

Psychological Factors of Investing and Their Relationships - An Empirical Analysis

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ABSTRACT

The main purpose of the research paper is to determine and analyse the association among the behavioural biases namely home bias, recency bias, gamblers fallacy, and self-control bias. The study area belongs to behavioural finance discipline, an emerging field in academia for contemporary research, challenging the rational behaviour of investor. Survey research method was employed and data was collected from the investors of Belagavi. Data was analysed with descriptive statistics and Pearson correlation technique using SPSS Software. The most prominent bias exhibited by the investors was gamblers fallacy with the mean of 4.04 followed by home bias with mean of 3.97. The study found positive correlation among all the variables. Highest correlation coefficient (0.259) was found between Self-control bias and home bias in the study. The result reveals that prevalence of one bias leads to emergence of other bias that is effect of multiple biases on investment decisions. An understanding of psychological errors exhibited by the investors enables them to take more rational investment decisions with awareness of manifold effect of the biases and contributes to disciplined investment behaviour. The research findings help the financial planners and investment advisors in building investment strategies suitable for specific clients by understanding their behavioural tendencies and preferences.

Key words: - Investment psychology, irrationality, behavioural biases.

INTRODUCTION

Contemporary research namely Behavioural Finance field emphasizes its prominence in understanding how do an investor behaves and influence of psychological factors, emotions, and cognitive biases. Emotions such as hope and fear determine the risk taking of an investor. Investment decisions of investors are filled with emotions, sentiments and feelings.

Sentiment drives investment decisions and this makes investors susceptible to psychological error arising from behavioural biases. (Kapoor and Prosad, 2017). Scholarly work by researchers have proved the presence and influence of numerous subjective factors namely home bias, gamblers fallacy, self-control, representative bias, herding and recency bias etc (Zahera and Bansal, 2018, Dickason & Sune Ferreira, 2018, Yakuban and Ramar, (2015), Lowies, et al., (2016). Pavani and Alagwadi, 2023). Contribution by **Rahul Sharma in economic times dates March 17th 2024** underlines the essence of psychology driving the behaviour of investors. The behavioural finance discipline explains psychological aspects associated with investment decision making. Several behavioural biases govern the investment decision making and makes it complicated ones. And these biases make the investments lousy. Study by **RBI staff** from January 2019 - March 2020 NSE data derived concentration of herding behaviour on mid cap stocks.

