



A STUDY OF ORIGIN AND HISTORY OF BEHAVIOUR FINANCE WITH SPECIAL REFERENCE TO INDIA

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ABSTRACT

The traditional finance researcher sees financial settings populated not by the error-prone and emotional Homo sapiens which are affected by behavioural factors but by the awesome Homo economicus. The latter makes perfectly rational decisions, applies unlimited processing power to any available information, and holds preferences well-described by standard expected utility theory. However in reality the assumption of homo economicus is false. Humans are not fully rational therefore Behavioralists in finance seek to replace Homo economicus with a more-realistic model. Richard Thaler, a founding father of behavioural finance said “The difference between us is that you assume people are as smart as you are, while I assume people are as dumb as I am.” Financial decisions are taken by people who are affected by emotions, biases and other psychological factors. This article dwells into the origin, history and development of behaviour finance as a discipline.

KEYWORDS: Behavioralist, Behaviour finance, Traditional finance, Home bias

INTRODUCTION

Richard Thaler, Founding father of Behavioral Finance, captured the struggle in a memorable national Bureau of Economic Research conference remark to conservative Robert Barro “The difference between us is that you assume people are as smart as you are, while I assume people are as dumb as I am.” Behaviorist argues that behavioral theories are indispensable to explain anomalies that cannot be accommodated by traditional finance theory. In return Traditionalist uses a philosophy of instrumental positivism to maintain that the competitive institutions in finance make deviation from Homo economicus. Traditional finance assumes that people process data aptly and correctly. In divergence, behavioral finance recognizes that people engage imperfect rules of thumb (heuristics) to process data which encourages biases in their belief and prompts them to commit errors. Traditional finance assumes that people are directed by reasons and logic and independent judgment. While, behavioral finance identifies that emotions and herd instincts play an important role in swaying decisions. Traditional Finance presumes that people view all decision through the transparent and objective lens of risk and return. Put in a different way, the form used to

describe a problem is insignificant. In divergence, behavioral finance suggests that perceptions of risk and return are considerably influenced by how decision problem is framed. In other words, behavioral finance assumes frame dependence. Traditional finance argues that markets are efficient, implying that the price of each security is an unbiased estimate of its intrinsic value. In contrast, behavioral finance resists that heuristic-driven biases and errors, frame dependence, and effects emotions and social influence often lead to inconsistency between market price and fundamental value. Efficient market hypothesis views that price follow random walk, though prices oscillate to extremes, they are brought back to equilibrium in time. While behavioral finance views that prices are pushed by investors to unmanageable levels in both direction.

OBJECTIVE

1. To study the difference between behavior and traditional finance
2. To study history and evolution of behavioral finance
3. To study behavioral financial studies in India
4. To study the importance of BF studies in India

RESEARCH METHODOLOGY

This article is based on secondary data collected from websites, research journals, books etc. Generally behaviour finance researches are experimental research conducted under controlled conditions an experimental research can be a lab experimental research or field experimental research. Like other behavioural researches our research is a field experimental research. Field experimental research has various advantages over lab experiments. The outcomes here are observed in a natural setting rather than in a highly controlled environment. Thus many times field experiment is considered to have higher validity over lab experiments.

BF vs TRADITIONAL FINANCE

Investor idealists are disappointed and pessimists are astounded. Stock prices are future estimates, a forecast of what investors expect tomorrow’s price to be, rather than an assessment of the present value of future payment streams. Behavioral finance questions whether the behavioral conventions underlying the EMH are true. Additional facet of behavioral finance concerns how investors form expectations regarding the future and how these expectations are converted into security prices. By bearing in mind that investors may not always act in wealth maximizing manner and that investors may have biased expectations. Behavioral finance may be able to elucidate some of the incongruities to EMH that have been reported in finance literature.

Table 2

Traditional finance vs behavioral finance

TRADITIONAL FINANCE	BEHAVIORAL FINANCE
<ul style="list-style-type: none"> • Prices are correct; equal to intrinsic value • Consistent with efficient market hypothesis • Investors are homo economicus 	<ul style="list-style-type: none"> • What if investors don’t behave rationally?

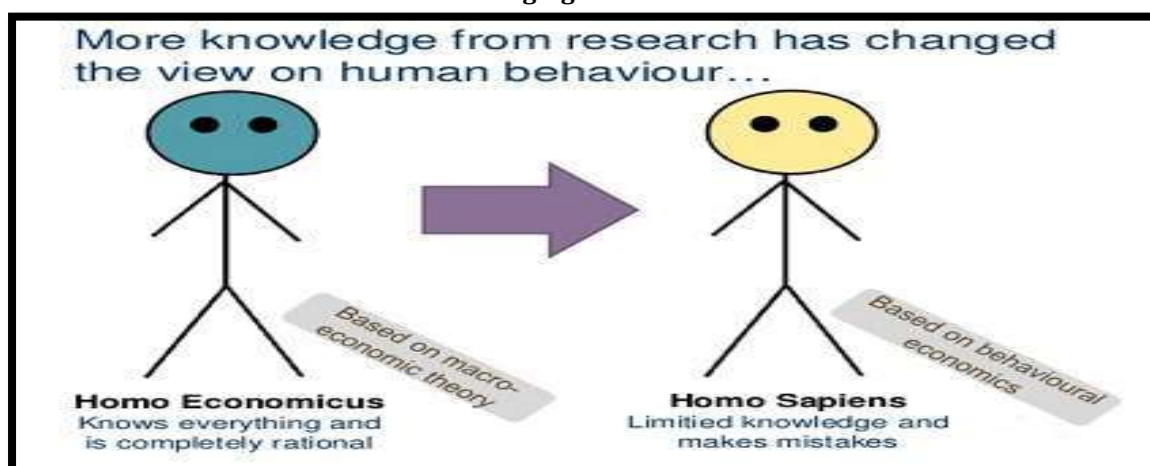
According to Adam Smiths’ theory of moral sentiments investors makes decisions on the basis of imprecise impressions and beliefs rather than rational analysis. Cognitive psychologist Daniel Kahneman and Amos Tversky are considered to be the fathers of behavioural finance whereas Richard Thaler is responsible for its evolution. Critics of behavioural finance claim that although there are some anomalies that cannot be explained but it doesn’t mean that market efficiency theory should be totally abandoned in favour of behavioural finance. Many consider these anomalies short term chance events that are eventually corrected over time. However importance of behavioural finance cannot be ignored.

