HOUSE OF FINANCE
Goethe-Universität Frankfurt

Newsletter Q4

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RESEARCH: Investment, Income, Incompleteness_4

RESEARCH: Customer Equity Reporting as a Smart Way to More Transparency_6

RESEARCH: Venture Capital Exit Rights_8

INTERVIEW: The G20 Summit Pittsburgh – a Strong Signal for a Stable and Sustainable Global Financial System_10

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NEWSLETTER SUBSCRIPTION

The House of Finance opened in 2008. It amalgamates Goethe University's interdisciplinary research on finance, monetary economics, and corporate and financial law under one umbrella. Eight academic research and training units work together in the House of Finance.

As part of its aim to disseminate research results and to promote an exchange between academics and practitioners, the House of Finance issues a newsletter on a quarterly basis.

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EDITORIAL

Ladies and gentlemen,
Dear friends of the House of Finance,

The financial crisis has laid bare serious defects in the architecture of financial markets which can only be repaired by adopting an internationally coordinated approach. Fortunately, the enormous costs of the crisis – not only the fiscal costs but also in terms of welfare losses – have strengthened policymakers' willingness to act.

However, the window of opportunity this presents is closing as financial markets and economies around the world continue their recovery. We therefore have to act swiftly, and the decisions taken in Pittsburgh by the G20 embodied a strong and helpful commitment to implement the required reforms. These decisions have also achieved a much needed broadening of the decision-making process to encompass major emerging markets. The Pittsburgh declaration covers a wide range of policy fields. The G20 did not just define the details of the required reforms, and rightly so, given the nature of the forum and the complexity of the problems involved.

Spelling out the often intricate details of the agreement reached in Pittsburgh requires us to combine the knowledge and insights of economists, lawyers, accountants, practitioners and many others. The challenge we are currently facing is to do this rapidly without compromising on thorough analyses of the specific reform measures.

I am glad to say that this need to bring together experts from various disciplines in order to deal comprehensively with financial markets was, in a sense, already anticipated by the basic premise behind the House of Finance. Now, it is all the more important to have such an institution, in which a continuous exchange and discussion of ideas among experts from different fields can take place.

The need to take due account of interdependence of financial markets and systemic risk has been one of the core lessons of the crisis that were addressed in Pittsburgh. This will lead to a strengthening of macroeconomic supervision and the creation of new institutions responsible for conducting this, such as the European Systemic Risk Board (ESRB) at the EU level. Central banks, in general, and the Eurosystem, in particular, will naturally play a key role in this area: firstly, they have a strong interest in financial stability in order to be able to fulfil their primary mandate to maintain price stability. Secondly, they combine excellent expertise with real-time information on the state of the financial system, collected, in particular, from their daily monetary policy operations. Thirdly, they often also play a role in banking supervision – and, as the crisis shows, supervisors, too, cannot confine themselves to ensuring the solvency of individual institutions, but must also take into account interdependencies within the banking sector as well as in the financial sector as a whole. Accordingly, the ESRB will be located within the ECB. The creation of this and other institutions is an essential building block of a more stable financial system.

Still, much remains to be done, not only in terms of setting new and better rules, but also with respect to gaining a better understanding of how future crises can be prevented or, at the very least, contained. There are still many aspects of the crisis and the functioning of financial markets in general where we need to gain a better knowledge and a deeper understanding. I am confident that the House of Finance will play an important part in closing these gaps.

With best wishes,

Prof. Dr. Axel A. Weber
President of the Deutsche Bundesbank
Chairman of the Executive Board

INVESTMENT, INCOME, INCOMPLETENESS

Bjoern Bick
Goethe University

Prof. Holger Kraft
Goethe University

Prof. Claus Munk
Aarhus University

In our research paper we suggest an easy procedure for finding a simple consumption and investment strategy for an investor receiving (unspanned, i.e. labor income cannot be hedged by financial assets) labor income, which is near-optimal in the sense that the wealth equivalent loss compared to the unknown optimal strategy is very small.

MARKOWITZ VS. INVESTING OVER THE LIFE CYCLE

The classical portfolio theory by Markowitz considers a one period model and analyzes how to optimally invest an individual's wealth across different assets or asset classes. Essentially, it is a myopic theory. As we all know, we should not act myopically. We must make decisions not only for the next month or the upcoming year, but also for our retirement or for the education of our kids in the future. Furthermore, as John Campbell pointed it out in his Presidential Address to the American Finance Association on January 7, 2006, "…the largest component of wealth for most households is human capital, which is non-tradable". Labor income, however, cannot be modeled realistically under the classical theory, since it has a life-cycle pattern that cannot be captured in the (too) simple mu-sigma world. Having said this, studying a dynamic model of portfolio decisions including labor income seems to be the obvious way to go. This comes at some costs: Firstly, such a model is generically more complicated, but this is not surprising given the involved structure of our investment and retirement decisions. Secondly, the stylized facts of labor income lead to some major challenges. In particular, we are not able to sell the present value of our future stream of labor income (partly because slavery is not allowed). Therefore, the major asset that we all own is essentially non-tradable and – even worse – not perfectly correlated with any traded asset. Consequently, the utility-maximizing consumption and investment strategy of an individual investor receiving an unspanned labor income stream seems impossible to find in a closed form, and extremely difficult to find using numerical solution techniques.

A BRIEF LOOK AT THE RELATED LITERATURE

Most of the present literature disregards labor income completely or assumes that it is deterministic or spanned by traded assets – see Campbell and Viceira (2002) for an overview. Some recent papers do allow for unspanned labor income, but they have to resort to coarse and computationally intensive numerical solution techniques that can handle only low dimensional problems. It is thus complicated to identify the economic forces driving consumption and portfolio decisions. A detailed overview of the related literature is provided in our paper.

