Code No: MB194B5/19

JAWAHARLAL NEHRU TECHNOLOGICAL UNIVERSITY- GURAJADA VIZIANAGARAM

MBA IV Semester Regular/Supplementary Examinations, May-2025

Behavioral Finance

Time: 3 Hours **Max. Marks: 75**

Answer any FIVE Questions One Question from Each Unit

All Questions Carry Equal Marks

UNIT-I

1.	a	Define behavioral finance and explain its nature and scope.	6M
	b	Explain the investment decision cycle under uncertainty.	6M
		OR	
2.	a	Discuss subjective probability and its relevance in investment behavior.	6M
	b	Evaluate the role of perception errors in investment behavior.	6M

UNIT-II

3.	a	Define utility theory and explain its application in finance.	6M
	b	How is expected utility used as a basis for financial decision-making?	6M
		OR	
4.	a	Analyze the empirical data questioning market efficiency.	6M
	b	What is the role of psychology in financial decision processes?	6M

UNIT-III

5.	a	Discuss the role of fundamental information in financial markets.	6M
	b	Analyze the predictability of financial markets.	6M
		OR	
6.	a	Explain market anomalies through a behavioral finance lens.	6M
	b	Explain psychological factors leading to market bubbles and crashes.	6M

UNIT-IV

7.	a	Explain how behavioral factors influence corporate decisions on capital structure.	6M
	b	Discuss emotional factors in executive financial decisions.	6M
		OR	
8.	a	Discuss mechanisms linking external factors to corporate finance outcomes.	6M
	b	How does loss aversion influence corporate investment decisions?	6M

UNIT-V

9.	a	Explain the role of emotions in financial decision-making.	6M
	b	What is the impact of emotional states on investment risk attitudes?	6M
		OR	
10.	a	Analyze experimental findings on emotions and investment choices.	6M
	b	How can investors mitigate emotional biases in their decision-making?	6M

CASE STUDY

11 Mr. Michael Nicholas ("Mr. N") is a single, 59-year-old, hardworking, international pharmaceutical marketing executive (an employee of a large multinational company). He earns a salary of $600,000 annually. He has residences in both Geneva and New Jersey and generally lives within his annual income net of taxes. He occasionally spends more than his net income, but in other years he saves and invests. His current portfolio is worth approximately $4 million. It reached this value primarily because of some successful high-risk biotechnology investments as well as stock options granted by his employer. Mr. N is a widower and has no children. His primary financial goal is to retire comfortably at age 68 with a reduced spending level of $150,000 and to bequeath any assets remaining at his death to his alma mater, Tulane University. Mr. N's financial advisor, Mr. Clayton Spencer, has been working with Mr. N for less than a year. During that time, Spencer has 15M

proposed a comprehensive financial plan. Despite Spencer's recommendations, however, Mr. N's asset allocation has remained the same, at nearly 80 percent equities, with 35 percent in his employing company's publicly traded stock. Still, Spencer has developed a good working relationship with Mr. N.

Spencer believes that Mr. N. is a well-grounded, fairly rational person, but he also believes that Mr. N has some behavioral issues to address. In Spencer's view, the most important issue is that Mr. N has not taken action yet on the new, more conservative allocation that Spencer proposed months ago of 50 percent stocks, 40 percent bonds, and 10 percent cash. Spencer worries about the lack of diversification in Mr. N's portfolio. Spencer's concern is that a severe downward market fluctuation or drop in Mr. N's employing company's stock may cause him to sell assets irrationally, affecting his long-term financial plan. Spencer's financial plan demonstrates that even with a somewhat less aggressive portfolio, Mr. N could still meet his primary financial objectives if he could save just $25,000 annually. Spencer believes that one of the issues is that Mr. N thinks of himself as a good investor because of the biotechnology bets that worked out well for him in the past. Spencer suspects that Mr. N hasn't changed his allocation because he thinks Spencer's allocation recommendation is too conservative. Spencer also notices that Mr. N constantly worries about missing out on hot stocks that go up, which his friends are investing in. Spencer decides to ask Mr. N to take a behavioral bias diagnostic questionnaire. When Spencer gets the answers to the questionnaire, he decides to focus on three biases: *regret aversion, overconfidence*, and *self-control*. Spencer asks Mr. N further questions on these three biases.

Through this process, Spencer finds that Mr. N is indeed susceptible to the following emotional biases:
Regret-aversion bias (the tendency to avoid making a decision for fear the decision may cause regret later).
Overconfidence bias (the tendency to overestimate one's investment savvy).
Self-control bias (the tendency to spend today rather than save for tomorrow).

As part of the original financial planning process, Spencer administered a risk tolerance questionnaire to Mr. N for the purpose of generating a mean-variance optimization portfolio recommendation. When Spencer generated the optimization recommendation, Mr. N's proposed asset allocation was 50 percent stocks, 40 percent bonds, and 10 percent cash. Spencer's job is now to answer the following three questions:

1. What effect do Mr. N's biases have on the asset allocation decision?
2. Should Spencer moderate or adapt to Mr. N's biases?
3. What is an appropriate behaviorally modified asset allocation for Mr. N?