

Analysis of Behavioral Finance Affecting in Investment Decision

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Abstract

This article is to analyze what factors influence investment decision making. The method used is a systematic review. Information used in scientific articles and reports that are relevant to the research topic. Investment decision making depends on investor behavior factors. Therefore, this study aims to determine the impact of behavioral finance on investment decisions on investment instruments. Herding behavior, market, loss aversion, and overconfidence were selected as behavioral financial factors. It was found that the most influential factors were market and herding. These results can be used by related parties in making investment decisions.

Keywords: Herding Behavior, Market, Loss Aversion, Overconfidence, Investment Decision.

INTRODUCTION

Investors make investment decisions in unsafe, uncertain and involving risk. Old fashion finance argued that databases of diverse investment prospects were equally accessible to all investors and investors deciphered the database rationally. However, the stock market is not safe and because of the uncertainty, investors lead the activities of others and make investment decisions as other people's activities dictate (Sabir et al., 2019).



Table 1: Transaction of Indonesia Composite Index 2020

IDX	Transaction of 2019											
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Number of companies	624	625	626	629	630	634	649	647	652	656	661	668
Volume (Million stock)	293512	272166	300768	290020	284584	25371	00624	38713	07071	383301	228062	8175
Value (IDR Billion)	236675	180005	175149	230389	87098	56966	94938	84896	72000	202327	155332	5144
IHSG	6532.97	6443.35	6468.76	6455.35	209.12	358.63	390.51	328.47	169.1	6228.32	6011.83	299.54

Source: Statistic Indonesia, 201

Table 2: Transaction of Indonesia Composite Index 2021

IDX	Transaction of 2020					
	January	February	March	April	May	June
Number of companies	674	680	685	690	691	691
Volume (Million stock)	164351	122322	143293	158484	137187	198152
Value (IDR Billion)	140067	131392	166004	143486	157169	189655
IHSG	5940.05	5452.7	4538.93	4716.4	4753.61	4905.39

Source: Statistic Indonesia, 2020

Data accumulation and graphs reported by Indonesia Stock Exchange (IDX). There were high fluctuations in the period from the end of 2019 to 2020. IDX Composite fell from 6299,54 into 5940,05. This is also influenced by unpredictable external factors, namely the mass spread of the virus.

Behavior finance is a new term introduced in finance as a helpful paradigm economic and financial theory by considering behavioral aspects of decision making. The researcher proposes that the existence of an efficient market is impossible where prices are does not match the available information, in this way, investors are always reluctant to invest. Investment decisions are usually made based on available information, not just on guesswork. One researcher argues that investors usually deviate from standard decision-making models due to fear and risk factors. Psychological evidence says that investors differ rationally from the laws of fundamental decision making rather than at random. Behavioral finance focuses on the concept that why sometimes finance behaves irrationally, leading to wrong decision making. To understand the concept of behavioral finance, small investors make their own



investment decisions. Humans experience many anomalous behavior, which usually holds them to gain more wealth through business (Iram et al., 2020).

Behavior finance considers how several psychological traits bear on how individuals or groups act as investors, analysts, and portfolio managers. Heuristics can be defined as the use of practical encounter and attempt to reply to questions or to inhale performance. When faced with uncertainty, group rely on heuristics or rules of thumb to subjectively examine another commonly confused word risks, which reduces the complicated mission of evaluating probabilities and predicting values to simpler valuation operations.

A psychology literature that documents that inhabitants make systematic errors in aside they think, they're overconfident, they overburden current experiences, etc. This preference can make distortion. Therefore, the field of behavior finance tries to enquire the psychological and sociological issues that bear on the investment decision-making process of individuals and institutions. In current years, the investment market has witnessed a titanic enhance in the country. On the other hand, the determined response from investors is proven by repeated oversubscription of shares. Yet various investors have had to endure the tenderness of loss from following the masses and overconfidence (Donkor et al., 2016).

The purpose of this study, the author will analyze what factors influence investment decision making, for companies as a reference for several factors in making investment decisions, there are many theories about behavioral finance. This concept is also discussed by many authors and there are many behavioral factors that influence individual investment decisions. But in our study, we focused on four behaviors, such as herding behavior, market, loss aversion and overconfidence.