A SIMPLE, NEAR-OPTIMAL STRATEGY

We work in a continuous-time framework where uncertainty is generated by a number of shocks (standard Brownian motions). If labor income were spanned, then the entire labor income stream could be seen as the dividend stream from the asset spanning labor income, i.e. the present value of all future labor income would be uniquely valued by the no-arbitrage principle. The optimal consumption and portfolio decisions of an investor would then follow from the (often well-known) solution to the same problem without labor income, basically, by replacing financial wealth by the sum of financial and human wealth. In the more realistic case of unspanned labor income, the dynamics of the income rate are

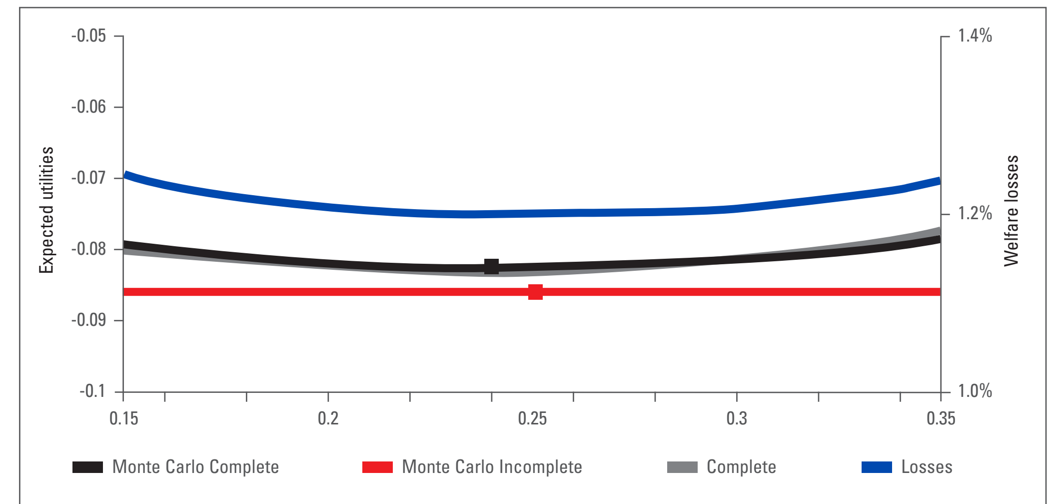
affected by an additional shock that cannot be hedged by traded financial assets. Therefore, the market is incomplete and it is no longer possible to derive the optimal decisions with income from the optimal decisions without income. This is because the risk premium of the additional shock is not known.

The specific consumption and investment strategy we propose to follow with unspanned income is motivated by the optimal decisions in a set of artificially completed markets, a concept originally introduced by Karatzas et al. (1992). Essentially, we define artificially completed markets where the individual can invest in the same assets as in the original incomplete market plus a hypothetical asset that completes the market and that is exposed to the unknown risk premium. All these markets are characterized by specific (but different) choices of the unknown risk premium. Since these markets are complete, we can find simple, closed-form expression for the optimal consumption and investment strategies. We then transform these strategies into admissible strategies in the true, incomplete market by disregarding the investment in the hypothetical asset and by modifying the remaining strategy slightly to ensure non-negative wealth. Finally, we optimize over all these markets to find the best strategy within this set of strategies.

Although our approach is not restricted to low-dimensional problems, we explain and test our strategy in a simple setting with constant interest rates, a single risky asset, and an exogenously given income stream.

Firstly, we consider only the artificial markets corresponding to different constant values risk premia. With our benchmark parameter values, we find that a long-term, moderately risk-averse investor following our proposed strategy will suffer a loss of less than 2.3% of total wealth for a zero correlation between shocks to labor income and stock returns. When the correlation is increased, the upper bound on the loss becomes even smaller, e.g. roughly 0.9% for an income-stock correlation of 0.6. Secondly, we generalize to the case where the risk premia are deterministic, affine functions of time. This leads to a significant reduction of the upper bound on the loss, e.g. 1.04% for a zero correlation and 0.04% for a correlation of 0.6.

These results are robust to changes in key parameter values. We generalize the idea and the procedure to the case where the investor endogenously determines his labor supply at a stochastic, unspanned wage rate. We find that the bound on the welfare loss is slightly bigger than in the exogenous income case,



Lambda 1: Expected utilities and the welfare loss for a correlation of 0.4

but still only 1% or lower when the wage-stock correlation is 0.4 or higher. Finally, we generalize our approach to a setting with stochastic interest rates where the individual can invest in a long-term bond in addition to stock and short-term deposits. We find that the wealth equivalent losses are also very small in this case. In sum, our numerical results demonstrate that the simple consumption and investment strategy we propose is near-optimal.

This paper won an outstanding paper award at the annual meeting of the German Finance Association (DFG) in 2009.

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CUSTOMER EQUITY REPORTING AS A SMART WAY TO MORE TRANSPARENCY

By Prof. Bernd Skierra, Manuel Bermes and Lutz Horn, Goethe University and E-Finance Lab

Securitization risks have turned down the economy. Yet, the current discussion has largely ignored the shift towards short-term profit realization at the expense of long-term value creation that is also inherent to securitization. This shift creates additional threats because it might cause a misperception of a bank's economic situation and its future profitability.

