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"How Can Beta be Saved in the Face of Loss Aversion?

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Abstract

Beta is based on co-variance, a bi-directional measure of risk implying that below-the-average and above-the-average variations are treated symmetrically. Loss aversion, however, treats losses differently from gains. Thus, if the range of possible outcomes for a project includes losses, the use of variance, co-variance and beta are put into doubt. The paper examines possible ways to save the use of beta for discounted cash flow analysis. This would affect the fair value of future cash flows which needs to be disclosed in accounting documents.

Key words

Behavioral finance, corporate finance, project evaluation, WACC, cost of capital, psychology, bias

JEL: D7, D8, D81, D21, D23, G31, L2