUF (i.e., Draghi Law)
b) the 2003 Corporate Law Reform
c) the 2005 Law on Savings

12) If dividend differences between Italian voting and non-voting classes of shares are not taken into consideration and the voting premium is estimated only form the price differences between the two classes of shares, the value of the voting right is:

a) underestimated
b) overestimated
c) correctly estimated

13) According to the Market Abuse Directive, the following are considered as market abuses:

a) Buyback shares
b) Front running
c) Price Stabilization during an IPO

14) According to the passivity rule (board neutrality) of the EU takeover directive, after a takeover has been launched:

a) shareholders must remain passive and not approve any defensive measures
b) the board must obtain shareholders' meeting authorization before putting in action defensive measures
c) the board can't put in action defensive measures even with the shareholders' approval

15) 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

16) Which of the following statements is true for the Equal Opportunity Rule ("efficient" is the Bebchuck definition)?

a) only "inefficient" control-transfer transactions take place
b) efficient" control-transfer transactions cannot take place
c) only "efficient" control-transfer transaction can take place

17) What is the right of "squeeze-out"?

a) The right of firing the management
b) The right to buy at least the 50 per cent of the shares
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) The maximum threshold set by the EU Takeover directive after which the squeeze-out option must be granted to the offeror is:

a) 90%
b) 95%
c) left to member states

19) 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

20) What is the dual-class voting (adopted also in Italy for dual-class firms):

a) a voting procedure that sums up the voting outcome of two different voting class of shares
b) a voting procedure that requires the approval of two different classes of shareholders
c) a voting procedure that allows one class of shares to vote also in the shareholders' meeting of the other class

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 millions is the value of the private benefits of the old owner charged 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?
C) Which is the total value of the tender offer the new owner will have to make?

A) 120-45= 75 = mkt value of 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%
C) 120x 3 = 360 (ok also if you have referred only to the floated share, then it would be 66.6% of 360= 237.60)

2) Still referred to the previous case: C) How much will the new owner end up paying (overall) for the private benefits of the old owner? D) 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?

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

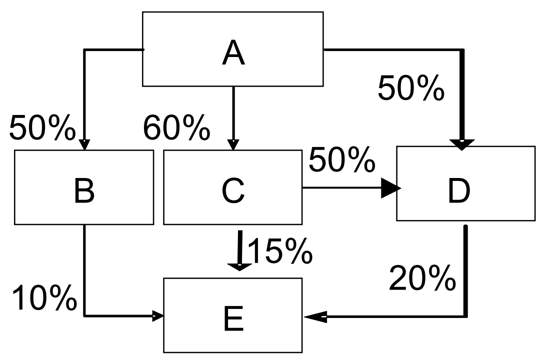
3)Which is the percentage Ownership (OWN) of cash flows in firm B owned by a family which controls 40% of firm A, which controls half of the voting rights of firm B (whose equity is made of 60.000 voting shares carrying one vote and 40.000 non-voting shares carrying no votes?

OWN= 40%* 50%* 60%= 12%;

4) Company A owns 50% of Company B's cash flows. Company B acquires a 60% stake in another company (company C) and pays 30 millions more than the fair value of the stake. The ultimate controlling shareholder (which owns 20% of A's cash flows) is expecting to extract an amount of private benefits equal to 5 millions. What is the overall gain or loss for the ultimate shareholder?

-30 mln x 20% (own of A) x 50% (A's Own of B) = -3mln +5 mln = +2 mln

5) Assuming there are only 1 share 1 vote shares in the companies reported and shown below: 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