ABSTRACT: The field of behavioural finance is an interdisciplinary field of study which applies the theories of behavioural sciences to explain the irrational financial behaviour of investors. Initially the finance field was reluctant to accept the view of psychologists who had proposed the behavioural finance model but later on financial economists started to believe that the investors do behave irrationally. The present article reviews the existing literature to understand the biases in behavioural finance.


INTRODUCTION: Behavioural finance has opened up new vistas to the field of financial research. It studies the psychology of financial decision-making and differs from the traditional Efficient Market Theory. Emotions are very important in an individual’s life and they affect investment decisions. Financial experts do believe that greed and fear do play important role in driving stock markets and Behavioural Finance extends this analysis to the role of biases in decision making. Hence it takes the insights of psychological research and applies them to financial decision. Retail investors do make decisions based on their intuitions and feelings rather than collecting sufficient information which will facilitate effective decision making. Researches show that investors make irrational investment decisions. In reality, investors behave irrationally many a times by trading excessively, purchasing stock without considering the fundamental value, buying stocks which their friends are buying, retaining loss making stocks while selling bullish stocks etc. Behavioural biases have been attributed to the irrationality in decision making. In Behavioural Finance, “sentiment” is synonymous with “error”. The main characteristic of the market is extreme nervousness. The market sways with the moods and powerful emotional preferences of investors. The mood of an investor changes from Exuberance to Complacency and Panic in the Emotional Life cycle. This is also reflected in market sentiments. The upheaval of Enthusiasm and Over Confidence due to recurring gains may decline drastically on a huge loss, causing repeated biasness in consecutive decisions. This Emotional Cycle repeats again after a short span, on recuperation of the market. Behavioural Finance has emerged as an imperative area of study which demands scholarly investigation. It deals with the influence of psychology on the behaviour of financial practitioners and the subsequent effect on markets. Although there are enough research evidences which support investment portfolio, the concept of behavioural finance still seems to be in embryonic stage.

LITERATURE REVIEW: Bhatta and Kumar (2009) emphasized the paradigm in the financial market scenario and investigated through behavioural finance approach whether, in the milieu, the Indian investors are really trapped and then, attempts to throw some tips to get out of the trap. Sadi et al (2010) tried to recognize the popular perceptual errors among investors and its connection with their personality.200 of the investors in Tehran’s stock market were taken randomly
as samples and the needed data was gathered through questionnaire. By using the parametric analysis and correlation they have tried to check the accuracy of the hypotheses. The finding demonstrated that the offered perceptual errors have got a significant correlation with the investors’ personality. The conclusions exhibited that there is direct correlation between extroversion and openness with hindsight bias and over confidence bias, between neuroticism and randomness bias, between escalation of commitment and availability biases. Also, there was a reverse correlation between conscientiousness and randomness bias, between openness and availability bias.\(^{(2)}\)

Veeraraghavan and Anbalagan (2011) tried to establish the relationship between the heuristic behavioral factors and the investment decisions of the investor. The study categorised the Investors into three categories, i.e., Risk Avoiders, Risk Takers and Risk Neutralists and also identified eight dominant heuristic behavioural factors. These decision biases in each of the heuristic factor varied from investor to investor depending on what category the investor fall, i.e., Risk Avoiders, Risk Takers and Risk Neutralists. The study concluded the economic decisions of a human being are more emotionally based than rationally based.\(^{(3)}\)

Gholizadeh, Shakerinia and Sabet (2013) studied the effect of behavioral financial knowledge on the behaviors of the investors in Tehran Stock. The research studied six behavioral biases, viz., compatibility, familiar concept, idealistic belief, event oriented, fresh pot, irreversibility. Data was collected through a questionnaire. Investors of Tehran stock were interviewed for filling up the questionnaire. Structural equation method was used for analysis of the data. The results showed that only event-oriented bias doesn’t have meaningful relationship with investor’s decisions.\(^{(4)}\)

Sharma and Vasakarla (2013) examined the linkages between gender and behavioural finance biases. Attempt was made to look at how gender, risk aversion and overconfidence may affect the investment decision making of the individual investor. The purpose was to study possible gender effects on risk aversion and overconfidence in investment decision making. Data was collected through questionnaire and Chi-square Test was used as a statistical tool for data analysis. The authors found that female are more conservative than their male counterparts in terms of risk aversion. In terms of overconfidence, they could not reach to any conclusion with certainty because research has shown mixed results.\(^{(5)}\)

Bashir et al (2013) investigated the impact of behavioural biases on investor's financial decision making. Behavioral biases including overconfidence, confirmation, and illusion of control, loss aversion, mental accounting, status quo and excessive optimism were studied in the research. Questionnaire was used for data collection. Correlation and Linear regression model techniques were used to investigate whether investor decision making is affected by these biases. The study concluded that the Confirmation, Illusion of control, Excessive optimism, Overconfidence biases have direct impact on the investor's decision making while status quo, Loss aversion and Mantel accounting biases have no impact according to data collected from financial institutions.\(^{(6)}\)

