Behavioral Finance Perspectives on Investor Financial Decisions

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The hypothesis of an efficient market stated that investors act rationally, but this paper showed that investors act irrationally in decision making. This matter can be seen from the decision making of investors that was affected by some psychological factors; therefore, this paper concluded that there is no market efficiency.

Keywords: Behavioral Finance, Efficient Market Hypothesis, Financial Decisions, Psychological Factors, Decision Making.

1. INTRODUCTION
Efficient Market Hypothesis (EHM) is a major research in specialized literature. There are many views of the EMH, from which some reject and other support it. A good starting theory is that of efficient capital markets in the modern theory of finance. The efficiency means that the investors have no opportunity of obtaining abnormal profits from capital market transactions and cannot be at the market. So, the only way an investor may obtain is a larger profits by investing in higher risk assets.

Malkiel defined an efficient capital market as being a market in which "prices fully reflect all known information, and even un informed investors buying a diversified portfolio at the tableau of prices given by the market will obtain a rate of return as generous as that achieved by the experts." It means that when the market came efficient, the investors cannot obtain the abnormal profits from capital market transactions.

Fama stated that economics and financial theories have been based on ration all investors and on market efficiency hypothesis, which posits that market prices fully reflect all available information. Traditional models explained that rational investor use the information, their decision making is based on utility function with beliefs, calculated via optimal statistical procedures. Thus, representative investor is an individual who acts as an expected utility maximize. The hypothesis that investors are fully rational which instantaneously process information in a correct manner is unrealistic. It is hard to explain it because the human behavior is often unpredictable. Therefore, based on the explanation above that it is too difficult to see the real of efficient capital market because decision making of investors often affected by psychology.

2. LITERATURE REVIEW
Haugen explained that the evolution of finance as a separate discipline by identifying three schools of thought: old finance, modern finance and new finance. The old finance school focused on financial statement analysis and the nature of finance claims. Modern finance focused on asset pricing and valuation based on rational Economic behavior. In the 1980s several papers challenged the modern finance doctrine, leading to the emergence of the new finance school of thought in the 1990s. The new finance doctrine deals with in efficient markets, primarily by adopting behavioral models.

Statman stated that neo classical finance tells us the following: (i) the market value of an asset should be aligned with its fundamental value; (ii) finance markets react quickly to new information; (iii) prices follow a random walk process resulting from the random arrival of information; and (iv) no investor can consistently earn abnormal return in excess of what is consistent with risk.

Stracca stated that behavioral finance theory based on the psychology literature actually challenges the efficient market hypothesis by stated that psychological factors influence stock prices. Loewenstein stated that investors 'emotional state affects asset prices. Cao and Wei stated that investors mood swings have been attributed to weather conditions including sunshine, daylight, temperature, and lunar cycles, these psychological factors actually do influence stock returns. This evidence showed that behavioral finance theory can be used to explain why finance markets can be informational in efficient.

Buss stated that Behavioral finance was formulated a new branch of theory, combining the knowledge of psychology, sociology and other social sciences. In order to better understand an individual financial behavior, the behavioral theory of psychology, sociology and anthropology is applied.
Glasner and Weber stated that many empirical studies demonstrate that overconfidence leads to excessive trading and that the more overconfident the investor, the more likely the investor is to choose higher-risk investments. Nasic and Weber demonstrated that overconfidence and risk perception has a positive effect on the risk—taking behaviors of investors. Therefore, we can say that overconfidence corresponds to individuals who are too confident and ex generate in estimating their own competence and under estimate risk.

Al-Hajeh et al. stated that generally assume that some environmental factors (e.g., sunshine, hours of daylight, sports events, religious holidays) can trigger mood changes in a large fraction of the investor population, which in turn translate into changes in risk aversion and/or optimism and affect portfolio choices.

Isen and Patrick found that happy mood fosters risk taking in a game of roulette involving low-risk bets; when high-risk bets are considered, however, individuals in a positive mood tend to be more risk averse than controls. Grable and Roszkowski find that people currently experiencing a happy mood display a higher level of financial risk tolerance when confronted with hypothetical investment decisions than people in a neutral mood.

Lim had examined the relationship between psychological biases, namely the over confidence bias, conservatism bias, herding and regret and the decision making of investors in the Malaysian share market. The result is that over confidence, conservatism bias and regret have positive significant impacts on investors' decision making. However, herding behavior was found to have no impact on investors' decision making. Lui showed that the behavior patterns of individual investors in Hong Chi Minh stock market such as: over confidence, anchoring, herding, loss aversion and regret aversion have moderate impacts on the investors while market factors have the highest impact among all on the investors' decision making.

Pourjaban et al. found that over confidence bias has a significant impact on investment in Tehran Stock Exchange Market. Qureshi and colleagues examined about the effects of behavioral factors such as heuristics (representativeness, gambler's fallacy, anchoring, over confidence, and availability bias) and risk aversion on the decision making of equity fund managers of Pakistan. The results demonstrated a positive and significant relationship exist between the behavioral factors and investment decision making. In conclusion, most of the previous studies have found psychological factors have positive and significant impacts on investors' decision making.

3. METHOD

To answer these research questions, we used the step of research as has been done by Franco-Santos et al. and logical analysis by Guzavicius et al.

4. DISCUSSION/CONCLUSION

Based on several explanations above that theoretically, studies in behavioral finance had demonstrated that emotion influenced investment decisions. It meant that the trading was influenced by the investors' irrational behavior. Human behavior was generally reactive, not proactive; therefore, it was difficult to make predictions on the basis of narrow rules. Behavioral finances could relatively easily explain why an individual had made a decision. Based on behavioral finance theory, investors are influenced by psychological factors in decisions making. Investors allowed themselves such as their beliefs and emotions, thus deviating from rational choices and causing a shift in asset prices in relation to their intrinsic value.

Several studies has explained us that existence of irrational investor behavior on the capital market, concluding that such investors can cause changes in the movement of prices in relation to their fair values. For example, the previous studies has analyzed that the impact of both rational investors (who ground their trading behavior on rational expectations) and irrational investors (who show psychological and emotional facets of the human decisions/behavioral errors) on the trading volume. The results showed that trading is influenced by the investors' irrational behavior. It meant that the rationality hypothesis could be rejected for both capital markets. Capital markets can be influenced by psychological and sociological factors, so we can call the capital market are not necessarily efficient. Therefore, we concluded that Behavioral finance gave the evidence that the market was not efficient and the investors were not rational. This matter can be seen from the decision making of investors affected by some psychological factors. It means that there will be no market efficiency.

References and Notes

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