Educational Administration: Theory and Practice
2023, 29(4), 936-941
ISSN: 2148-2403
https://kuey.net/
Research Article

An Empirical Review Of Behavioral Biases In Investment Decisions

Mr. Vangala Jalender Reddy[1*], Dr. B. Ravi Kumar[2], Dr. K. Sivasubramania Deepak[3]

[1*]Research Scholar, Department of Business Administration, Annamalai University, Annamalai Nagar, Chidambaram, Tamil Nadu. Email:jalender7@gmail.com.
[2]Professor, Department of Mathematics, Joginpally B. R. Engg. College, Hyderabad, Telangana. Email:ravikumarstats@gmail.com.
[3]Assistant Professor, (Deputed), Department of Business Administration, Annamalai University, Annamalai Nagar, Chidambaram, Tamil Nadu.

***Corresponding Author:** Mr. Vangala Jalender Reddy
*Research Scholar, Department of Business Administration, Annamalai University, Tamil Nadu. Email:jalender7@gmail.com

Citation: Mr. Vangala Jalender Reddy, et al (2024), An Empirical Review Of Behavioral Biases In Investment Decisions, *Educational Administration: Theory and Practice*, 29(4), 936-941, Doi: 10.53555/kuey.v29i4.3998

ARTICLE INFO

ABSTRACT

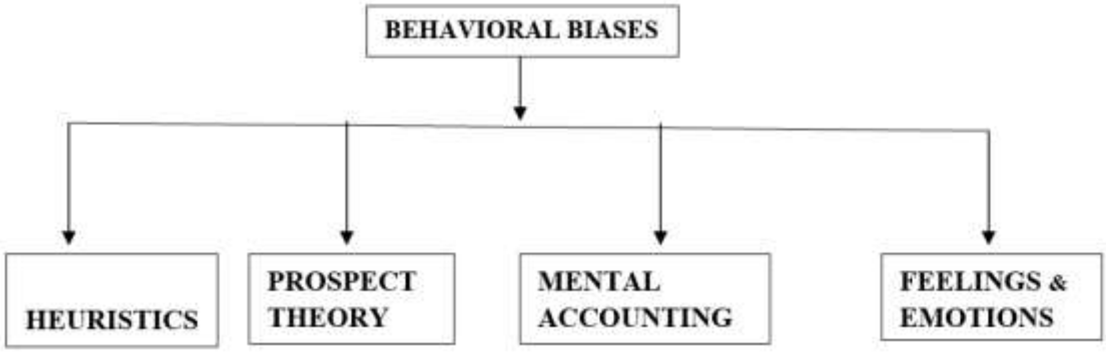
The present study is to focus on the insights of investment behavior of investors in general. Investment analysis was performing from very long periods, but most of times analysis was proven wrong and investor couldn't make fruits of their investment. The main reason for the failure of analysis is they focus on the different aspects of Economies and predict what happens in future but they neglect the capacity and failure of human brain while analyzing and processing the data. Here this research will focus on the different issues corresponding to the behavioral aspects which plays crucial role while investing the funds. Cognitive behavior of investors will create disadvantageous result of an investment. These behavioral issues are called Behavioral Biases. These biases influence an investor unknowingly to deviate from the actual analysis for choosing investment option. This research made to find such aspects to influence the investor decisions. The behavioral biases create chaos to the investors and guiding others to fear for Markets, hence market flies down trend. The Behavioral Biases includes Herding, Home bias, Over Confidence, Anchoring, Gambler Fallacy, Loss Aversion, Regrets and Mental Accounting and so on.

Keywords: Prospect theory, Herding, Home bias, Over Confidence, Anchoring, Gambler Fallacy, Loss Aversion, Regrets and Mental Accounting.