HISTORY AND EVOLUTION OF BEHAVIOUR FINANCE

Before 1930 Finance was considered to be a part of economics. The nature and scope of work of finance manager was narrow. However with increasing complexities of business environment, growth of international trade, growth of international

markets and introduction of new and innovative financial instrument lead to the development of finance as a separate field of study. According to traditional finance, financial decisions are not taken by emotional and error prone Homo sapiens but by rational homo economicus. A homo economicus wants to maximize his / her return from investment by application of traditional financial theories. Financial settings is populated not by the error-prone and emotional Homo sapiens, but by the awesome Homo economicus who makes perfectly rational decisions, applies unlimited processing power to any available information, and holds preferences well-described by standard expected utility theory. However in reality the assumption of homo economicus is false and unrealistic. Behavioralists in finance seek to replace Homo economicus with a more-realistic model.

Figure 1
Changing view of finance



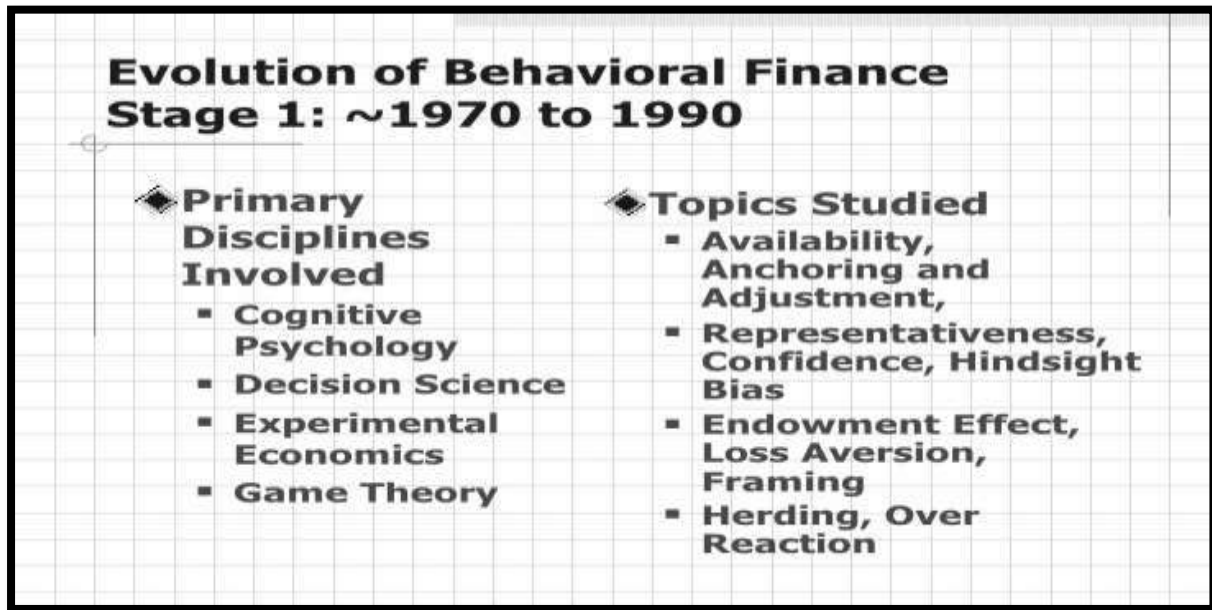
In the 1976 book *The Economic Approach to Human Behavior*, Gary S. Becker outlined a number of ideas known as the pillars of ‘rational choice’ theory. The theory assumes that humans have stable preferences and engage in maximizing behavior. Becker applied rational choice theory to domains ranging from crime to marriage, believed that academic disciplines such as sociology could learn from the ‘rational man’ assumption advocated by neoclassical economists since the late 19th century. The decade of the 1970s, however witnessed the beginnings of the opposite flow of thinking history.

1. Phase 1 (from 1970 to 1990)

In 1896, Gustave le Bon wrote *The Crowd: A Study of the Popular Mind*, one of the greatest and influential books of social psychology (le Bon 1896). Selden wrote *Psychology of the Stock Market* in 1912. He based the book ‘upon the belief that the movements of prices on the exchanges are dependent to a very considerable degree on the mental attitude of the investing and trading public’. In 1956 the US psychologist Leon Festinger introduced the concept of social psychology: the theory of cognitive dissonance (Festinger, Riecken and Schachter 1956) in which he states that when two simultaneously held cognitions are inconsistent, this will produce a state of cognitive dissonance. Because the experience of dissonance is unpleasant so the person will strive to reduce it by changing their beliefs. Pratt (1964) considers utility functions, risk aversion and also risks considered as a proportion of total assets.

