

FIN-E0307 - BEHAVIORAL AND SUSTAINABLE FINANCE

M.Sc. (Econ), Dept. of Finance, Aalto University, Fall 2020, Period I

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- Professor:** Markku Kaustia – markku.kaustia@aalto.fi
- TA:** Erkki Vihriälä – erkki.j.vihriala@aalto.fi
- Class sessions:** All sessions are from 14:15 - 16, held via Zoom. Below is a summary, see section 6 for more detail.
- Sept 9. Course kick-off. Brief introduction to substance and assignments, Q&A.
- From Sept 15 to Oct 6: *Tuesdays:* Student group work presentations, substance and assignment Q&A, midterms, etc.; *Wednesdays:* Concepts, theories, and models; *Thursdays:* Further examples, applications, discussions
- Oct 13 & 14: Final group project presentations.
- Office hours:** During the Tuesday sessions, after other matters on the agenda have been dealt with, at least one of the course organizers remains available to address any group or individual student questions. Please use these sessions as the primary means of contacting us. This is for two reasons: 1. We are running a big course and it is challenging to handle a large volume of email, 2. co-creation of knowledge is more efficient when we can observe and learn from each other.
- Readings:** Scientific articles (See Section 5 for a tentative list), media, industry reports. Note that more material will be added, up to three scientific articles, so the additions are mostly news articles or media reports, i.e., lighter reading.

1. REQUIREMENTS AND GRADE COMPONENTS

- Group project, 50%
- Term paper, 20%
- Two midterm examinations, 2 x 15%. The exams cover all aspects of the course. No retakes are offered but for legitimate documented reasons you can substitute an exam with an additional term paper.
- Up to 5% extra may be awarded for class activity.
- The final grade (0 to 5) is based on cutoff points that are determined ex post, partly reflecting relative student performance. This means there is no absolute standard on how many raw points are needed for a particular final grade. The cutoff levels are not published.
- Note that turning in class assignments is considered acknowledgement of guidelines on scholastic honesty and academic integrity (see Section 4).

2. TERM PAPER

This is an individual assignment. Deliverable: Term paper as a PDF file. Turn in: By email to the TA, unless otherwise agreed.

Topics should be specific and focused. For example, “Prospect theory” is not good, but “Prospect theory and labor supply - evidence from the field” is much better.

Your goal is to learn something significant on a new topic, communicate it well, and present a value adding application. The best papers are able to teach something to the professors as well.

The topic needs to be in the realm of behavioral or sustainable finance and must be approved by organizers.

Register your topic on the Google Docs. It should be unique, i.e., no two can be the same. Registration is open when the course starts, and needs to be done by Sept 18.

Format is max. 4 pages. Use 2-3 pages for literature review, then final page for a new present day application on how we could productively use this knowledge. Use the MS Word template from MyCourses for formatting. Adding a relevant graph or table is very welcome, but still adhering to the page limit.

Reference: 1-3 main and 2-4 auxiliary references to scientific articles, plus an additional 1-3 to industry reports or media articles.

3. GROUP PROJECT

Teams. Up to five students per team. Deliverables: Three presentations and a final slide pack in native file format. Turn in: By email to the TA, unless otherwise agreed.

The assignment

Alternative 1: Analyze a behavioral aspect of an existing financial product, service, or a corporate finance transaction of your choice. Your output should consist of these components:

- Short description of the object
- Discussion linking it to some aspect of behavioral finance
- Comments from relevant people. Try to connect your topic to comments in the media, or you can find someone to interview (an interview is a must if you have a new product idea).
- You are also welcome to, but not required, to perform some data analysis

You may want to begin by brainstorming about potential links between behavioral finance and different objects of analysis. While many topics often have many such links, it makes sense to focus, at least later on. I.e., rather than covering many issues lightly, the best teams are able to provide strong coverage and convincing arguments for one or two key behavioral issues. Even if you have several issues in mind, it makes sense to mostly focus on your strongest storyline.

