Applications of Psychology and Economics – Econ 219B
Spring 2004
Wednesday 12-3, 639 Evans
Instructor: Stefano DellaVigna, 515 Evans. sdellavi@econ.berkeley.edu.

Homework 6.
Due on March 16 at 12pm

This homework will be a brief (one- to two-pages overall) report on corporate finance and earnings announcements. In class we discussed briefly a number of topics on corporate decision-making: CEO compensation, corporate governance, investment, mergers, and corporate financing. We introduced the concept of event study. In addition, we discussed the function of analysts and in particular measures of earning surprise.

Here are some questions that I would like you to think about for next week. Feel free to just elaborate on one question.

- Which biases do you think could be most relevant for corporate decisions like the ones listed above? Who is likely to be biased? The board? The CEO? The investors? The employees?
- Can you think of a law change that affected company decision making as the anti-takeover law did? (yes, this IS a million dollar question!)
- Can you think of other event studies (beyond merger announcements, announcement of CEO change, and earning announcements) for corporate finance? Any that would allow one to test behavioral motives?
- Finally, when it comes to investors trading, which biases do you think would be most important? Any way to test this?

The readings for next week are:

*Chan, Louis, Narasimhan Jegadeesh, Josef Lakonishok,"Momentum Strategies", The Journal of Finance, Vol. 51, No. 5, Dec. 1996, 1681-1713.

*DeLong, B. Shleifer, A., Summers, L., and Waldman, R., "Noise trader risk in financial markets", JPE, v98 n4, Aug 1990, p.703-38. Reprinted in Richard H. Thaler, ed., *Advances in Behavioral Financ*e, Russell Sage Foundation, 1993.

*Shleifer, Andrei, Summers, Lawrence. "The Noise Trader Approach to Finance". *Journal of Economic Perspective*s, Spring, 1990.

The homework is due on Tuesday by noon. See you next week!