However the real development of the theory started with introduction of the availability heuristic: ‘a judgmental heuristic in which a person evaluates the frequency of classes or the probability of events by availability, i.e. by the ease with which relevant instances come to mind.’ by Tversky and Kahneman (1973). The development of behavior finance as a field of study starts with the discoveries of market anomalies in the 1980s and continuous efforts to explain these anomalies with the foundational ideas of behavioral economics proposed by Daniel Kahneman and Amos Tversky. In 1974 Amos Tversky and Daniel Kahneman, described three heuristics that are employed when judgments are made under uncertainty. First one is representativeness which happen when people are asked to judge the probability that an object or event A belongs to class or process B, probabilities are evaluated by the degree to which X is representative of Y i.e., by the degree to which X resembles Y. second one is availability where people are asked to assess the frequency of a class or the probability of an event, they do so by the ease with which instances or occurrences can be brought to mind. And third one was anchoring and adjustment in numerical prediction which states that a relevant value (an anchor) is available, people make estimates by starting from an initial value (the anchor) that is adjusted to yield the final answer. The anchor may be suggested by the formulation of the problem, or it may be the result of a partial

Figure 2
Stages 1 in evolution of finance



Source: <https://www.slideshare.net/CitywireWebsite/robert-olsen-v2>

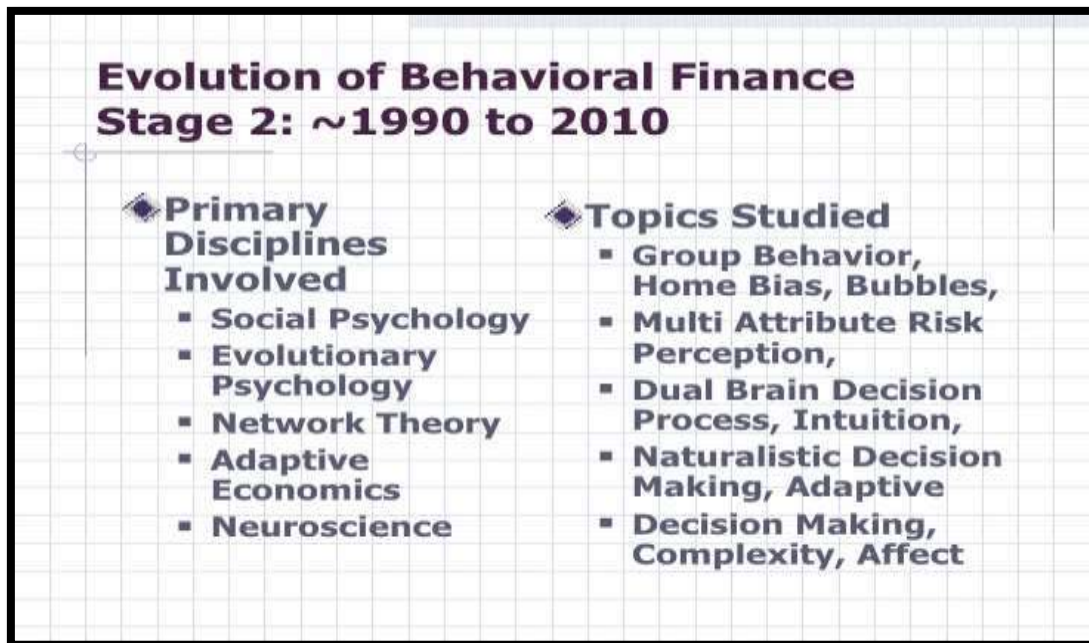
Computation. In either case, adjustments are typically insufficient. This is called anchoring bias. The overconfidence bias is the tendency people have to be more confident in their own abilities, such as driving, teaching, or spelling, than is objectively reasonable. This overconfidence also involves matters of character. Kahneman writes, “Experts who acknowledge the full extent of their ignorance may expect to be replaced by more confident competitors, who are better able to gain the trust of the clients.” Kahneman & Tversky, 1979 first gave the concept of Loss aversion which is an important concept associated with prospect theory and is encapsulated in the expression “losses loom larger than gains”. It is thought that the pain of losing is psychologically about twice as powerful as the pleasure of gaining. Thus people are more willing to take risks to avoid a loss, loss aversion can explain differences in risk-seeking versus aversion. This bias states why we treat wins and losses differently. Daniel Kahneman and Amos Tversky gave Framing effect which is the tendency of the people’s decisions to get affected by the way in which the choices are framed. The minds of individuals react differently to the information based on the way it is presented. The perception will change due to some variation in framing. Framing effect has also been discussed as a part of the Prospect Theory by Daniel Kahneman and Amos

Tversky. Based on the theory, framing effect affects the investment decisions because a loss is more significant to an individual than the equivalent gain, an individual prefers a sure gain is over a probabilistic gain and a probabilistic loss is over a definite loss. The period from 1970 to 1990 marks the beginning of the development of BF.

2. Phase 2 (1990 to 2010)

This phase saw the use of social psychology, evolutionary psychology, network theory, adaptive economics and neuroscience etc. in the formulation of BF theories. Social psychology refers to understanding individual behavior in a social context. Baron, Byrne & Suls (1989) define social psychology as “the scientific field that seeks to understand the nature and causes of individual behavior in social situations.” Kurt Lewin is considered to be the founding father of modern social psychology. Lewin's Equation, $B=f(P,E)$, states behaviour as a function of the person and environment, and he advocated "action research" applying this equation and scientific methods to address social problems such as prejudice and group conflict. Floyd Allport is the founder of experimental social psychology, in part for his theoretical rigor and prominence of measurement, Gordon Allport conducted pioneering research on attitudes, prejudice, religion, and rumour transmission etc.