Alternative 2: Develop and field-test a tool for eliciting/detecting a particular investor preference or bias. Whereas traditionally investment service providers would just ask their clients “On a scale of 1 to 5, how risk-averse are you?”, there is nowadays huge interest in providing a more complete multidimensional investor profile having various preference parameters, knowledge assessment, and behavioral bias detection.

Your output should consist of these components:

- Describe the characteristic you are measuring, and a hypothesis of its relevance to investment behavior.
- Web-based application / survey tool for measuring it

- Field study with user data (contact me or the TA to organize data collection within our class, though you can also use other subjects if available)

One place to browse for ideas: https://en.wikipedia.org/wiki/List_of_cognitive_biases. Obviously these biases have varying relevance for investment behavior. For example, anthropomorphism (the tendency to characterize animals, objects, and abstract concepts as possessing human-like traits, emotions, and intentions) may not be particularly relevant (although could be, who knows...). The ambiguity effect, on the other hand, has been shown to be very relevant in many behavioral finance studies. Also note that in addition to biases, very interesting topics include various kinds of investor preferences (risk, time, social preference, ...), as well as aspects of financial literacy.

Schedule & deliverables

Topic proposals. Two separate sessions (see class schedule), each group only presents once. One session accommodates a maximum of 10 groups. Contact the TA to secure a slot, first-come first-served basis applies. As students (and humans in general) tend to procrastinate, as a countermeasure we may apply a bit of a grade boost to those taking the first session. *Presentation format*: Two minutes, two slides: 1. What is the topic and motivation, 2. Execution, i.e., what we plan to do, followed by a bit of Q&A.

Halfway checkpoint (see class schedule), organized the same way as the topic proposals, the same rules apply. *Presentation format*: Two minutes, two slides: 1. What we have accomplished, 2. Remaining to do plan, Q&A.

Final presentations (see class schedule). The presentation order will be set by course organizers. This is mostly just random, but can be based on topics as well. If you have a conflicting schedule and cannot be there for the entire session please inform the TA two working days prior to the session. *Presentation format*: Five minutes, plus Q&A. You should plan 4-5 slides. You can include a couple more slides in addition to those you show, but those need to be self-explanatory (“consultant style”). The total slide pack may not exceed 10 slides. Format: Name your slide pack file with your last names in alphabetical order, e.g., ‘Dickinson_Harris_Smith.pptx’, max file size is 5Mb.

Examples

Below are some exemplary topics (Alternative 1) of former student groups, followed by relevant behavioral aspects in parentheses. While there are countless possible topics, if by coincidence you were thinking of analyzing an object already listed here, or you find out that another group is working on a similar topic, don’t let that stop you! Different takes on the same subject are actually interesting.

- Nordea ePossu -service (mental accounting); Credit Default Swaps as investments (attribute substitution); Innofactor reverse takeover (confirmation bias); Nokia Siemens Networks merger (overconfidence); ‘Crazy Money’ – The Wenzhou private lending crisis (social influence); White-labeling mutual funds at Nordea (familiarity bias); Live betting at Veikkaus (favorite-longshot bias)

4. SCHOLASTIC HONESTY AND ACADEMIC INTEGRITY

We expect adherence to highest standards of scholastic honesty. Examples of scholastic dishonesty are exercise answer sharing between groups, presenting text or case answers downloaded from the internet as own work without proper citation (plagiarism) or sharing answers during the final exam.

All class work (exercises and reports) is to be done by the students that return the work, co-operation in preparing answers to the exercises between groups (or individuals not belonging to the same group) is strictly prohibited. However, you are allowed to discuss the exercise problems with fellow students on a principal level: the definition of terms and concepts in the questions, and what issues are central to a particular question. Every group should proceed on their own from there.

Failure to adhere to these guidelines is subject to disciplinary action, such as cancellation of class work credit, extra assignments, or removal from the course. Turning in class assignments is considered acknowledgement of these guidelines. Please read more in Into:

<https://into.aalto.fi/display/enregulations/Aalto+University+Code+of+Academic+Integrity+and+Handling+Violations+Thereof>

5. READINGS

The readings consist of scientific articles, media, and industry reports. The latter will be referred to *later during the course*, here you find the list of scientific articles. Up to three scientific articles *can be added* later. The material below is either available through the school library (and in some cases through unrestricted internet access), or a link is provided.

