

Behavioral Finance

Behavioral Finance

Module Number | 88-021-WM03-H-0120

Degree | Master

Semester | Summer

Course Type | Lecture/Tutorial

Participation Limit | None

Creditable for | Business and Psychology (elective), Entrepreneurship and Innovation (required elective), FACT (required elective)

Contact Hours | 4 SWS

Number of Credits | 5 ECTS

Language | English

Chair | Economics, esp. Macroeconomics

Chair Owner | Prof. Dr. Simon Wiederhold

Lecturer | Prof. Dr. Simon Wiederhold

Learning Outcomes/Skills

- Behavioral finance uses insights from psychology to understand how human behavior influences the decisions of individual and professional investors, markets, and managers. Some decisions are simple, day-to-day choices, such as how hard we are going to study for the next test, or what brand of soda we are going to buy, but others significantly impact our financial wellbeing, such as whether we should buy a particular stock, or how we should allocate our money among various investment funds. The purpose of this lecture is to present what we have learned about financial decision-making from behavioral finance research.
- Students will develop the ability to understand how modern concepts of financial-decision making go beyond traditional concepts of finance: expected utility theory, asset pricing (CAPM), the efficient market hypothesis, and agency relationships.
- Students can describe the psychological foundations of Behavioral Finance: prospect theory, cognitive limitations and heuristics, overconfidence, and emotion. They will develop the ability to understand and assess their role in explaining investor behavior.
- Students will learn how psychology impacts financial-decision making at the level of the individual. For instance, the lecture will investigate the extent to which the faulty use of heuristics leads to suboptimal financial decision-making (e.g., familiarity bias can lead to excessive domestic and local investment; availability bias pushes people into concentrating investments in securities where information is freely available).
- Students apply the gained knowledge to assess the role of behavioral explanations for some of the central stock-market puzzles (e.g., equity premium puzzle, price bubbles, financial crisis of 2008).
- A guest lecture with PwC representatives will familiarize students with the behavior and thinking of various stakeholders (banks, investors, employees) when a firm tumbles into crisis. Based on the insights from this lecture, students will themselves develop strategies to rescue crisis-laden firms in a case study.

Module Content

- Foundations of Neoclassical Finance
 - Expected Utility Theory
 - Asset Pricing, Market Efficiency, and Agency Relationships
- Theoretical Foundations of Behavioral Finance
 - Prospect Theory
 - Framing, and Mental Accounting
- Psychological Foundations of Behavioral Finance
 - Heuristics and Biases
 - Overconfidence
- Investor Behavior
 - Implications of Heuristics and Biases for Financial Decision-Making
 - Implications of Overconfidence for Financial Decision-Making
 - Individual Investors and the Force of Emotion
- Market Outcomes
 - Behavioral Explanations for Anomalies
 - Do Behavioral Factors Explain Stock Market Puzzles?
- Case Study PwC

Teaching methods/course type

- Lecture
- Tutorial
- Case study
 - The topic of the case study is a firm that enters a severe crisis (e.g., risk of bankruptcy). From the perspective of a consultancy, students will develop strategies to rescue the firm, which at the same time meet the expectations of the stakeholders (e.g., banks and employees).
 - Successfully finishing the case study also requires a number of soft skills, such as the ability to work in a team and presentation skills.

Types of examination and grading

Written exam	100%
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Assessment criteria in detail

- Written exam (90 minutes) at the end of the term.
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Workload

28 h = Time of attendance lecture
32 h = Preparation and postprocessing lecture
28 h = Time of attendance tutorial
30 h = Preparation and postprocessing tutorial (including the case study)
32 h = Exam preparation
150 h = Total workload

Previous Knowledge/Prerequisites in accordance with examination regulation

- Basic knowledge in microeconomics and finance
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Readings

- Main reading
 - Ackert, Lucy F. and Richard Deaves (2010). Behavioral Finance Psychology, Decision-Making, and Markets. Cengage Learning.
- Further readings
 - Burton, Edwin and Sunit Shah (2013). Behavioral Finance: Understanding the Social, Cognitive, and Economic Debates. Wiley.
 - Daxhammer, Rolf J. and Máté Facsar (2012). Behavioral Finance. UVK Verlagsgesellschaft mbH. (in German)