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Editorial

The Dynamics of Behavioral Finance

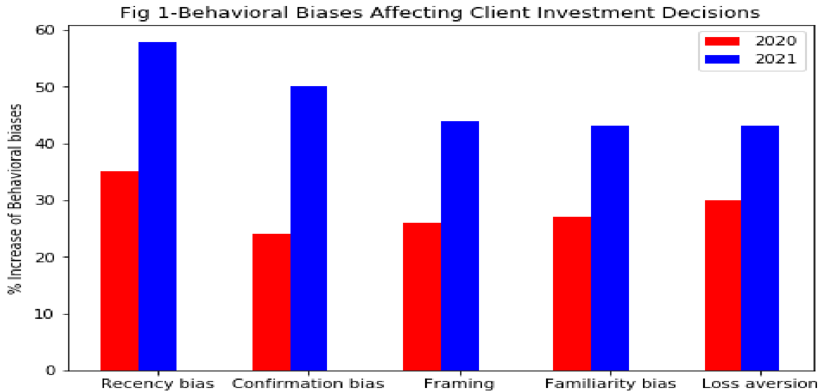
Behavioral finance basically addresses the influence of psychology on investment decision-making. It's difficult to expect the same behavior from all the investors in their investment decision-making process, which might have made the academicians, industry experts, and market participants focus on the study on the field of behavioral finance. Many psychological factors may influence an investor's decision making such as emotions, personality, society, government policies, and economy. The literature acknowledges that the field of behavioral finance mainly emphasizes on identifying heuristics and biases of individuals in making financial decisions.

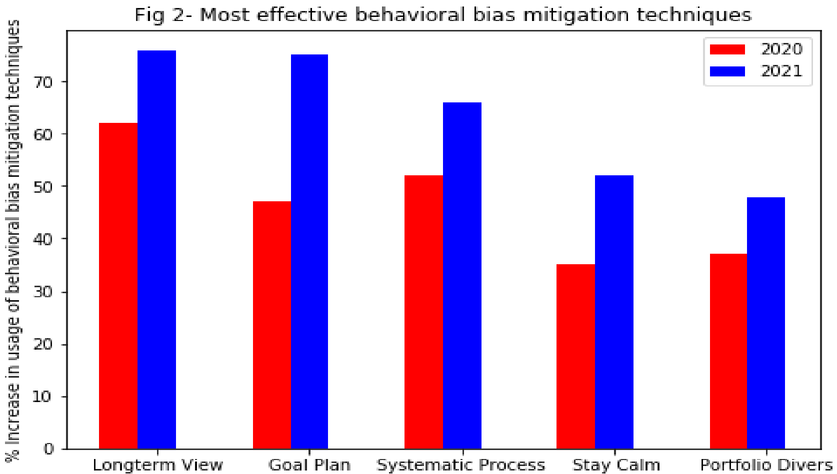
Decision-making is a complex process that involves choosing the best option out of available options. Markwitz (1952), Fama's Efficient Market Hypothesis (1970) and four eminent researchers proposed a traditional financial theory of CAPM model which assumed that all investors are rational and make decisions based on logic and prudent analysis. Shillee (1987) states that rational decision-making is difficult to achieve in practical situations. Barberis and Thaler (2003) are considered to be the pioneer researchers in behavioral finance. In their seminal research paper, they addressed the influence of behavioral psychology on investment decision-making.

Wynes (2021) studied the influence of investors' emotions on their information processing ability. He found that fearful investors process information more deeply than angry investors. Sedliacikova(2021) found that behavioral biases such as emotional, cognitive, and psychological significantly influence top-level business leaders and managers. Gavrilakis & Floros (2021) found that heuristics bias influences investors' portfolio construction. Chataway (2020), Bollen etal. (2015), and Kaustia (2008) observed a strong correlation between investor's behavioral psychology and their investment decision making. Ahmed and Noreen (2021) observed a significant positive effect of investors' behavioral aspects on financial decision-making. Fan et al. (2019) observed the influence of advancement in technology and social media on the availability of information to people more quickly and rapidly. Cheng (2014) and Taffler (2017) state that the dynamics of people's decision-making can be understood by studying a new field called neuroscience. It

is a combination of different functional knowledge such as science, psychology, and finance.

BeFi Barometer 2021 conducted a survey to understand the influence of behavioral aspects on investment decision-making, especially during the COVID-19 uncertainty period.





According to BeFi Barometer 2021 report, the financial and investment advisors observed an increase in behavioral biases among investors and also usage of behavioral bias mitigation techniques by the advisors from the year 2020 to 2021. Figure 1 shows the surge in five different biases among clients such as Recency, Confirmation, Framing, Familiarity and Loss Aversion biases. Further, Figure 2 depicts that advisors observed the surge in usage of behavioral bias mitigation techniques. It depicts a percentage increase in behavioral biases such as focusing investments on a

long-term perspective, integrating investments with individual financial goals, encouraging to follow systematic plans and processes, cautioning investors to be patient during volatility periods, and finally advising investors to diversify their investment in different less correlated asset classes. Some of the important behavioral biases which can influence the financial decision are discussed in the literature as follows.

Herd Mentality is basically an irrational behavior of an investor. Their investment decisions are mainly influenced by the other groups of investors such as friends, family members, and any other reference groups. Investors can avoid this herd mentality behavior by being rational and carrying out independent research, and taking some calculated risks.

Recency biasis a very common behavior exhibited by investors. They give more weightage to their most recent news, experiences or performances, and based on this, try to judge the long-term performance of the assets.

Confirmation bias refers to the investors having their own perceptions or beliefs about the performance of the various assets. They always tend to seek information or news that supports their beliefs and try to ignore any news or information or idea which is opposite to their preconceived notions.

Framing mainly emphasizes that the investor's choice depends mainly on the way of presenting the available information rather than the actual information itself. Tabseh et al. (2019) found that framing behavior has a strong influence on the investor decision-making process. Kahneman & Tversky (1979) observed that investors end up making investment decisions based on their perceived gains or losses.

Familiarity Bias refers to the investors who prefer to invest only in the asset classes or stocks that are comfortable or familiar to them. Familiarity bias leads to less diversification of their investment portfolio and exposure to greater loss or risk.

Loss-Aversion is a cognitive bias where the investors try to avoid a loss in the process of earning profits. Generally, loss aversion investors'pain of losing is higher than the pleasure of gain.

Conclusion

The literature addresses the influence of irrational behavior on financial decision-making due to various human psychological biases. These psychological biases and their mitigation techniques gradually increase periodically. Further, today the technology-driven world has been attracting many new investors into financial markets. Many factors such

as easy availability of the Internet, usage of social media, and financial apps may provide various information rapidly and influence the behavior of the investors. Investors can make financial decisions based on their financial objectives and systematic investment analysis.

Manu
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