

**MASTER OF ARTS EXAMINATION, 2023**

(2nd Year, 2nd Semester)

**ECONOMICS****[ FINANCIAL ECONOMICS A II (CORPORATE FINANCE) ]****(PRE-REQUISITE FINANCIAL ECONOMETRICS AI)**

Time : Two Hours

Full Marks : 30

Answer any *two* questions from the following questions:

15×2=30

- The firm also has financial slack  $S < R$ . Taking the standard assumptions from Myers-Majluf model, explain under what conditions, the manager's decision to issue and invest will have to carry additional information about the state of the nature. Show the equilibrium graphically.
- b) Explain why in Myers Majluf frame work debt is a preferred source of finance compared to equity. 10+5
3. Using two suitable frame works, explain how capital structure and dividend payment can work as a signal when there is asymmetric information. How is the Modigliani-Miller hypothesis modified in the presence of such signalling effect? 10+5

1. a) Explain and prove dividend irrelevance hypothesis.  
b) What do you understand by agency cost of debt and agency cost of equity? Explain how in presence of agency cost of debt and agency cost of equity, the Modigliani-Miller hypothesis will be violated. 5+10
2. a) Consider the following example in Myers-Majluf three date model :

	State H	State L	Probability of the state occurring
Asset-in-Place	$a_H$	$a_L$	$\alpha$
Investment opportunity (NPV)	$b_H$	$b_L$	$1 - \alpha$

$$a_H > a_L, b_H > b_L$$

The project requires an investment

$$R < \alpha b_H + (1 - \alpha) b_L.$$

[ Turn over