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AN ANALYSIS OF BEHAVIOURAL FINANCE AND ITS INFLUENCE ON INVESTMENT DECISION

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ABSTRACT

This research delves into the fascinating realm of Behavioural Finance, exploring its significant influence on investment decision-making among residents in India's National Capital Region (NCR). By drawing on insights from relevant studies, this work seeks to uncover the intricate link between human behaviour and financial decision-making within this demographic. The study begins by examining the unique financial behaviours of investors in the region, aiming to identify the key investor profiles that shape the investment environment. As a multidisciplinary field combining elements of psychology, sociology, and finance, Behavioural Finance provides the primary framework for this exploration. The research distinguishes between its micro and macro perspectives: the detailed analysis of individual behavioural traits of investors and the broader identification of inefficiencies in the market. Recognizing the pervasive impact of behavioural biases on investment behaviours and decisions, this study offers an in-depth review of diverse research within the Behavioural Finance domain. It sheds light on how human psychology and social dynamics interact with financial decision-making, highlighting the crucial role of Behavioural Finance in contemporary financial practices. In an era where financial markets are not merely governed by rationality but are also shaped by complex human behaviours, this research offers valuable insights into the dynamics of Behavioural Finance. By illuminating the distinct investment choices, the study aims to deepen our understanding of the factors influencing these decisions, ultimately equipping investors and financial professionals with more informed decision-making strategies.

KEYWORDS*: Finance, Behavioural Biases, Investment Decision.*

Introduction

The realm of finance, traditionally dominated by rational decision-making models and efficient market theories, has witnessed a paradigm shift with the emergence of Behavioural Finance. This multifaceted field, blending insights from psychology, sociology, and finance, has gained prominence by recognizing that financial decisions are not solely dictated by rational analysis, but often influenced by deeply ingrained human behaviours, emotions, and cognitive biases. The profound implications of behavioural finance on investment decisions are particularly intriguing, warranting an in-depth exploration. This research paper embarks on a comprehensive investigation into the dynamic interplay between Behavioural Finance and Investment Decision Making among residents of the National Capital Region (NCR) in India. The NCR, with its diverse demographic and economic landscape, provides an excellent backdrop to delve into the complexities of financial choices influenced by human behaviour. Our study is rooted in the belief that understanding the distinctive behavioural patterns and biases affecting investment decisions in this specific region can have far-reaching implications for investors, financial professionals, and the broader financial industry. To begin our exploration, we aim to identify the prevailing investor archetypes that shape the investment landscape in the NCR. By doing so, we intend to shed light on the diverse financial behaviours exhibited by investors and provide insights into the factors guiding their investment decisions. It is essential to recognize that the nature of these decisions often extends beyond the traditional framework of rationality, rational expectations, and market efficiency.

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Behavioural finance provides the guiding framework for our study, distinguishing between its micro and macro dimensions. The microscopic dimension involves an in-depth examination of the behavioural traits of individual investors, while the macroscopic dimension seeks to uncover anomalies within the efficient market due to collective behavioural patterns. The presence of behavioural biases, such as overconfidence, loss aversion, and herding behaviour, significantly impacts financial behaviours and judgments, thus creating opportunities and challenges within the investment landscape.

This research constitutes an extensive review of various endeavours within the realm of behavioural finance, drawing upon insights from academic studies, empirical research, and real-world observations. By synthesizing these diverse sources of information, we aim to unravel the intricate interplay between human psychology, social factors, and financial choices. This understanding will highlight the pivotal role that behavioural finance plays in shaping investment decisions and underscore its substantial relevance in contemporary financial scenarios.

In a world where financial markets are not solely driven by rationality but are also influenced by the fascinating complexities of human behaviour, our research contributes valuable insights into the dynamics of behavioural finance within the NCR. By illuminating the distinctive investment choices made by individuals in this region, we strive to foster a deeper understanding of the factors guiding their decisions. Our ultimate goal is to empower investors and financial professionals with enhanced decision-making tools, allowing them to navigate the complex and often unpredictable landscape of financial markets more effectively.

As outlined by Schindler (2007), is built upon three fundamental cornerstones: sociology, psychology, and finance. Each of these fields plays a pivotal role in unravelling the intricate web of financial decision-making influenced by human behaviour.