Figure 3
Stage 2 in evolution of finance



Source: <https://www.slideshare.net/CitywireWebsite/robert-olsen-v2>

Solomon Asch is best known for laboratory studies on conformity showing that under certain situations, a large percentage of people will conform to a majority position even when the position is clearly incorrect. Evolutionary psychology is a theoretical approach to psychology that tries to explain useful mental and psychological behaviors such as memory, perception, or language as adaptations, i.e., as the functional harvests of natural selection. The drive of this approach is to bring the functional way of thinking about biological contrivances such as the immune system into the field of psychology, and to approach psychological mechanisms in a same way. In short, evolutionary psychology is concentrated on how evolution has shaped the mind and behavior. Charles Darwin's observations laid the groundwork for the field of study that emerged more than a century later. In 1873 he argued that human emotional expressions evolved in the same way as physical features Darwin acknowledged emotional expressions served the very useful function of communicating with other members of one's own kind. In 1890 William James's classic text *The Principles of Psychology* used the word evolutionary psychology, and James argued that many human behaviors imitate the operation of instincts i.e., inherited tendencies to respond to certain stimuli in adaptive ways. A classical instinct for James was a sneeze, the predilection to respond with a rapid blast of air to clear away a nasal irritant. Evolutionary psychology, which emerged in the late 1980s, is a fusion of developments in several different fields, including ethology, cognitive psychology, evolutionary biology, anthropology, and social psychology. At the foundation of evolutionary psychology is Darwin's theory of evolution by natural selection. Darwin's theory made it clear that an animal's physical features

can be formed by the demands of frequent problems posed by the environment. Seals are more closely correlated to dogs than to dolphins, but seals and dolphins share a number of physical features shaped by common problems of aquatic life Social network theory focuses on the role of social associations in transmitting information, channeling personal or media influence, then enabling attitudinal or behavioral change. Since the 1960s, social network theory has pointedly expanded the vista of media effects research, with increasing application of network analytic methods in various empirical contexts. The two-step flow of communication hypothesis, the theory of weak ties, and the theory of diffusion of innovations are three foremost theoretical approaches that integrate network concepts in considering the flow of mediated information and its effects. Social network analysis has its roots in the work of early sociologists such as Georg Simmel and Émile Durkheim, who wrote about the prominence of studying patterns of relationships that connect social actors. Social neuroscience uses the procedures methods and tools developed to size mental and brain function to study social cognition, emotion, and behavior. Various psychologists, neurobiologists, psychiatrists, radiologists, and neurologists now focus on the neurobiological underpinnings of social information processing, particularly the mechanisms underlying "people thinking about thinking people." Social neuroscience is the interdisciplinary field which studies neural, hormonal, cellular, and genetic mechanisms, and the associations and influences between social and biological levels of organization. Humans are profoundly a social species whose social environment shapes their genes, brains, and bodies, and biology which fundamentally shaped the social environments created by them. Social neuroscience,

therefore, provides an all-encompassing paradigm to investigate human behavior and biology, and to determine where humans as a species fit within a broader biological context. Cacioppo of the University of Chicago, a pioneer in the field of social neuroscience made contributions in studying persuasion, loneliness, and the relationships among social experiences, emotions, neural activity, cellular physiology, genetics, and health. **Home bias** is a propensity to invest in companies that reside in the investor's home country. This bias is assumed to have arisen as a result of the additional difficulties associated with investing in foreign equities, such as legal constraints and additional costs. Investors may simply display home bias due to a partiality for investing in what they are already familiar with rather than moving into the unknown. The home bias in equities was first acknowledged by French and Poterba in 1991 and Tesar and Werner in 1995. Coval and Moskowitz in 1999 exhibited that home bias is not restricted to international portfolios, but that the preference for investing close to home also spread on to portfolios of domestic stocks showed that U.S. investment managers demonstrated a strong preference for locally headquartered firms, particularly small, highly leveraged firms that produce no tradable goods. When social scientists started to get involved in suitable-risk debates e.g., Lowrance in 1976, Slovic, Fischhoff and Lichtenstein in 1976 and Rowe in 1977,

there seemed to be a compact conviction in the statistical and engineering community that 'risk' was a one-dimensional concept whose size or gravity could be quantitatively measured. Fairly soon, this idea was sturdily criticized. Following Kaplan and Garrick (1981) risk cannot be properly stated in terms of a single number or even a single curve. In their view the best formal definition of risk is a probability distribution of promising (future) frequencies of harmful consequences, which themselves may be multidimensional. More complicating still was the steady unfolding of a host of different definitions of risk (e.g., Coombs, 1972; Libby and Fishburn, 1977; Vlek and Stallen, 1980). In their search for a valid answer, social and behavioral scientists have discovered a variety of basic dimensions of perceived risk or riskiness. They found out that different groups of 'risk perceivers' regarded, or compared, the riskiness of diverse sets of risky activities and situations as following various basic risk character. The empirical and theoretical work of Vlek and Keren (1992) have compiled the list of basic dimensions underlying the perceived riskiness of an activity or position. Using this set of magnitudes one may either analyze the reasons why a particular activity or situation is (to be) seeming as 'risky', or one may consciously change a given activity or situation such that it appears to be riskier, or safer, than it initially was.

Table 1
Basic dimensions of perceived riskiness

<p>Basic dimensions underlying perceived riskiness as per vlek and keren:</p> <ol style="list-style-type: none"> 1. Potential degree of harm or fatality 2. Physical extent of damage (area affected) 3. Social extent of damage (number of people involved) 4. Time distribution of damage (immediate and/or delayed effects) 5. Probability of undesired consequence 6. Controllability (by self or trusted expert) of consequences 7. Experience with, familiarity, imaginability of consequences 8. Voluntariness of exposure (freedom of choice) 9. Clarity, importance of expected benefits 10. Social distribution of risks and benefits 11. Harmful intentionality

Neuroeconomics pursues to gain a greater understanding of decision making by merging theoretical and methodological principles from the fields of psychology, economics, and neuroscience. Initial studies using this multidisciplinary methodology have found proof suggesting that the brain may be engaging multiple levels of processing when making decisions, and this notion is consistent with dual-processing theories that have acknowledged extensive theoretical consideration in the field of cognitive psychology, with these theories arguing for the disconnection between automatic and controlled mechanisms of processing. One of the most famous dual-process models draws a distinction between two systems of processing referred to as System 1 and System 2 (Evans, 2008; Kahneman, 2003; Kahneman &

