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Do Behavioural Biases Affects Individual's Investment Decisions: A Myth or Reality!!

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Abstract

The standard finance theories considered human beings 'Rational' i.e. human beings analyses The positives and negatives of any circumstance and then act accordingly. But in contrast to it Behavioural finance states that human beings acts irrationally when it comes to investment decision making. The 2000 dot bubble and the subsequent world financial collapse of 2007 affected the market badly. And conventional financial concepts neglected to accurately forecast the marketplace. That is when Nobel Prize-winning economist Robert Shiller declared that in 2003 markets are inefficient.He utilized behavioural economic concepts to demonstrate all of this.Therefore,this paper Proposes to examine the fact that "Behavioural biases affects individuals' investment decisions:A Myth or Reality.?" The paper will be based on secondary data i.e. the literature related to behavioural biases and investment decisions will be reviewed to exhibit the presence of behavioural biases among individual investors' while making investment decisions.

Keywords. *Behavioural Biases, Finance, Investment Decisions, Investors*

1. Introduction

Capital investment is the catalyst for wealth accumulation. In an universe of financial unpredictability, investors strive to increase their assets by identifying the optimal financial and investing possibilities that offer the highest predicted returns at the lowest possible risk. Many theories had been developed and categorized financial market into traditional financé and behavioural finance theories. Earlier business philosophies claim that investors are logical and make choices based on increasing profitability and preventing errors. These the traditional theories of finance considered investors as rational and emotionless. One of such theory is Efficient Market Hypothesis Theory, which was coined by Eugene Fama. His theory states that whenever any new information comes in the market, it is indicated in stock prices. Therefore, stocks are always traded. Therefore, it is not feasible to purchase individual stock at a cheap cost or sell overpriced stock for a profit. But investor like Warren Buffett had beaten this theory many times by buying stocks or businesses that are undervalued which gave him very good returns. Moreover,

The Dot bubble in 2000 and the Global Financial Crisis in 2008 also put a question mark on standard theories of finance which failed to predict the market.

Finance is the study of money and investments, as well as its management and generation. Finance can be broadly categorized into three groups:

- Public finance;
- Corporate finance; and Investment finance.
- Personal Finance.

There are also other particular categories, such as behavioral finance, which attempts to understand the cognitive reasoning underlying financial actions, including emotional, social, and psychological factors.

An investment is an asset or object acquired with the intention of generating revenue or recognition. In an economic forecast, an investment is the purchase of non-consumed products that are used to build wealth in the future. In finance, an investment is a financial asset acquired with the expectation that it will continue to generate income or will be resold for a profit. Behavioural finance is a branch of study that proposes psychological and emotional aspects significantly impact investment decisions. According to Sattar et al., (2020), behavioural finance not only combines classic finance paradigms relating to rational investment decision-making and increasing investment returns, but also takes individual behavior into account as an investment element. According to Boda & Sunitha (2018), behavioural finance examines the psychological influence on financial decision-making and financial markets. The conventional view of finance implies that humans are rational and that economic models function efficiently and in isolation. The more people study financial decision-making, however, the clearer it becomes that human emotions, intentions, intuitions, and habits play a significant influence in all financial decisions. The assumptions of the traditional finance theories that market is efficient failed due to market anomalies which arises due to speculations and fluctuations in the market. Thus, an alternative theory was introduced by Tversky, Kahneman & Thaler commonly known as 'Behavioural Finance Theory. This theory pointed the market inefficiencies and anomalies. It emphasized on the investors' psychology and biases that influences the investment behaviour. The human psyche is not constantly reasonable, just as economies are not necessarily effective. Respect to some characteristic, including ignorance and selfishness, can impact people's choices economic decisions (Nkupornu et al., 2020). While rational thought may indicate that investment in, say, the financial market is good for a certain particular type of investor, this is not always the case. The fear of losing wealth and meeting a competitor who has spent investments in the stock market may impact the shareholder's choice, though. Consequently, behavioural economics has become significant field of research.

2. Different Types of Behavioural Biases Associated with Investment Decisions

Shareholders' perception has always been affected by behavioural factors, and this will continue to be the case. In certain circumstances, it becomes essential for investors to prevent particular behavioural biases, even when they cannot be eliminated. As stated by Deger & Reis (2020), reiterating that share price abnormalities and financial decision are influenced by outcome characteristics and elaborating on the psychological causes that lead to such abnormalities. Psychologists have identified numerous confirmation bias in an effort to comprehend people's behaviour and judgment. Among these are the following:

2.1. Heuristics

According to Kahneman & Tversky (1996), "Heuristics can be devised as cognitive shortcuts or rules of thumb that help people make decisions by eliminating a difficult question and replacing it with an easier one".They introduced the three factors related to heuristics such as Representativeness, availability bias and Anchoring. Waweru et al. (2008) listed two more factors in Heuristics i.e.,Gambler's Fallacy and Overconfidence. Investors make instantaneous choices and assessments by establishing techniques personal anecdotal, instruction, or basic experimentation (Olenski et al., 2020). Despite the fact that heuristics may be useful for decision-making on occasion, they are typically inappropriate for economic decision since they tend to disregard or overlook significant investment-related facts. The following behavioural biases impact heuristics-based decision-making mechanisms:

