



Behavioral Finance In Investment Decisions

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Abstract

Behavioral finance has an important role in finance, namely understanding human behavior, including investor behavior. The type of data used is secondary data, namely data that is not directly given to data collectors, this data is obtained from books, scientific articles and internet sites, materials related to behavioral finance. The data collection technique in this study is a literature study that is directly related to behavioral finance. The method used in this research is the Systematic Literature Review (SLR), where the results of this study try to map the trends that occur regarding behavioral finance, also try to predict where this research will go, so that later it is expected to provide new input and views for the world of behavioral finance, what needs to be explored at this time, what contributions are needed at this time, and can be an attraction for other researchers to study behavioral finance.

Keywords: Behavioral financial, investment decisions, SLR

1. Introduction

The Covid-19 pandemic has not only had an impact on public health, but has also had an impact on the economic, educational and social conditions of the world community. As well as people worry about their own health and the health of their family, friends, and loved ones, people also worry about their financial well-being. The pandemic has caused countries to implement Social Restrictions policies which have implications for limiting community activities, including economic activities, educational activities, and other social activities.

One of the major impacts of the Covid-19 pandemic on the national economy is the decline in investment figures in various business sectors. Communities are hesitant to start investing, entrepreneurs also have doubts whether the investment made is in accordance with the conditions and needs of the community. This study aims to see how insights from behavioral finance can help researchers and investment decision makers to understand financial market movements and various actions taken.

The Institute for Development of Economics and Finance (INDEF) predicts that there is a potential loss in investment value of IDR 127 trillion due to the outbreak of Covid-19. This is not without reason, bearing in mind that one of the contributing factors is the increasingly depressed outlook for economic activity and growth. Investment is needed to increase the output of a commodity (Baddeley et al., 2012).

Whether or not there is a Covid-19 pandemic, investment is in fact faced with classic problems, especially those that affect investors' interest in investing, especially in medium and small scale enterprises. The problems faced are (1) capital and financing, (2) investor interest, (3) tariff and non-tariff barriers, (4) infrastructure, (5) low product competitiveness, and (6) the level of convenience regarding licensing and bureaucracy (Rachmat et al. 1995). The Covid-19 pandemic adds to this series of problems because increasing investment also requires an element of decision and an assessment of the prospects of future business development. This study aims to see how insights from behavioral finance can help researchers and investment decision-makers understand financial market movements and the actions taken in response to the COVID-19 crisis.

2. Literature Review

2.1. Investment Decisions

Investment is the use of a number of funds or other resources that aim to obtain a number of benefits in the future which are characterized by investment. Investment contains a lot of risks and uncertainties; The level of profit from investment activities can be used as a benchmark for investment performance in upstream and downstream activities. According to Tandelilin (2001), investment is a commitment to a number of funds for other resources carried out at this time with the aim of obtaining a number of benefits in the future. Basically there are two groups of investors, namely individual investors (individual investors) and institutional investors (institutional investors). Individual investors are individuals who make investments, while institutional investors usually consist of insurance companies, depository institutions (banks and savings and loan institutions), pension fund institutions and investment companies.

In general, investors will expect the highest rate of return from their investments. However, there are several things that are considered by investors in making investments, including risk. The greater the risk faced by investors, the greater the level of investors' expectations of the rate of return from these investment activities. Risk in the investment context is when the actual rate of return does not match the rate of return expected by the investor.

Brennan (1995), said that if it is associated with investors' preferences for risk, then investors are divided into three, namely:

- a. Investors who like risk (risk seekers) are investors who when faced with two investment choices that provide the same rate of return with different risks, investors will prefer investments with greater risk. These investors are usually aggressive and speculative in making investment decisions.
- b. Investors who are risk neutral are investors who will ask for an increase in the same rate of return for every increase in risk faced. This type of investor is generally quite flexible and tends to be prudent in making investment decisions.
- c. Investors who avoid risk (risk averter), are investors who, when faced with two investment choices that provide the same rate of return with different levels of risk, will tend to choose investments with lower risks. This type of investor usually tends to always consider carefully and planned for their investment decisions.

There is a need to focus on specific investment strategies in the long term to control "mental mistakes" by investors. Investors should keep detailed records of the specific stocks purchased for their portfolios. Investors also have to decide on specific criteria to make an instant decision to buy, sell or hold. Classical investment theory is based on the assumption that investors always maximize their profits. However, a number of studies show that investors are not always so rational. Recent research shows that the average investor makes decisions based on emotion, not logic; Most investors buy high on speculation and sell low on panic. Psychological studies reveal that the pain of losing money from investing is actually three times greater than the pleasure of earning money. Emotions such as fear and greed often play an important role in investor decisions.

2.2. Behavioral Finance

Behavioral finance is important at the individual as well as corporate level. Behavioral finance combines the impact of psychology and economics to find the underlying reasons for irrational solutions to investment, borrowing and saving spending. Behavioral finance contradicts one of the axioms of conventional finance, which states that humans are rational, and make all financial decisions after careful consideration of all issues. The premise of behavioral finance is that conventional financial theory ignores how humans actually make decisions and that everyone makes different decisions (Barberis & Thaler, 2003; Bikas et al., 2013; Haroon & Rizvi, 2020).

