

Corporate Finance and Corporate Governance

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ABSTRACT

A combined treatment of corporate finance and corporate governance is herein proposed. Debt and equity are treated not mainly as alternative financial instruments, but rather as alternative governance structures. Debt governance works mainly out of rules, while equity governance allows much greater discretion. A project-financing approach is adopted. I argue that whether a project should be financed by debt or by equity depends principally on the characteristics of the assets. Transaction-cost reasoning supports the use of debt (rules) to finance redeployable assets, while non-redeployable assets are financed by equity (discretion). Experiences with leasing and leveraged buyouts are used to illustrate the argument. The article also compares and contrasts the transaction-cost approach with the agency approach to the study of economic organization.

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