LITERATURE REVIEW

Investment Decision

Create investment decisions is an extremely hard task. Investors must keep updating themselves multidimensional field in order to get wanted purposes in business. According to the vast majority of financial and economic theories, individuals act rationally and reflect of the reports so that you can get it for fabrication investment decisions. But behavior finance believes that investors act irrationally in the stock market. According to investor psychology, behavior and emotional biases lead to

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systematic errors in aside they process their databases (Farooq et al., 2015). The empirical findings of the study conducted by (Javed & Marghoob, 2019) show that investors make poor trading and investment decisions due to behavioral bias and identify many different behavioral factors that influence investment decision making.

Herding Behavior

The herding effect is an individual's tendency to follow the actions of others in the stock market. Vigilant analysis bypasses the grazing influence as investors try to rely more on collective databases than on personalized information, this results in deviations of stock prices from their core or fundamentals. Herding links to several biases. Investors overall pick up herding because they believe it will assist them gain useful information. Herding can greatly play a role to analysis and assess professional performance because individuals who have low capacities try to mimic the behavior of individuals who have lofty capacities to design their reputation (Anum & Ameer, 2017).

A research conducted in Istanbul by (Kubilay & Bayrakdaroglu, 2016), the authors consider heuristics, over-optimism, regret aversion, overconfidence, restraint and herd behavior as factors of individual investment behavior and openness to experience, extraversion awareness, agreeableness and neuroticism as traces of distinct personality traits. Pressure from colleagues is also one reason to do this. The main reason is peer pressure or influence. Usually, small investors and private investors try to follow what experienced investors do. The researcher argues that other analysts also exhibited herding behavior, but this is not confirmed due to lack or lack of data. Herd behavior is to minimize individual decision-making tendencies and focus on significant group decisions. Under group decisions, people are usually social and generally tend to follow rules generally accepted by groups rather than individuals.

Market

Limited arbitrage theory suggests that if an irrational trader causes a deviation from fundamental values, the trader is often powerless to do anything about it. To say more about this deviation, behavioral models repeatedly believe a certain form of irrationality. For guidance on this, economists spin to the extensive experimental evidence collected by cognitive psychologists about the systematic biases that occur when people form beliefs, and on people's preferences. Market factors intends changes in stock prices, market databases and past stock trends that influence individual



investment decisions. Market factors also influence investors to behave rationally (Bhatt & Pahuja, 2016).

Market may cause investors to respond insufficiently or excessively to market situations (Keswani et al., 2019). Changes in basic values, market prices, market databases can bring on an investor's reaction and his decision to invest in the market. Investors may mistakenly view that market databases can make decisions in the market and this overreaction links to meaningful market swings. Past fairness trends should not encourage investors to reply to past expectations and experiences. Market-related factors are behavioral factors, but they influence investor behavior and can bring on meaningful changes in investor decision making. Market has significant positive toward investment decision because market information stimulates over and under reaction of investors to the changes in price (Anum & Ameer, 2017).

Loss Aversion

According to (Vijaya, 2016) loss aversion refers to the difference in the mental level of a person due to the loss or gain of the same measure. Loss aversion can be measured through three indicators, namely: expect your investment to demonstrate that for sure, always be careful of changes that will be harmful and knowing with certainty the performance of the form of investment to be invested. Loss aversion is a process of holding more shares of stock in the event of a loss to get rid of when over there is profit. It's additionally defined as the tendency of a person to be more sensitive when over there is loss compared to when over there is a gain. Natives with loss aversion are more cautious in fabrication investments during the period when there's no profit in comparison with the times over there is sufficient maintain (Madaan & Singh, 2019).

Overconfidence

Overconfidence happens when a person does not believe in his knowledge and ability to judge without any recommendation from others. Overconfidence consults to overestimating the likelihood of being right. It's individuals to overestimate the correctness of their initial judgment about a specific position and their initial judgment therefore overconfidence is a mixture of individual and narrated factors as an example the outside fairness of the individual's age (Cao et al., 2021).

The overconfidence bias has significant positive with investment decision because overconfidence shows irrational investor behavior in relying more on their own abilities and optimistic assessments was found by (Antony & Joseph, 2017) research.

