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A Study on Impact of Behavioral Biases on InvestmentDecision

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ABSTRACT

Worldwide the financial markets are influenced by several factors such as the changesin economic and political processes that occur in the country and the globe, information diffusion and approachability and so on. Yet, the foremost important factor is the investor's reaction and perception. For an individual investor, decision making processcan be perceived as a continuous process that have significant impact of their psychology while making investment decisions. Individual investor's behavior isextensively influenced by various biases that highlighted in the growing discipline of behavior finance. Therefore, this study is also one of another effort to assess the impactof behavioral biases in investment decision-making. A questionnaire is designed and through survey responses collected from 105 investors. In the present research, exploratory research design & descriptive research design are used. In the existing study, four behavioral biases have been reviewed namely, herding bias, overconfidencebias, loss aversion bias, optimism bias, recency bias. The results show that overconfidence and herding bias have significant positive impact on investment decision. Overall results conclude that individual investors have limited knowledge and more prone towards making psychological errors. The findings of the study also indicate the existence of these five behavioral biases on individual investment decisions. This study will be helpful to financial intermediaries to advice their clients. Further, study can be elaborated to study other behavioral biases on investment decisions.

Keywords: Behavioral biases, overconfidence bias, herding bias, loss aversion bias and individual investor.

Introduction

Research has demonstrated that when people face complex decisions, they often rely on basic judgments and preferences to simplify the situation rather than acting completely rationally. Although such approaches are quick and intuitively appealing,
they may lead to suboptimal outcomes. In contrast to this body of research, traditional economic and financial theory generally assumes that individuals act rationally by considering all available information in the decision-making process, leading them to optimal outcomes and supporting the efficiency of markets. Behavioral finance challenges these assumptions by incorporating research on how individuals and marketsactually behave. In this reading, we explore a foundational concept of behavioral finance: behavioral biases. Investment professionals may be able to improve economic outcomes by understanding these biases, recognizing them in themselves and others, and learning strategies to mitigate them.

Literature Review:

(Madaan & Singh, 2019) has done a research on **"An Analysis of Behavioral Biasesin Investment Decision-Making."** The objective behind this study was to determine how and what behavioral biases affects investor's investment decisions. The actual sample size for the study was 385. Convenience sampling technique was used to collectdata from investors in in National Stock Exchange. The research stated following conclusions (i) Investors fail to update their beliefs precisely and (ii) There is a systematic variation from the normative process in making investment choices.

(Katper et al., 2019) has done a study on **"Behavioral biases and investors' decision making: The moderating role of socio-demographic variables."** The purpose of thisstudy is to investigate the impact of behavioral biases on investment decision, and the interaction effect of socio-demographic characteristics. The authors conducted a hierarchical regression analysis to test the moderating effect of socio-demographic variables on behavioral biases. The results show that behavioral biases have a significant impact on investors' decision-making. Moreover, socio-demographic variables (education, occupation and marital status) moderate the relationship between emotional biases and investors' decision-making.

(Dervishaj, 2018) has done research on **Psychological Biases, Main Factors of Financial Behaviour - A Literature Review:** In the context of the sophistication of financial relationships, investment alternatives, risk and recurrent recent financialcrises, human factor has become increasingly important in investor decision-making. n order to understand and explain individual decision making and investment behavior, it is necessary to study behavioral factors which impact it. Various scholars have studied factors of financial behavior and their impact on financial decision making, andin particular a special focus has been given to psychological biases. Usually, investorsare not aware of their behavioral biases.

(Gupta & Shrivastava, 2021) has done a research on **"Impact of Behavioral Biases on Investment Decisions: Moderating Effect of Preferred Sector of Investment."** in order to understand how greatly behavioral biases influence investment decision. Theobjective to undertake this research was to study of behavioral biases on a particular sector. The target population of the study was investors. Purposive sampling was employed, and a total of 384 responses were collected. The research concludes that thedifferent biases that influence retail investor's decisions to invest in securities of specific sector.

(Sushma 2021) has done a research on **"A Study On Behavioral Biases And Its Impact On Financial Risk Tolerance Among Investors Of Uttar Pradesh."** The study here has been targeted on analysing the behavioral aspect of the investors which make their financial decision biased. The research design used here is a Descriptive one where a framework is developed to find reasons and to generate a causal relationship among dependent and independent variables. The data for this study has been collected from primary as well as secondary sources. Primary data has been collected from distributing well-structured questionnaires and collecting responses. Secondary data has been collected from different secondary sources (web links, journals, magazines, etc. The primary objective of the study was to develop a financial model considering the Behavioral aspects towards various risk tolerance levels.