Sanghvi and Gandhi (2014) investigated the psychological impact on investors in the financial world. They studied the biases in behavioural finance mainly emphasized on the impact of loss aversion and mental accounting on investment decision of retail investors. They tried to highlight that behavioural finance tries to elucidate and increase understanding of the reasoning patterns of market members, including the emotional course of actions involved and the degree to which they influence the decision-making process.\(^{(7)}\)
Zindel, Zindel, and Quirino (2014) tried to demonstrate that the emergence of behavioral finance contributes to a better understanding about the decision making process. They explained that behavioral finance presents evidence that the decision making process of investors can be triggered by cognitive illusions, heuristics and cognitive biases, resulting in misleading investment decision-making, which is not based on rationality. The study tried to learn about the cognitive biases. The study explained that the knowledge about cognitive illusions that can affect the decision process allows investors to avoid mistakes in the financial decisions. Thus, knowing and letting the investors know about cognitive illusions to which they are subject is crucial for the improvement of investment allocation. It is believed that only through the systematization of information on investor behavior and the process of decision making, it will be possible to construct appropriate tools to support decision-making, which can contribute to economic efficiency in the markets. 

Onsomu (2014) tried to identify behavioural biases which affect individual investors at the Nairobi Securities Exchange. The relationship between gender and the behavioural biases was also investigated in the study. The study was conducted by issuing questionnaires to investors of Nairobi Securities Exchange, Kenya. A total of 58 investors responded of which 69% were men and 31% were women. Collected data was analysed using descriptive statistics and Pearson Chi-square test. Pearson Chi-square technique was used to analyse the relationship between gender and the behavioural biases. The results indicated that investors are affected by Availability bias, Representativeness bias, Confirmation bias and Disposition effect. Overconfidence bias has no significant effect because less than 50% of the investors were affected. There was no significant correlation between Availability bias, Representativeness bias, Confirmation bias, Disposition effect and Overconfidence bias and gender. 

Chaffai and Medhioub (2014) studied the influence of psychological and emotional factors on the behaviour of Tunisian stock market investors. Based on a questionnaire distributed to the Tunisian investors in the stock market, and by using the Multiple Correspondence analysis, the study focused to explain how behavioural finance can affect Tunisian stock market. It was concluded that persons having a high level of education are subject to behavioural biases, and agents who invest amounts between 1,000 and 20,000 TND are most vulnerable to behavioural biases. In this research, the researchers found the presence of stock market anomalies, a lack of investor behaviour rationality in the Tunisian stock market. They also concluded that subjective judgments and persistence of behavioural biases can give an explanation to the market inefficiency. 

Qadri and Shabbir (2014) studied the impact of two biases, overconfidence and illusion of control, on the investor’s decisions on the Islamabad stock exchange. Researchers used questionnaire for data collection. The study found that over confidence and illusion of control bias have a lot of impact on investors' decision in ISE. The study also showed that Male are more overconfident than female and Investors do not focus much on fundamental or technical analysis while taking their decisions.

Raut and Das (2015) studied the psychological and social patterns merging with individual’s capital market investing behaviour. Through the review of various studies they observed that social factors like herding, emotional contagion, imitation and information cascades along with psychological patterns like representativeness availability and anchoring heuristics are the basic key factors that determine individual decisions. The study highlighted the common decisional errors made by investors to help the investors and portfolio managers in making their choices keeping the discussed behavioural biases in mind.
CONCLUSION: From the review of literature it is clear that there is a paradigm shift of attention from the Efficient Market Hypothesis to Behavioural Finance. Though there is no concrete solution to the unpredictable human behaviour, several studies by the behaviorists have thrown light on the biases in Behavioural Finance. Different kinds of biases, like Anchoring bias, Mental Accounting bias, Confirmation Bias, Hindsight Bias, Gambler’s Fallacy, Herd Behaviour, Over Confidence, Prospect Theory etc., affect the investment decisions.

While explaining the different kind of biases, researchers have also tried to give tips to avoid being trapped by the investors’ biases. Through the review of literature, it is found that Behavioural Finance cannot predict the future earnings and the actual movements of the stock markets, but advocates the psychological biases which are repeatedly found in decision making of individuals. If individuals are aware of the biases then only they can try to avoid them. Human psychology is really an ocean, depth of which cannot be measured accurately. But if individuals are aware of the biases, then they can become cautious before taking any irrational financial decisions.

REFERENCES:

AUTHORS:
1. Leena Roy Mallick

PARTICULARS OF CONTRIBUTORS:
1. Assistant Professor, Department of MBA, Supreme Knowledge Foundation Group of Institutions.

NAME ADDRESS EMAIL ID OF THE CORRESPONDING AUTHOR:
Leena Roy Mallick
Supreme Knowledge Foundation
Group of Institutions, #1, Khan Road,
Mankundu, Hooghly-712139,
West Bengal.
E-mail: leenaroy2303@gmail.com

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