Economic theory, explaining human decisions in the market, refers to psychological motives. Behavioral theorists argue that human decision-making is not always based on material or rational reasons. Often a person simply follows certain traditions or tries to avoid risks and difficulties. Prospect theory proponents, associated with behavioral theory, argue that human behavior is often determined by a constant desire to avoid loss rather than a desire to generate income. Behavioral finance is important at the individual as well as corporate level.

Behavioral finance replaces normal people with rational people in standard finance. It replaces the behavioral portfolio theory for the average variance portfolio theory, and the behavioral asset pricing model for the CAPM and other models where the expected return is determined only by risk. Behavioral finance is very popular in stock markets around the world for investment decisions. According to Reilly & Brown (2011), states that the decision to invest is strongly influenced by the framing effect, namely the effect caused by the individual's point of view of a matter consisting of three things, namely:

- a. Over-confidence bias. This occurs when investors feel more confident than they should be.
- b. Reliance on expert bias. It is the tendency of investors to get advice or opinions from experts before making investment decisions.
- c. Self-control bias. The bias that arises when an investor holds back his current consumption to make more consumption in the future.

Behavioral finance is the psychological and sociological study of the behavior of financial practitioners and their subsequent effects on markets. It helps to understand why people buy or sell stocks without conducting fundamental

analysis and behaving irrationally in investment decisions. Where behavioral finance is the application of scientific research on psychological, social and emotional contributions to market participants and market price trends. It also studies the psychological and sociological factors that influence the financial decision-making processes of groups of individuals and entities.

Kapoor and Prosad's 2017 study examined developments in financial behavior through the history of finance. This provides the earliest evidence of behavioral abnormalities reported by researchers in the stock market. This research then highlights the importance of Behavioral finance and its unique position in bridging the gap between real-life situations and traditional theories.

Financial behavior is related to the soul of investors and their role in making financial decisions. This field loosens the assumptions of rationality present in standard financial theory and explains that real investors are affected by their psychological biases (Yew et al., 2017). These biases are translated into their behavior so that they can make sub-optimal decisions. Such decisions, on a large scale, can cause disruption in the market and are known as market anomalies. Since, such anomalies have an adverse impact on the financial health of individuals as well as the financial health of the entire economy, they need to be prevented. Prevention can only come about by increasing practitioners' awareness of their psychological and behavioral limitations. To increase understanding of how people make financial decisions, it is important to investigate what psychological characteristics influence positive financial behavior and individual financial well-being.

3. Methods

The research method used in this research is juridical normative. Which is the normative juridical approach carried out with how to study and interpret theories related to principles, doctrines, conceptions and legal norms related to Investment and Behavioral Finance. This research was also carried out by means of a Literature Study with different materials related to Investment and Behavioral Finance. The type of data used is data secondary. According to Sundarasan et al. (2016), secondary data is data that is not directly given to data collectors, this data is obtained from books, scientific writing articles and internet sites related to research which is conducted". The data collection technique in this study was a literature study directly related to the research object and research title, through books, print media and the internet.

4. Results and Discussion

Theoretical and empirical evidence shows that psychological influence is very important in decision making. Investors are vulnerable to psychological factors that drive their behavior and influence their decisions at the financial market level. In the Japanese and French markets, there are two characteristics that characterize the Japanese and French markets. Initially, fluctuations in trading volume were caused by investors being overly confident and more optimistic. On the contrary, the presence of more pessimistic investors greatly influenced the evolution of trading in the specific case of the French market.

Conducted research has proven that when making decisions under conditions of uncertainty and risk, people experience the effects of various illusions, emotions, misinformed perceptions and other "irrational" factors. Corporate social responsibility reflects the new role of business in society. A number of studies from ASEAN, Middle East and Western countries have actually established that psychological factors have a relationship and impact on investors' decision making in their stock market.

Babajide and Adetiloye (2012) conducted an empirical study on the behavioral biases of investors in the Nigerian security market. This study finds strong evidence that overconfidence, denial, framing and status quo biases exist among Nigerian investors. A weak negative relationship between bias and stock market performance also forms. Wamae (2013) has investigated the behavioral factors influencing investment decisions in the Kenyan stock market focusing on investment banks. The behavioral factors investigated were herding, prospecting, risk aversion and retention. He found that all factors influence investment decisions, with herding having the most impact, followed by prospecting, anchorage and finally risk aversion having the least impact.

Bashir et al. (2013) studied behavioral biases including overconfidence, confirmation, and illusion of control, loss aversion, mental accounting, status quo and over-optimism in investors' financial decision making. Nofsingera and Varmab (2013) looked at the availability bias in decision-making by exploring how the availability heuristic can lead investors to focus on known stocks, including those that he or she has owned several times (repurchased).

5. Conclusion

Many studies analyzing the financial behavior of companies have been carried out in the last few decades. Research on financial behavior is important at both the individual and corporate levels. With this research, it is hoped that it can become additional material for knowledge related to financial behavior in determining investment decisions. Based on the research results, it can be concluded that the psychological side of investing is the elements that can determine investment policy.

Acknowledgments

This research was supported by [Indonesian University of Education], [Ma'soem University] and [Indonesian Cooperative University]. We thank you for helping in the smooth running of this community service activity.

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