- **Sociology**, the first cornerstone, serves as a systematic study of human social behaviour and the dynamics of groups. It explores how social relationships impact attitudes and behaviours, shedding light on the collective influences that mold financial choices. The sociological lens allows us to understand how individuals within the National Capital Region (NCR) of India are shaped by their societal surroundings, culture, and peer influences in their investment decisions.
- **Psychology**, the second cornerstone, delves into the scientific study of behaviour and mental processes. The decisions and actions of individuals are not isolated from their physical, mental, and external environments. In the context of behavioural finance, it helps us comprehend how the cognitive and emotional aspects of human psychology affect financial choices. The myriad of emotional biases and cognitive biases, such as Status Quo Bias, Loss Aversion Bias, Confirmation Bias, and many more, have significant implications for investment decisions, often leading investors down paths that deviate from traditional economic rationality.
- **Finance**, the third cornerstone, is the discipline concerned with determining value and making financial decisions. The finance function involves the allocation of capital, including the acquisition and distribution of assets. Within the NCR, as in any other region, individuals make pivotal choices regarding the allocation of their financial resources. Behavioural finance recognizes that these decisions are not merely driven by rational analysis but are profoundly impacted by human behaviour.
- Pompian (2006) delineates two vital subtopics that contribute to our understanding of the complexities surrounding investment decision-making:
- **Behavioural Finance Micro** (BFMI) scrutinizes the behaviours and biases of individual investors that distinguish them from the rational actors envisioned in classical economic theory. This dimension allows us to dissect the idiosyncrasies in the financial choices made by individuals within the NCR.
- **Behavioural Finance Macro** (BFMA) is dedicated to detecting and describing anomalies within the efficient market hypothesis that behavioural models may explain. It uncovers the broader market trends influenced by collective behavioural patterns, often leading to market inefficiencies that astute investors can capitalize on.

This study is not merely an exploration of the theoretical underpinnings of behavioural finance; it is a practical endeavour to bridge the gap between theory and real-world financial decision-making in a region known for its economic dynamism and diversity. As we delve deeper into the fascinating world of behavioural finance and its impact on investment decisions, we anticipate that our findings will offer valuable insights, enrich the academic discourse, and have practical applications for investors and financial practitioners alike.

Literature Review

Sewell (2005) defined behavioural finance as the study of psychology's influence on financial practitioners and its subsequent effects on financial markets.

Phillips (1995) analysed the changes in financial decision-making and investor behaviour after participating in investor education programs, emphasizing the positive impact of SEBI's investor awareness initiatives in India.

Madhusudan & Jambodekar (1996) noted that investors expect better services from the companies where they invest, with a focus on safety of principal, liquidity, and capital gain. SEBI's survey in 1998 underscored the importance of investment objectives, risk appetite, and available funds in shaping investment behaviour in the securities market.

Ranganathan (2006) assessed financial behaviour and conceptual awareness of mutual funds among 100 respondents in Mumbai, concluding that funding qualities, fund sponsor qualities, and investor-related services significantly influence the decision-making process.

Kabra, Mishra, & Dash (2010) studied the impact of age and gender on investment risk tolerance and decision-making processes among 196 government and private sector employees. Their research revealed that age and gender influenced risk-taking capacity.

Parashar (2010) investigated the effects of personality traits on investment choices using cluster analysis, correspondence analysis, Kruskal-Wallis test, and factor analysis with 100 individual investors. The study indicated that demographics and personality types play a role in investor behaviour.

Rushdi (2014) explored the influence of psychological factors on the investment behaviour of 1627 salaried investors in India, with demographic factors and gender appearing as significant influencers across all aspects of investment behaviour.

Kannadhasan (2015) delved into behavioural finance's role in investment decisions, discussing prospect theory and heuristic decision processes. The study emphasized that different investors face unique challenges in their decision-making processes influenced by various behavioural factors.

Tavakoli, Tanha, & Halid (2011) examined 13 factors influencing investor decisions, highlighting the significance of financial statements, consulting with others, second-hand information resources, financial ratios, reputation of firms, and profitability variables, especially dividends.

Kadariya (2012) investigated various factors affecting investor decisions in the Nepalese capital market, revealing the influence of factors like capital structure, media coverage, luck, financial education, and trend analyses. Investors, particularly young ones, often consider media coverage and recommendations from friends as significant information sources.

Kiran & Rao (2004) utilized Multinomial logistic regression and factor analysis to segment investors based on demographic and psychographic characteristics, drawing data from 96 respondents. Their study identified distinct investor groups.

Gupta & Jain (2008) examined investor preferences among various financial assets using descriptive analysis with 1463 household investors. They found that household investors favoured shares over mutual funds due to relatively higher returns.

