The role of behavioral finance theory in investors' financial decision-making

Le rôle de la théorie de la finance comportementale dans la prise de décision financière des investisseurs

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Received: 30/06/2023 *Accepted: 17/09/2023* *Published:14/12/2023*

Abstract:

Behavioral finance theory is one of the modern theories in the field of economics and finance, focusing on studying investors' behaviour and its impact on the stock market and prices. This theory is based on the study of the psychological, social and cultural factors affecting financial decision-making and the impact of such decisions on prices in financial markets. This article aims to study the role of behavioral finance theory in improving investors' financial decisions. This study found that psychosocial and cultural factors significantly affect investors' behaviour and financial decision-making. Thus, it can be argued that behavioural finance theory is an important tool for investors in financial decision-making, helping to understand the psychological, social and cultural factors that influence financial decision-making and improve financial performance. They also help to avoid common mistakes in financial decision-making, such as being overly optimistic or pessimistic and being influenced by misinformation

Keywords: *behavioral finance, financial decisions, investors, psychological factors*

.Jel Classification Codes: G11,G14,G40

Résumé:

_ La théorie de la finance comportementale est l'une des théories modernes dans le domaine de l'économie et de la finance, axée sur l'étude du comportement des investisseurs et de son impact sur le marché boursier et les prix. Cette théorie est basée sur l'étude des facteurs psychologiques, sociaux et culturels affectant la prise de décision financière et l'impact de ces décisions sur les prix sur les marchés financiers. Cet article vise à étudier le rôle de la théorie de la finance comportementale dans l'amélioration des décisions financières des investisseurs. Cette étude a révélé que les facteurs psychosociaux et culturels affectent de manière

significative le comportement des investisseurs et leur prise de décision financière. Ainsi, on peut affirmer que la théorie de la finance comportementale est un outil important pour les investisseurs dans la prise de décision financière, aidant à comprendre les facteurs psychologiques, sociaux et culturels qui influencent la prise de décision financière et améliorent la performance financière. Ils aident également à éviter les erreurs courantes dans la prise de décision financière, comme être trop optimiste ou pessimiste et se laisser influencer par de fausses informations.

Mots clés : *finance comportementale, décisions financières, investisseurs, facteurs psychologiques*

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1. INTRODUCTION :

Recent financial market crises have taken hold, leading to a major controversy in academia, which has begun to call into question the theory of market efficiency, by a number of researchers who have demonstrated a number of distortions in the money market, above all. "1981" Shiller, "" .Debodt & Thaler "1985," Banz "1981. As evidence grew, research began into the various influences governing the behaviour of investment decision makers. and investment decision-making, a new field known as Finance Behavioral. (Montier, 2010)

Money and investment are vital and important issues in the lives of individuals, businesses and communities, where everyone seeks to profit and achieve their financial goals. But when it comes to financial decision-making, investors have to look at many different factors, such as financial markets, financial risks, technical and basic analysis, and psychological factors.

Hence, behavioral finance theory helps to understand the psychological, social and cultural factors that affect investors' behaviour and financial decision-making. Using this theory, the factors affecting investors' behaviour can be better understood, thereby improving their financial performance and making investment decisions.

They include behavioral finance theory factors such as psychological

beliefs, biases, cognitive error, past experience, culture, knowledge and social relations. This knowledge can be used to better improve investors' performance and financial decision-making by providing training and information and improving financial awareness among individual investors.

Thus, this research aims to highlight the knowledge of the dimensions of behavioral biases on the motivations and tendencies of individual investors to invest and which of these biases are more influenced by aspects of investment behaviour, so that we can understand trading activities and behaviors.

The problem with research is**: What is the role of behavioral finance theory in making investors' financial decisions?**

2. General concepts on behavioral finance theory:

Behavioral Finance is a branch of financial economics that studies how psychological and behavioral factors influence financial decision-making. This theory focuses on studying investors' behaviour and methods of making financial and investment decisions, and how psychological factors such as personal values, expectations, fear and covetousness influence such decisions.

The theory of behavioral finance is based on the premise that investors are not always rational and rational, but are influenced by the psychological and behavioral factors that influence their financial and investment decisions. This theory suggests that investors tend to make decisions based on initial impressions, personal expectations, and their own faith, not on rationale and science.