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REVIEW OF LITERATURE

Several researches have shed light on association among the behavioural biases. Weixiang S, Qamruzzaman Md, Rui Wang and Kler Rajnish. (2022) explored behavioural biases namely overconfidence, anchoring and representativeness shaping the heuristics bias and all three found to be positively and statistically predicting heuristics. The coefficient values are overconfidence (0.572), anchoring bias (0.795) and representativeness (0.773). And they found association of framing effect with mental accounting, endowment effect and regret aversion. Mishra & Metilda (2015) found increase in overconfidence bias with an increase in investment experience and education and it is higher among men than women. Also revealed Self-attribution increases with education. Dr. Kulal (2021) said investors make lousy investment choices because of cognitive and emotional biases. Study assessed the association between overconfidence and self-attribution bias through the data gathered from retail investors. With correlation coefficient of 0.405 study found positive association between overconfidence and self-attribution bias. Scholarly work by Dr. Taqqadus (2013) examined the influence of behavioural biases like overconfidence bias, loss aversion propensity, availability bias and confirmation bias on investment decision making among the students both graduate, post graduate and employees. Except between overconfidence bias and loss aversion among others there was weak negative correlation. Isidore and Christie (2018) investigated relationship among eight behavioural biases like loss aversion, regret aversion, mental accounting, availability, representativeness, anchoring, gambler's fallacy and overconfidence bias. The study found overconfidence bias (Mean value = 16.98) was highly exhibited. Investors and are more likely to prone to regret aversion and anchoring bias. Baral & Pokhrel considered investment performance as dependent variable. Prospect, market, heuristic and herding factors were independent variables. They found that investment performance was significantly impacted by market factors. And there was no significant relationship between independent variables and performance of investment. Also found the positive relations between the heuristic, prospect and herding with p values of less than 0.05. A study by Nkukpornu Etse, Gyimah Prince & Sakyiwaa Linda (2020) focuses on the nexus between investment decisions and behavioural biases. Snakebite effect that is worry about impact of financial crises on investment was more with standard deviation of 4.86. The study found significant relationship between belief bias, regret bias and snake bite effect with r value of 0.952, 0.964 and 0.946 respectively. The study confirmed the prospect theory and influence of independent variables of the study viz regret, belief, snakebite and overconfidence. Wagid (2019) examined irregularities in the market being caused by psychological biases. The study at Islamabad Stock Exchange found the negative correlation between overconfidence bias, self-attribution bias with market efficiency with r value of -0.313. Also, there was positive correlation with r value of 1 between self-attribution bias and overconfidence bias. Kumar & Balamurugan (2023) studied behavioural biases impacting IPO investment decisions was explored at Hyderabad and secunderabad. Significant correlation was found between prospect theory (0.721), herding (0.537), heuristic factors (0.431) and market forces. IPO investment decision was driven by herding bias. Hayat and Anwar (2016) research analysis revealed overconfidence and disposition effect had negative relation whereas herding has significant positive effect. There was significant positive relation of Herding Bias with Investment Decision ($r = .530$, $P = 0.000$). Effect of herding was weakened by financial literacy. Ullah (2015) investigated illusion of control and self-attribution biases influencing the investment decision with moderating effect of financial literacy. The illusion of control had positive significant impact on investment decision. Grezo (2020) examined the relationship between financial decision making and overconfidence. The study found that financial decision making was significantly affected by overconfidence but the magnitude of that effect was low. Singh and Sharma (2022) studied the role played by behavioural finance in individual decision-making process and found significant impact of regret aversion, fear of missing opportunities and loss aversion on mutual fund investment. The correlation coefficient among the independent variables and investment decision was 0.400.

OBJECTIVE

The main objective of the research is to determine and analyse the relationship among behavioural biases namely home bias, recency bias, gamblers fallacy, and self-control bias.

RESEARCH HYPOTHESIS

H1: - There is a significant correlation among the selected behavioural biases.

RESEARCH METHODOLOGY

The survey research methodology was used employed. And through systematically administering the questionnaire to investor, survey was done. The primary data for the study was collected from the investors of Belagavi via purposive and snow ball sampling technique. 376 responses were collected. The questionnaire designed consisted of scenario-based statements to capture the underlying behavioral biases of investors. Using a five-point Likert scale, ranging from 1 (Strongly Disagree) to 5 (Strongly Agree) responses were measured. The relationship among the selected biases exhibited by the investors were examined through Pearson correlation analysis.

DATA ANALYSIS

Table 1 Descriptive Statistics			
	Mean	Std. Deviation	N
Gamblers fallacy	4.0426	.75068	376
Recency bias	3.4628	1.16559	376
Home bias	3.9787	.92640	376
Self-control bias	3.7207	1.12152	376

Table 1 shows descriptive statistics of all four biases considered for the study. It explains which bias have highest influence on the investment decisions. From the above we found gamblers fallacy with the highest mean score of 4.04 and is the most prominent bias the investors are susceptible to. The preference towards domestic investment opportunities that is home bias is the second most influencing bias with mean score of 3.97. Comparatively self-control bias and recency bias have moderate and lower effect on investment decisions respectively.

H1: - There is a significant correlation among the selected behavioural biases.

To test the hypothesis Pearson correlation found to be suitable method. It helps in understanding the magnitude and the direction of the relationships among the variables chosen for the study.