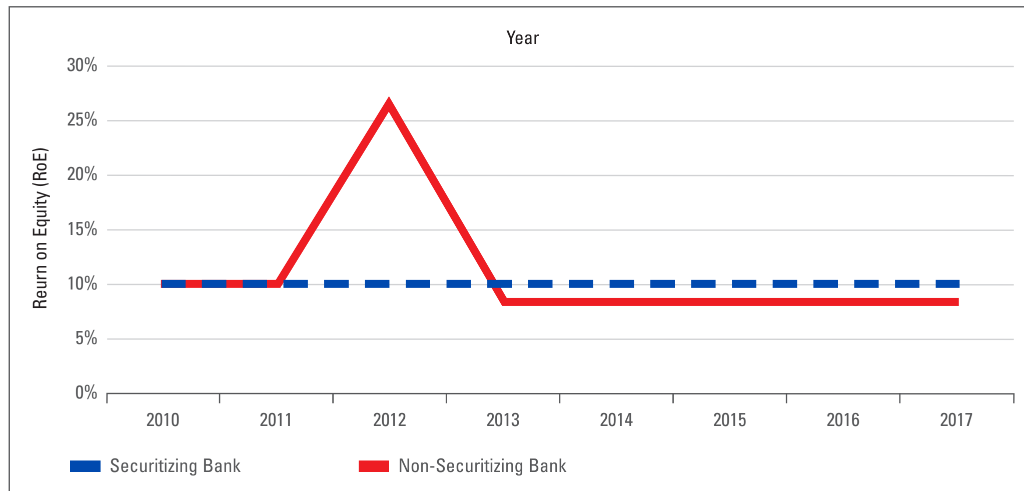
The financial crisis currently disrupting the economic system and banking worldwide often gets blamed on securitization. Banks, however, fundamentally need securitization due to liquidity, funding, capital and risk considerations. But they commonly use securitization also to manage their earnings streams by transferring loans and the credit risk of their loan portfolios to other investors. In return, the banks do not hold the loans until their maturity on their own books, but instead receive earnings from them directly at their net present value. As such, they do not follow the traditional "buy and hold" banking business model, rather they switch over to an "originate and distribute" model.

The move towards short-term profit realization at the expense of long-term value creation yields additional, largely ignored threats. The transformation of periodic loan payments into one down payment enables a bank to realize earnings immediately instead of over the lifetime of the loans. Basically, this corresponds with the behavior of soccer clubs, such as Schalke 04, which started selling revenues from future ticket sales to banks, and whose coach only realized recently that the respective income would be lacking in upcoming periods. Ambiguous requirements for financial statements provide limited means for detecting such value shifts, and make the consequences of securitization for long-term value creation nontransparent – banks (as well as other firms) are not required to report future earnings. Instead, they generate incentives to use securitization excessively in order to boost short-term profits. Such a lack of transparency can lead to severe problems. For instance, supported by accounting rules, managers have incentives to adjust a bank's earnings streams through securitization to better reach personal goals. Unfortunately, the problems that arise from such shifts in profit realization continue to be largely ignored in current discussions of the financial crisis.

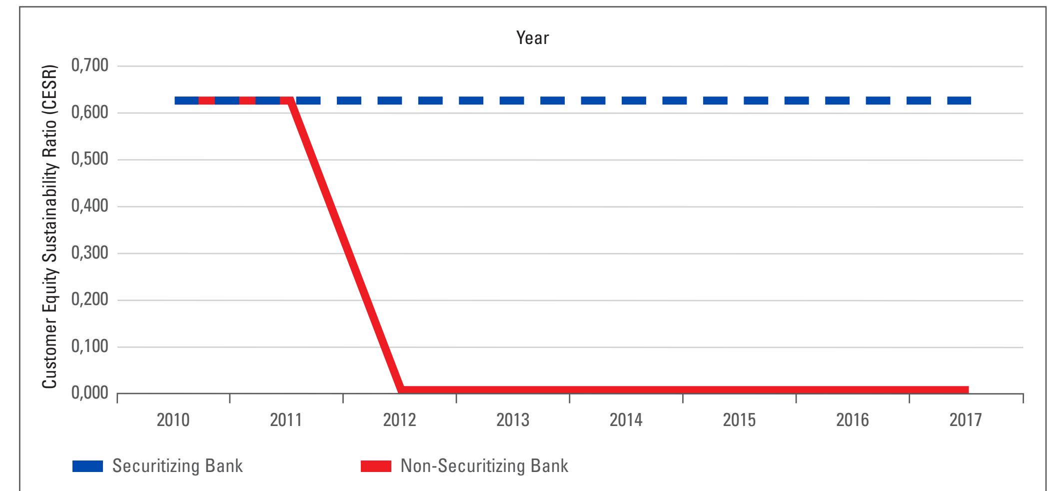
In our research, we analyzed 32 banks in the most important banking markets in the United States and Europe to determine how much information they provide about securitization in their financial statements. Our empirical results illustrate that many banks fail to provide sufficient transparency about their securitization activities. Actually, only about 10% of the analyzed banks rudimentarily report the information required to detect a shift from long-term value creation towards short-term profit realization. This lack of transparency makes it difficult, if not impossible, for stakeholders to evaluate which earnings come from ongoing banking business and which result from the one-time effects of securitization. Hence, an evaluation of the consequences for long-term value creation has to be omitted.

Customer equity reports, however, may offer a smart way of creating the transparency necessary in financial statements. Over the past decade, enough knowledge has been accumulated by research to calculate customer equity, i.e. the value of a customer base, so that the ignorance of future earnings now prevalent is no longer justified. Based on this approach, we propose two means of reaching more transparency.