2.1 Definition of behavioral finance:

Behavioral finance theory is a set of theories and assumptions that focus on studying investors' behavior and its impact on the stock market and prices. Among the various definitions of this theory are:

- "Behavioral finance theory focuses on the study of investors' financial behaviour and the impact of psychological, social and cultural factors on their financial decision-making and the impact of such decisions on financial asset prices." Barberis, N., Thaler, R. (2003)
- "The theory of behavioural finance is based on the study of the psychological, social and cultural factors affecting financial decision-

making and the impact of such decisions on prices in financial markets." Samurai Ngo and Michael Bond . (2014).

- "Behavioral finance theory focuses on the study of individuals' financial behaviour and the impact of psychological, social and cultural factors on their financial decision-making and the impact of such decisions on prices in financial markets." John Natch2009**.** (Barberis, 2003)

2.2Evolution of the concept of behavioural finance:

Behavioral finance theory is one of the modern theories in financial science, which is interested in studying investors' behaviour and how psychosocial and cultural factors influence financial decision-making. This theory has undergone remarkable development over the past decades, as it has been improved and developed to encompass a variety of concepts and methods.

Initially, behavioral finance theory was developed to interpret financial behavior that differs from the classical model of financial science, which assumes that investors act logically and make the most useful financial decisions. However, studies have shown that investors' behaviour is influenced by psychological, social and cultural factors, and can sometimes be irrational.

In the 1980s, research into behavioral finance theory focused on studying several psychological biases that affect investors' behaviour, such as confirmatory bias, bias, error ascertainment, cognitive bias, psychological bias and others. The theory of "psychological supply and demand" has also been developed, suggesting that prices are influenced by investors' behaviour and psychological biases. (Montier, 2010)

In the 1990s, the theory of behavioral finance was developed to include analysis of psychosocial events that could affect financial markets, such as media events, economic reports, political events and natural events. This analysis led to the development of the theory of "Panic selling", which suggests that investors act hysterically in the event of financial crises and make unreasonable decisions (Odean, 1998).

In the last decade, research into behavioral finance theory has focused on studying social and cultural factors that influence investors' behaviour, such as social relationships, religious beliefs, education and past experience. This

analysis led to the development of the theory of "cultural factors", which suggests that cultural factors can influence investors' behaviour and financial decisions.

The evolution of behavioural finance theory is characterized by a focus on the psychological, social and cultural factors affecting investors' behaviour and a better analysis of methods of interpreting non-typical financial behaviour. This analysis is important to better understand investors' behaviour and make financial decisions, especially in the current social, cultural and technological changes in financial markets.

Behavioural finance theory is expected to continue to evolve in the future, as it will further study other factors affecting investors' behaviour, such as political, economic, technological and environmental factors. Based on these results, financial tools and products can be developed that are more effective and compatible with investors' behaviour, helping to better achieve their financial objectives. (Nagao, 2014).

2.3.Importance of behavioral finance theory in understanding investors' behaviour:

The importance of behavioral finance theory is the following points**:**

- **Understanding psychological factors:** Behavioral finance theory helps understand psychological factors that influence financial decision-making, such as biases, misconceptions and corporate error, and this can help investors make better financial decisions.
- **Improving investment performance:** Behavioral finance theory helps improve investment performance, helping to analyze investors' behaviour and identify correct financial decisions, thereby improving investors' financial performance.
- **Improving the investment industry:** Behavioral finance theory helps improve the overall investment industry, helping to understand investor behaviour and analyze factors that influence financial decision-making, and this can help develop financial products and improve investment services.

Improving investors' experience: Behavioral finance theory helps improve investors' experience, helping to learn optimal financial behaviour and avoid common financial decision-making errors.

- **Improving financial education:** Behavioral finance theory helps

improve financial education, helping to teach investors about the importance of understanding psychological factors in financial decision-making, and how to analyze investors' behaviour to make the right financial decisions.

2.4 Difference between traditional finance theory and behavioral finance theory:

Traditional finance theory focuses on the assumption that investors act independently and rationally, and that financial markets operate effectively in accordance with sports and logical laws. Under this assumption, quantitative financial instruments, such as financial valuation models and investment theory, are used to analyse financial statements and make financial decisions.

In contrast, behavioral finance theory focuses on understanding investors' behaviour and the psychosocial and economic factors that influence financial decision-making. Under this approach, psychological financial instruments, such as emotional response analysis and cognitive bias theory, are used to analyse financial statements and make financial decisions.