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Overconfidence has significant negative to investor decision on investment. Overconfidence is the least considered behavioral factor among behavioral studies. Overconfident people usually have fewer emotions (Iram et al., 2020). (Hala et al., 2020) found overconfidence has significant negative to investor decision on investment because is the least considered behavioral factor among behavioral studies. (Madaan & Singh, 2019) found that overconfidence has significant positive with investment decision because overconfidence make investors overconfident about their knowledge and skills and ignore the risks associated with investment decisions

RESEARCH METHOD

This research is conceptual research related to financial behavior that drives investment decisions. The data used in this study is secondary data in the form of scientific articles of previous years' research related to the problems studied. The analysis used in this study is a systematic review method. This research is to analyze the relationship between herding behavior, market, loss aversion, and overconfidence on investment decision.

The research is based on the previous literature that has been collected and reviewed. We classify publications based on the year of publication, the name of the journal published, the behavior discussed in the paper, the overall result of the document and the name of the author with total citations to date. In principle, systematic review research begins by making a systematic research protocol review and the next stage is implementing systematic review research, and the stages in this research consist of 1) identification, 2) evaluation, and 3) interpretation (Siswanto, 2010).



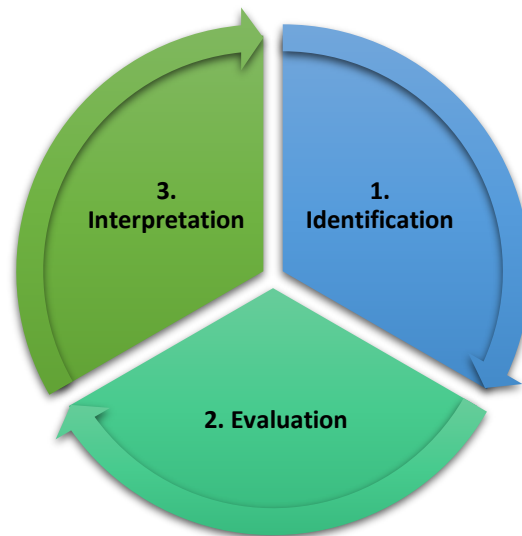


Figure 1: Research Method

RESULTS AND DISCUSSION**Identification.**

Researchers found articles related to research topics between 2014-2021 based on keywords used for financial behavior that drives investment decisions via web browser, namely herding, market, Loss Aversion, Over Confidence. The results of topic identification obtained more than 50 articles, and from the inclusion criteria process, 12 articles were determined in the next step.

Evaluation**Table 3. Herding**

Herding	References
The herding effect is a phenomenon in which investors follow what they think other investors are doing, rather than their own analysis. In other words, investors who exhibit herd instinct will be attracted to the same or similar investments. This is based on the fact that many other people bought the stock. The need for quick decision making can put investors in a vulnerable situation. Thus, they make themselves feel more secure by following the decisions of the majority.	(Anum & Ameer, 2017)

Herd behavior has significant positive with investment decision because investment decision is the most commonly accepted observation in financial markets worldwide in a psychological context. People generally trust friends, relatives and colleagues more when making decisions.

Herding is important because all traders who have the same priority behave similarly.

Herding affecting investment decision because investors against create same decision to maximize profits while insane grazing entails decisions composed in a panic and emotional state due to the transaction of shares or other investors' assets and which causes instability in case of unforeseen errors in both financial and asset markets.

Herding affected in investment decision because investors try to rely more on collective information than personal information, this results in the deviation of stock prices from their core or fundamental values.

Herding affected in investment decision positive relationship among these two variables and if herding bias increases, then investor make investment decisions accordingly.

(Antony & Joseph, 2017)

(Iram et al., 2020)

(Hala et al., 2020)

(Anum & Ameer, 2017)

(Madaan & Singh, 2019)

All research proves that herding is a very influential factor in making decisions made by investors.



Table 4. Market

Market	References
Market factors refers to situations in which financial markets are affected by investor behavior. So, by looking at price changes, market information and other market factors, it can be said that investors' decision making is influenced by market factors.	(Noah & Lingga, 2021)
Market has significant positives toward investment decision because market information stimulates over and under reaction of investors to the changes in price.	Anum & Ameer, 2017)
Market factor is composited within the combinations of variables of market information and customer preference. According to the result presented in market information and customer preference do not have significant positive influence on investment performance	(Kengatharan & Kengatharan, 2014)
Market variable have a significant impact on the decision-making process of investors, which led to the acceptance of all assumptions regarding the level of influence of behavior factors in decision making for individual investors.	(Keswani et al., 2019)

All research shows that market is a very influential factor in making decisions made by investors.

