Theoretical Approaches to
Financial Frictions and Investment

Recommended surveys and textbooks
Amaro de Matos, Theoretical Foundations of Corporate Finance, 2001
Bolton and Dewatripont, Contract Theory, 2005

Topics and Readings
1. Screening and credit rationing
Stiglitz and Weiss, "Credit Rationing in Markets with Imperfect Information," AER, 1981
Milde and Riley, "Signaling in Credit Markets," QJE, 1988
Innes, "Financial Contracting under Risk Neutrality, Limited Liability and Ex ante Asymmetric Information," Economica, 1993

2. Signaling and project finance
Myers and Majluf, "Corporate Financing and Investment Decisions when Firms Have Information That Investors Do Not Have," JFinE, 1984
Brennan and Kraus, "Efficient Financing under Asymmetric Information," JFin, 1987
Nachman and Noe, "Optimal Design of Securities under Asymmetric Information," RFinStud, 1994

3. Security design

4. Costly state verification
Gale and Hellwig, "Incentive-Compatible Debt Contracts: The One-Period Problem," REstud, 1985
5. Agency costs and incentive contracts

Harris and Raviv, "Optimal Incentive Contracts with Imperfect Information," *JET*, 1979
Sappington, "Limited Liability Contracts between Principal and Agent," *JET*, 1983
Innes, "Limited Liability and Incentive Contracting with Ex-ante Action Choices," *JET*, 1990

6. Incomplete financing contracts


7. Managerial discretion and financial policy


8. Monitoring and financial intermediation


9. Liquidation externalities

10. Internal equity and the financial accelerator