3.The role of behavioral finance theory in investors' financial decision-making:

Behavioral Finance is a modern theory that is interested in studying investors' behaviour and how they make financial decisions. This theory depends on understanding the psychosocial factors that influence investors' behaviour while making financial decisions, such as erroneous judgments and cognitive biases.

Behavioral finance theory focuses on the study of human behavior and how it affects financial decision-making. For example, investors can be influenced by negative and positive news, and therefore tend to buy or sell based on that information Hersh Shefrin (2002). Fear and covid can also affect investors' decisions, as they tend to make the wrong decisions under those psychological factors. (Shiller, 2000)

Behavioral finance theory uses various tools to study investors' behaviour and make financial decisions, such as psychological studies, questionnaires and historical data analysis. These tools allow investors to understand why

they are making financial decisions, and to analyse in depth any future decision-making error and avoidance.

Behavioral finance theory can help improve investors' financial performance by providing them with more accurate analysis and important information and identifying those psychological factors that may influence their financial decision-making behaviour.

In addition, the behavioral finance theory can help improve the long-term performance of financial markets, as this approach helps investors realize the risks and potential returns of investments.

False provisions (Cognitive Biases) in behavioral finance theory are psychological factors that influence investors' behaviour in making financial decisions. The erroneous provisions refer to misperceptions and misperceptions that man can adopt, which negatively affect his financial decisions.

Among the common erroneous provisions investors can be exposed to in financial markets:

- Excessive self-confidence: it is the practice of some to evaluate their personal abilities in excess, which leads to an inaccurate assessment of potential financial risks.
- Being influenced by the clear margin: the custom that makes investors directly affected by current events and news, which leads to financial decisions on an inaccurate basis.
- Proven bias: A certain bias can be to insist on a particular vision or to make a particular decision without fully looking at available data.
- Overly optimistic: A habit that makes investors expect their investments to always perform well, and therefore make financial decisions based on exaggerated expectations.
- Fear of loss: a habit that makes investors fear losing more than gains, and therefore make financial decisions to avoid risk.

It is important to understand and analyse these erroneous provisions thoroughly, as investors can do so by drawing on historical data and deep analysis, thereby avoiding common financial decision-making errors.

Avoiding erroneous provisions is very important in making the right financial decisions, and investors can take some effective ways to achieve

this Barberis, N., (Montier, 2010)among these:

- Continuous learning: Investors should constantly search for information and news about investments and financial markets and learn from past experiences and mistakes.
- Accurate data analysis: Investors should accurately analyze data on financial markets and investments and use various tools available to better analyze data, such as graphs, technical analysis and basic analysis.
- Hiring financial advisers: Investors can resort to financial advisers for professional advice and advice on investments and financial markets, where advisers can address erroneous provisions and provide important advice to investors.
- Identifying and continuing with investment objectives: Investors must identify their investment objectives and continue to achieve them, and do not change them repeatedly based on current news or surface analysis.
- Focus on real data: Investors should focus on real data and reliable information in financial decision-making, and avoid relying on false judgments and misperceptions.
- Control of emotions: Investors must maintain control over negative emotions such as fear, greed and anger, and think about financial decisions logically and objectively.

Cognitive Biases are a kind of cognitive error that affects human decisions, ideas and perceptions. Cognitive biases are defined as psychological factors that distort reality, distort thinking and inaccurately judge objects and events. These biases can affect all aspects of life, including work, family, social and financial relations. (Shefrin, 2002)

Cognitive biases are divided into several types, including:

- Cultural prejudices: biases enjoyed by man because of the culture to which he belongs, which affect his perceptions and judgment of things and events.

It is important to understand and analyse these cognitive biases thoroughly, as human beings can do so by drawing on available data and information and deep analysis, thereby avoiding common mistakes in decision-making.

Although cognitive biases are a common phenomenon and cannot be

completely eliminated, some of these biases can be avoided by human beings following certain preventive actions and measures, including:

- Search for information from multiple sources: Human beings can avoid some cognitive biases by searching for information from multiple sources and getting different opinions on the subject.
- Deep and systematic analysis: Human beings can avoid cognitive biases by deep and systematic analysis of information and data, and not relying on superficial impressions.
- Recognize common biases: Human beings can avoid some cognitive biases by recognizing common biases and identifying their causes and factors.
- Consulting and discussing with others: Human beings can avoid some cognitive biases by discussing, consulting with others, getting different opinions and exchanging experiences.
- Broadening the horizons of knowledge: Human beings can avoid some cognitive biases by expanding the horizons of knowledge, learning about new and different fields and sharing diverse information.
- Emotion control: Human beings can avoid some cognitive biases by controlling negative emotions and thinking logically and objectively.