- **Customer Equity Reporting (CER)** provides stakeholders with valuable information about the long-term value of a bank's current customer base and its development



Graph 1: Return on Equity



Graph 2: Customer Equity Sustainability Ratio (CESR)

over time. Detailed customer structures with related earnings and costs in absolute numbers are published that allow for issuing forward-looking statements.

- **The newly developed Customer Equity Sustainability Ratio (CESR)** compares the likely future profit of existing customers to corresponding current profits. It identifies shifts in value realizations over time and reports the sustainability of a bank's earnings as a relative number in a simple and substantial way.

Both means provide banks with an opportunity to offer stakeholders sufficient information regarding the time horizon of their business models without disclosing confidential information.

The results of our recent counterfactual analysis of Countrywide (US) show that this bank shifted from a situation in which approximately 75% of the value created is realized in the future towards one in which 80% of value creation is realized immediately.

In the numerical example shown in Graphs 1 and 2, we compare a non-securitizing bank with a securitizing one. In the non-securitization case, the bank generates a stable earnings stream and return on equity (RoE) from its long-term oriented loan portfolio. The securitizing bank, however, aims at increasing its RoE and starts securitizing all its loans in 2012. In this case, the bank already receives the earnings in the short-term, and realizes a significantly higher RoE in the relevant year. An investor who solely considers the RoE for that year when assessing the bank's growth potential will overestimate its value if he fails to adjust for the inflationary effects of securitization.

However, as securitization per se neither creates nor destroys value, this short-term profit realization comes at the expense of long-term value creation. Additional value accrues only if securitizers and buyers differ in their valuation of underlying earnings. Thus, in the long-run, the RoE for the securitizing bank falls below that for the non-securitizing bank (Graph 1).

The Customer Equity Sustainability Ratio (CESR) enables the transparency required for long-term value creation. Graph 2 illustrates that the non-securitizing bank exhibits a constant CESR while the securitizing bank's CESR drops to a minimal zero at the moment when all its earnings are securitized, indicating the shift towards short-term profit realization.

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VENTURE CAPITAL EXIT RIGHTS

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In this paper, we look at factors that determine the inclusion of exit rights in German venture capital (VC) contracts, in particular, drag-along and tag-along clauses.

We thus define a "drag-along right" as one that gives its holder the right to force all other shareholders in the firm to sell their shares to an (outside) buyer at the same price at which the right holder sells his shares. We define a "tag-along right" as one that allows the holder to include his shares in a sale for the same price as all other shareholders.

IMPORTANCE OF EXIT DECISION IN VC INDUSTRY

The provision of venture capital is a crucial element for entrepreneurial firms and their lifetime dynamics and success. However, the relationship between the venture capitalist (VC) and the entrepreneurial firm is temporary in nature. Therefore, the way the VC exits is a central element in the venture capital cycle. Of the two exit channels possible – initial public offerings (IPOs) and trade sales (i.e. a complete sale of the firm to a strategic buyer) – trade sales have always been predominant in Europe. Recently, trade sales have also become the exit channel of choice in the United States: since 2001, IPOs have represented only 10% to 20% of all exits in the U.S. venture capital industry, while 80% to 90% of all firms in this market were sold via a trade sale.

However, there is a potential conflict of interest between the entrepreneur and the VC with respect to IPO timing. Both the VC's organizational structure and the temporary nature of his competitive advantage make the VC more impatient than the entrepreneur. Trade sales may cause far more severe conflicts of interest between VCs and entrepreneurs compared to IPOs. This is because an entrepreneur loses private benefits from being an owner-manager and so may oppose a trade sale altogether.

Thus, it is not surprising to see that contracts between VCs and company founders often include provisions that govern the exit decision. Exit rights under clauses related to initial public offerings may involve demand rights and piggy-back rights. As regards trade sales, drag-along rights, tag-along rights, and preemption rights may be involved here. Although we analyze the allocation of exit rights in general, we highlight clauses for drag-along and tag-along rights as being of particular importance. This is because our results suggest that trade sale rights matter more in our data sample than IPO rights.

A UNIQUE DATA SET

We introduce a new, hand-collected sample of 464 contracts between VCs and entrepreneurs from Germany. Our sample comprises 290 different portfolio firms and 91 venture capital firms and is randomly drawn from a large proportion of the German market for venture capital. The sample's time period ranges from 1990 to 2004. Thus, our data set allows us to analyze the allocation of exit rights for a broad spectrum of the German market, which matured significantly during our observation period. Our data set not only provides us with the contracts between VCs and entrepreneurs, but also makes it possible for us to observe the characteristics of the firms, the VCs, and the entrepreneurs involved. Moreover, since we had access to not only contracts, but also to term sheets, business plans and shareholder agreements, we were able to gather detailed information about the timing and conditions of investments.

SPECIFIC INVESTMENTS DETERMINE USE OF EXIT RIGHTS

We find that in Germany contracts predominantly allocate these rights to the VC. Our results suggest that these rights protect a VC's specific investments, namely in the form of capital, consulting services and monitoring, against possible renegotiation. Furthermore, we observe that the majority of exit rights are focused on trade sales as the channel of exit, rather than on the second empirically relevant channel, IPOs. We show that the use of these exit rights is linked to variables that serve as proxies for the presence of a hold-up problem in the case of an exit.

Our findings are robust to the inclusion of other factors that also drive the allocation of exit rights, such as ex-ante bargaining power and VC sophistication. We find that conflicts of interest mainly arise between the VC and the entrepreneur, rather than between different VCs in an investor syndicate. Our results also indicate that the protection of the VC's specific investment is not the only force that drives the use of exit rights: the amount of ex-ante bargaining power the VC has and the amount of income that the entrepreneur can pledge also influence the use of exit rights.

