

# Management Development Institute

Behavioral Finance & Business Valuation (BFBV)

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## Introduction

BFBV is a multidisciplinary course spanning over 1 ½ terms constituting 30 contact sessions.

I will use key ideas from economics, engineering, psychology, mathematics, probability, accounting, history, neurology, and evolutionary biology to teach BFBV students the narrower subjects of finance & investing.

Contrary to traditional finance courses based on the “rational man model” in economics, I will use the “foolish man model” from social psychology and numerous examples from the history of human follies to help students overcome their own behavioral biases. Students will also learn how to think about valuation, how to spot mis-priced opportunities in financial markets, and how to exploit them.

## Role Models

As the instructor for BFBV, I will teach specific topics drawn from the work done by some of the most successful and original thinkers in their fields and include Warren Buffett, Charlie Munger, Benjamin Graham, Walter Schloss, Philip Fisher, Danny Kahneman, Robert Cialdini, John Templeton, Martin Whitman, Nassim Taleb, the partners of Tweedy Brown, John Kenneth Galbraith, Seth Klarman, and Benjamin Franklin.

I will also teach BFBV students important lessons from my own experience acquired over the last 18 years as a practitioner of deep value investing. Live cases with real-time learnings will be an integral part of BFBV.

## Course Structure

BFBV will have five components. Each component will help students answer some key questions:

1. **You:** Who are you? Are you rational? How do you make decisions? What mistakes do you make? How can you correct them?
2. **Businesses:** What's a good business, a bad business, or a mediocre business and why?
3. **People:** Who are the people who run businesses? How do you evaluate them? How can you find intelligent fanatics?
4. **Money:** How should you approach security markets with an objective of creating long-term wealth? How should you think about valuation? How should you think about building portfolios? How should you think about buying, holding, selling decisions?
5. **You:** Do you really want to be a perfectly rational human being? Is there a moral side to investing? Who are you now?

## Attendance for Guest Lectures

I will be inviting several guest lectures for taking classes in this course. There will be entrepreneurs and global investors who will come to take classes. It will be compulsory for students to attend these classes. Anyone who is absent (without my prior permission) **will not be evaluated for the course.**

## Reference Material

### Books

"Security Analysis" By Graham & Dodd.

"The Intelligent Investor" by Benjamin Graham.

Extracts from the letters of Warren Buffett to the Shareholders of Berkshire Hathaway Inc from 1978 to 2013. You can get these from [www.berkshirehathaway.com](http://www.berkshirehathaway.com)

"Poor Charlie's Almanack" by Charlie Munger. Several copies of this book have been kept in the library, thanks to its editor, Peter Kaufman.

"100-to-1 in the Stock Market" by Thomas Phelps.

"Extraordinary Popular Delusions and the Madness of Crowds" by Charles Mackay.

"The Crowd: A Study of the Popular Mind" by Gustave Le Bon

"The Great Crash 1929" by John Kenneth Galbraith.

“A Short History of Financial Euphoria” by John Kenneth Galbraith.

“The Power of Noticing: What the Best Leaders See” by Max Bazerman

“Stalking the Black Swan: Research and Decision Making in a World of Extreme Volatility” by Kenneth A. Posner.

“The Little Book that Creates Wealth” by Pat Dorsey.

“The Investment Checklist” by Michael Shearn.

“A Few Lessons for Investors and Managers from Warren E. Buffett” by Peter Bevelin

“Seeking Wisdom: From Darwin to Munger” by Peter Bevelin

“Value Investing: From Graham to Buffett and Beyond” by Bruce Greenwald

“Margin of Safety” by Seth Klarman

“Accounting for Value” by Stephen Penman

“Common Stocks & Uncommon Profits” by Philip Fisher

“Conservative Investors Sleep Well” by Philip Fisher

“Developing an Investment Philosophy” by Philip Fisher

“Understanding Michael Porter: The Essential Guide to Competition and Strategy” by Joan Magretta

“The Ten Commandments of Business Failure” by Don Keough.

“Business Model Generation: A Handbook for Visionaries, Game Changers, and Challengers” by Alexander Osterwalder, Yves Pigneur.

“Brand Breakout: How Emerging Market Brands Will Go Global” by Nirmalya Kumar.

“Leverage: The CEO’s Guide to Corporate Culture” by John Childress.

“The Aggressive Conservative Investor” by Martin Whitman

“Poor Charlie’s Almanack” by Charlie Munger

“This Time Is Different: Eight Centuries of Financial Folly” by Carmen M. Reinhart and Kenneth S. Rogoff.

“Thinking, Fast and Slow” by Daniel Kahneman.

“Seeing What Others Don’t: The Remarkable Ways We Gain Insights” by Gary Klein.

“Influence: Science and Practice” by Robert Cialdini.

“The Psychology of Judgment and Decision Making” by Scott Plous.

“Why I Failed: Lessons from Leaders” by Shweta Punj.

“Think Like a Freak: How to Think Smarter about Almost Everything” by Steven Levitt and Stephen Dubner

“Why Smart People Make Big Money Mistakes And How To Correct Them: Lessons From The New Science Of Behavioral Economics” by Gary Belsky and Thomas Gilovich.

“Being Wrong: Adventures in the Margin of Error” by Kathryn Schulz.

“Mistakes Were Made (But Not by Me): Why We Justify Foolish Beliefs, Bad Decisions, and Hurtful Acts” by Carol Tavris and Elliot Aronson.

“Fooled by Randomness: The Hidden Role of Chance in Life and in the Markets” by Nassim Nicholas Taleb.

“The Black Swan: The Impact of the Highly Improbable” by Nassim Nicholas Taleb.

