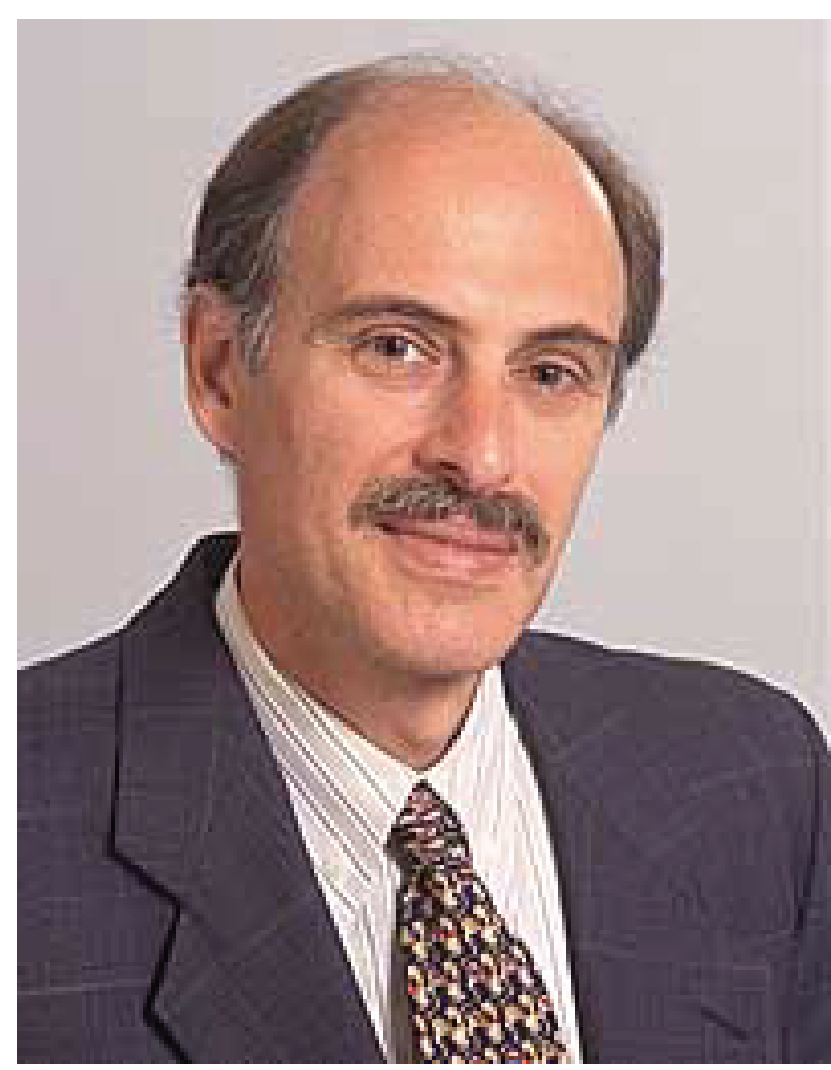




Presented by:
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Sanford J. Grossman

