

Behavioral Finance and Investment Decision Making

Akshara J Nair, ²Shakthi Prathiba K & ³Neethu Philip

^{1,2,3}B.COM Finance & Accounting, Christ University, Bangalore (India)

ARTICLE DETAILS

Article History

Published Online: 10 December 2018

Keywords

Availability Bias, Investment Decision Making, Behavioral Finance

ABSTRACT

This study focuses exclusively on Availability Bias under Behavioral Finance which will serve as awareness to the investors, fund managers, etc. This study aims to detect the relationship between availability bias and investment decision making and also to analyze the relationship between income and availability bias. Regression analysis is used to analyze the relationship between these factors. The analysis shows that there is a weak correlation between availability bias and investment decision making and that income does not play any major role in influencing the decision making through availability bias.

1. Introduction

According to traditional financial theory, all investors are rational in making decisions. Traditional theory ignores the fact that emotions play a role while making decisions. Behavioral finance came into practice in order to do away with this limitation of traditional theory. Under behavioral finance there are some biases which affect investment decision making. One of such bias is availability bias. Availability bias is judging the performance of a stock or company in the financial market based on the ease to recall certain events or based on the frequency of occurring events. In our study we aim to find out the relationship between availability bias and investment decision making, the relationship between age and availability bias. Previous studies have focused on ascertaining the relationship between availability bias and investment decision making, but a very few research of this sort is carried out in a developing economy like India rather than a developed economy. Apart from this the study also analyses the relationship between income and availability bias.

2. Review of Literature

a) Availability heuristic will affect decision making and result in bias:

Availability heuristic is an important factor that makes investor's take irrational decision. This study mainly focused on determining the probability of the existence of availability bias with four main factors such as irretrievability, illusory correlation, imaginability and the effectiveness of the research set which is directly connected to the process of decision making. It describes availability bias as mental shortcut and the results in estimation bias's. A simple model has been established in this paper to assess the probability of the existence of availability bias in particular situation and assumed that no other factor apart from availability bias will be able to cause bias in such situation. This study is under taken to fill the gap that exists in the field of investment. As conclusion, it is said that availability heuristic is a psychological phenomenon which has significant impact on investor's decision making and the investors should be aware of the drawbacks of this bias and understand it correctly to optimize their decisions (Meng, 2017).

b) Impact of availability bias and loss aversion bias on investment decision making moderating role of risk perception:

This study looked into the moderating effect of investors risk perception on the relationship of investment decision making, availability bias and loss aversion bias respectively. The main objective is to find out the effect of these biases on investment decision and investor risk perception effect the relationship or not. This study is taken up to increase the awareness' in the Pakistani economy and used regression and correlation as a tool to analyze the data collected through questionnaire using convenience sampling which is a cross sectional study with descriptive nature.

The study concludes that there is a weak negative correlation between availability bias and investment decision making, exists no significance difference between responses of male and female decision-making regarding loss aversion bias and no significant association between risk perception and gender (Khan, 2015).

c) A study on behavioral factors influencing investment decision making:

According to this article it is said that the investor's decision is believed to be one of the key factors in determining the market movement. The main objective of this paper is to study and validate the model based on the behavioral bias which was suggested by Le Phuoc Luong a Doan Thi Thu Hai in the regions of south Gujarat and also to study the behavioral biases that affect the decision making of the retail investors of the southern part of Gujarat. The article concludes that the model of the behavioral biases showed a positive impact on the investor's decision making and also the behavioral factors had an impact of the investment performance on the retail investors of the Gujarat region(Lad & R, 2018).

d) An understanding of role of heuristic of investment decision

The traditional theories of finance assume that investors have all the information and unlimited cerebral capacity and comes up with an accurate decision. In real, investors take decision with the imperfect and inadequate information and with limited cognitive capabilities. Existing studies on behavioral finance focuses on understanding the effect of heuristic on decision making. The data for this research is collected from secondary sources. This study focuses on

mainly representativeness, anchoring and availability bias. And also aims to build awareness to minimize or eliminate the heuristics in investment decision process (Sarin & J.k, 2017).

e) Herding effects, over confidence, availability bias and representativeness as behavioral determinants of perceived investment performance: An empirical evidence from Pakistan stock exchange (PSX)

This study aims to find out which behavioral determinants out of over confidence, availability bias and herding effects and representativeness has more impact on perceived investment performance. The study is conducted through a questionnaire which is adopted from previous studies which satisfies the conditions of Pakistan stock exchange. This study uses regression to test the hypothesis. All the hypothesis are true and all the behavioral determinants have a positive and significant impact on investment. This study is useful for individuals, investors, financial advisors, companies and government. Previous study focuses on developing countries stock market (Javed, Bagh, & Sadaf, 2017).