Although these actions cannot completely eliminate cognitive biases, they can help people avoid some of these biases and reduce their impact on their decisions, ideas and perceptions.

4.Psychological factors affecting investors' financial decisions:

The theory of behavioral finance indicates that psychological factors influence investors' financial decisions and include some psychological factors influencing financial decisions as follows:

•**Positive and negative bias:** This bias is the tendency of investors to make financial decisions based on optimistic or pessimistic expectations And this bias can lead to wrong investment decisions, For example, positive bias can lead investors to invest in certain companies based on optimistic expectations without analysing the company's current situation while avoiding investment in other companies because of pessimistic expectations, although they are good investment opportunities.

•**Legal error:** This error is to look at facts from a particular point of view

and interpret reality incorrectly. This error leads to financial decisions based on misinterpretations of facts, which can lead to financial losses.

•**Misconceptions:** This factor is to rely on misconceptions without analyzing actual facts, and can lead to false investment decisions. For example, misguessing can lead investors to invest in certain stocks based on false expectations rather than analysing the company's actual performance.

•**Wanting to avoid risk:** This factor is risk avoidance in financial decision-making. This factor can lead to loss of investment opportunities and loss of high profit opportunities.

•**Aversion, enthusiasm, fear and greed:** these factors influence investors' financial decisions For example, fear can reduce the level of investor investment and shift to safer investments, While covid can lead to investment in the most dangerous assets, although these psychological factors can lead to false financial decisions. approach ", but could be avoided or minimized through careful analysis of financial realities and learning the skills needed to make the right financial decisions. Financial analysis techniques, management processes and other scientific methodologies can also be used to analyse data and information and make correct financial decisions.

5.Providing practical examples of the application of behavioural finance theory:

There are many practical examples of applying behavioral finance theory, here are some common examples: (Dreman, 2012)

•**Affirmative Bias Theory:** This theory says that investors deal more cautiously when it comes to losses, preferring to maintain current gains rather than risk getting bigger gains. This theory can help identify investment assets suitable for investors who prefer to invest in low-risk assets.

•**Theory of cognitive bias:** This theory says that investors tend to make financial decisions based on information available to them, and do not take into account previous information that may influence their decisions. This theory can be used to improve financial performance by analyzing financial statements and relying on previous data to identify correct financial

decisions.

•**Emotional response theory:** This theory says that investors are greatly influenced by emotions when making financial decisions, and this can lead to wrong decisions. This theory can be used to improve financial performance by providing financial training and awareness of the importance of maintaining calm and lack of emotion when making financial decisions.

•**Risk appetite theory:** This theory says that investors disparate in how much they want to risk, and this theory can be applied to identify investment assets suitable for investors who prefer to risk and look for high returns.

•**Passion and Social Impact Theory:** This theory says that investors tend to follow and influence their financial decisions of social influence and common emotions. This theory can be used to raise investors' awareness of the importance of autonomy in financial decision-making and improving financial performance.

•**Self-control theory:** This theory says that investors need to control themselves and make high-risk financial decisions. This theory can be used to provide financial training and advice to investors to improve their ability to control themselves and make correct financial decisions.

•**Theory of individual differences:** This theory says that investors disagree on how they think and respond to financial information. This theory can be used to identify appropriate financial instruments for investors who prefer evidence-based financial decisions and careful analysis.

6.Challenges to the application of behavioural finance theory:

Applying behavioral finance theory faces many challenges and difficulties (Shiller, 2000)The most important of these are:

- Difficulty in predicting investors' behaviour: Investors' behaviour depends on many psychological, social and economic factors that are difficult to predict, and therefore it is difficult to determine precisely future financial decisions.

Assessing the impact of psychological factors on financial performance: Assessing the impact of psychological factors on financial performance is a major challenge, as it is difficult to determine and analyze accurately the

impact of these factors on financial performance.
- Lack of data: Behavioral finance theory studies need a large amount of data to accurately analyze investors' behaviour, but in many cases it is difficult or expensive to obtain such data.
- Geographical and cultural factors: Investors' behaviour varies greatly in different cultures and countries, and therefore behavioral finance theory is difficult to apply globally.
- **Other factors:** Many other factors are difficult to identify and analyse thoroughly, such as experience, education, personality, economic and political events.