INTRODUCTION

Earning is a common objective of all. People will try to enhance their earning for future safety purpose and savings will be made from their earnings. These savings meant to meet future expenses because of inflation. Inflation is not only the single criteria for the future price changes. So many other factors like availability of material, the cost of living, the societal Expectations and other issues are going to influence their part in increasing the total prices in the market. To meet the future obligations and to carry the same value for the savings the one has to generate money out of the savings. The regular savings which is not invested anywhere will decrease the value. Hence one has to take the decision with respect to invest their funds in any of the investment option to eliminate the decreasing effect. Even after deciding about the investment option, the main question arises that where to invest funds.
The different investment options will be available for an investor but these investment options are not going to create value unless until it is going to generate more returns than the future expected price fluctuations. So many investment analysis procedures were considered like Capital Asset Pricing Model (CAPM), Efficient Market Hypothesis (EMH). But these tools were not enough to identify the preferable investment option as they are having some basic assumptions that all the investment options are going to give moderate returns and all the investors are of rational behavior. Here the actual returns and expected out of the investment options were differed because of the different issues like market expectations, operational efficiency of the company, market trends, etc. Here the investor knowledge and analysis of investment option is going to play vital role to predict the future. The Expectation and the selection of right investment option is performed on different basis. Here the selection options are given by the investment market, but selection purely depends on the investor. For collection of right investment at right time the investor is going to depend on different analysis methods.

Even after collecting information from all sources analysis tools must be appropriate. Most of the investors will make some mistakes while Analysing the Data for decision making. These mistakes are due to the behavior aspects of an individual. These Behavioral aspects in the investment decisions are called as Behavioral Biases. Common Behavioral Biases are derived from the Heuristics, Prospect Theory, Mental Accounting and Investor Feelings and emotions.



REVIEW OF LITERATURE

Most of the time decision making is influenced by different factors, which will change the psychic characteristic of a human being. Many investment decisions are taken by scientific approaches that are going to analyse the market trends. Eventually these techniques and tools were not in a situation to give the right projection of future trends in the market which leads to the losses to the investors. The major investment decisions will be made in the stock market; these decisions are influenced by different factors. For the decision making so many investors will depend on different financial theories. These theories are formulated earlier to 1990s. As time passing away it is prove that these financial theories are not sufficient anymore to suggest the best investment option. The major financial theories that are used in financial decision making are CAPM and Efficient market hypothesis theory. But it is proved that these theories are inefficient to analyse different investment options and suggest the best among available. So many researches were conducted to identify the gap between usage of these financial theories and incapability of these theories in actual.

Theory of Contradiction (1)

According to these theory persons regular Behavior is no way concerned with financial decision making. In this theory the author mainly focused on psychological and cognitive Concept for decision making. To eliminate the inapplicable theories, Behavioral Finance is used to identify the sociological and psychological issues.

Traditional Theories (2)

According to this theory all the investors will have the rational Behavior and mainly focuses on maximization of profits. These theories will not focus on behavioral decision making. Different persons will have deferred personality and takes the situation in a different manner and response to it accordingly. All individuals will not react in same manner. It also reviews there are different anomalies in investment decision making.

Behavioral Finance Influence (3)

Behavior Finance influence in decision making of Investments differently. The major factors to influence the decision making approach differently is due to the intrinsic factors of investment.

Akkaya C. U. (4):

Decision making process is purely depending on the psychology. The one who makes the decision in a particular situation may not be the same in same situation due to the other factors. If we consider about the valuation process of students the same paper corrected by one faculty in one day, will not get same marks on the other day. The above example gives how psychology is going to influence the decision making of an individual.

Kannadhasan, M. (5):

So many investment companies will have the financial manager or fund manager to manage the total funds of their clients. The financial manager will forecast and predict the future to have a call or put based on his Prediction and while deciding so many Behavioral Aspects will influence the fund manager. These Behavioral aspects will be discussed in this study.

Behavioral Finance

Behavioral Finance is mainly comprising of Heuristics, Prospect Theory, Mental Accounting and Investor Feelings and emotions.