The winner of John Bates Clark Medal in 1987



Introduction

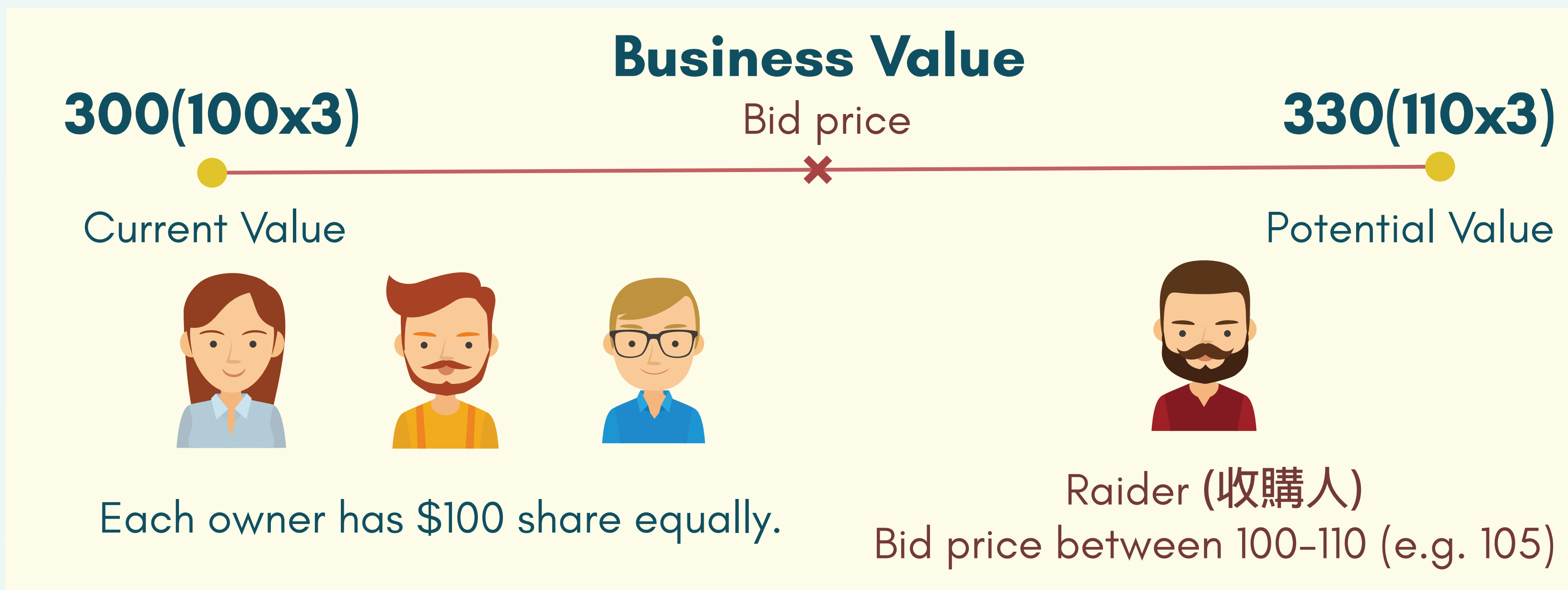
Sanford J. Grossman, also known as “Sandy”, is a famous researcher in the United States specializing in **quantitative finance**. His economic researches concern **rational expectations equilibrium** when it is about privately owned information and **the incentives of managers in modern corporations**. He is the winner of John Bates Clark Medals by the American Economic Association in 1987.

Here are two of his major and famous works that we would like to introduce to you!

Takeover Bids, the Free-Rider Problem, and the Theory of the Corporation

Considering a case:

A raider (收購人) provides an offer to **takeover** a firm
Accept offer: get **105**
Decline offer: get **100** (takeover failed) or **110** (takeover)



Given accept the offer,

Owner 2	Owner 1	
	Accept bid	Decline bid
Accept bid	(105,105)	(110,105)
Decline bid	(105,110)	(100,100)

Result: No Pure Strategy Nash Equilibrium!

Note that all owners want to be the last person to decline the offer (earn \$110).

Question: How to win the game?

Before takeover

Owners who want to accept the offer

After takeover

Raider
Find that the successful owner benefit from free-ride conduct

Non-tendering shareholder
React to raider (new shareholder) dilution

Goal: Higher Bidding Price

- Working harder (Increase management efficiency)
- Setting higher tender price

Goal: Strike for more benefit

Revaluation of the business dilutes the property right of non-tendering shareholder

Goal: Maintain his/her value of property

- Lobbying for incumbent support
- Requiring outside appraiser

An introduction to the theory of rational expectations under asymmetric information

What is Asymmetric Information?

Also known as "information failure", occurs when one party in an economic transaction has **greater material knowledge** than the other party

Considering a case:

You are the girl with **no private information**. You want to buy a house with 3 million initially.