Frederick, 2002; Stanovich & West, 2000). While making decisions, two different systems of thinking. System 1 is intuition or gut-feeling: fast, involuntary, emotional, and involuntary. System 2 is slower and more deliberate: deliberately working through different considerations, applying diverse concepts and models and weighing them all. A lot of people have propagated the idea to trust your intuition but surely there are situations where we shouldn't trust it. So we should in its place be asking not whether to trust it, but when to. One takeaway from the psychological research on dual process theory is that our System 1 (intuition) is more accurate in areas where we've gathered a lot of data with dependable and fast feedback. Insult someone, results in sadness or defensive attitude. That's because intuition has been trained by repetitively witnessing

incidences and receiving fast feedback on the consequences. Whereas System 2 tends to be better for choices where we don't have a lot of experience; involving numbers, statistics, logic, abstractions, or models; and phenomena our ancestors never dealt with. Both systems could also be used, acknowledging intuition and feeding it into System 2 model. Plous (1993) wrote *The Psychology of Judgment and Decision Making* which gives an inclusive introduction to the field with a strong emphasis on the social aspects of decision making processes. Fernandez and Rodrik (1991) model an economy and show in what way uncertainty regarding the personalities of gainers and losers can lead to status quo bias. Kahneman, Knetsch and Thaler (1991) discuss three irregularities: the endowment effect, loss aversion and status quo bias. Thaler in 1992 wrote "The Winner's Curse: Paradoxes and Anomalies of Economic Life". Odean (1998) confirmed and found proof for the disposition effect, the inclination of investors to sell winning investments too soon and hold losing investments for too long. Holt and Laury (2002) piloted a simple lottery choice experiment and found differences in risk aversion between behavior under hypothetical and real incentives. Harrison and Rutstrom (2009) proposed a settlement between expected utility theory and prospect theory by using a mixture model.

3. Phase 3 (2010 till now)

In the recent years the research in the field of BF has picked up pace. Previously most of the researches were being done in abroad but now Indian researchers are also recognizing the importance of BF as a research field. but whereas in abroad the researches have started exploring the area of behavioral biases found while investing in traditional investments specially real estate. In India still most of the research focuses on stocks and mutual funds and the area of traditional assets remained underexplored. Proponents of traditional and behavioral finance still have deep ideological division and still the debate over the importance and validity of BF is going on

BEHAVIOUR FINANCE STUDIES IN INDIA

In "Role of Behavioural Finance in the Financial Market" Amlan Jyoti Sharma (2015) describes primarily two disciplines of financial market study viz. Conventional Finance and the recent progress known as Behavioural Finance. Conventional finance foundation is mainly created on efficient market concept, Investor rationality concept and the modern portfolio theory established by Markowitz. But till 1990 the orthodox finance theories were not so been defied. But from mid-90's researchers have shown many shortages of the existing theory and predominantly challenged the investor rationality concept. As a consequence a new model known as behavioural finance has been acknowledged. In this paper an effort has been made to highlight the insufficiencies of the traditional finance theories as barbed out by behavioural finance factions and also an argument on the importance of behavioural finance. The key objective of the paper is to climax the

limitations of the traditional finance theories and the importance of the growth of behavioural finance discipline in the study of investors' behaviour in financial market. A few behavioural finance principles are retrieved as the next objective. To complete the author say the inadequacies of conventional finance put forwarded by the empirical findings must be recognised, and at the same time an objective investigation is said to arrive at a conclusion. The evolution of behavioural finance in this respect is absolutely a positive aspect to better study the investor behaviour. However the behavioural finance unaided cannot be said to be a faultless one because the discipline is not too old to assent as a theory. And the behavioural finance is only an assortment of ideas and thoughts which are descriptive and advice-giving in nature but they are not in-depth. More discussions and studies are mandatory to point the restrictions of behavioural finance itself so as to polish it to be a good theory. It is a theoretical framework, which is certainly a modest attempt and it has many positive edges in the background of stock market study but it requests more refinement and more demanding analysis to replace a far impacted theory like EMH. In "Impact of behavioural finance in investment decisions and strategies – a fresh approach" Amar Kumar Chaudhary (April 2013) present altering economic scenario, investment in various companies has converted to complex as public invested large sum of money even when there is a slight chance of company being profitable. Most of the investors have rational opportunities and exploit their utility. Behavioural economist copes based on their active studies that market are not efficient, particularly in the short-run and people do not make rational decisions to make the most of profits. Human beings are vulnerable to numerous behavioural discrepancies which became counterproductive to the wealth maximization principles leading to irrational behaviour. This paper analyses the meaning and prominence of behavioural finance and its application in investment decisions. This article has also debated some trading approaches for investors in stocks and bonds to support them in demonstrating and monitoring their psychological obstructions. Behavioural finance provides clarifications for why investors make irrational financial decisions. It finds how emotions and cognitive errors influence investors in the decision making process. Behavioural finance comprises anchoring, overconfidence, herd behaviour, over and under reaction and loss aversions. Behavioural finance approach inspects the behavioural patterns of investors and tries to comprehend how these patterns guide investment decision. Behavioural finance suggestions many useful intuitions for investment professionals and thus, delivers a framework for appraising active investment strategies for the investors.