Kandpal & Mehrotra (2018) emphasized the role of behavioural finance in addressing a lack of long-term planning and the need for increased financial education in guiding investment decisions within the Indian capital market. Their research highlighted the importance of aligning financial goals and behaviour for effective investment choices.

Objectives

The study aimed to achieve the following objectives:

- Identify factors influencing investor decisions.
- Analyse savings and investment decisions.

Research Methodology

- **Nature of Study**: Descriptive and exploratory.
- **Sample Population**: Residents of the Delhi/NCR region who are investors.

- **Data Collection**: Utilized both primary and secondary sources. The primary data collection involved the use of a questionnaire, with 358 responses obtained from the sample population.
- **Data Analysis**: Employed various analytical tools such as percentages, frequencies, charts, and Likert-scale assessments for data analysis.

Data Analysis

Age

21-30	70	27.6%
31-40	127	50.0%
41-50	39	15.4%
Above 50	18	7.1%

A significant portion of the participants, constituting 27.6%, falls within the age group of 21-30. The age group of 31-40 represents the majority of the respondents at 50.0%. A smaller percentage, 15.4%, falls within the 41-50 age bracket, while the remaining 7.1% are aged above 50.

Marital Status

Single	70	27.7%
Married	184	72.3%

Out of the total respondents, 27.7% were single, while the majority, constituting 72.3%, were married.

Qualification

Doctorate	119	46.8%
M Ed	4	1.7%
B Ed	0	0.0%
PG	113	44.6%
Graduate	18	7.0%

The majority of respondents hold doctorate degrees, comprising 46.8% of the sample. A significant portion, 44.6%, have postgraduate qualifications, while 7.0% are graduates. A small percentage, 1.7%, possess a Master of Education (M Ed) degree, while none have a Bachelor of Education (B Ed) qualification.

Monthly Income

Less than 5,000	22	8.7%
5,000-10,000	0	0.0%
10,000-20,000	9	3.4%
20,000-30,000	40	15.6%
Above 30,000	184	72.3%

Among the participants, 8.7% reported a monthly income of less than 5,000, while 3.4% fell within the 10,000-20,000 range. A substantial portion, constituting 72.3% of the respondents, had monthly incomes exceeding 30,000. No respondents reported a monthly income between 5,000 and 10,000.

Years of Experience

Under 5 years	61	24.0%
5-10 years	61	24.0%
Above 10 years	132	52.0%

Approximately 24% of the respondents have less than 5 years of experience, another 24% possess 5-10 years of experience, and the majority, accounting for 52%, have over 10 years of experience in their respective field.

Assured Return [What is the main purpose for Investment decision?]

Very Important	144	56.8%
Important	92	36.2%
Moderately Important	13	5.3%
Slightly Important	4	1.7%
Not Important	0	0.0%

It shows that the majority of respondents, 56.8%, considered it very important, while 36.2% regarded it as important. A smaller portion of respondents, 5.3%, remained moderately important, and only a minority found it slightly important (1.7%), with none deeming it not important.

Low Risk [What is the main purpose for Investment decision?]

Very important	66	26.0%
Important	118	46.6%
Moderately Important	57	22.3%
Slightly important	9	3.4%
Not important	4	1.7%

It shows that a significant proportion, 72.6%, considered risk to be an important or very important factor. Specifically, 46.6% found it important, while 26.0% regarded it as very important. In contrast, a smaller percentage, 26.7%, viewed risk as either moderately important or slightly important, with 22.3% taking a moderately important stance and 3.4% regarding it as slightly important. A mere 1.7% of respondents deemed risk as the not important factor in their investment decisions.

Tax Benefits [What is the main purpose for Investment decision?]

Very important	79	31.0%
Important	145	57.0%
Moderately important	26	10.3%
Slightly important	4	1.7%
Not important	0	0.0%

Notably, 31.0% of respondents considered tax benefits as very important, while 57.0% deemed them important. A relatively smaller percentage, 10.3%, expressed a moderately important stance towards tax benefits, and only 1.7% found them to be slightly important. None of the respondents categorized tax benefits as the not important factor in their investment decisions.

Safety of Investments [What is the main purpose for Investment decision?]

Very important	153	60.3%
Important	88	34.6%
Moderately important	13	5.0%
Slightly important	0	0.0%
Not important	0	0.0%

A majority of respondents, constituting 60.3%, considered it "Very important," while 34.6% deemed it "Important." A smaller percentage, 5%, expressed a "Moderately important" stance, while no participants found it "Slightly important" or "Not important".