A) HEURISTICS

Kumari, A. K. (2017) (1) The general phenomenon each and every individual is going to make the decision making with respect to the different factors that are going to influence his psychic nature. Shortcuts that are helpful in decision making are called as Heuristics. These emotional and cognitive factors are going to play a crucial role to influence the decision maker.

a) Representativeness

Ghayekhloo, S. R. (2011)(6): The people will have the choice from historical decisions that gave them positive experience. The strategies, tricks, stocks, tools, methods and even timing will also considered for presentation based on the old selection.

Jacob Niyoyita Mahina1, W. M. (2017) (7): While choosing the stocks and individual will focus on any historical experience with a particular stock whether the stock had track with our portfolio will be given priority rather than a stock which had loss. In this context the decision maker will not focus on present scenario and future expectations.

b) Overconfidence

Mwangi, G. G. (2011)(8) The prime factor to influence the cognitive and emotional factors is overconfidence. Without proper analysis and follow up if a decision maker comes to his selection may leads to overconfidence. Due to the over confidence the risk of losses will increases for the investment options.

c) Anchoring

Acar, M. K. (2009). (9): The basic heuristic Behavior of a decision makers in investment is Anchoring. The one who decides to invest the funds in any of investment option may have predetermined plan. Based on the historical evidence the decision make stick on to a particular principle or information or a stock. Sticking on a particular aspect is called as anchoring.

d) Gambler fallacy

Bhattacharya, R. (2012)(10): in investment options is the investor is not accurate by chance he took an investment and it made profit out of the choice. In actual the decision maker itself is not having a clear idea how it works. In other words it is just a fluke and was happened luckily. This scenario is called as Gambler fallacy. These situations will help the decision maker much confident about his investment option due to which he may get future losses.

e) Escalation of commitment

Nathalie Abi Saleh Dargham, C. D. (N. D.)(11): insist wrong result to prove by belief of decision maker. Simply the decision maker is going to believe and execute the same formula or procedure which he exercised earlier or which gave him some profit.

f) Availability Bias

In some situations decision maker has to rely on available data which sufficient enough to analyse the situation accurately. Even in case of lack of information the decision maker has to go forward because of different issues. Such case is called as availability bias.

g) Hind Sight/ knew it all along

Nathalie Abi Saleh Dargham, C. D. (N. D.)(11): Sometimes Decision maker will look behind for the reference. Based on the historical evidences the one is going to make the decision with respect to the present situation.

h) Randomness

Singh, S. (2012)(2) Due to the unexpected situations unrealistic results may occur which may influence the decision maker to rely on a conclusion. In this manner a random selection may give positive result.

i) Herding

Kumari, A. K. (2017)(1): Most of the cases decision maker will not take much risk simply decides by observing the others. Herding is most observed in traders with low efficiency to follow another efficient firm.

j) Disposition Effect

Anwar, A. H. (2016)(12): Even though the decision maker is having appropriate information the execution timing makes a lot of difference in the result. Most of the investors will be happy with initial profits and sell the stocks immediately. In some other cases the decision maker will not sell a loss making stock immediately will try to recover from the loss in that situation which may give much deeper losses.

k) Home Bias

Goyal, S. K. (2015)(13): All the investors by knowingly or unknowingly will be influenced with home bias. The investors will look forward with respect to their references like location or historical investment decision.

B) PROSPECT THEORY

Anastasios Konstantinidis, A. K. (N. D.). (14): The major reason behind Behavioral aspects and fluctuations in mental condition is loss aversion. All the decision makers will try to avoid losses mean while they will face adverse situations. These adverse situations are due to prospect theory. When profits are compared with the losses the happiness out of the profits will be very less compared to the sadness due to losses.

a) Regret Aversion

Qureshi, S. A. (N. D.). (15): Most of the investors will plan to purchase Penny Stocks in a view that they are avoiding huge Investments with huge losses. But these investors will get very limited income. Due to the regrets of low income out of these small Investments the decision maker may reverse the strategy to face losses.

b) Framing

Kanan Budhiraja, D.T.(2018). (3) Due to the situations and occurrence of few similar acts the decision maker will create his own understanding about a particular situation. Due to the own frame he decides what to do and how to tackle expected Returns. This framing may lead to the adverse result.