In "Behavioural finance: an introspection of investors psychology" by Dr. G. K. Deshmukh, and Dr. Sanskrity Joseph states investors at all times try to make rational decision while examining and understanding

information put together from various sources for diverse investment possibilities to reach at an optimal investment decision. But at the same time they are question to various psychological factors that sway them mentally and bias their investment decision. The main drive of the paper is to weigh influence of behavioural factors over mutual fund investment decision made by investors in Raipur city. The researchers directed a survey on factors of behaviour of investors with respect to investment in mutual fund industry from 300 investors of mutual funds through different demographic profiles in Raipur city. The researchers reflected that factors like perception, motivation, incentive potential and intensity of prompts play major role in development of meaning to invest which further impact investors in Raipur city to take investment decision that regulates their fulfilment with mutual fund which is based on performance and growth of a specific mutual fund. This paper helps in assessing the factors which influence development of meaning to invest and further direct towards investment in a particular mutual fund. Various mutual fund companies can emphasis on these factors to create strategies to pull investors to invest in their mutual fund. The study exposed that demographic factors like gender, income and occupation cannot be connected with degree of mindfulness that an investor has about the mutual fund market and its mechanics. It was found that investors of service class reliant on upon the fund performance to make the investment choices whereas investors from business class or professional believed in calculating the regulatory frame work of their AMC. It can be settled that heuristics and frame of mind play an important role while determining to choose a mutual fund in Raipur City. The investors from service class measure the past performance and select the best performing mutual fund across the obtainable alternatives and smear the rule of thumb. On the other hand the professionals and business men choose the best mutual fund based on its rating by rating agencies. The supposition that higher the risk higher the return and mutual fund are not as much risky in contrast to equity investment due to its capability to diversify risk helps in creating the frame of mind of the investors while making investment decisions. These factors agree that positive perception about the mutual fund industry with deference to lower risk and higher return in contrast to other equity investment has aided investors in choosing mutual fund investment higher rate of return, income tax reduction, investment and precautionary motive and wealth maximization were the chief factors which moved investors to invest in mutual funds. It was tacit that after the beginning of new pension scheme companies working both in public sector and private sector are providing opportunities to its employees to investment in mutual funds through them. Thus mutual fund has appeared as a workable choice for investors of young age. Income tax rebate and option to invest monthly over SIP were basic activating cues which predisposed the investors to put in mutual funds. Informational and utilitarian effect of

the reference groups has also operated as prompting signal for the investors to invest in mutual funds. Many investors quantified that customer appointment activities of mutual fund companies notify through SMS and email alerts, regular reports and counselling by AMC (Asset Management Company) has signified as no triggering prompts for investors which has indirectly prejudiced them to trade with a specific AMC for investing in mutual funds. The presentation of Indian companies and the confidence that the new government will invent policies which will save the Indian capital markets and will chief to higher profits for companies and will in turn deliver higher NAV (Net Asset Value) and upsurge in unit value has acted as an inducement potential for investors to invest in mutual fund markets. The study disclosures that the investors have restricted knowledge about the mutual industry and they fundamentally depend on their financial consultant or investment and brokerage firms to take investment choices on their behalf. The investment in mutual fund for them is stranded upon restricted criteria chosen by them like, past performance, return and analyst reports based on heuristics, Framing, emotion and market impression which is recommended by their reference group. It was further originated that the investors principally depend on the advice given by their respective agents or personal consultants to choose a plan and essentially wish to invest for a period of three years in the close ended mutual funds schemes. The most favoured investment schemes are either of growth equity kind or tax benefits kinds. The results direct that investment in mutual fund is not connected with conjecture but it is an investment decision on the part of investors. The asset management companies must grow mutual fund option around these dependent criteria to grow the permeation of mutual funds in Indian markets.

In “Comprehensive review of literature on behavioural finance” Bashir Ahmad Joo and Kokab Durri, India(May 2015) contends investors are rational and that they deliberate all available information in portfolio investment decision procedure is the main assumption of standard finance and this grasps true by Efficient Market Hypothesis (EMH), being an significant theory of Standard finance though over the years this supposition has been challenged by the psychologists and they contend that investors can't be rational as their decisions are biased by cognitive and psychological errors. The work done by the various behaviour psychologists in this course caused in the development of a new branch of financial economic called as Behavioural Finance. Behavioural finance anticipates how various psychological characters disturb the way investors make their investment decisions. The paper makes a diffident effort has been made to review various studies in this area so as to have clear consideration of the subject and to see how noteworthy it is in financial decision making. From the review of literature it is realised that behavioural finance goes to fill the break between actual behaviour (Normal behaviour) and expected behaviour (Rational

Behaviour), however, presently there is no amalgamated theory of behavioural finance that gives an appropriate place to the factors controlling financial decisions of investors. Up to 1970s when the importance was on the study of the environment, the agents of the environment were set under some simple assumptions of standard finance theory. These assumptions were impractical and hence led to inaccurate deductions. So during 1980s when these conventions were investigated the agents of the decision making process and environment, i.e. the people became the focus matter of the study. This gave growth to a not the same branch of finance called behavioural finance, wherein investigation is completed about the role of psychological biases in decision making. This branch vexed to reduce the assumptions of standard finance theory and shape the better-quality models of decision making process. From the examination of the review of literature it can be coherent that currently there is no combined theory of behavioural finance but the importance has been on classifying portfolio irregularities that can be elucidated by various psychological traits in individuals or groups when it is conceivable to develop highly productive portfolio by using the behavioural bias and to distinguish that rational behaviour and profit maximization is not comprehensive since it does not envisage individual behavioural traits of investors, analysts or portfolio managers. Behavioural finance only acts as a counterpart and not as a substitute to standard finance theory because it elucidates those phenomena that cannot be elucidated by the traditional finance theory. Theories of behavioural finance that are made on the models of standard finance can help the investors to distinguish their own behaviour and thus help them to progress upon their decision making process observance in view the models of traditional finance theories.

