

Information and Communication in Finance: MFE Elective Course

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Information and Communication in Finance

"Never invest in a business you cannot understand". Warren Buffett

- ① Good information is crucial to markets' ability to fund the most productive opportunities.
 - ▶ *e.g. How to ensure we fund a Facebook, not a MySpace?*
- ② The Efficient Market Hypothesis states that all relevant information is contained in **prices**.

Question: But then why do we see so much independent research and communication?

- Why not simply rely on prices to allocate our investments?

Why study anything other than prices?

- **Problem 1: Information in prices must come from somewhere.**
 - ▶ But if prices are so informative, why do any research in the first place?
 - ▶ Grossman & Stiglitz (1980).

- **Problem 2: Markets are not informationally efficient.**

- **Problem 3: In many financial interactions, prices are not available.**
 - ▶ Internal operations of corporations are based on command, not markets.

“Successful investing is anticipating the anticipations of others.”

– John Maynard Keynes

- Participants in financial markets spend time/energy trying to acquire & communicate information on how to ‘beat the market’:
 - ▶ **Firms:** Approx. 3% of US GDP spent on R&D (World Bank, 2015).
 - ▶ **Executives:** Live and die on the quality of their communication to investors.
 - ▶ **Analysts:** Research asset prospects & recommend trades to clients.
 - ▶ **Clients:** Buy-side pay approx. \$15bn per year for bank research in 2016. (FT, 2017).
 - ▶ **Regulators:** Provide stress tests of banks’ financial health.

- **Question:** How do financial markets motivate agents to use and share information?

Course Outline

In this course, we ask:

- 1 What are the strategic motives for market players to acquire and communicate information?
- 2 What are the consequences of information sharing for financial market outcomes?
- 3 How do we improve communication and information production?

Our approach: Use economic theory to shed light on the questions above.

Course Outline

We study the role of four different types of information on strategic financial decision-making:

- 1 Cheap talk: Interpreting financial advice.
- 2 Communication with evidence: Communication to investors through audited accounts.
- 3 Communication through actions: Information acquisition in trading environments; herding in finance.
- 4 Institutional design for the purpose of Persuasion.

Course Structure

General course structure

- The course consists of **8 × 3 hr lectures**.
 - ▶ Dr. Best will teach 4 lectures on Herding in Finance and Information Design (Stress Tests)
 - ▶ Dr. Quigley will teach 4 lectures on Information Acquisition and Cheap Talk/Communication with Evidence

- Practice problems will be distributed in lectures.
 - ▶ Solutions will be discussed in pre-specified lectures
 - ▶ You are **not** required to submit answers to practice problems, but you are expected to attempt the problem sets

Format of Assessment

Course assessment

- The course will be assessed by a single **3 hour exam**.
- The exam will consist of **2 sections**:
 - ▶ **Section A**: 8 compulsory short-answer questions
 - ▶ **Section B**: 3 long answer questions, of which 2 must be answered.
- Questions in Section A will be short, problem based questions.
- Questions in Section B may contain problems, essays or mixtures of both.