We show that specific investments play a crucial role in explaining the use of exit rights, and that the more pronounced and asymmetric ex-ante specific investments , the more frequently exit rights are included in contracts. Also, we find that such rights are more often present in contracts where the bargaining power of the party contributing most to the relationship would be weak if they were absent. If this is the case, renegotiation is more of a concern for the party with the weak bargaining power, leading to a more likely inclusion of exit rights in the contract. Secondly, we show that exit rights are mainly allocated to the VC, not the entrepreneur. This result is in line with much of the theoretical literature on venture capital, but contrasts with other studies on large shareholders. We have some evidence that there are situations where the conflict of interest is not between the VC and the entrepreneur, but between different VCs within a syndicate.

This article is available at:
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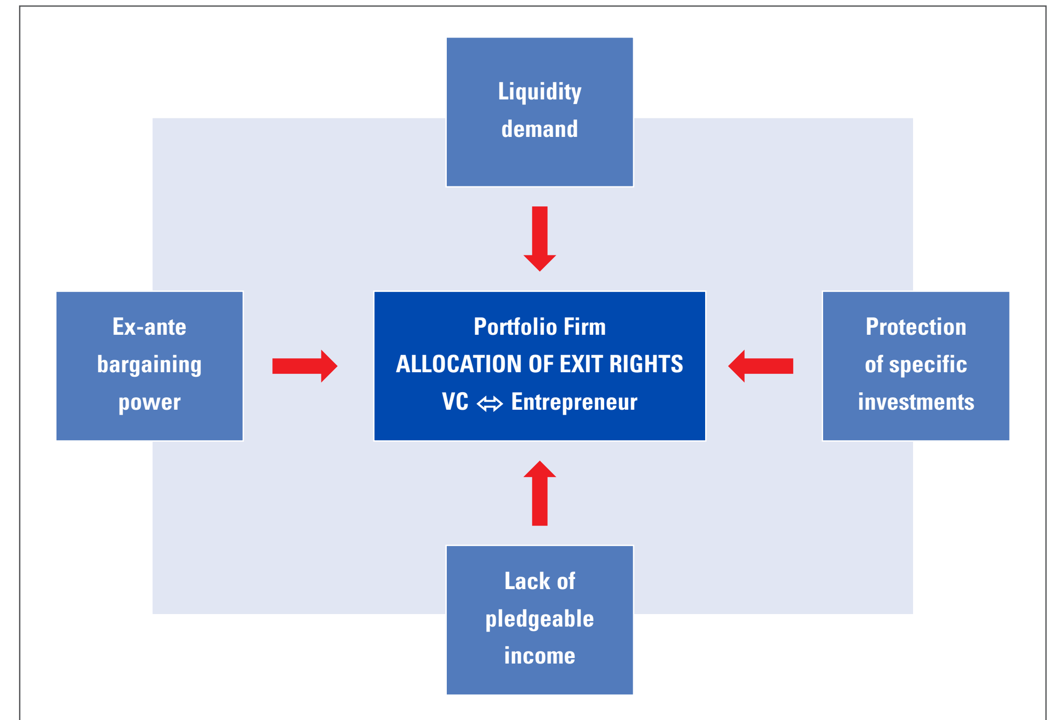

Graph 1: Factors Determining the Allocation of Exit Rights

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THE G20 SUMMIT PITTSBURGH – A STRONG SIGNAL FOR A STABLE AND SUSTAINABLE GLOBAL FINANCIAL SYSTEM

Jens Weidmann is the economic and financial policy advisor of Angela Merkel, the Chancellor of the Federal Republic of Germany. As her "Sherpa", he prepared all three G20 summits held in Washington (November 2008), London (April 2009) and, most recently, in Pittsburgh (September 24 – 25).

What are the most important results of the Pittsburgh Summit and what do they mean for the world financial system?

Jens Weidmann: The heads of states and governments pushed forward their work to strengthen financial market stability, especially regarding capital requirements, compensation practices, over-the-counter derivatives markets and systemically important financial institutions. By addressing these issues in some detail and by agreeing on a tight time schedule for implementation, Pittsburgh was an important step towards a more stable and sustainable global financial system. Moreover, leaders consented to closer economic cooperation in order to ensure a strong, sustainable and balanced growth of the world economy, and they expressed their commitment to develop coordinated exit strategies allowing for reduced governmental support measures once it is clear that economic recovery is on track.

Will all G20 countries equally implement the measures agreed on at Pittsburgh?

Jens Weidmann: Indeed, the top priority after Pittsburgh lies in swift, comprehensive and coordinated action. In a follow-up meeting earlier in November, all G20 finance ministers reaffirmed their determination to cooperate by embarking upon an ambitious process of implementing the measures agreed on in Pittsburgh. In particular, we must ensure a level playing field in global financial markets. Therefore, I welcome that the Financial Stability Board was provided with a strong mandate to monitor and to expedite the implementation of financial market reform, and to report back to G20 finance ministers.

Will the political initiative of the G20 countries prevent future crises like the current one?

Jens Weidmann: The crisis has unveiled two interconnected problems: first, the incentives for financial markets were badly designed, encouraging excessive risk-taking, moral hazard and ultimately the socialisation of private losses. Second, financial institutions were exposed to risks for which no appropriate provisions had been made, and had transferred substantial risks to unregulated institutions. Thus, it is crucial that all financial markets, products and participants are subject to appropriate oversight and regulation to avoid regulatory arbitrage and loopholes. Furthermore, we have to set the right incentives for financial markets. Various important steps have already been taken. All in all, I am quite confident that we will succeed in building a more stable financial system.