Other buyer with private info You no private info

Bidding price: **3 → 4 million** willingness to pay: **3 million**

Model 1: Walrasian model

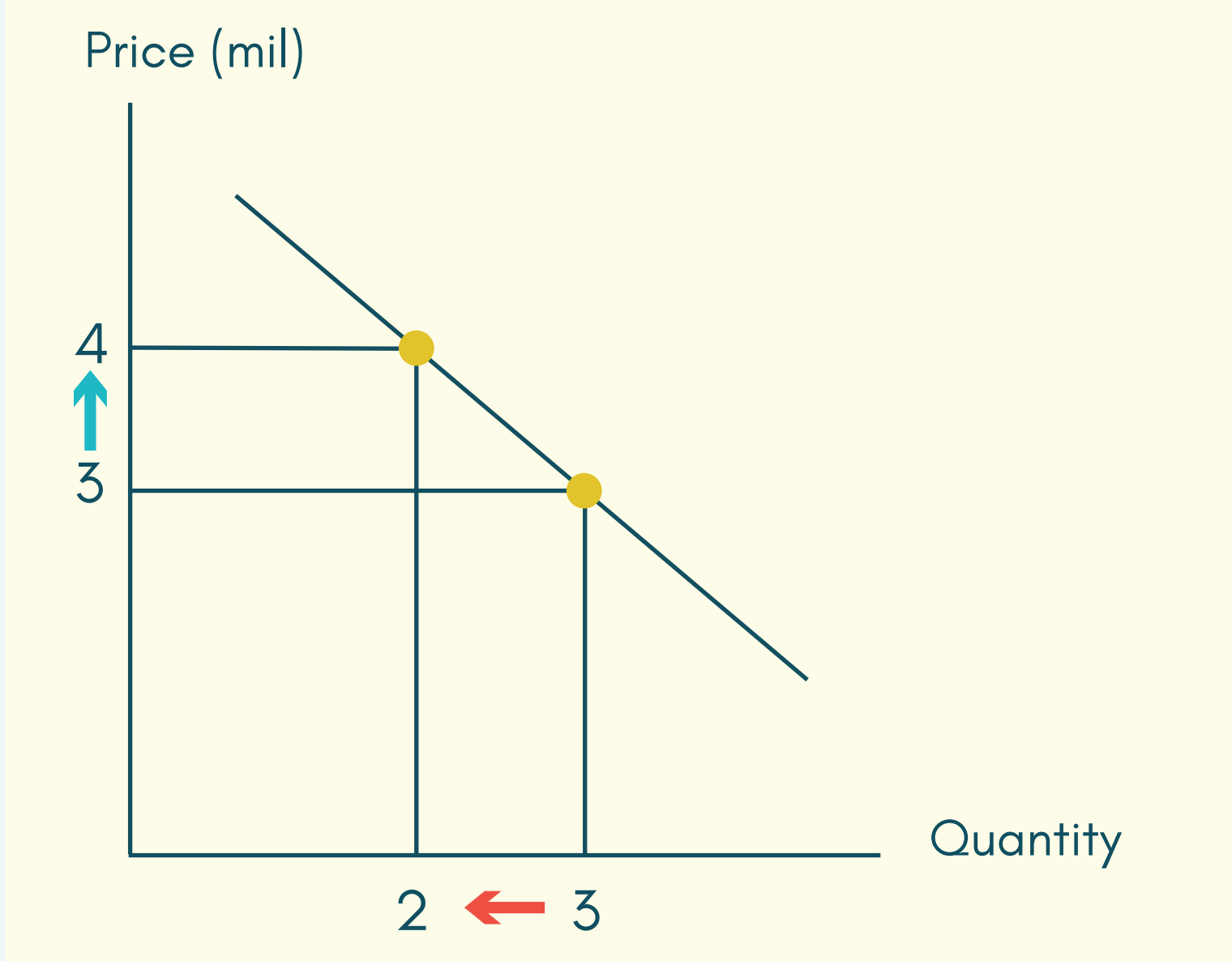
Classical (Walrasian) Model

Price Quantity Demanded

Functions of Price

✓ tell you whom to trade & private valuation of goods

✗ giving information



Bidding price: **3 → 4 million** **Will not change your demand**

Model 2: Rational Expectations model

Agents inside the model are assumed to "know the model" and on average take the model's predictions as valid

This model concerns about **Uncertainty**

Price change gives information of others' preferences
→ More information about future

Bidding price: **3 → 4 million** **Price rises = others think this house worths more than you expect! Change your demand!**

Functions of Price
Indicating agent's private information

→ Optimal forecast that uses all available and relevant information

→ Equilibrium