Investment amount [What are the factors having implications on Investment Decision?]

Very important	88	34.6%
Important	153	60.3%
Moderately important	4	1.7%
Slightly important	9	3.4%
Not important	0	0.0%

It shows that a majority of respondents, 60.3%, consider the investment amount as "Important," while 34.6% rate it as "Very important." A smaller portion of participants, 3.4%, find it "Slightly important," and only 1.7% are "Moderately important" on this aspect. No respondents rated the investment amount as "Not important".

Potential Risk [What are the factors having implications on Investment Decision?]

Very important	101	39.7%
Important	127	50.0%
Moderately important	9	3.4%
Slightly important	13	5.3%
Not important	4	1.7%

The majority, comprising 39.7% of participants, found these risks to be "Very important." Additionally, 50.0% considered them "Important." A smaller proportion, 3.4%, had a "Moderately important" stance on the risks. Relatively fewer respondents perceived the risks as "Slightly important" (5.3%) or "Not important" (1.7%).

Tax Advantage [What are the factors having implications on Investment Decision?]

Very important	61	24.0%
Important	166	65.4%
Moderately important	18	7.3%
Slightly important	9	3.4%
Not important	0	0.0%

The majority, constituting 86 respondents (24.0%), found it very important, while 234 respondents (65.4%) considered it important. A smaller portion, 26 respondents (7.3%), maintained a moderately important stance. For 12 respondents (3.4%), tax advantage was deemed slightly important, and none considered it the not important among the options.

Liquidity [What are the factors having implications on Investment Decision?]

Very important	61	24.0%
Important	145	57.0%
Moderately important	44	17.3%
Slightly important	4	1.7%
Not important	0	0.0%

A significant majority, comprising 24.0% of respondents, consider liquidity to be "Very important." Furthermore, 57.0% of respondents view it as "Important." About 17.3% maintain a "Moderately important" stance on liquidity's importance, while only 1.7% find it "Slightly important." Notably, none of the respondents categorized liquidity as "Not important."

Past Experience [What are the factors having implications on Investment Decision?]

Very important	70	27.7%
Important	114	44.7%
Moderately important	44	17.3%
Slightly important	18	7.0%
Not important	9	3.4%

It shows that 27.7% of respondents consider past experience to be very important, 44.7% find it important, 17.3% remain moderately important, and only 7.0% regard it as slightly important. A small 3.4% consider past experience to be the not important factor.

Information through Internet [What are the factors having implications on Investment Decision?]

Very important	37	10.3%
Important	179	50.0%
Moderately important	68	19.0%
Slightly important	55	15.4%
Not important	19	5.3%

The majority of participants, 50.0%, considered it important, while 19.0% held a moderately important stance. A total of 15.4% regarded internet-based information as slightly important, and 5.3% considered it the not important. A significant 10.3% of respondents found it very important.

Financial Knowledge [What are the factors having implications on Investment Decision?]

Very important	70	27.7%
Important	136	53.4%
Moderately important	31	12.0%
Slightly important	13	5.3%
Not important	4	1.7%

A majority, comprising 27.7%, consider it "Very important," while 53.4% find it "Important." A smaller proportion, 12.0%, hold a "Moderately important" view, indicating a lack of strong opinion on the matter. Only 5.3% perceive financial knowledge as "Slightly important," and a mere 1.7% view it as "Not important." These responses reflect varying degrees of emphasis on the significance of financial knowledge among the surveyed individuals.

Conclusion

Investment decisions in India are often influenced by behavioural biases, including overoptimism, loss aversion, and herding behaviour, which can lead to suboptimal choices. The study underscores the significance of addressing these biases within the framework of behavioural finance.

Our research, comprising insights from 358 respondents, reveals that the majority of investors in India, particularly those between the ages of 31 to 40, are influenced by their behavioural patterns. They tend to invest their surplus income in the capital markets with monthly incomes exceeding Rs. 30,000, emphasizing the need for financial education and planning.

Successful investors recognize the influence of biases on their decision-making processes and strive to align their investment choices with their behavioural patterns, life goals, risk tolerance, and financial aspirations. In the context of Indian capital markets, understanding and mitigating these biases are essential to make informed and strategic investment decisions that lead to long-term financial success. This conclusion highlights the intricate interplay between behaviour, biases, and investment choices, providing valuable insights for investors and financial professionals operating in the Indian capital market.

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