### Articles

“Are Investors Reluctant to Realize Their Losses?” by Terrance Odean, The Journal of Finance, Vol LIII, No. 5, October 1998.

“Boys will be Boys: Gender, Overconfidence, and Common Stock Investment” by Brad Barber and Terrance Odean, The Quarterly Journal of Economics, February 2001.

“Lord, Charles, Ross, Lee, and Lepper, Mark (1979). 'Biased Assimilation and Attitude Polarization: The Effects of Prior Theories on Subsequently Considered Evidence', Journal of Personality and Social Psychology, 37 (11): 2098-2109.

“Everybody’s An Expert: Putting predictions to the test.” by Louis Menand, New Yorker, DECEMBER 5, 2005.

“Misunderstanding the Nature of Company Performance: THE HALO EFFECT AND OTHER BUSINESS DELUSIONS” by Phil Rosenzweig, California Management Review, 2007.

“Why Foxes Are Better Forecasters Than Hedgehogs” by Philip Tetlock.

“Market Shock: AAA Rating May Be Junk” by FLOYD NORRIS, New York Times, July 20, 2007.

“Dr. Drug Rep” by Daniel Carlat, New York Times, November 25, 2007

“Pearls Before Breakfast: Can one of the nation's great musicians cut through the fog of a D.C. rush hour?” By Gene Weingarten, Washington Post, April 8, 2007.

“Is Justin Timberlake a Product of Cumulative Advantage?” by DUNCAN J. WATTS, New York Times, April 15, 2007

“Does Rejection Hurt? An fMRI Study of Social Exclusion” by Naomi I. Eisenberger, Matthew D. Lieberman, Kipling D. Williams, Science, Vol 302 , 10 October 2003.

“How Rating Firms' Calls Fueled Subprime Mess: Benign View of Loans Helped Create Bonds, Led to More Lending” By AARON LUCCHETTI and SERENA NG, The Wall Street Journal, August 15, 2007.

“All Fall Down” by Thomas Friedman, New York Times, November 25, 2008.

“Triple-A Failure: The Ratings Game” By ROGER LOWENSTEIN, New York Times, April 27, 2008.

“Home Equity Frenzy Was a Bank Ad Come True” by Louise Story, New York Times, August 15, 2008.

“You don’t have to be a Dupe to be Duped: Lessons from the Madoff Affair” by Robert Cialdini.

Document on “How Warren Buffett runs Berkshire Hathaway’s Insurance Operations.”

Document on “Warren Buffett on Incentive Compensation.”

“A House Built On Sand” by Carol Loomis, FORTUNE, October 26, 1998.

“Lies, Damned Lies, and Managed Earnings” by Carol Loomis, FORTUNE, August 2, 1999.

“AOL+TWX=???” by Carol Loomis, FORTUNE, February 7, 2000

“The 15% Delusion” by Carol Loomis, FORTUNE, February 5, 2001

“The Revenue Games People (Like Enron) Play” by Carol Loomis, FORTUNE, March 31, 2002

“The Blow-Up Artist: Can Victor Niederhoffer survive another market crisis?” by John Cassidy, New Yorker, October 15, 2007.

“Blowing Up” by Malcom Gladwell, New Yorker, April 22 and 29, 2002.

“Veteran Trader Loses Investor, Closes a Fund” by GREGORY ZUCKERMAN, The Wall Street Journal, October 10, 2007.

“Emperor Corzine’s Goldman clothes” by JOHN GAPPER, Financial Times, November 3, 2011.

“Corzine Forgot Lessons of Long-Term Capital” by ROGER LOWENSTEIN, Bloomberg, NOV. 2, 2011.

### **Movies and Video Clips**

Extracts from these movies and clips will be used in classes: Dot Con - PBS Documentary, Twelve Angry Men, The Fog of War, Maxed Out, Boiler Room, “The Man Who Knew” 60 Minutes documentary on Harry Markopolos’ exposure of Bernie Madoff, Freakonomics Documentary, Glengarry Glen Ross, Tin Men, Bugsy, Buffett & Munger Videos, Seth Klarman Video, Prem Watsa Video, Peter Cundill Video, Joel Greenblatt Video, Walter Schloss Video, Nassim Taleb Videos, Barbarians at the Gate, Wall Street, Moneyball, Maxed Out, Boiler Room, Thank You For Smoking, Trading Places, Selected TED Talks, Jiro Dreams of Sushi, and Discovering Psychology.

I advice students to see these movies and videos in totality.

### **Session Plan**

## **TERM V**

1. Lecture 1: Multidisciplinary Thinking
2. Lecture 2: Sense & Nonsense in Modern Corporate Finance
3. Lectures 3 to 7: The Psychology of Human Misjudgment
4. Lecture 8 to 11: The Graham & Dodd Investing Style
5. Lecture 12 to 16: The Warren Buffett Investing Style
6. Lecture 17 to 20: Cases in Value Investing

## **TERM VI**

Lectures 1 to 10: Cases in a variety of corporate actions including M&A, share buybacks, leveraged buyouts, leveraged recapitalizations, spinoffs, valuation of a variety of businesses, bankruptcy investing, investing in uU (unknown and unknowable) situations, sidecar investments, activist investments, valuation of unique assets, special situations, statistical themes, and turnarounds.

## **Evaluation**

Component	Weight Term V	Weight Term VI
Quizzes	20 marks	20 marks
Written Assignments	20 marks	—
Mid Term (2 hours, closed book)	20 marks	—
End Term (3 hours, closed book)	40 marks	—
End Term (2 hours, closed book)	—	30 marks
<b>Total</b>	<b>100 marks</b>	<b>50 marks</b>