In the recent years behavioural finance studies has gained momentum in India. There are various reasons responsible for it. Developed in the 1970s and 1980s by scholars including Amos Tversky, Daniel Kahneman, Richard Thayer and Meir Statman, behavioral finance stresses that psychology and emotion prompt investors to behave in ways that are varying with what is considered rational in modern portfolio theory. According to world wealth report the field has now developed to the point where “more mainstream uses of behavioral finance approaches will have a significant impact across service delivery models and platforms,” according to the report. What’s more, the report concluded, wealth management firms can “differentiate themselves by integrating behavioral finance as they strengthen portfolio management and risk models and capabilities.” Following points highlight the importance of BF

1. Explaining the debatable issues in traditional finance

Traditional finance theory is based on some essential assumptions. Firstly investors make rational decisions. Secondly investors are unbiased in their calculations about future returns of the stock. Thirdly every investor takes cautious account of all accessible information before making an investment decision. Though as time went on, academics in both finance and economics started to find glitches and behavior that could not be explained by the theories existing at the time. Financial economist have now recognized that the long held conventions of traditional finance theory are wrong and found that investors can be irrational and make predictable errors about the return on their investments. Recent researches have revealed that the average investor makes decision based on emotion, not logic; most investors buy high on speculation and sell low in panic mode. Efficient market hypothesis states that nobody can consistently beat the market and get a higher return in the long run. However, we see a lot of Investment narratives such as Mr. Warren Buffett (Buffett and Clark, 2001), Mr. Peter Lynch (Lynch and Rothchild, 2000), Sir John Mark Templeton (Templeton and Scott, 2008), Mr. Andre Kostolany (Kostolany, 1996), Mr. Jim Slater (Slater, 2000), Mr. Jim Rogers (Rogers, 2004), Mr. George Soros (Soros and Volcker, 2003) etc. who were able to beat the market. If the modern portfolio theory is valid then would not be able to beat the market.

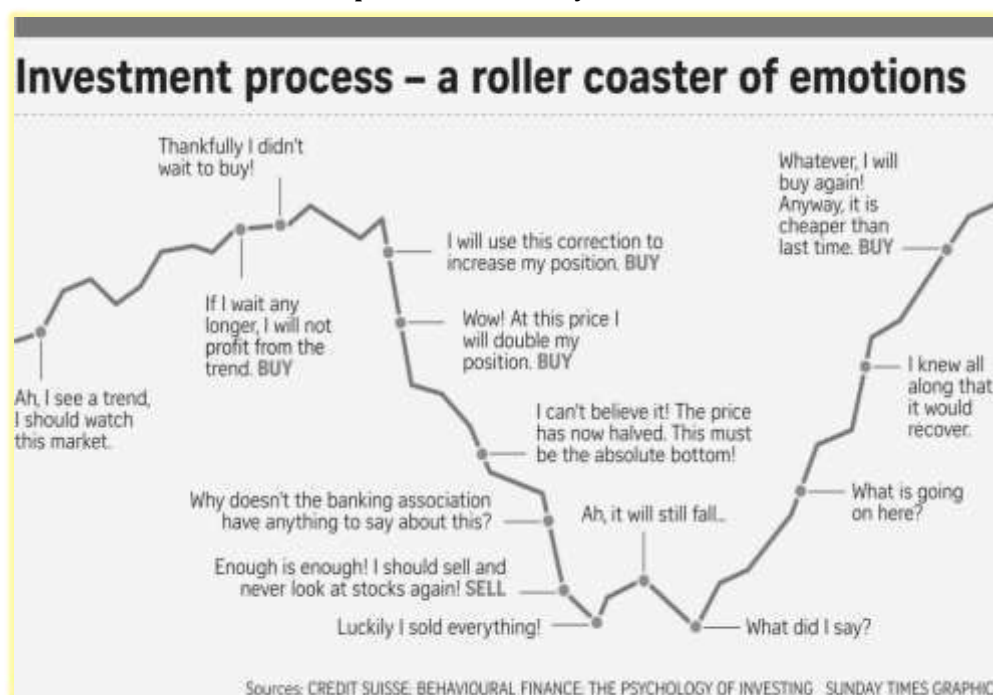
1. Protecting investors in this volatile investment scenario and better investment decision making

In today’s world of uncertainty investment decision making has become complex. The investors is faced by a variety of investment options. The investor can also invest outside his country now. But as the choices of investment has grown, so has the vitality and risk. Nowadays a firms business is not also affected by factors acting within the country but abroad also. The while making investment investor has to be very vigilant and careful. Understanding of the BF and his/her behavioural biases will make investor to take better decisions.

2. Analysis the impact of behavioural factors on investment decisions

The following figure show the emotion process the investor go through while making investment. It throws light on different emotional biases that he/ her go through which affect his decision. These various investment has implication on his investment behaviour. For example when the price of his/her investment false, he/ she will sell it thinking it may fall further which suggest that people have aversion to not only loss but with the thought of it also. So instead of relying on dependable information they use their intuition make investment decision. These emotions comes in way of the investor and hinder his/her rational thinking.

Figure 4
Investment process affected by various emotions



Source: credit Suisse

Discussing emerging issues in financial world and effect of behavioural biases in Corporate finance Investing in financial markets in recent decades has become widespread not only among institutional but also individual investors. Communications and information have become available worldwide in seconds speed. Undeniably, investment decisions depend on the object and its financial status in the future, but often short-term price changes are motivated by market participants that are not always based on logic, sometimes are stimulated by mood or instantly "received news". Tseng (2006) advocated combining the traditional efficient market exploring investor's behaviour on of decision-making under uncertainty and neural finance. Thus, Tseng shape adaptive markets hypothesis, which comprises evolutionary biology, information technology, neuroscience, psychology and sociology. The aim is to help investors to better calculate the stock market changes and make better decisions. Subrahmanyam (2007), like Tseng (2006), offers to combine the traditional financial theories that support the rationality with the behavioural finance theory, which predicts that investors' behaviour is not at all times in line with the norms of rationality. Subrahmanyam concludes that the financial behaviour properly complements traditional financial theories. It may help to predict not only the expected returns, but also provide occasions that influence the return. Behavioural finance has lead the way to behavioural corporate finance which is a sub discipline that integrates psychology and economics into the study of human