C) MENTAL ACCOUNTING

Malena Johnsson, H. L. (N. D.)(16) Most of the investors will depend on different believes like investment time, frequency and return pattern. The decision maker will believe that because of these pattern impact only they got profit out of their investment.

a) Self Control

Thomas M. Zellweger, U. F. (N. D.)(17): maker will not have a perfect cap on his investment and expenses as well. Due to uncontrolled spending nature of an individual the losses may arise.

Daniel Kahneman, E. H. (1998)(18): The investor will also focus and prioritise to avoid the losses. In this process he will lose the control over his actual plan. The feelings emotions and psychology is going to influence the ones investment decisions.

b) Personality

Dr. V. Shanmugasundaram, D. (2011)(19): Based on individual personality the approach will differ to handle a situation. It all matters how the individual is going to deal with. Due to the personality issues the decision maker may suffer with losses.

c) Extroversion Personality

Rasoul Sadi, H. G. (2011)(20): Many investment decision makers will depend on external sources for decision making rather than own analytical capability and evaluation. This self evaluation and analysis process must be followed for decision making.

d) Agreeableness Personality

Because of the relationship between the people's the one is going to compromise for the others opinion which may lead to losses. As people are closely associated they tend to pretend for others.

e) Conscientiousness Personality

The people who rely on own decisions will have self motivation for profit making and earning may have the chance of profit or loss.

f) Neurotism

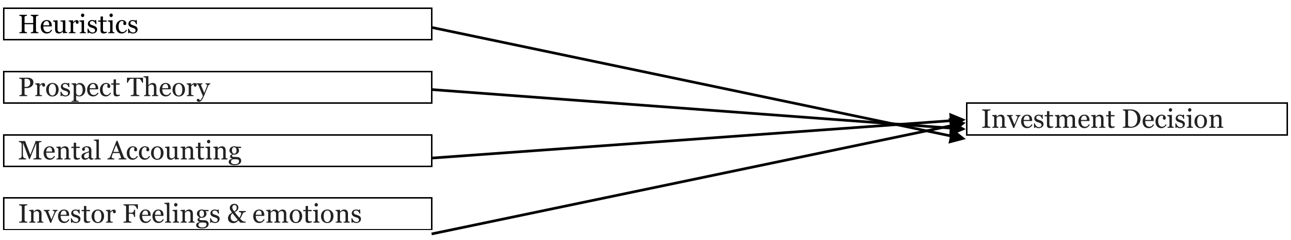
The own interest for profit making will help the people to gain knowledge as well as returns out of their investment decisions. This enthusiastic nature and profit seeking behavior will motivate people to learn and improve.

g) Openness to Experience
Most of the budding investors will have the personality to learn the things they are going to make the investment decisions in different assets.

D) FEELINGS AND EMOTIONS

Dar. M. A. (N. D.)(21): Due to the age factor biological changes health condition mood of decision maker sometimes ecological factors and environmental factors will also influence a person's investment decisions in significant manner. Due to these emotional factors the person may face differed result out of their investment preference

CONCEPTUAL FRAMEWORK



FINDINGS

The investors decision making is going to depend on different factors among all these factors the once decision making capacity is fluctuated mostly because of heuristics, prospect theory, personality, characteristics and other situations. By considering all the factors it was found that heuristics are going to play crucial role than the other aspects of behavioral Finance.

CONCLUSION

Due to the different factors of investment influences the one is going to make is spontaneous decision with respect to his investment, but this decision may give the expected return but most of the times it fails to do so. To expect the average return out of the investment option the decision maker has to make his own plan to eliminate and overcome these Biases.

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