Table 5. Loss Aversion

Loss Aversion	References
Loss aversion refers to a situation where investors prefer to avoid losses rather than to get. The emotional impact of losses is proven to be 2.5 times the impact of gains. This is a bias where, as described by Daniel Kahneman and Amos Tversky, the developers of the	(Noah & Lingga., 2021)



Loss Aversion	References
original prospect theory as in situations where "losses seem to outweigh gains"	
Loss aversion has significant positive because the findings show that individuals with increased loss aversion tend to be more afraid to make investment decisions and are mostly risk averse.	(Hala et al., 2020)
Loss aversion has significant negative to investor decision because investors do not want to bear the loss and afraid of losing	(Iqbal et al., 2020)
Loss aversion is people's feelings will change when they have to make important decisions in their lives. When making significant decisions, they generally encounter an endowment effect, where they give consideration to think about gaining something and losing the same in other commonly confused word choices.	(Bakar & Yi, 2016)
Loss aversion has significant negative because investors behave irrationally because they are afraid of future losses and affect decision making.	(Antony & Joseph, 2017)

Most journals show that loss aversion influences investment decisions.

Table 6 Over Confidence

Over Confidence	References
The overconfidence bias has significant positive with investment decision because overconfidence shows irrational investor behavior in relying more on their own abilities and optimistic assessments.	(Hala et al., 2020; Bakar & Yi, 2016)

Overconfidence has a significant negative to investor decision on investment. Overconfidence is the least considered behavioral factor among behavioral studies. Overconfident people usually have fewer emotions.	(Iram, 2020)
Overconfidence has significant positive to investor decision on investment because Overconfidence composed investors overestimate the knowledge possessed by investors themselves, and underestimates the predictions composed because investors overestimate their capabilities	(Pahlevi & Oktaviani, 2018)
Overconfidence has significant positive to investor decision on investment because Outperforming business skills and Expert opinions motivate to invest	(Iqbal et al., 2020)
Overconfidence has significant positive with investment decision because overconfidence make investors overconfident about their knowledge and skills and ignore the risks associated with investment decisions	(Madaan & Singh, 2019)

Most journals show that overconfidence has an effect on investment decisions.

INTERPRETATION AND DISCUSSION

Behavioral factors (Najaf et al., 2015) significantly affect the decision-making process of investors. Herding factor, market factors, loss aversion and overconfidence greatly influence investors' investment decisions. Market factors investigated include: price changes, market information, and past stock trends. Market information shows a very high impact on the market, while changes in stock prices and past trends show a high impact on the market. Finance studies how behavior elements introduce variation in individual decision-making processes. From the summary above, it can be concluded that previous studies also show that these factors have an influence.

One study examined how herding behavior was related to rational decision making among individuals. The results of the study imply the existence of herding behavior in individual investment decision making. Also, further in this study, it was shown that

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herding bias was different in the case of males and females (Iram et al., 2020). One of the studies is contributing to an understanding of the impact of herding behaviors on investment decisions made in a highly volatile environment. This study suggests that herding behavior may be in the decisions made by fund managers (Kubilay & Bayrakdaroglu, 2016).

Market factors refers to situations in which financial markets are affected by investor behavior. So, by looking at price changes, market information and other market factors, it can be said that investors' decision making is influenced by market factors. Loss aversion is people's feelings will change when they have to make important decisions in their lives. When making significant decisions, they generally encounter an endowment effect, where they give consideration to think about gaining something and losing the same in other commonly confused word choices (Bakar & Yi, 2016).

Overconfidence is studied using initial answers and realized results. People tend to underestimate their initial beliefs when they find out that they have succeeded. Investment advisors are generally less exposed to hindsight bias than advisors who have the strongest tendency to overestimate their initial ability to generate returns on assets, after knowing the realization. Exaggeration is reinforced by experience (Najaf et al., 2015).

CONCLUSION

From the results of this study, four factors that greatly influence decision making by investors are herding, market, loss aversion and overconfidence. Of the four, it was found that the most influential factors were market and herding. The point of this paper is to determine the impact of behavioral tendencies on leadership required by financial specialists and to raise questions about why the behavior of financial specialists deviates from prudence. Investigations and discourse studies have presented many problems for future research. These studies are in-depth. First, further research is focused on research on emerging market exchanges. It has been seen that after globalization, emerging economies have higher development prospects and finance specialists are more likely to put resources into supply markets, which could be of great help for future research.



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