

BEHAVIORAL BIASES ON INVESTMENT DECISION MAKING

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Abstract

Fundamental difference of behavioral finance from traditional finance is the recognition of investors' irrationality. The study aims to find the behavioral biases, which influence investors decision making. Disposition effect and herd behavior were the chosen behavioral biases for this study. Study also intends to find the influence of demographic profile on the behavioral biases. Results of the study indicated that both disposition effect and herd behavior did have influence on investment decision making. Demographic profile of the investors influenced disposition effect but it did not influence the herd behavior.

Keywords: Behavioral bias, Disposition effect, Herd behavior, Investment decision making

Introduction

Any decision-making process requires, appropriate use of mental and financial resources, to acquire and process information. In an attempt to make quick and easy decisions, individuals tend to deviate from rationality, or what is required for a standard decision-making process when he or she is rational. These decisions are termed biases. Thus, biases are systematic errors or offshoots of constraints that individuals themselves place on resources, like time, cost or capacity, to process the available information about his or her surroundings. In another sense, they are shortcuts that help in conserving time and energy in the process of decision making.

According to Welch (2000), and Hirshleifer and Teoh(2003), it is a mutual imitation leading to convergence in action space. It is also said to be the patterns of behavior, that are clustered or correlated across individuals by interaction, where the incentive to adopt a behavior increases with the number of previous adopters (Kim and Pantzalis, 2003; Welch, 2000). Further, human beings are social beings and hence they have inherently a strong belief in group behavior. When in an unpredictable environment, he or she considers that his or her personal security would be better off and even enhanced through cooperative behavior. Skyrms (2004) and Richerson and Boyd(2005), opine that it is this