

INDIAN INSTITUTE OF TECHNOLOGY KANPUR
Department of Management Sciences
Proposal for New Course

Title: Behavioral Finance

Course No: MBA XXX

Department: Management Sciences

Proposer: Suman Saurabh

Units: 3-0-0-1[10]

Duration of the course: Full semester

Prerequisites: MBA607, MBA770, MBA780

Other interested faculty: NA

Course objectives:

This course is aimed at providing the students with an understanding of the influence of behavioral biases in various facets of finance. The course first introduces the important theories in conventional finance based on the assumption of a rational agent, employing the expected utility theory for decision-making. It then demonstrates the idea of irrationality in an agent's behavior and exposes the students to the role of heuristics and biases in judgment under uncertainty. It provides a detailed discussion of the foundational theories in behavioral finance namely, prospect theory, mental accounting and narrow framing. The course includes topics such as disposition effect, overconfidence and optimism, underreaction and overreaction, goal-based investing. The course concludes with an illustration of the state-of-the-art evidence on the influence of investor irrationality and managerial sentiment in asset pricing, risk management and corporate finance.

Course contents:

| S.No. | Broad Title | Topics | No. of Lectures |
|-------|---|---|-----------------|
| 1 | Introduction to Behavioral Finance | Foundations of Behavioral Finance, Behavioral Finance versus Standard or Conventional Finance | 2 |
| 2 | Standard Finance: The theoretical underpinnings | Expected Utility Theory, Rationality of Agents, Risk Aversion | 3 |
| 3 | The need for an alternate view in Finance | Challenge to the Market Efficiency, Noise Trading, Imperfect markets and Limits to arbitrage, Departure from rationality | 3 |
| 4 | Heuristics and Biases in Decision making | Psychological Foundations of Behavioral Finance, Familiarity and related heuristics, Representativeness and related biases, Anchoring, Irrationality and Adaptation | 4 |
| 5 | Prospect Theory | Prospect Theory: The foundational ideas behind behavioral finance, An alternative to Expected Utility Theory, Cumulative Prospect Theory | 4 |
| 6 | Narrow Framing and Mental | Mental Accounting, Framing Effects in Financial market forecasts | 4 |

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| | Accounting | | |
| 7 | Effects in Financial Markets | Financial behavior stemming from familiarity and representativeness, The Disposition Effect, Overconfidence and Optimism, Underreaction and Overreaction | 4 |
| 8 | Advanced Topics | Impact of irrationality and managerial sentiment: Asset pricing, portfolio management, risk management, corporate finance; Goal Based investing | 4 |

Short summary for including in the Courses of Study Booklet:

This course is aimed at providing the students with an understanding of the influence of behavioral biases in various facets of finance. It provides a detailed discussion of the foundational theories in behavioral finance namely, prospect theory, mental accounting and narrow framing. It covers the ideas related to the influence of familiarity and related heuristics, and representativeness and related biases on the financial behavior of investors and managers. The course includes topics such as disposition effect, overconfidence and optimism, underreaction and overreaction, goal-based investing. The course concludes with an illustration of the state-of-the-art evidence on the influence of investor irrationality and managerial sentiment in asset pricing, risk management and corporate finance.

Recommended textbooks:

- Behavioral Finance: Psychology, Decision Making and Markets by *Lucy Ackert and Richard Deaves* (Cengage Learning)
- Understanding Behavioral Finance by *Lucy Ackert and Richard Deaves* (Cengage Learning)
- Behavioral Finance by *Prasanna Chandra* (McGraw Hill)

References:

- Inefficient Markets: An Introduction to Behavioral Finance by *Andrei Shleifer* (Oxford University Press)
- Advances in Behavioral Finance, Volume – II, Edited by *Richard Thaler* (Princeton University Press)
- Irrational Exuberance by *Robert J. Shiller* (Princeton University Press)
- A Behavioral Approach to Asset Pricing by *Hersh Shefrin* (Academic Press)
- Behavioral Risk Management by *Hersh Shefrin* (Palgrave Macmilan)

Any other remarks: The course is an advanced PG course and the course pedagogy involves lectures and discussion of research papers in the domain of behavioral finance.

Signature of Proposers:



Sd/- Suman Saurabh [Date: 16 February 2024]

This course is Approved/ Not Approved
DPGC Convener, DoMS

This course is Approved/ Not Approved
Chairperson SPGC