Benartzi, Shlomo and Richard H. Thaler, 1999, "Risk aversion or myopia? Choices in repeated gambles and retirement investments", *Management Science* 45(3), 364-381.

Beshears, John, James J. Choi, David Laibson, and Brigitte C. Madrian, 2008, "How are preferences revealed?", *Journal of Public Economics* 92(8-9), 1787-1794.

Borgers, Arian, Jeroen Derwall, Kees Koedijk, and Jenke ter Horst, 2013, "Stakeholder relations and stock returns: on errors in investors' expectations and learning", *Journal of Empirical Finance* 22, 159-175.

Dyck, Alexander, Karl V. Lins, Lukas Roth, and Hannes F. Wagner, 2019, "Do institutional investors drive corporate social responsibility? International evidence", *Journal of Financial Economics* 131, 693-714.

Ferrell, Allen, Hao Liang, and Luc Renneboog, 2016, "Socially responsible firms", *Journal of Financial Economics* 122, 585-606.

Kaustia, Markku and Samuli Knüpfer, 2008, "Do investors overweight personal experience? Evidence from IPO subscriptions", *Journal of Finance* 63(6), 2679-2702.

Kaustia, Markku, 2010, "Disposition effect", Ch. 10 in "Behavioral Finance" (Robert W. Kolb Series in Finance), H. Kent Baker and John R. Nofsinger, eds., John Wiley & Sons, Inc. Available at: https://www.aalto.fi/sites/g/files/flghsv161/files/2018-12/disposition_effect.pdf

Kaustia, Markku and Milla Perttula, 2012, "Overconfidence and debiasing in the financial industry", *Review of Behavioral Finance*, 4(1), 46-62.

Kaustia, Markku, Andrew Conlin, and Niilo Luotonen, 2018, "What Drives the Heterogeneity in Portfolio Choice? The Role of Institutional, Traditional, and Behavioral Factors", SSRN Working Paper No. 2845963. Available at: <https://ssrn.com/abstract=2845963>.

Malmendier, Ulrike, and Geoffrey Tate, 2008, "Who makes acquisitions? CEO overconfidence and the market's reaction", *Journal of Financial Economics* 89(1), 20-43.

Riedl, Arno and Paul Smeets, 2017, "Why do investors hold socially responsible mutual funds?" *Journal of Finance* 72, 2505-2550.

Savor, Pavel G. and Qi Lu, 2009, "Do stock mergers create value for acquirers?", *Journal of Finance* 64(3), 1061-1097.

Thaler, Richard H., 1999, "The end of behavioral finance", *Financial Analysts Journal* 55(6), 12-17.

6. CLASS SCHEDULE

Tentative, slight changes are possible.

Time: 14-16 (start: 14.15) unless otherwise announced. Place: Online via Zoom.				
[Monday of week]	Tuesday	Wednesday	Thursday	Readings, approximate
Sept 7	[No class]	Introduction	[No class]	Thaler (1999)
Sept 14	Group project topic proposals I	Behavioral decision-making	Applications	Kaustia and Perttula (2012); Kaustia and Knüpfer (2008); Beshears, Choi, Laibson, and Madrian (2008); Benartzi and Thaler (1999)
Sept 21	Group project topic proposals II	Household and corporate finance	Applications	Kaustia, Conlin, and Luotonen (2018); Kaustia (2010); Savor and Lu (2009); Malmendier and Tate (2008)
Sept 28	Group project check I, 1st midterm exam	Sustainable and green finance	Applications	Borgers et al. (2013); Ferrell, Liang, and Renneboog (2016); Riedl and Smeets (2017); Dyck et al. (2019)
Oct 5	Group project check II, 2nd midterm exam	[No class]	[No class]	
Oct 12	Group project presentations I	Group project presentations II	[No class]	Fri Oct 16: Term paper DL at 18:00