Decision Making Inconsistent with Economic and Financial Theory

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Ask yourself the following questions:
Question 1: Imagine that you have decided to see a play where admission is $10 per ticket. As you enter the theater, you discover that you have lost a $10 bill. Would you still pay for a ticket to see the play?
Question 2: Imagine that you have decided to see a play and have paid the admission price of $10 per ticket. As you enter the theater, you discover that you have lost your ticket. The seat was not marked and the ticket cannot be recovered. Would you pay $10 for another ticket?

Most people (88%) said yes to Question 1 but no (54%) to Question 2, even though a $10 ticket is equivalent to a $10 bill in value. Why? Because people consider the $10 ticket and $10 bill are in two different mental accounts in this case. In Case 1, a lost $10 bill is not a ticket, then a $10 bill is considered as a cost. However, in Case 2, a lost ticket is considered as a loss. The above example is one of many topics focused by the behavioral economics and finance, which has profound implications in people's financial and other decision making.

During the 1998 AFCPE conference, Harold Evensky, a Certified Financial Planner, mentioned behavioral finance in his keynote speech and aroused interests among the audience. The term "behavior finance" is becoming hot in the finance industry and recently often appear in popular press. Several personal finance magazines reported the research progress of this new field (Peltz, 1999; Rowland, 1999a, 1999b). If you are interested in this emerging new field, you might want to read this book. This book is about the behavioral economics and finance. The book is based mainly on the teaching notes of the author on the subject. The author is Visiting Professor at the Federal University of Paraná in Brazil, was on faculty at the University of Kansas, Yale University, and Case Western Reserve University, and served as a Senior Economist at the Inter-American Development Bank. The forward is given by Shlomo Maital, a leading scholar in behavioral economics.

The book has two goals. The first is to outline the wide array of behavioral considerations that appear to be relevant to financial and economic decision making. The second goal is to indicate which of those anomalies contribute to a genuinely behavioral theory of decision making, and what can be done to take account of the other anomalies and less completely resolved considerations that do not yet achieve such an objective. The signal this book wants to send is that the traditional economic theory can not describe human decision making adequately based on numerous empirical studies. To better describe human behavior, a new economic theory incorporating advances in modern psychology should be developed. This book is a progress report of this emerging field.

Chapter 1 is an overview. The author describes how traditional economic and financial approaches portray human decision making. Then the author lays out psychological, sociological, cultural, and political considerations on the topic. Chapter 2 to 8 include the major content of the behavioral economics and finance. Chapter 2 describes the behavioral considerations in economics in a historical perspective. Chapter 3 compares the traditional economic approach with approaches from other fields, such as sociology, psychology, and other social sciences in terms of the objectives under economic and financial decisions. Chapter 4 examines the characteristics of the decision making process including a discussion of learning process. Chapter 5 compiles many major behavioral anomalies viewed by the traditional economic approaches. Chapter 6 discusses expectations and expected profits from a perspective of psychology. Chapter 7 proposes the outline of behavioral finance. Chapter 8 provides guidelines for decision making from a behavioral perspective. Chapter 9 concludes the book.

This book includes five lists of bibliography on the behavior economics and finance, which accounts for almost one third of the book pages. The lists are for introductory students, for intermediate level students, for

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advanced students, an annotated bibliography, and additional references, respectively. The advantage of this arrangement is that readers who have various needs can go to different lists for further readings of the subject. The disadvantage is that there is not a comprehensive list of references and a reader has to go through different lists if one is not sure one's level of understanding of this subject.

This book is mainly for researchers. For the researchers who are interested in human behavior, or financial behavior in particular in this field, this book provides a starting point for background information and major references. The book provides a fair description of this emerging field with historical background and future trends of the research. The annotated bibliography is convenient for the researchers to preview and locate major studies in this field. The book also provides extensive details of a case study that explores the entrepreneurial response to economic liberalization and integration based on the behavioral approach to financial and economic decision making using data collected from Uruguay. The case demonstrates how to apply the theory of behavioral economics to the business management setting. For the researchers in personal financial counseling and planning, this case may inspire the research design of decision making in personal and family settings.