Table 2 Correlation of Gamblers fallacy with Recency bias, Home bias and Self-control bias

		Gamblers fallacy	Recency bias	Home bias	Self-control bias
Gamblers fallacy	Pearson Correlation	1	.166**	.086	.150**
	Sig. (2-tailed)		.001	.097	.003
	N	376	376	376	376
**. Correlation is significant at the 0.01 level (2-tailed).					

Pearson correlation test revealed in **table 2** shows the linear positive correlation by gamblers fallacy with recency bias, home bias and self-control bias. The strength of the association is found to be weak but there exists statistically significant relationship. Except between gamblers fallacy and home bias, there exists statistically

significant relationship (p- value less than 0.05). Investors exhibiting gamblers fallacy are more likely to emphasize on recent happenings while taking investment decisions.

Table 3 Correlation of Recency bias with Gamblers fallacy, Home bias and Self-control bias

		Gamblers fallacy	Recency bias	Home bias	Self-control bias
Recency bias	Pearson Correlation	.166**	1	.165**	.203**
	Sig. (2-tailed)	.001		.001	.000
	N	376	376	376	376
**. Correlation is significant at the 0.01 level (2-tailed).					

Table 3 shows the positive correlation of recency bias with gamblers fallacy, home bias and self-control bias and statistically significant with p value less than 0.05. Among all, the correlation between recency and self-control is high (0.203). The results depict those investors demonstrating recency bias are also prone to self-control bias. Emphasize on recent happenings by the investors is influencing self-control tendencies of the investors.

Table 4 Correlation of Home bias with Gamblers fallacy Recency bias and Self-control bias

		Gamblers fallacy	Recency bias	Home bias	Self-control bias
Home bias	Pearson Correlation	.086	.165**	1	.259**
	Sig. (2-tailed)	.097	.001		.000
	N	376	376	376	376
**. Correlation is significant at the 0.01 level (2-tailed).					

Pearson correlation test revealed in **table 4** shows the linear positive correlation among the variables. The strength of the association found to be highest between home bias and self-control bias ($r=0.259$). The relationship is statistically significant as p- value less than (0.05), except between home bias and gamblers fallacy. Investors preference towards domestic securities or investments highlights their restraint and disciplined investment behaviour.

Table 5 Correlation of Self-control bias with Gamblers fallacy, Recency bias and Home bias

		Gamblers fallacy	Recency bias	Home bias	Self-control bias
Self-control bias	Pearson Correlation	.150**	.203**	.259**	1
	Sig. (2-tailed)	.003	.000	.000	
	N	376	376	376	376
**. Correlation is significant at the 0.01 level (2-tailed).					

The test results shown in **table 5** shows the linear positive correlation with statistical significance p- values being less than (0.05). Investors demonstrating self-control bias are subject to home bias, recency bias, and believe in trend reversals in stocks and market performance.

RESULT

H1: - There is a significant correlation among the selected behavioural biases is accepted.

FINDINGS

The research indicates gamblers fallacy and home bias as more prominent ones prevalent in investors investment decisions. And study found positive and significant association among the variables namely home bias, recency bias, gamblers fallacy, and self-control bias. Simultaneously multiple behavioural tendencies investors are exhibiting. Even though the strength of association is weak but statistically significant highest positive association was found between home Bias and self-Control with correlation coefficient of 0.259 in the study. The test results are statistically significant in all the cases except between gamblers fallacy and home bias. Since there exists association among the biases, the investor needs to understand the combined effect of these biases and take informed investment decisions.

CONCLUSION

Research in the discipline of Behavioural finance facilitates an understanding of irrational behaviour of investors caused by presence of behavioural biases. The researchers highlighted the positive significant association among the biases namely home bias, recency bias, gamblers fallacy, and self-control bias. This creates awareness among the investors in knowing the biases they are subject to and emergence of other biases because of significant association. From the perspective of investors, education on psychological faults contributes to reducing impulsive decisions and better long-term investment results.

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