2.1.1 Representatives

Investments are stereotypical. Profitable past economic matters impact shareholders' prospective judgments, and they have a tendency to perceive patterns where none present. This demonstrates that investors disregard the rule of averages and do not wager on protracted trends. Substantial attention is focused on short-term characteristics, such as a boost in the value of an inventory levels or a market sector that has outperformed others in recent years. If markets were assumed to be entirely reasonable, current movements in stock prices should not affect the company's current price. Nonetheless, this is not the case. The same was corroborated by Dahlin et al. (2018), who emphasized that shareholder analyses are typically based on previous triumphs and disappointments, and that this influences their assessment regarding future ventures. Khan et al. (2018) in the paper titled "Heuristic and Biases Related to Financial Investment and the Role of Behavioural Finance in Investment Decisions: A Case Study of Pakistan Stock Exchange" found out that the influence of predictive value on observed portfolio performance is favourable and substantial. Similarly, Subramaniam & Velnampy (2017), Seth & Kumar (2020), Rehan & Umer (2017), Srividya & Susana (2021) also stated in their research that representativeness

bias has a significant impact on the investors' investment decisions. However, Aigbovo & Ilaboya (2019) in their study revealed that Specific investment performance was unrelated to representativeness prejudice in a major way.

2.2 Anchoring

When evaluating investing selections, market participants focus on a particular number or statistic. There could be a number of causes for this, including too much material to absorb, insufficient time, or a lack of comprehension. Heavy reliance on a particular characteristic or "anchoring" may result in considerable inadequate or the loss of prospective revenue. By neglecting critical pieces of information and modifying financial judgments based on one fact, traders have a tendency to be biased and may suffer long-term losses. In their study, Wanjohi & Mwita (2019) determined that investors are likely to "anchor" on specific information when asked to define a quantity, such as the long-term investment of a share price. Consequently, shareholders react strongly to new knowledge. Kartini & Nahda (2021), Rehan & Umer (2017), Wanjohi & Mwita (2019) in their research concluded that anchoring bias has a strong influence on the investors decision.

2.3 Overconfidence

While assurance in one's capacity to foresee and earn above-average profits is advantageous, excessive confidence can be damaging to investing choices. When traders exaggerate their abilities to analyze a certain share, business, or market as an investment opportunity, disposition effect bias occurs. Due to this, people may disregard contradictory indicators and participate in excessive investing in a certain stock. The outcomes of a transaction may be distorted if these investors do not examine historical patterns or future predictions for an individual stocks and depend disproportionately on their own opinion. Many studies (Nkukpornu et al. (2020), Khan et al. (2018), Madaan & Singh (2019), Subramaniam & Velnampy (2017), Gautam et al. (2021), Samal & Mohapatra (2020)) revealed the presence of overconfidence bias among investors which to a large extent affects their investment decisions.

2.4 Gambler's fallacy

The gambler's fallacy refers to the perception of entrepreneurs that encourages them to expect that patterns will change. This is comparable to what a casinos gambler could encounter. If the dice have recently landed on black numbers while playing Russian roulette, the player will wager on a red number in the hope that the trend would reverse. Consumers tend to feel that a company that has been outperforming for an extended period of time will have a loss of momentum, making it a good buy. According to Huang et al., 2019, it is a person's erroneous perception of a likely conclusion based on the event that took place or set of events. Very few researchers have studied the effect of gambler's fallacy on investors decision. Charles & Kasilingam (2016), Filiz et al. (2018) in their

study explored that gambling bias plays an important role in influencing investors' equity investment decisions.

2.5 Availability bias

Individuals commonly base their selections on the most accessible facts. Similar behavior has been noticed in investors. When investing decisions, traders frequently rely on particular heuristic techniques and knowledge that has previously been in the news or shared by peers. Facts that can be stored in memory at the time investing choices are made may not be accurate and is likely to result in poor decision-making. According to (Qawi, 2010), the more recent and consequential an incident is, the more likely it is to impact the decision-making processes. Subramaniam & Velnampy (2017) & Sharma (2012) explored in their paper the effect of availability bias and concluded that it affects the investment decisions of investors to some extent.