If used appropriately, this book can be a good supplement for a graduate course on consumer decision making or personal financial management. The book presents details of many interesting experimental studies, which could be used as attractive teaching tools in classroom instruction. In addition, students can use the theories and studies presented in the book as a reference to develop hypotheses and conduct projects that test the hypotheses based on the theory of behavioral finance and economics.

For financial counselors and planners, this book can be used to understand clients' behavior from a unique perspective. Since the findings and conclusions from the book are based on the research that utilizes both economic and psychological theories, the conclusions would be of interest to counselors and planners who have either economics, finance, or psychology background. For example, some research shows that the psychological factors are more important in explaining the ups and downs of sophisticated financial markets that offer frequent, reliable feedback data than in explaining much less sophisticated, once or twice in a lifetime, real estate markets (p120). A person who has not made peace with her losses is likely to accept gambles that would be unacceptable to her otherwise (pp120-1). Most of those who obtain credit cards do not seek out banks or other distributors that offer the lowest interest rates, though somewhat more search is made to find the much less important annual fee (p121).

References

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A long tradition in decision theory develops models of how humans make decisions under uncertainty. A crucial idea in this development is that of translation invariance.Â For a dataset to be maxmin rationalizable, but inconsistent with subjective expected utility, it needs to contain a sequence in the conditions of SARSEU in which #I0,1+#I1,1+#I2,1=#I0,1â€²+#I1,1â€²+#I2,1â€², but where #I0,1+#I1,1âˆ'#I1,1â€²>0. As we have emphasized, the result in Theorem 4 is for two states. There are two simplifications afforded by the assumption of two states, and the two are crucial in obtaining the theorem.Â You are going to email the following Testing theories of financial decision making. Message Subject (Your Name) has sent you a message from PNAS. Both economists and finance professionals are being employed in governments, corporations, and financial markets. At some fundamental level, there will always be a separation, but both are likely to remain very important to the economy, investors, and the markets for years to come. Key Takeaways. Economics and finance are interrelated disciplines that inform each other, even if the specifics are distinct. Finance, as a discipline, is derived from economics; it involves assessing money, banking, credit, investments, and other aspects of the financial systems. Finance can be further broken down Economic decision making is the process of making business decisions involving money. The purpose of making these decisions is generally to come up with strategies that help to either make the company more valuable or to increase the owner's revenue. Those involved in the decision-making process must have access to the company's detailed financial reports and must have a good understanding of the company's economic climate. Success in the world of business depends on a company's leaders ability to make wise economic decisions. Since economic decisions have to do with the am Nuamber three. Theories of decision-making I n economics and behavioral science. [Editor's note: This is the first of eight survey articles on recent developn~entsin economics scheduled for appearance in the Review over the next few years. Financial support of the series has been generously provided by the Rockefeller Foundation. The managing editor is particularly grateful for the personal interest which the late Dr. Nor-man S. Buchanan, Director for the Social Sciences a t the Foundation, took in the plan-ning of the project 1.Â 'The models of rational decision-making employed in operations research are surveyed in Churchman, Ackoff, and Arnoff [I61 ; Bowman and Fetter [I I I ; and Vazsonyi [691. Types of Financial Decisions: Investment Decision, Financing Decision, Dividend Decision and Working Capital Management Decision. Types of Financial Decisions â€“ That Every Company is Required to Take: Investment Decision, Financing Decision and Dividend Decision. Every company is required to take three main financial decisions, they are: 1. Investment Decision.Â A financial decision which is concerned with the amount of finance to be raised from various long term sources of funds like, equity shares, preference shares, debentures, bank loans etc. Is called financing decision. In other words, it is a decision on the â€˜capital structureâ€™ of the company.