An Investigation of Reviewed Literature on the Influence of Behavioural Finance on Financial Decision Making

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Abstract: The evolving field of behavioural Finance examines the psychological and sociological factors that impact the decision-making process of individuals, groups, and business organizations. Individuals’ savings and investments are crucial for personal financial well-being and economic growth. Money invested in productive assets or capital goods will fetch a very lucrative return compared to financial institutions’ savings. Investment in productive areas enhances the national product or per capita income and increases the standards of living of the investor. The financial services sector has turned out to be tremendously diversified, offering investors a wide-ranging variety of investment opportunities. Through appropriate investment tactics and financial planning, investors can upsurge personal wealth, which will boost economic growth. Economic growth is the utmost imperative factor affecting the quality of life individuals lead in a country. In this paper, an attempt has been made to diagnostically review the findings of various existing works of literature regarding the influence of behavioural Finance on financial decision-making.

Keywords: Behavioural Finance, Decision Making, Investment, Financial Planning

Introduction

Modigliani and Miller Arbitrage Principles, Markowitz Portfolio Theory, Sharpe’s Capital Asset Pricing Model and Black Scholes Option Pricing theory, and Eugene Fama’s Efficient Market hypothesis are central pillars of standard finance theories. These theories have common assumptions stated as follows: (i) Presence of an efficient market, (ii) decision making by rational investors, (iii) investors have access to market information (iv)investors have perfect self-control. Nevertheless, later, the psychologists opposed these assumptions and argued that financial decisions are influenced by emotional biases and cognitive errors for which investors act irrationally.

Income, Saving, and Investment are the three variables that measure the growth of an economy. Behavioural Finance is generally characterized as the use of psychology in Finance (Robert J. Shiller, 1997) and its incorporation with other disciplines like cognitive science, experimental economics, behavioural economics, cognitive psychology &behavioural science. (Angner et al., 2012).

Objective of the Study

To study the literature review on analysing behavioural biases that influence individual investors’ financial decisions making capacity.
# A diagnosis analysis of review of literature

