Finance Theory

Course Syllabus, Spring 2009

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This required course selectively reviews the major contributions made by financial economists in *asset trading, corporate finance, and banking* to the first-year graduate students with finance major. Finance is a subfield of economics, with its focus on one input market–the capital market. Just like in other input markets, households and firms respectively constitute the major suppliers and demanders of the input (funds). Unlike in other input markets, suppliers do not receive the payments from the demanders at the time funds are supplied; instead, they receive "financial assets," which specify how payments by the demanders will be made in the future. Inevitably, finance must deal with the interactions of "time, money, and uncertainty." Financial economists study the behavior of households (investments), the behavior of firms (financial management), the functioning of markets (financial institutions), and how trades are consummated (asset pricing) under various trading mechanisms (market microstructure). This course intends to go over some important issues in these areas.

The course is divided into two parts. Part I considers asset trading with strategic investors, and since this literature commonly takes a game-theoretic approach, a brief review of the non-cooperative game theory will be given. Part II will survey several important theories in corporate finance and banking, where the game-theoretic approach is again proven most useful.

Lecture notes will be passed out constantly. The performances in problem sets solving and in the midterm and final exams jointly determine the course grade. A detailed schedule will be passed out in class during the first meeting.