3. Research Design

a. Scope of Study:

This research paper aims to provide awareness to the investors regarding the effect of psychological factors on investment decision. This paper enables a detailed study on availability bias, as very limited studies have been undertaken on behavioral finance especially availability bias in India.

b. Statement of Problem:

The behavioral finance as a subject explains how the human psychology plays a role in investment process. Though this field existed over a period of time, investors are still not aware of how psychological factors affect their investment decisions.

Based on the review of literature done, we encountered that hardly any studies had been attempted on availability bias in India. So there is a lack of awareness among investors in India in this area of study. As a consequence, investors land up making irrational decisions.

c. Objectives:

1. To determine the relationship between availability bias and investment decision making.
2. To analyze the relationship between income and availability bias.

d. Hypothesis:

1. H_0 -Availability bias has no significant relation on investment decision making.
2. H_0 - Income level has no significant relation on availability bias.

e. Sources of data:

The data for this study has been collected through a primary source via questionnaire.

f. Data analysis tools:

The data for this study is analyzed in SPSS using linear regression method.

g. Expected outcome:

The anticipated resultant of this research could be that there exists a significant relation between availability bias and investment decision making, and income level has a significant relation on availability bias.

h. Limitation:

This study does not take into consideration all the factors that affect decision making of the investors.

The study is more focused on availability bias but there are other key factors under behavioral finance which influence the decision making.

Due to time and resource constraints, only one factor (availability bias) has been considered and the data has been collected only from 104 respondents.

4. Data Analysis and Interpretation

Data for this study is gathered using a questionnaire. The population of study for this research is total number of investors from Bangalore. Sampling is done using convenience sampling method. The total number of respondents is 104. Increased sample size makes data more reliable. Hair Et Al proposed that if quantitative approach is followed, respondents should exceed 100 to fit the statistical analysis.

To analyze the data, SPSS software is used. Technique that has been used to prove the hypothesis is linear regression.

Demographic analysis:-From the 104 respondents, 49% are female and 51% are male. Around 60.6% are of 21-30 age group, 19.2% are of 31-40 age group, 11.5% are of 41-50 age group, 5% are of 51-60 age group and the rest belongs to the age of 60 and above.

Income level:-41.3% respondents earn below 2.5 lakhs, 27.9% from 2.5 lakhs-5 lakhs, 15.4% from 5 lakhs-10 lakhs, 10.6% respondents earn between 10 lakhs-20 lakhs and the rest earn 20 lakhs and above.

Profession:-32.7% of the respondents are students, 46.2% are salaried persons, 14.4% are business man and the rest are self-employed.

For proving the objectives, this study frames 2 hypotheses:

Hypothesis 1:- Availability bias has no significant impact on investment decision making.

This hypothesis is validated by using regression. This test is used to find the relationship between variables. It involves techniques for analyzing and modeling several variables. It helps understand how dependent variable changes with the change in an independent variable. Here availability bias is the dependent variable and investment decision making is an independent variable.

To interpret the table, we have to look at p value or the significance value in the table. If significance level is more than 0.05 then there is no significant difference between availability

bias and investment decision making. If significance value is less than or equal to 0.05 there is a significant difference between availability bias and investment decision.

Table No: 1
Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.979	.763		1.283	.202
	I_KNOW_HOW_TO_INVEST	.265	.145	.181	1.826	.071
	BUYING_DECISIONS_BASED_ON_FUNDAMENTALS	-.005	.123	-.004	-.037	.970
	BUYING_DECISIONS_BASED_ON_HISTORICAL_INFORMATION	.269	.098	.267	2.754	.007

In this table the dependent variable availability bias is measured by a factor that is "I would be convinced when someone tells about the crises". The dependent variable is measured with 3 components i.e. I know how to invest, buying decision based on fundamentals, buying decision based on historical information. The p value of I know how to invest is 0.71 (more than 0.05), the p value of buying decision based on

fundamentals is 0.970 (more than 0.05), the p value of buying decision based on historical information is 0.007 (less than 0.05) is a strong measure of investment decision, the factor-buying decision based on historical information (since its p value is less than 0.05) is not a strong measure of investment decision.

Table No: 2
Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.298 ^a	.089	.061	1.073

In table 2, the R square value is 0.089 or 8.9%. It means that the variable availability bias and investment decision making has weak correlation and the remaining 91.1% variation in investment decision remains unexplained.

The dependent variable for testing this hypothesis is availability bias. The data about the income level is collected through questionnaire. The independent variable for testing this hypothesis is Income.

Hypothesis 2:- There exists no relationship between income level and availability bias.