To anchor the principle of sustainability more broadly and to minimize the danger of a future crisis, Chancellor Merkel has proposed to work on a Charter for Sustainable Economic Activity, an initiative that was also endorsed in Pittsburgh.

Will international cooperation decline once the crisis is over?

Jens Weidmann: The G20 summit process has proven that both industrial and emerging countries are committed to coping with what is the most severe global crisis in the last 50 years. In Pittsburgh, leaders went beyond traditional ad hoc crisis management and designated the G20 to be the premier forum for international economic cooperation in the future. It is only in a truly global forum like the G20, which includes rising economic powers such as China and India as well as other emerging economies, that some of the most pressing policy challenges for our globalizing economy can be addressed. Of course, the views here are more heterogeneous than those for the group of most industrialized countries, the G8.

On the whole, my impression from the three summits so far is that the crisis has brought industrial and emerging countries closer together – the spirit of shared responsibility has considerably increased, and the willingness to deepen international economic cooperation has gained much more ground.

LEADERSHIP DEVELOPMENT IS MORE THAN SKILLS ACQUISITION

By Wolfgang Amann and Alper Tengüz,
Goethe Business School

In today's business world, companies are facing challenges that force them to adapt constantly. Companies have to adapt their strategies to meet changing business environments. And they need to equip their senior managers with the skills and abilities to cope with these challenges. The days of merely disseminating knowledge in executive education are definitely over.

Business schools typically say they do not merely develop a set of skills in a specific area. They promise to help managers "grow" into business leaders. In this sense, executive education really is a "growth" business. The problem is that there is an enormous variety of approaches to leadership development programs. Most programs are not explicit about the beliefs underlying them. The Goethe Business School differs in this regard. Its programs are quite explicit about the assumptions they make and follow a singularly distinct approach to executive education.

For a start – we listen. This is why we have set up an HR Council that brings together those in charge of personnel development at companies – large and small – with academics from a broad range of fields relevant to business education. The point most often made is that companies need a partner who is really willing to listen and to learn about what they require, and who is capable of developing joint programmes that focus exactly on their particular needs at a given time. The set of competencies required varies according to the business sector concerned. Each company's needs are different. Nothing should simply "come off the shelf". There is a consensus on only one set of competencies – the so-called "soft skills" considered highly relevant across all sectors that are growing in importance.

DEVELOPMENT IS MORE THAN JUST KNOWING MORE

Basically, leadership is about leading oneself, leading others, and leading an organization. With the help of external experts and feedback from our HR Council members, we have identified competencies widely recognized as being elements of highly effective leadership. We have also examined the problems that may typically stall a career. Our executive education programs have been developed with these results in mind. Indeed, our starting point is the assumption – based on the latest research on adult development in psychology and the neurosciences – that people develop rather dramatically throughout their lives, but differ as to their degree of development. We are convinced that development is more than just knowing more. A defining feature of "more developed" people is their complexity of thinking and their mental bandwidth. When people think in a more complex way, explanations move from black and white to shades of grey. As they develop, their ability to use a variety of styles and to lead also increases. Indeed, those who have worked through personal and interpersonal issues can relate differently to the challenges posed by business and people.

GBS Executive Education Offerings	
1. Open programs	**2. Custom programs**
Course modules in: ■ Leadership ■ Finance & Accounting ■ Management & Strategy	**Courses and modules, customized or newly designed, with sector focus in:** ■ Professional Service Firms ■ Industry ■ Financial Services
Certificates and diplomas (individualized sequence of courses → Creditable towards EMBA)	

IMPACT, THOUGHT LEADERSHIP, AND INNOVATION

Our executive education programs build on three principles: impact; thought leadership; and innovative learning methods. They have one aim: to support companies to achieve their business objectives. We do not merely regard ourselves as a training provider. We design our programs to foster development that is lasting, rather than just the acquisition of skills or knowledge. And we measure whether our programs really achieve what they are supposed to achieve. In our programs, we draw on insights that bridge the divide between academia and the business world. We achieve this because of our access to one of the largest and most renowned faculties of business administration and economics in Germany, and because we work closely with international experts who provide a business expertise that is relevant to the main issues of today. We are innovative and apply learning methods going far beyond traditional case studies and lectures. We use the real world problems that our participants face, and ensure that peer and individual coaching are integrated into the various programmes we offer. Returning participants demonstrate that we are very much on track.

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RESEARCH OUTSIDE THE HOUSE OF FINANCE

EINLAGENSICHERUNG UND ANLEGERENTSCHÄDIGUNG – DEPOSIT GUARANTEES AND INVESTOR INDEMNITY, Jochen Bigus and Patrick C. Leyens, Tübingen, 2008 (in German)

This monograph is based on an expert opinion written for Germany's Federal Ministry of Finance. The two authors, professors of financial accounting (Bigus) and private law (Leyens), were mandated to address this issue in August 2007. The protection of deposits and investors has been an important topic both from a legal and an economic perspective. For this reason, it is advisable that an economist and a lawyer work together in treating it.

It took the European Union a long time to set minimum standards. The respective directives were blocked for a protracted period and then watered down considerably. The standard they set was markedly below the requirements of the Federal Deposit Insurance Act of the United States. The resulting drawback was at least threefold and relates to: the clarity of the rules; the amount protected; and the solvency of the institutions providing coverage. A completely different approach was generally favored in Great Britain, where the market was basically supposed to take care of adequately securing protection. This concept failed completely in a time of need. As soon as queues lined up in front of Northern Rock, the British Government hastily established government guarantees, a tool which had long been frowned upon. A similar development could be seen in Germany in October 2008, when both the country's Chancellor and Minister of Finance declared that deposits in all German banks were secure. Aside from the legal dubiousness of this assurance, the government of Germany could hardly command the means required to fulfil it, if necessary.

