A Conceptual Perspective On Behavioural Finance

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***Abstract:***  *Conventional Finance and the recent development known as Behavioural Finance. Conventional finance foundation is mainly based on efficient market concept. But till 1990 the conventional finance theories were not so been challenged. But from mid 90’s researchers have shows many shortcomings of the existing theory and particularly challenged the investor rationality concept. As a result a new paradigm known as behavioural finance has been developed. In this paper an attempt has been made to disclose the the traditional finance theories as pointed out by behavioural finance supporters and also a discussion on the significance of behavioural finance.*

***Key words:*** *Traditional finance, Behavioural Finance, Rationality.*

# Introduction:

Financial assets mainly directed towards the securities issued by companies or in other words they include mainly the shares or stocks, debentures, bonds etc. The study of financial markets has always been a centre of attraction of the researchers. Different stages or developments have resulted due to this curiosity of scholars. Different theories were also developed in this regard. Basically these developments are classified into three broad categories, viz. Traditional Finance theories, Modern Finance Theories and the latest concept is the Behavioural Finance theories. In this paper an attempt has been made to throw some light in the development of the Behavioural finance in spite of the presence of other theories and will also discuss a few behavioural finance principles and their significance in the financial market study.

# Statement of the topic:

Finance is the most essential part of business and in this competitive world the company requires more capital to expand their activities. The growth of companies is also necessary for rapid industrialization and economic growth of the country and which ultimately depends on the public. So to attract more and more investors towards securities market will not only boost the economy of the individual companies but also contribute to the national development as a whole. Therefore to study not only highlight in the financial market but also the behaviour of its investors which causes such ups and downs seems very effective for the growth of the financial market.

# Objectives of the Study:

The main objective of the paper is to the limitations of the traditional finance theories and the significance of the growth of behavioural finance discipline in the study of investors’ behaviour in financial market also identify the portray of conclusion of the study.

# Methodology of the Study:

The paper is mainly conceptual and descriptive in nature and it is based on the different research papers, journals, articles related to behavioural finance available over internet based sources. Various other related books and journals which are available in physical form are also accessed to develop the foundation of the paper.

# Literature Review:

**Seth L. Elan(2010)** stated that Active Trading, More Attention to the Past Returns, Familiarity Bias, Momentum Investing, Under diversification, etc are some of the common mistakes made by the investors and Financial illiteracy and the lack of trust in financial markets play important roles in curbing participation in retirement plans.

**Abhijeet Chandra** and **Ravinder Kumar** in a study attempting to investigate the factors influencing individual investor behaviour in Indian Stock Market found that there are five underlying psychological axes that appear to be driving the Indian individual investor behaviour. These five pertinent axes on the basis of the underlying variables are named as prudence and precautious attitude, conservatism, under confidence, informational asymmetry, and financial addiction.

**JAY R RITTER** has given a brief introduction of behavioural finance published in pacific basin finance journal .In his research article he rejected the tradional assumptions of expected utility maximization with rational investors in efficient market .The two blocks of behavioural finances are cognitive psychology and limit of arbitrages .The article further highlights many empirical pattern like stock markets bubbles in japan,taiwan and us.

**Amar kumar Chaudhary(2013**) studied on impact of behavioural finance in investment **deciscions and strategies –** he highlighted that in present changing economic scenario, investment in various companies has become complex as people invested large sum of money even when there is little change of company being profitable .Most of the investors have rational ecpectations and maximize their utility.

# Limitations of Conventional Finance:

Many limitations are shown by different researchers. Some of them are specifically tabulated below:

**Reliability:** Conventional finance lays its base first on the concept that investors are completely rational. But this has been proved to be the main shortcoming of the theory by different empirical researches. Rationality means the investors always make the best and proper use of the information they possess and analyses them in an objective manner. But many studies[Paul Gerrans et al (2012); Ganesan Balaji (2013); Pal. Mukul (2009) ; Ricciardi Victor et al (2000) ] have shown that in most of the times the investors being the social beings, with a brain and a heart full of emotions, behave in an irrational way, in spite of having different important information. They just overlook the rationality attitude and become biased in many cases.

**Emotions in Investment:** Conventional finance completely ignores the role of emotions in investment decision making. But the investors are also normal human beings with emotions and we cannot ignore the role of emotion in any decision making including the field of investment.

**Accuracy**; Conventional Finance always believes that the investors have access to all information and stock prices reflect that information instantly. But in practice, this may not be possible always because all the investors may not have access to all information at the same time. ―In the world of investing, there is nearly an infinite amount to know and learn; and even the most successful investors don’t master all disciplines‖ [Michael Pompian, 2006]

**Demographic factors:** Age, income, sex, family background, etc. are the demographic characteristics of investors are not considered by conventional finance, but they are also having effects on investment decision making abilities.

These are the main limitations of the traditional finance theories and which are proved to be true at different situations under the purview of behavioural finance. Thus the behavioural finance discipline seems to be a good development in the field of financial market study.

# Implications of Behavioural Finance principles:

1. **Cognitive Dissonance:** It implies the mental discomfort felt by an investor while taking any decision against his belief or attitude. ―Cognitive dissonance is nothing but a feeling of discomfort or disharmony resulting from the contradiction with the set beliefs or attitudes.‖ [Sharma A.J.,2014 (1)] In such a situation he tries to relieve his tension by following different irrational heuristics.
2. **Rude Behaviour:** Many times investors knowingly or unknowingly reveals this type of behaviour which is completely against the rationality concept. ―It is often seen that in many cases a particular group forms and it goes in a particular direction. And when a new investor comes by his own nature of being a human just follows the trend of the group without any consideration of his own values or beliefs or analysis. He takes it for granted that when so many people are there in that direction, they all must have something which is profitable as an investor.
3. **Loss Aversion**: Aversion means the feeling of dislike or disinclination and loss aversion means disliking or feeling uncomfortable about a loss. This psychological feeling was first proposed by Kahneman and Tversky (1979) in their famous prospect theory. Tversky (1991) further used this concept in his study about making decisions under certainty. To date many scholars have studied the effect of loss aversion on decision making under different situations.
4. **Mental Process Accounting:** Mental Accounting; a concept first named by Richard Thaler in an attempt to describe the way in which a person subjectively frames a transaction in their mind the utility they receive or expect. People weigh the money value on the basis of the source from which that income has been generated. This is also a bias in investment decisions. Although having the same value, investors place different weights on an income earned as interest and income from lottery.

There are many other such theories available in the field of behavioural finance which challenges the conventional finance theories of rational choice.

# Conclusion

Therefore we can say that we must agree the shortcomings of conventional finance put forwarded by the empirical findings, and at the same time an objective analysis is necessitated to arrive at a conclusion. The growth of behavioural finance in this regard is definitely a positive aspect to better study the investor behaviour. However the behavioural finance alone cannot be said to be a perfect one because the discipline is not too old to accept as a theory. And the behavioural finance is only a collection of ideas and thoughts which are descriptive and advisory in nature but they are not exhaustive. More discussions and studies are required to point the limitations of behavioural finance itself so as to refine it to be a good theory.

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