Table No: 3
Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	2.904	.209		13.870	.000
	INCOME_LEVEL	.160	.087	.180	1.847	.068

In table 3, the variable income has a p value of 0.068 (more than 0.05) and the p value of the constant is 0.00 (less

than 0.05). It means the factor for measuring, variable income is a strong measure.

Table No: 4
Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.180 ^a	.032	.023	1.053

In table 4, the R square value is 0.032 or 3.2 %. It means that the variable income and availability bias has correlation of only 3.2% and rest 96.8% variation in availability bias remains unexplained.

Therefore there is no major relationship between income and availability bias. There is only a negligible percent of relationship between income and availability bias.

5. Findings and Suggestions

The article examines the relationship between Availability Bias and investment decision making. It further examines the relationship between Income and Availability Bias. From the analysis of the data collected from the Bangalore region, it appears that there is no significant relationship between availability bias and investment decision making. And also the results prove that there is no relationship between the income factor and Availability Bias meaning variance in income level does not make any difference in investors' decision making.

This article has chosen only availability bias as a factor under behavioral finance and has analyzed whether the income level has any relation with availability bias. There are various factors under behavioral finance such as over confidence, anchoring, representative bias, herding effect, etc. which

affects the decision making factors of investors. Further researchers may consider this and can explore various concepts under behavioral finance. The sample size for this study is 104 respondents among the population of Bangalore investors. Further researchers can increase the number of respondents to get better results as increase in sample size increases the reliability.

6. Conclusion

The behavioral finance is an emerging field in the economy because of its consideration of investor's emotional factors in investment decision making. The main purpose of this study is to find out the relationship between availability bias and investment decision making and also to examine the relationship between income level and availability bias. Investors should know the factors that will affect their investment decision which ultimately affects their long term growth. This paper is an attempt to provide awareness to the investors regarding the role of emotional factors in their decision making process rather driven by the traditional theory which assumes that investors make rational decisions. The results of this study may differ with variances in the market conditions. To optimize the decision making process, one has to consider the behavioral aspects which in turn provides better results in future.

References

1. Abdin, S., Farooq, O., Sultana, N., & Farooq, M. (2017). The impact of heuristics on investment decision and performance: Exploring multiple mediation mechanisms. *Research In International Business And Finance*, 42, 674-688. doi: 10.1016/j.ribaf.2017.07.010
2. Bakar, S., & Yi, A. (2016). The Impact of Psychological Factors on Investors' Decision Making in Malaysian Stock Market: A Case of Klang Valley and Pahang. *Procedia Economics And Finance*, 35, 319-328. doi: 10.1016/s2212-5671(16)00040-x
3. Javed, H., Bagh, T., & Razzaq, S. (2017). Herding Effects, Over Confidence, Availability Bias and Representativeness as Behavioral Determinants of Perceived Investment Performance: An Empirical Evidence from Pakistan Stock Exchange (PSX). *Journal Of Global Economics*, 06(01). doi: 10.4172/2375-389.1000275
4. Khan, H., Naz, I., Qureshi, F., & Ghafoor, A. (2017). Heuristics and stock buying decision: Evidence from Malaysian and Pakistani stock markets. *Borsa Istanbul Review*, 17(2), 97-110. doi: 10.1016/j.bir.2016.12.002
5. Kumar, S., & Goyal, N. (2016). Evidence on rationality and behavioral biases in investment decision making. *Qualitative Research In Financial Markets*, 8(4), 270-287. doi: 10.1108/qrfm-05-2016-0016
6. MENG, S. (2017). Availability Heuristic Will Affect Decision-making and Result in Bias. *Destech Transactions On Social Science, Education And Human Science*, (msie). doi: 10.12783/dtssehs/msie2017/1544
7. Lad, C., & R, T. H. (2018). A study on behavioural factors influencing individual investment decision making with special reference to south gujarat region. *International journal of latest engineering research and applications* , 70-80.
8. Dr. Chetankumar J Lad, M. H. (2018). A study on behavioral factors influencing individual investment decision making with special reference to south Gujarat region. *International Journal latest engineering research and application* , 70-80.
9. javed, h., Bagh, t., & Sadaf, R. (2017). Herding effect, over confidence, availability bias and representativeness as behavioral determinants of perceived investment performance: An empirical evidence from pakistan stock exchange. *Journal of global economics* .
10. Lad, C., & R, T. H. (2018). A study on behavioural factors influencing individual investment decision making with special reference to south gujarat region. *International journal of latest engineering research and applications* , 70-80.
11. Sarin, A. B., & J.k, C. (2017). An understanding of role of heuristic on investment decision. *international review of business and finance* , 57-61.