After treating extensively the legal and economic framework, and developing criteria for evaluation, the study eventually concludes that changes in the national legislation are not advisable concerning the sums protected and provisions of the insolvency code (pp. 43, 46). Developments have proven that this result is very questionable. In the meantime, minimum sums and treatment in insolvency have improved considerably under EU and national legislation – and for very good reasons, as previously shown by other scholars.

In respect to structural changes, the authors differentiate between short term and medium range measures. Eventually, they recommend a consolidation of the very heterogeneous conglomerate of backing institutions in Germany, basically following the "three pillar" system of German banking. In depth preventive measures are also discussed. This is appropriate, as preventive measures are necessary to keep "free riders" from exploiting sound institutions. The reader misses, however, an in depth analysis of two crucial issues: (1) the solvency and liquidity of the existing funds in Germany; and (2) the problem of an explicit government guarantee. One small fund (EdW) was already technically insolvent and only a government guarantee prevented a bank-run and kept the banking system from a meltdown in October 2008. The advantage of an explicit guarantee or a true insurance system would be that a risk-adjusted premium could be charged, and the cost of protection would be revealed.

Prof. Dr. Helmut Siekmann, Goethe University and Institute for Monetary and Financial Stability

CREDITOR CONTROL RIGHTS AND FIRM INVESTMENT POLICY, Nini, Greg, Smith, David C., Sufi, Amir, in Journal of Financial Economics 92 (2009), pp. 400–420

The authors extend the research on how the reliance on external finance affects firm investment. By examining a large sample of syndicated loans for public firms from 1996 to 2005, the authors firstly find that 32% of the agreements contain an explicit restriction on the firm's capital expenditures and that secondly creditors are more likely to impose a capital expenditure restriction as a borrower's credit quality deteriorates. Therefore the authors' findings indicate that the use of a restriction appears at least as sensitive to borrower credit quality as other contractual terms, such as the interest rate. Furthermore, capital expenditure restrictions cause a reduction in firm investment, and firms which obtain contracts with a new restriction experience subsequent increases in their market value and operating performance. Overall, the authors present convincing empirical evidence that conflicts of interest between creditors and their borrowers have a significant impact on firm investment policy.

Markus Fischer, E-Finance Lab

HOUSE OF FINANCE RESEARCHERS WIN BEST PAPER AWARDS

Jingjing Chai, Research Assistant at the Chair of Investment, Portfolio Management, and Pension Finance has won the DAAD prize for 2008. This prize is aimed at supporting especially qualified foreign students.

Wolfram Horneff, Research Assistant at the Chair of Investment, Portfolio Management, and Pension Finance was awarded a prize by the Deutsches Institut für Altersvorsorge for his dissertation, "Dynamic Portfolio Choice with Pension Annuities and Life Insurance".

Dr. Ralph Rogalla, Assistant Professor at the Chair of Investment, Portfolio Management, and Pension Finance received the IHK-Dissertationspreis for his work, "Essays on Pension Fund Management and Real Estate Investment".

Melanie Döge and **Stefan Jobst**, research assistants at the Institute for Law and Finance, were singled out by the Stiftung Hessischer Wirtschaftsprüfer for its 2009 prize. This award recognizes their excellent publication, "Aktienrecht zwischen börsen- und kapitalmarktorientiertem Ansatz".

PROF. THEODOR BAUMS AND PROF. REINHARD SCHMIDT RECEIVE HONORARY DOCTORATES

At a celebration held on Friday, September 11, **Prof. Theodor Baums**, *Director of the Institute for Law and Finance*, was named an honorary doctor of the Aarhus School of Business. Professor Baums was honored for a longstanding and distinguished legal career which includes professorships at several German universities, as well as international visiting professorships at universities such as Stanford and Columbia, USA.

On September 29, the WHU – Otto Beisheim School of Management awarded an honorary doctorate to **Prof. Reinhard Schmidt**, *Director of the Department of Finance*. This award recognizes Schmidt's outstanding contribution to overcoming the boundaries that exist between the various social science disciplines with respect to research and teaching. His research areas not only comprise the area of finance but also those of economic theory, economic policies as well as business management and law.

ROUND TABLE DISCUSSION WITH DR. ROBERT POLLARD AND PROF. DAVID SINGER

Dr. Robert Pollard

On October 13, **Dr. Robert Pollard** (*Minister-Counselor for Economic Affairs at the US Embassy in Berlin*) and **Prof. David Singer** (*Department of Political Science at MIT in Boston*) conducted a round table discussion on the financial crisis at the House of Finance.

Prof. David Singer

Researchers from both HoF and Goethe University's Faculty of Social Sciences participated in the discussion, which focused on the causes of and remedies for the crisis.

The participants agreed that the causes of the financial crisis are multifaceted, making it difficult to properly assess the contributory role of each dimension – not to mention an analysis of how particular facets may have interacted with each other.

"TOO BIG TO FAIL, BUT A LOT TO BAIL"

On 13.10.09, the House of Finance welcomed **Stavros Panageas**, *Assistant Professor at the Chicago Booth School of Business*. In a paper he presented to a joint session of the Seminar Series in Macroeconomics (VWL Kolloquium) and of the Seminar Series in Finance, Dr. Panageas considered the optimal way to finance a bailout of a financial firm in order to prevent its liquidation and the associated social costs. Some of the results of the standard (Ramsey) model of optimal taxation are seriously altered when the objective is not to finance a given stream of government expenditures but to bail out a financial firm. Importantly, some procyclical taxation (low taxes in bad times, high taxes in good times) is always optimal. This is because government spending in bad times can help boost demand, generate business for the financial firm, and thus lower the amount of distortionary taxes needed to finance its bailout.