<table>
<thead>
<tr>
<th>Author</th>
<th>Objectives of Research</th>
<th>Sample of the study</th>
<th>Methodology used in research</th>
<th>Research Outcome</th>
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<tr>
<td>Cletus, A. (2021)</td>
<td>income and savings of I.T Employees is examined to identify the factors influencing their savings</td>
<td>Descriptive analysis, Factor Analysis</td>
<td>Found a strong correlation between savings and features like age, income and education of I.T Employees</td>
<td></td>
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<tr>
<td>Sudhindra Bhat, Swati Sharma, and Bert Wolfs (2020)</td>
<td>relationship between demographic variables and dimensions of investment decision behaviour is investigated</td>
<td>70</td>
<td>Factor analysis, ANOVA, and t-test.</td>
<td>Perceived self-imagery, self-confidence, allegiance, financial inadequacy, risk aversion, prudence, and self-responsible are identified as seven dimensions of investment behaviour.</td>
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<tr>
<td>NC Raghavi Chakravarthy (2019)</td>
<td>1. To understand the reasons for which the households save 2. To find out if the reasons for saving are the same across all the households under the study</td>
<td>Garret ranking score and Independent Samples Kruskal-Wallis test</td>
<td>The reasons which were identified include saving for reserve for unforeseen situations, having a reserve for unforeseen situations, earning interest and appreciation, sustaining even when there is a gradual increase in the cost of living, having independence regarding financial decisions, undertaking speculation, for investing in a business, to leave something as an heirloom, to fulfill the desire to save money, for the education of their children, for the marriage of their children, for purchasing a house, for purchasing other consumer durables, for making down payments and for clearing debts.</td>
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<tr>
<td>RenuIsidore R. and Christie P.(2018)</td>
<td>examined the relationship between the behavioural biases exhibited by the investors and the income received by them.</td>
<td>ANOVA, Correlation Analysis</td>
<td>The investors with lower annual income were more prone to the overconfidence biases when compared to investors with higher annual income. Investors with extraordinary annual income were more on the verge of exhibiting higher overconfidence bias but lower representativeness, loss aversion, availability, and mental accounting biases. It was revealed by correlation analysis.</td>
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<tr>
<td>Chakravarthy NC Raghavi (2017)</td>
<td>1. Investigating various aspects that the investor considers before taking Investment decisions 2. Effect of demographic factors on the choice of investment instrument is studied 3. Aspects concerning choice of investment instrument is also considered here.</td>
<td></td>
<td>Investment: safety, returns, advice of an agent, and advice of family and friends are four aspects considered for the study.</td>
<td></td>
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<td>Kalluvelil Janardhanan (2015)</td>
<td>To present a recent and comprehensive review of experiential studies on investor’s behaviour. Furthermore, to reconnoiter the miscellaneous literature existing worldwide for identifying the variables that administrate an investor’s decision to save and invest for building the investor’s behaviour model.</td>
<td>cross-tabulation, Chi-Square test, and percentages</td>
<td>The following aspects have been studied here investor’s portfolio practices, preferences, risk perceptions, intentions, a pattern of investment, awareness level, factors affecting their investment behaviour, and their problems</td>
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<tr>
<td>Parimalakanthi and Dr. M. Ashok Kumar (2015)</td>
<td>behaviour of individual investors of Coimbatore city towards available investment avenues in the Indian financial markets. is studied</td>
<td>107</td>
<td>Friedman test, Garratt ranking, and Factor analysis.</td>
<td>Collection of information from the internet and consultation with friends, peers, and investment experts. Investors before investing is advisable. Bank deposits followed by investment in gold &amp; silver and FD are preferred in Coimbatore</td>
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<td>Bhushan (2014)</td>
<td>awareness level of salaried individuals’ towards financial products is observed</td>
<td>516</td>
<td>Descriptive Statistics</td>
<td>awareness level of new-age financial products is low as respondents are parking most of their money in traditional and safe financial products,</td>
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<tr>
<td>Amiri, Razavizade and Gholam (2013)</td>
<td>Tehran Stock Exchange is taken into consideration for knowing the collaboration between five personality traits and demographic factors with behavioural biases in investment decisions</td>
<td>215</td>
<td>SEM</td>
<td>choice of investment instrument is mostly influenced by advice received from the agent, family, and friends</td>
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<td>Jayaraj (2013)</td>
<td>Examined the existence of any psychological biases among Indian investors.</td>
<td>300</td>
<td>Principle component analysis</td>
<td>conservatism, diligence, discreet, remorse abhorrence but prudence and under-confidence fall in line with earlier research</td>
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<tr>
<td>Chandra and Kumar (2012)</td>
<td>Prevailing psychological heuristics and biases among the Indian individual investors are examined.</td>
<td>350</td>
<td>Principle component analysis</td>
<td>Heuristics, representativeness, and mental accounting prevail among the Indian individual investors.</td>
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<td>Subash (2012)</td>
<td>To what extent Portfolio Investors’ decision making is affected by behavioural factors</td>
<td>658</td>
<td>Discriminant analysis</td>
<td>both young and experienced investors were equally impacted by the crisis and suffered losses. All most all the biases were affecting the suffering of Investors.</td>
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<tr>
<td>Chandra and Kumar (2011)</td>
<td>Psychological biases identification and conformation and their impact on Behaviour of Individual Investors</td>
<td>500</td>
<td>Principle component analysis</td>
<td>Influencer of investor decision-making are found as follows conservatism, under-confidence, prudence, precautionous attitude, and informational asymmetry,</td>
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<td>Mwangi, (2011)</td>
<td>Property Investment is studied here and to what extent behavioural factors affect the same in Kenya</td>
<td>155</td>
<td>Factor Analysis</td>
<td>anchoring, representativeness &amp; availability bias influence the property investment decisions to a great extent</td>
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<td>Zoglami and Matoussi (2009)</td>
<td>Identification of factors influencing Decision making of Individual investors</td>
<td>92 brokers</td>
<td>Univariate and Multivariate analysis</td>
<td>precaution, confidence, conservatism, optimism, and informational inferiority complex are the psychological factors that drives the investor behaviour.</td>
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</table>

Source: Compiled by the author
Findings & Conclusion

While reviewing the works of literature from the above tables, the following list of common opinions are observed:

- Most of the analysis is carried on to analyze the psychological biases that influence individual investor behaviour.
- The reasons which were identified include saving for reserve for unforeseen situations, earning interest and appreciation, sustaining even when there is a gradual increase in the cost of living, having independence regarding financial decisions, undertaking speculation, investing in the business, leaving something as an heirloom to fulfil the desire to save money, for the education of their children, for the marriage of their children, for purchasing a house, for purchasing other consumer durables, for making down payments and for clearing debts.
- Psychological factors such as conservatism, confidence, prudence, precautious attitude, optimism, informational inferiority complex, and informational asymmetry influence investors’ decision-making.
- Property investment decisions are mostly influenced by heuristic factors such as anchoring, representativeness & availability bias.
- Self-imagery, self-confidence, allegiance, financial inadequacy, risk aversion, prudence, and self-responsibility are identified as seven dimensions of investment decision behaviour.
- Representativeness highly influences Investment behaviour and they do much mental accounting in the sense of grouping their gains and losses while decisions-making.
- Those pieces of information which are easily adjustable to their investment decision-making are mostly sought by Investors.
- Investments are affected by the existence of information asymmetry patterns among individual investors.
- The agent’s advice significantly influenced the choice of investment instrument, followed by the safety and advice of family and friends.

Future study

The present study highlighted the significant contributors in the particular area, as it is an area of frequent development, so more recent outcomes should be considered to understand the psychological factors that affect individuals’ financial decision-making. Behavioural Finance can help to understand why investors make the decisions they make, how they are likely to react to the uncertainty inherent in investing, and how can the irrational elements of investment decisions still satisfy their individual preferences.

References


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