Introduction

Business schools all teach multiple courses in Corporate Finance. Until recently none taught Consumer Finance. Yet Consumer Finance is a much larger segment of the economy. In the U.S. as of 2013, households hold $88 trillion in assets, and $14 trillion in liabilities. Corporations have less than half the assets, and less than 2/3 of the debt. This course provides a remedy to the imbalance.

The course will be inter-disciplinary -- Johnson is a psychologist and a professor in the Marketing division, and Zeldes is an economist and a professor in the Finance and Economics division. We will bring different perspectives to every topic:

- What is the economic theory describing how people behave?
- What does psychology and behavioral economics contribute to understanding behavior?
- What are the facts about how consumers actually behave? What are the existing markets, institutions, firms, and regulations, both in the U.S. and abroad?
- What are the opportunities for and barriers to innovating in these markets?

We will examine markets for borrowing (mortgages, credit cards, peer-to-peer lending, payday loans), saving (401(k)s, strategies to promote saving, optimal asset allocation), and insurance (including life, health, and longevity). We will emphasize both how
people do and how people should make financial decisions, and the implications for financial services firms.

We will use the tools of traditional economics, behavioral economics, and psychology to better understand consumer financial decisions, current and possible future financial products, the consumer finance industry, and financial public policy. Important new research illustrates how combining insights from psychology and economics can improve our understanding of consumer financial behavior. In their book Nudge, for example, Cass Sunstein and Richard Thaler argue that firms and policymakers can design mechanisms to guide people’s choices in a way that improves outcomes yet maintains freedom of choice. The aftermath of the financial crisis and continuing debate about consumer financial protection will keep the class lively and yield lots of class content that is “torn from the headlines.”

Why consumer finance?
This will be the fourth time that we have taught this course together (the second time as a block week). When we were first thinking about creating this course, we identified several trends that suggested that the introduction of an MBA consumer finance elective was overdue:

• Over the last 30 years there has been a global shift from defined-benefit to defined-contribution pension plans, putting decisions about the management of retirement wealth increasingly into the hands of households.

• Consumer debt to income ratios in the U.S. have risen from about 70% in the late 1970’s to about 105% today, while the personal saving rate has dropped to under ½ of its level in the 1970s.

• This is a ‘hot’ area of research, and new and interesting results are being published in journals in economics, psychology, and marketing. One of our goals is to translate these findings into products that will lead to better outcomes.

• The recent financial crisis highlighted the importance of consumer decisions to consumer well-being and to the overall economy (e.g. 401(k) asset allocation, sub-prime mortgages, home foreclosures). There has also been renewed interest (and employment opportunities) in government regulation of the consumer finance sector. We plan on having a speaker from the Consumer Financial Protection Bureau.

Who should take this course? Why?
This course should appeal to a wide variety of students:

• First, those who want to work for financial services firms, including asset management, banking, and insurance.

• Second, those who are interested in consulting, investment banking, or private equity, and need to understand and value firms that provide financial services to consumers.
• Third, those interested in marketing and consumer decisions more generally.
• Fourth, those interested in broader public policy issues (consumer finance is at the heart of many important public policy debates.)
• Finally, the course will be helpful to anyone interested in learning how to better manage his or her own personal finances.

Course structure
The course will include lectures, class discussions, guest speakers, case analysis, small assignments, and student presentations. It will be highly interactive, and you are expected and encouraged to take part in class discussions. Both professors will participate in all of the classes throughout the week. We bring different perspectives to these questions, and we look forward to some lively debates!

What’s Broken, How to Fix It (optional assignment)
In recent years, there have been enormous advances in technology, in our understanding of consumer decision-making, and in financial instruments. This suggests there is a lot of opportunity for financial innovation in consumer finance. The idea of the ‘What’s Broken, How to Fix It’ exercise is to identify such an opportunity by finding a problem (this could be one that annoys you) and suggesting a solution. This should be done in small group teams (formed over lunch on Monday). Some or all of the teams will give 5-minute presentations to the class later in the week.

Cases and assignments
We will use cases during the course. Three will require short write-ups (the first done individually and the other two done as a team). The remaining cases should be read and analyzed in preparation for class discussion. In addition, there will be two short assignments.

Panel discussions / outside speakers
We will have at least 3 sessions with outside experts. In the past, we have included individuals whose companies are start-ups, decision makers featured in the cases, executives with responsibility for introducing new products for large firms, and well known financial writers. See the course calendar for details.

Class participation
We will be grading your participation in the cases, class discussions, and exercises. We will also use interactive technology in the form of audience response indicators (“clickers”) provided by Turning Technologies. Please bring your clicker with you for the week. We will bring extra clickers on the first day for anyone who does not already have an assigned clicker. Note that the clickers will be registered to you, so that your responses will available to us to use for class discussion and participation grading. We will not use your specific responses for grading without prior announcement, but your attendance in class can be ascertained by your responses and may be a part of your participation grade. When asking for your opinions on sensitive issues, we will put the clickers into a mode that makes your responses anonymous.
**Class meetings and attendance**
This is a block-week course, so all classes will be held in a one week period: Monday, January 13 through Friday, January 17, 2014. Classes will run between 9 am and 5:30 pm, Monday through Thursday, and 9-2 on Friday, with breaks and a few preparation sessions interspersed. There will also likely be an evening session with a speaker and reception on Wednesday. Class attendance and participation is important. If for some reason you need to miss class, please let us know in advance via e-mail.

**Course materials**
There is no textbook for the course. We will be identifying a set of core readings that you should read sometime before our first meeting on January 13th. Most of the cases and readings will be included in the course pack and also posted in Canvas. Additional materials, including class notes, will be posted in Canvas and distributed during the week.

**Final Exam.**
The final will be a timed, open-book, take-home exam that you can download any time between 2:15 pm on Friday January 17th and Monday night January 20th. You will have 2 hours for the exam, i.e., you will need to upload your answer no more than 2 hours after your download time. If you wish, you may use our classroom to take the exam on Friday afternoon, starting any time at or after 2:15 pm.

**Course requirements and grading**
Grades will be based on the assignments and short case write-ups, class participation, and a final exam, as follows:

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<thead>
<tr>
<th>Weights for grading</th>
<th>%</th>
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<tbody>
<tr>
<td>Assignments and case write-ups</td>
<td>30</td>
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<tr>
<td>Class participation</td>
<td>30</td>
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<tr>
<td>Final exam</td>
<td>40</td>
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**Office hours**
We are generally available via e-mail and also after classes each day. Please feel free to contact us with any questions or feedback about the course.

**Teaching assistants**
There will be two TAs for the course. They will be attending class, and their contact information will be posted in Canvas. You can contact the TAs with questions related to readings, assignments, calendar, etc.
The Psychology and Economics of Consumer Finance: course overview

Psychology
- Mental Accounting
- Loss Aversion and Framing
- Hyperbolic discounting
- Limited attention
- Over-confidence
- Subjective probability and emotion

Borrowing
- Mortgages
- Credit cards
- Peer-to-peer / payday loans

Saving and investing
- How do people save?
- Encouraging saving
- Investing / portfolio allocation

Risk management
- Longevity risk and annuities
- Life and health insurance
- Social Security

Innovations for the future
- Financial services and markets
- Strategy
- Public policy

Economics
- Utility maximization
- Risk attitudes
- Exponential discounting
- Incentives
- Competition
- Adverse selection / moral hazard

Advice

Consumer Financial Protection

www.gsb.columbia.edu/faculty/szeldes/Courses/PECF.htm