For further details please visit:
http://www.wiwi.uni-frankfurt.de/kolloquium/ws0910/ CR3_extensionsb.pdf

CITIGROUP CEO GRANTS SCHOLARSHIPS TO 12 GSEFM STUDENTS

On September 8, **Vikram Pandit**, *the Chief Executive Officer of Citigroup*, made one of his few public speeches in Europe at Goethe University. He provided insights into developments at Citigroup during the ongoing financial crisis, and laid out the key policy and regulatory imperatives for the future. Pandit concluded by presenting the 'Citi Foundation Frankfurt Scholars in Economics and Finance' award to a select group of twelve students from the Graduate School of Economics, Finance, and Management.

PRESTIGIOUS DGF ANNUAL CONFERENCE AT THE HOUSE OF FINANCE

From October 9 – 10, the Deutsche Gesellschaft für Finanzwirtschaft held its annual meeting at the House of Finance. This conference was organized by Prof. Schlag and his team. Interested scholars and practitioners were invited to discuss the latest theoretical and empirical research from all areas of modern finance. In addition, there was a special panel for leading academics and finance industry representatives to debate the implications of the current crisis for risk management in research and practice.

QUARTERLY EVENT CALENDAR

JANUARY

Monday, 11th
5pm
EFL Jour Fixe:
"Green Computing through Grid Technology – Empirical Results from the Financial Services Industry",
Speaker: Jens Vykoukal, E-Finance Lab

Tuesday, 12th
5.15pm
Finance Seminar:
Speaker: Peter Schotman, Maastricht University

Wednesday, 13th
12pm
Finance Brown Bag Seminar:
Speaker: Raimond Maurer, Goethe University

Thursday, 14th
7.30pm
ILF Corporate Circle:
"Variable Forwards – ein strategisch sinnvolles Instrument zur Kapitalbeschaffung",
Speaker: Hermann Georg Bader, Barclays Capital

Tuesday, 19th
5.15pm
Finance Seminar:
Speaker: Lars Norden, Rotterdam School of Management, Erasmus University

Tuesday, 19th
6pm
Doctorate / Ph.D. Program Law and Economics of Money and Finance and Exzellenzcluster „Die Herausbildung normativer Ordnungen“:
„Wettbewerb als normative Ordnung“,
Speaker: Dr. Horst Satzky (Hengeler & Mueller) and Prof. Dr. Roman Inderst

Wednesday, 20th
7pm
ILF Guest Lecture:
Speaker: Dr. Thomas Rüschen, Deutsche Bank

Wednesday, 20th
12pm
Finance Brown Bag Seminar:
"Trust, Sociability, and Stock Market Participation",
Speaker: Dimitris Georgarakos, Goethe University and Giacomo Pasini, Venice University

Tuesday, 26th
5.15pm
Seminar in Economics:
Speaker: Francisco J. Gomes, London Business School

Tuesday, 26th
5.15pm
Finance Seminar:
Speaker: Darren Kisgen, Carroll School of Management, Boston College

Wednesday, 27th
12pm
Finance Brown Bag Seminar:
"Optimal Asset Allocation in Retirement with Open-End-Real Estate Funds",
Speaker: Yuanyuan Shen, Raimond Maurer, Ralph Rogalla, Goethe University

Thursday, 28th
8am
CFS Lecture:
"The Future of European Equity Market"

Thursday, 28th
12pm
HoF Brown Bag Seminar:
„Angemessene Vorstandsgehälter – rechtliche Grundlagen“,
Speaker: Prof. Dr. Theodor Baums, Goethe University

FEBRUARY

Monday, 1st
5pm
EFL Jour-Fix:
„Measuring the Economic Value of Agency Broker Dark Pools – The exemplary Case of Liquidnet",
Speaker: Bartholomäus Ende, E-Finance Lab

Wednesday, 3rd
12pm
Finance Brown Bag Seminar:
"Robust Hedging – Simultaneous Use of Hedge Models",
Speaker: David Horn, Goethe University

Tuesday, 9th
5.15pm
Finance Seminar:
Speaker: Frans de Roon, Tilburg University

Wednesday, 10th
12pm
Finance Brown Bag Seminar:
"Fair Value Accounting and Bankruptcy Risk: An Asset Allocation Perspective",
Speaker: Eduard Dubin, Goethe University

Tuesday, 23rd
2pm
EFL Frühjahrstagung:
"The New Financial Market Infrastructure – Trading and Clearing",
Casino, Campus Westend

Thursday, 25th
12pm
HoF Brown Bag Seminar

MARCH

Monday, 1st
5pm
EFL Jour-Fix:
"Referral Programs and Customer Value“,
Speaker: Philipp Schmitt, E-Finance Lab

Monday, 15th – Thursday, 26th
ILF Frühjahrslehrgang:
„Unternehmensrecht in der Beratungspraxis“, attendance only by application

Wednesday, 17th
5pm
CFS Colloquium:
Speaker: Josef Ackermann, Abtsaal, Deutsche Bank, Frankfurt

Friday, 26th – Saturday, 27th
CFS Research Conference:
"International Research Forum on Monetary Policy",
Speaker: Günter Coenen, European Central Bank, and Volker Wieland, Goethe University, Federal Reserve Board, Washington, USA

Please refer to http://www.hof.uni-frankfurt.de/veranstaltungen for continuous updates of the event calendar.

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