

BEHAVIORAL ASPECTS OF CORPORATE FINANCE

This course studies selected aspects of investment and financing decisions made in corporations, as well as some questions of corporate governance and organizational architecture. We put special emphasis on psychological, sociological and organizational determinants of behavior, e.g., executive hubris, management fads, or bureaucratic inertia. We wonder how corporate decision processes shape decision outcomes, good or bad.

Topics and assignments

WEEK 1: THEORY AND PRACTICE IN FINANCE

Werner De Bondt and Richard Thaler, "Financial decision-making in markets and firms: A behavioral perspective," in R. Jarrow et al., *Handbook of Finance*, 1995.

*(recommended) Rolf Banz, "Zero correlation between theory and practice in financial economics?" *Finanzmarkt und Portfolio Management*, 1997.

WEEK 2: DECISIONS, DECISIONS

John Payne, "The scarecrow's search: A cognitive psychologist's perspective on organizational decision-making," in Zur Shapira, *Organizational Decision Making*, 1997

James March and Zur Shapira, "Managerial perspectives on risk and risk taking," *Management Science*, 1987

Daniel Kahneman and Daniel Lavallo, "Timid choices and bold forecasts," *Management Science*, 1993

*(recommended) James March, "Understanding how decisions happen in organizations," in Z. Shapira, *Organizational Decision Making*, 1997

WEEK 3: CORPORATE CAPITALISM

Michael Jensen, "Value maximization, stakeholder theory, and the corporate objective function," *Journal of Applied Corporate Finance*, 2001.

Michael Jensen, "The modern industrial revolution, exit, and the failure of internal control systems," *Journal of Finance*, 1993.

WEEK 4: THE CREATION AND DESTRUCTION OF VALUE

George Baker, "Beatrice: A study in the creation and destruction of value," *Journal of Finance*, 1992.

Harry DeAngelo and Linda DeAngelo, "Union negotiations and corporate policy: A study of labor concessions in the domestic steel industry during the 1980s," *Journal of Financial Economics*, 1991.

*(recommended) Cynthia Montgomery, "Corporate diversification," *Journal of Economic Perspectives*, 1994.

WEEK 5: INVESTOR COMMUNICATION

Francois Degeorge, Jayendu Patel and Richard Zeckhauser, "Earnings management to exceed thresholds," *Journal of Business*, 1999.

Mary Bange and Werner De Bondt, "R&D budgets and corporate earnings targets," *Journal of Corporate Finance*, 1998.

Paul Healy and K. Palepu, "The challenges of investor communication: The case of CUC International," *Journal of Financial Economics*, 1995.

WEEK 6: THE POWER OF PERCEPTIONS

Harry DeAngelo, Linda DeAngelo, and Stuart Gilson, "The collapse of First Executive Corporation: Junk bonds, adverse publicity, and the "run on the bank" phenomenon," *Journal of Financial Economics*, 1994.

Harry DeAngelo and Linda DeAngelo, "Ancient redwoods and the politics of finance: The hostile takeover of the Pacific Lumber Company," *Journal of Financial Economics*, 1998.

*(recommended) Harry DeAngelo, Linda DeAngelo, and S. Gilson, "Perceptions and the politics of finance: Junk bonds and the regulatory seizure of First Capital Life," *Journal of Financial Economics*, 1996

WEEK 7: HUBRIS

Thomas Lys and Linda Vincent, "An analysis of value destruction in ATT's acquisition of NCR," *Journal of Financial Economics*, 1995.

Lawrence Weiss and Karen Wruck, "Information problems, conflicts of interest, and asset stripping: Chapter 11's failure in the case of Eastern Airlines," *Journal of Financial Economics*, 1998.

Donald Sull, "The dynamics of standing still: Firestone Tire & Rubber and the radial revolution," *Business History Review*, 1999.

*(recommended Werner De Bondt and Anil Makihja, "Throwing good money after bad? Sunk costs and investments in nuclear power plants." *Journal of Economic Behavior and Organization*, 1988.

*(recommended J.B. Heaton, "Managerial optimism and corporate finance," Working paper, University of Chicago, 1998.

*(recommended Barry Staw, "The escalation of commitment: An update and appraisal," in Z. Shapira (ed.), *Organizational Decision Making*, 1997.

WEEK 8: EXECUTIVE PAY

George Baker, Michael Jensen, and Kevin Murphy, "Compensation and incentives: Practice vs. theory," *Journal of Finance*, 1988.

Jay Dial and Kevin Murphy, "Incentives, downsizing, and value creation at General Dynamics," *Journal of Financial Economics*, 1995.

*(recommended Michael Jensen and Kevin Murphy, "CEO incentives: It's not how much you pay, but how," *Harvard Business Review*, 1990

WEEK 9: CORPORATE BUDGETING, FINANCIAL POLICY, AND PERFORMANCE

Michael Jensen, "Corporate budgeting is broken. Let's fix it." *Harvard Business Review*, 2001.

Karen Wruck, "Financial policy, internal control, and performance: Sealed Air Corporation's leveraged special dividend," *Journal of Financial Economics*, 1994.

WEEK 10: COMMITTEES

Cass Sunstein, "The law of group polarization," Working Paper, University of Chicago Law School, 1999.

Donald Langevoort, "The human nature of corporate boards: Law, norms and the unintended consequences of independence and accountability," Working Paper, Georgetown University Law Center, 2000.