judgment and biases in decision making under conditions of uncertainty. The application of behavioural finance theory to corporate finance is now enticing the attention of a group of academics. Behavioural corporate finance look at the investing and financing decisions of executives within firms from behavioural aspects. In an outstanding piece of empirical research titled "Managing with Style: The Effect of Managers on Firm Policies," Antoinette Schoar and Marianne Bertrand revealed that there is a pronounced "CEO effect" on decisions regarding capital structure. CEO decisions, they found, reflects a chief executive's personal style rather than a set of criteria determined by the firm. Financially aggressive CEOs use more leverage and hold less cash on the balance sheet, and many have a tendency to grow their firms through acquisitions. More conservative leaders have more cash on the balance sheet and grow more over internal investments.

CRITICISM OF BEHAVIOURAL FINANCE

Behavioral economists point the imperfections in financial markets to a mixture of cognitive biases such as overconfidence, overreaction, representative bias, information bias, and various other likely human errors in reasoning and information processing. Based on the application of psychology to finance, this new school proclaims that most investors are subject to a swarm of cognitive biases and defects, including loss aversion, myopia, and overconfidence. But critics to behavior finance points out the following:

1. Behavior finance do not define what does Irrational investors mean

Based on a few psychological hitches, one can barely characterize individual investors as irrational. If investors were indeed irrational, they should have calculatedly aimed at achieving the worst, rather than the best, possible investment results. Thus, instead of maximizing their returns and minimizing their risks, investors should have been detected to do the exact opposites. But such a reversed investment behavior is rarely witnessed in the securities markets. In other words, while investors may on occurrences display a lack of sound judgement, this is not the same thing as avowing that they are therefore intentionally acting out of sheer stupidity to harm their own interests.

2. Small nudges are not enough

One of leading critics of behavioural economics, Gerd Gigerenzer is critical that, ironically, the default view of behavioural economists is that humans are generally easily influenced and easily yield to biases and distortions. He goes suggests that decisions based on heuristics and rule of thumb influences can be just as effective as those shaped by a more rational approach. What Gigerenzer recommends is that individuals are provided with more opportunities to learn the skills of critical thinking, especially when making intricate financial decisions, as well as endorsing the use of risk averse rules of thumb like 'if it sounds too good to be true it

probably is'. Other critics argue that much of the impact of elbow-type policy is short term, and does not lead to long lasting changes in behaviour.

3. Uncertainty

The invented irrationality is in fact nothing more than rational behavior in the face of uncertainty. Lacking sufficient information about the future trends in security prices, numerous investors resort to a multitude of arbitrary rules of thumb to make investment decisions. This explains investors foregoing rational models in favor of their own intuitive judgements. In addition, given this lack of knowledge about the exact investment values of most securities, it is not startling that their market prices can temporarily over or undershoot their correct values. In the long run as more information becomes available, the market prices will sooner or later tend to revert to their more rational values.

4. Lab controlled experiments

Another criticism is that intrusions suggested by the results from controlled lab experiments may not necessarily work as effectively in the real world. Eugene F. Fama is the most cited critic of behavioural finance, who typically supports the efficient market theory. In his writing "Market efficiency, long term returns and behavioural finance" he focused that behavioural finance is more of a gathering of anomalies that are actually just enhance outcomes and support for the anomalies tend to evaporate with changes in the way they are measured.

Table 3

Limitations of behavioural finance studies

Curtis pointed out a number of limitations to behavioural finance studies that use experimental designs. These are as follows :

- (i) Participants of the experiments are aware that they were in an experiment and behave accordingly because of an unnatural environment of try to please (displease) the researcher.
- (ii) They do not always follow the instructions.
- (iii) The term "statistically significant" does not necessarily mean that an effect is substantial in degree.
- (iv) Experience and education often matter once the investors grasp their biases they are likely to change and finally the experimenter's hopes of the outcome may impact how participants behave.

The theories of behavioural finances significant as they allow explaining the events in the market and predicting the behaviour of investors in different positions as well as developing efficient market strategies. The theories of behavioural finances have a large real-world value as they allow explaining the events in the market and predicting the behaviour of investors in different situations as well as evolving efficient Market strategies. Studying behavioural finance might be the golden ticket to better investment management.

CONCLUSION

People time and again make systematic errors called cognitive biases, which lead them to less rational behaviour than what the classical economic paradigm dons. These cognitive biases have been found to be accountable for various irregular

occurrences. Traditionally finance was considered to be the part of economics later on it developed into a separate field and now a new dimension of finance as a field of study has emerged which is known as behavior finance. According to traditional finance, financial decisions are not taken by emotional and error prone Homo sapiens but by rational homo economicus. A homo economicus wants to maximize his / her return from investment by the application of traditional financial theories. The traditional finance researcher sees financial settings populated not by the error-prone and emotional Homo sapiens which are affected by behavioural factors but by the awesome Homo economicus. The latter makes perfectly rational decisions, applies unlimited processing power to any available information, and holds preferences well-described by standard expected utility theory. However in reality the assumption of

homo economicus is false. Humans are not fully rational therefore Behavioralists in finance seek to replace Homo economicus with a more-realistic model. The groundbreaking work done by psychologists Daniel Kahneman and Amos Tversky in the 1970s-1980s in the field of behavioral finance encouraged researchers to carry out researches in this under researched field. These researches have revealed striking insights on the complex ways in which the human mind operates. In India behavioural finance has ample opportunity of research. There are various areas still lying to be explored. Especially when it comes to real estate behavioural finance. Researchers here still are focusing on mutual funds and shares for analysing investor behaviour. Now it is time to shift focus towards the fields such as corporate behaviour finance.

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