Research Objectives:

The objective to undertake this research is to examine the impact of behavioural biases on investment decisions of investors and to understand if there is any relation betweenbehavioural biases and investment decision.

Research Methodology:

The research examines investor's behaviour to understand how people make decisions,individually and collectively. The study covers almost all the biases that affects or influence the investor's behaviour while making investments decisions. Descriptive study is undertaken when the researcher wants to know the characteristics of certain groups such as sex, age, educational level, income, occupation, etc. in contrast to exploratory studies, descriptive studies as well as structured. In this research, I used non-probability convenience sampling method, Convenience sampling is type of sampling method that involves the sample being drawn from that part of population thatis close to hand. For this research, the sample size taken for the survey purpose is 105 Investors. SPSS & Excel was also used for examine the data. Frequency test was applied for assessing the data.

Demographic Profile:

Gender		
	Frequency	**Percent**
Female	34	32.4
Male	71	67.6
Total	100	100%
Age		
Below 20	24	22.9
21-30	65	61.9
31-40	7	6.7
Above 41	9	8.6
Total	100	100%
Occupation		
Business	23	21.9
Employee	18	17.1
Housewife	3	2.9
Students	61	58.1
Total	100	100%
Qualification		
Below S.S.C	0	0
S.S.C	1	1

H.S.C	23	21.9
Graduation	59	56.2
Post-Graduation	19	18.1
Professional Degree	2	1.9
Ph.D	1	0.95
Total	100	100%
Income		
Upto 2 Lac	53	50.5
201000-500000	25	23.8
501000-1000000	17	16.2
Above 1000000	10	9.5
Total	100	100%

The table above shows that the sample size taken into consideration is of 105 investors out of which (32.4%) of the investors in the sample population are females and rest (67.6%) are males. majority of the investor's age is between 21-30 years that accounts for (61.9%). (22.9%) of respondents age is below 20 and (6.7%) of respondents age liesbetween 31-40 and (8.6%) of respondents age is above 41. (21.9%) of respondents are business people and (17.1%) are employees. Further, (2.9%) of respondents are housewives and (58.1%) of respondent's are students. (1%) of total respondent's qualification S.S.C and (21.9%) of respondents are H.S.C qualified and (56.2%) are graduates and (18.1%) are post graduates, (1.9%) are professional degree holder and (0.95%) is Ph.D. In income, data indicates that (50.5%) of respondent's incomes is lessthan 2 lacs. And (23.8%) of respondent's income lies somewhere between 2 to 5 lacs and (16.2%) of respondent's income lies between 5 to 10 lacs, and (9.5%) of respondent's income is greater than 10 lacs.

Q. What do you understand by the term "Behavioural Biases" on Investment Decisions?

Level of Understanding	Frequency	Percent
Preconceived notions or prejudices that often lead investors to make emotional and irrational decision when it comes toinvesting	71	67.6
False Beliefs	15	14.3
Any uncertainties happened in past	19	18.1
Total	105	100

The data above indicates that (67.6%) of the respondents are aware of behavioural biases that affects investment decisions, and the rest of the respondents somewhere lacks adequate knowledge.

Q. Which bias do you think has the highest influence on investment decision?

Responses	Frequency	Percent
Overconfident Bias	42	40.8
Loss - Aversion Bias	25	24.3
Attention Bias	32	30.5
Recency Bias	06	5.8
Total	105	100

By assessing above data, it can be concluded that majority of investors believe that overconfident bias has the highest influence on investment decisions compare to otherbiases.

Q. To whom you trust the most before buying/selling stock in the market?

Choices:	Frequency	Percent
Own Analysis	55	52.3
Friends/Relatives/Colleagues	16	15.2
Financial Advisors	19	18.1
Stock Broker	06	5.8
Internet	07	6.6
Other Random Source	02	1.9
Total	105	100

The data above figures out that majority of investors do their own analysis forbuying/selling stocks and considerable investors rely on some random sources and internet/internet/stock broker.

Q. Would you rather be happy if you book a profit of ₹.100000 or sad if you incurred aloss of ₹.20,000 simultaneously?

Responses:	Frequency	Percent
Will remain happy by thinking that still have a balance of ₹.80,000	62	59
Will remain sad by thinking about the loss and neglect gains	14	13.3
Will remain partially happy and sad at the same time	29	27.6
Total	105	100

The data above highlights that (59%) of the investors would give priority to happiness over sadness, and (13.3%) of investors would be highly disturbed with losses incurredand (27.6%) of investors would be partially happy and sad simultaneously.

Q. Would you rather invest in a company which is in limelight due to good recent performance or in a company having long term growth potential? (Recency Bias)

Responses:	Frequency	Percent
Company which recently performed well	35	33.3
Company having long term growth potential	70	66.7
Total	105	100

The data above results in (66.7%) of the investors would stick to their fundamentals and invest in company having long term growth potential over the company which recently performed well.