3. Prospect Theory

As per the economics, utility is the benefit a person derives from a physical element or activity. According to conventional financial theories, the long-term net profit of any transaction is the sum of the earnings and losses incurred by the investor. Nonetheless, people are rarely logical, as demonstrated by a theory proposed by (Kahneman & Tversky, 1979). According to the prospect hypothesis, individuals evaluate potential advantages and disadvantages differentially and choose likely gains over probably losses, even though the overall effect of both options is the same. Therefore, options expressing anticipated gains always are favoured above those expressing probable losses. Multiple prejudices relate to this behaviour. These consist of:

3.1 Framing

In behavioural economics, framing is the set of statements used to describe the dilemma at hand. When confronted with various options for putting their money, individuals will choose those that emphasize the likelihood of profits over those that emphasize the likelihood of damages. People are more upset by downside risk than by potential rewards. This implies that a loss of Rs. 500 would be double as stressful for a shareholder as a profit of Rs. 500. Levin et. al (1998) describe three different types of framing: risky choice framing — the risk implicated in having lost 10 of 100 lives instead of rescuing 90 of 100 lives; ascribe outlining — favouring 75% lean protein over 25% meat or fish; and goal phrasing — letting choose the greater good is simpler than sustaining a loss for the identical reason. Charles & Kasilingam (2016) in their paper “Impact of Selected Behavioural Bias Factors on Investment Decisions of Equity Investors” revealed that the certain cognitive bias elements, such as attitude, feelings, and framing, have a significant impact on the financial judgments.

3.2 Loss aversion

People would rather prevent lost

opportunity than obtain comparable profits; losses appear to be double as potent as multiplying the value. In a case involving a risk, a person who has a 50/50 chance of getting $500 or losing $450 will not take the wager because the significance of the losses is believed to be considerably more significant than the effect of the gain, even if the related gain is more. This indicates that if shareholders are anxious, they may exploit the principle of statistics to recuperate previous losses by purchasing more underperforming stocks. Loss aversion is also used to explain why negative punishments are more effective than extrinsic reinforcement for empowering people. Many studies have been undertaken which proved the presence of the loss Aversion bias among investors while taking investment decisions. Subramaniam & Velnampy (2017), Kartini & Nahda (2021), Samal & Mohapatra (2020), and Gautam et al., (2021) in their papers examined the effect of loss aversion prejudice on the investor's choices. They all found that the association with risk aversion biases and investing is substantial and beneficial decisions. Investors are loss averse in

3.3 Regret aversion

When the conclusion is unfavourable, people do tend to lament their actions. This implies that if an individual has incurred a loss on the share market, the remorse of finally making a poor judgment exceeds the economic loss. Investors may feel culpable for deciding to invest in a weak stock that eventually resulted in damages. This may lead to poor economic judgments, such as purchasing shares that have begun performing well, shunning investments in stocks that have fared badly in the past years, or participating in equities that everyone invests in so as not to feel left out only when they lose a lot of money. These people are not able to take major judgments since they fear that whichever choice they make; they will end up regretting. As stated by Xie et al., (2019) elaborates the psychology of people with regret that they often make bad decisions. Researchers like Subramaniam (2017), Seth & Kumar (2020), Samal & Mohapatra (2020), Rehan & Umer (2017) have stated in their studies that regret aversion do impact the investors decision to a notable extent.

3.4 Mental accounting

In accordance with the mental accounting tendency, people segregate their money and possessions into several groups or conceptual accounts based on specific characteristics, such as their source of revenue and intended purpose. As a means of self-control, people or investors may employ mental accounting. In order to avoid overspending, traders may separate their funds into investing and expenditure pools due to their limited market expertise. In doing so, they disregard the benefits of asset allocation and treat these two mental representations as wholly unrelated. According to Zhang & Sussman (2018), shareholders view funds from various origins similarly. It can be said that the amount earned as part of the salary is equivalent to the profit in capital gains. Entrepreneurs tend to view investment income favourably and are more

prepared to take risks with them than with their current salary. Singh & Jain (2021), Mahapatra & Mishra (2020), in their study established the existence of finance in Indian homes. Whereas in contrast to these studies, Road et al., (2013) in their study found that there is a considerable unfavourable association among cognitive bookkeeping and investment choices. Similarly, Novandalina et al., (2022) concluded in their paper Mental accounting has little impact on financial judgment.

3.5 Disposition effect.

The disposition effect argues that people attempt to achieve fictional advantages while avoiding write downs. This suggests that if a consumer purchased a share at $100 and it fell to $85 until rising to $95 again, the majority of buyers would not sell the shares until it rose beyond $100. Consequently, shareholders frequently decide to sell equities whose valuation has expanded while retaining investments whose valuation has decreased – holding losers for too quite a while now and attempting to sell successes prematurely. Dooren & Galema, (2018) suggested that shareholders in emerging economies like China typically experience dispositions impacts when they sell appreciating shares rather than depreciating ones. Madaan & Singh (2019) and Ullah et al. (2021) also verified the presence of disposition effect bias among the investors which influences the investors decisions to a great extent.

4. Conclusion

Many researches have been undertaken in the field of financial economics that indicates the presence of behavioral prejudices among individual investors.Based on the review of the research on cognitive factors and their effect on investing decisions,it can be concluded that investors exhibit these biases and it affects their decision-making ability to invest in various investment schemes. But some of the studies found out the negative influence of some of the biases on individual's investment decisions i.e., Rehan Umer (2017) in their study revealed that the influence of behavioral finance and accessibility on financial decisions is not statically important. Similarly, Novandalina et al. (2022) also specified that Investment plans are not much influenced by mental accounting. Among the various behavioural biases, overconfidence bias, loss aversion, disposition effect bias, anchoring bias seems to have prominent impact on the individuals' investment decisions.

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