Overall, applying behavioral finance theory faces many difficult challenges, but these can be overcome by improving research methods, increasing available data and developing new methods for analysing investors' behaviour.

7.Appropriate analytical tools and techniques to analyse psychosocial and cultural factors:

There are many appropriate analytical tools and techniques to analyse the psychosocial and cultural factors affecting investors' behaviour in the Shiller, R. J. (2000) financial markets, including:
- **Polls**: This tool is used to measure investors' opinions and trends by inquiring directly from them. Such surveys can be useful in analysing the psychological, social and cultural factors affecting investors' behaviour.
- **Psychoanalysis:** Psychoanalysis is used to analyze psychological factors that affect investors' behaviour, such as fear, greed, positive bias and negative bias. This technique includes analysis of the investor's history, trading pattern and knowledge of critical events that may affect the investor.
- **Social analysis:** Social analysis is used to analyse social factors affecting investors' behaviour, such as social networks, social influences and behavioral analysis of investors in specific groups.

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- **Cultural analysis:** cultural analysis is used to analyse cultural factors that affect investors' behaviour, such as social values, cultural traditions, religious beliefs, customs and traditions.

- **Statistical analysis:** Statistics are used to analyse the psychological, social and cultural factors affecting investors' behaviour, including regression analysis, practical analysis, hedge analysis and other statistical techniques.

- **Verbal analysis:** Verbal analysis is used to analyse texts, interviews, conversations and social media posts to understand investors' psychological, social and cultural patterns.

- **Machine learning techniques:** Machine learning techniques such as neural networks and deep learning are used to analyze data and extract investors' psychosocial and cultural patterns.

- **Psychosocial counselling:** psychologists and meetings can be used to analyse the psychosocial factors affecting investors' behaviour, and to provide counselling and training to improve investors' behaviour.

- **Geopolitical analysis:** geopolitical analysis is used to analyse political, economic, social and cultural factors affecting developing countries' financial markets and their impact on investors' behaviour.

It is important to note that the use of these analytical tools and techniques to analyse psychosocial and cultural factors in financial markets requires expertise and skill in the proper analysis and interpretation of data, and cooperation between financial and psychological analysts and sociologists and culture is needed.

Conclusion:

The theory of behavioral finance emphasizes that economists and investors are not pure minds who make decisions based on available information, but are influenced by psychological, social and cultural factors that influence their behaviour and financial decisions. The behavioral finance theory offers a different approach to analyzing and interpreting investors' behaviour in financial markets, and stresses that investors should be aware of the psychosocial and cultural factors affecting their behavior, and should learn how to analyze and apply these factors in financial decision-making.

Studies suggest that successful investment requires a comprehensive understanding of the psychosocial and cultural factors affecting investors' behaviour, and applying behavioral financial theory can help achieve this. Appropriate analytical tools and techniques can be used to analyze psychosocial and cultural factors in financial markets and provide appropriate recommendations to investors based on this analysis. Clearly, it takes collaboration between financial and psychological analysts and sociologists and culture to achieve the best results.

This study found the following findings:

- Successful investment requires a comprehensive understanding of the psychological, social and cultural factors that affect investors' behaviour.
- Applying behavioral financial theory can help achieve this.
- Appropriate analytical tools and techniques can be used to analyse psychosocial and cultural factors in financial markets.
- Behavioural finance theory suggests that psychological, social and cultural factors significantly affect investors' behaviour in financial markets.

Based on the findings, several investor recommendations may be proposed, including:

- Investors' performance in financial markets can be improved by developing self-management and emotion management skills, through learning and training in meditation practice, intellectual reflection and relaxation.
- Investors must be made aware of the psychological, social and cultural factors affecting their behaviour in financial markets and provide the necessary information and guidance to investors to improve their performance.
- Technical analysis can be used to better analyse financial markets by examining graphical patterns of prices and forecasting financial markets' future movements.
- Investors must diversify their investments well, reducing the risk of concentrating investments in one sector or one type of financial asset.
- Investors should pay special attention to the fundamental analysis of

financial markets, by studying the economic fundamentals and the companies and industries in which they invest.

- Investors should avoid making emotional financial decisions by comprehensively analysing available data, figures and information and making decisions in a logical and fact-based manner.

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