Q. Would you rather invest in a company which have a good track record or in any random company just because people around you are discussing over it? (Attention Bias)

Responses:	Frequency	Percent
Company having good track record	90	85.7
Invest in a company about which people are discussing over it	15	14.3
Total	105	100

The data above results in (85.7%) of the investors would stick to their ideology and invest in company having good track record over will neglect the company about whichpeople are discussing it.

Q. How would you react if things that interests you changes or go against you? (Conservatism Bias)

Responses:	Frequency	Percent
Changes won't affect you	52	49.5
Slow to react to a new information and continue to maintain prior views and forecasts.	16	15.2
React as per the situation	37	35.2
Total	105	100

The information above highlights that majority of investors would remain unchanged irrespective of circumstances and rest of the investors would be slow to react and adaptand the left ones tend to be reflex.

Q. Understanding all behavioural biases thoroughly can help investor to have control over emotions and external influences and would result in more rational decisions?

Responses:	Frequency	Percent
Agree	94	89.5
Disagree	11	10.5
Total	105	100

Through above data, it can be concluded that majority investors believe that understanding behavioral biases would really result into more rational decisions and the extent to which investors behavior is influenced would drastically reduced.

Findings:

- ➢ The demographic profile of respondents shows that the majority of investors are males, (35.2%) more than female respondents.
- ➢ Majority of investor's age lies between the age group of 21 to 30, i.e (61.9%) of investors are from 21 to 30 years out of 105 respondents.
- ➢ Considerable investors were found to be well educated, where more than (56.2%) ofinvestors found graduated.
- ➢ Majority of respondents are students (58.1%) and (21.9%) respondents are businesspeople.
- ➢ As per the data it was found that the income level of majority of investors (50.5%) is upto 2 lacs, and (23.8%) of respondents income lies somewhere between 2 to 5 lacs and (16.2%) of respondents income lies between 5 to 10 lacs, and (9.5%) of respondentsincome is greater than 10 lacs subsequently.

➢ Further, considerable investors (5.7%) of investors are matured investors as they into a capital market from more than 10 years and in addition (61.8%) of investors have lessthan 05 years of experience.

➢ Moreover (67.6%) of respondents possess awareness about behavioural biases which can have significant impact on decision making regarding investments.

➢ One of the prime findings is that investors believe overconfident bias has highest level of influenceon investment decisions.

➢ Majority of investors (52.3%) relies on own analysis and (18.1%) investors rely on financial advisors when it comes take buying/selling decisions.

➢ Most of the investors (50.5%) tend to act according to situations, (39%) tend to be proactive and (10.5%) are impulsive when it comes to Investors type.

➢ Majority of investors (59%) tend to give priority to happiness over sadness and (13.3%) of investors would get affected of loss aversion bias.

➢ The second important finding is (66.7%) of the investors would stick to their fundamentals and invest in company having long term growth potential over the company which recently performed well which highlights recency bias.

➢ The data above results in (85.7%) of the investors would stick to their ideology and invest in company having good track record over will neglect the company about whichpeople are discussing it, which indicates attention bias.

➢ Most of investors would remain unchanged irrespective of circumstances and rest ofthe investors (15.2%) would be slow to react and adapt and the left ones tend to be reflex, which gives idea about conservatism bias.

➢ Most investors (89.5%) have agreed that understanding all behavioural biases thoroughly can really help investor to have control over emotions and external influences and would result in more rational decisions.

Conclusion:

The discipline of behavioral finance has emerged in response to handle the difficulties faced by the traditional finance discipline. In essence, behavioral finance explains that investment choices not always influenced based on rationality. Behavioral finance also tried to understand the investment market anomalies by unwinding the two assumptionsof standard finance, that is, (i) investors fail to update their beliefs precisely and (ii) there is a systematic variation from the normative process in making investment choices. To understand the irrational behavior of investors in financial markets, researchers draw on knowledge from cognitive psychology theories. Researchers have developed "prospect theory" and "heuristics" to explain the behavior of individual investors in financial or economic decisions. Behavioral finance involves various behavioral biases based on an individual's social and emotional recognition and tolerance. The present study aims to determine the influence of behavioral biases on investment decision making of individuals. Mainly four behavioral biases are taken into current research for identification of impact, namely, Overconfidence, Attention, Recency, and Herding, Loss Aversion. The study concluded that two, namely overconfidence and herding, have a strong influence on the investment decisions of individuals. The current research also emphasized that participants in financial markets are not rational in their decision-making process, and even their choices are limited.

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