The Impact of Behavioral Factors on Individual Investment Decisions of Equity Investors: A Study in Kurunegala Area

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Abstract

Market anomalies and irrational behavior influence the stock market. Owing to the dearth of studies on the effect of behavioral factors in the Sri Lankan stock market, this study investigates the impact of behavioral factors on individual investment decisions of equity investors in the Colombo Stock Exchange (CSE). Representativeness, overconfidence, availability heuristic, and herding effect were considered as behavioral factors in this study. Equity investors in the Kurunegala area registered in the CSE are the population of the study. The data were collected through a structured questionnaire distributed to 100 investors selected using the convenient sampling technique. The data were analyzed using descriptive analysis, correlation analysis, and regression analysis. Correlation results confirm that all independent variables are positively and significantly related to investment decisions. Furthermore, regression results highlight a significant impact of availability heuristic and herding effect, whereas there is no significant impact of representativeness and overconfidence on individual investment decisions. There is no significant impact of demographic factors on individual investment decisions at CSE in the Kurunegala area. The findings imply that it will be important to initiate awareness programs while providing more reliable and updated information about the market for individual investors to improve their decision-making.

Keywords: *availability heuristic, herding effect, investment decision making, overconfidence, representativeness*

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ISSN 2792-1220

1. Introduction

Investment decisions of investors are always not similar to their previous decisions and investors are not well informed and their perceptions are different. According to Barberis (2016), the behavioral framework commenced after the 1990s, and it uses more practical psychological models to explain why some people are not fully rational. Behavioral factors influence the decisions made by investors. Bhatt and Chauhan (2014) stated that investors do not always act rationally due to the influence of cognitive and psychological errors. There are a large number of investigations regarding behavioral finance and behavioral factors, such as the studies done by Fama (1997), Barberis and Thaler (2002), and Ritter (2003). The study of Goyal and Kumar (2015) and also the investigation of Zahera and Bansal (2018) highlighted the existing literature on behavioral biases in investment decision-making. These studies underscore the need to carry out research on the impact of behavioral factors on investment decisions. However, many studies are carried out to find out the factors that impact individual investment decisions in Sri Lanka. The studies done by Gunathilaka (2014), Wijekumara and Madhushanka (2019), and Somathilaka (2020) focused on factors that influence investor behavior. The most recent Sri Lankan study on behavioral factors done by Mahanthe and Sugathadasa (2018) revealed the relation between selected behavioral factors and investment decision making using correlation analysis. Therefore, the present study focused on the impact of behavioral factors, and the findings are discussed based on the results of regression analysis. Further, this research only focused on investors in Kurunegala area since it was needed to clarify if there is any effect of the behavior of investors by the seminars, workshops and awareness programs held by CSE branch. There are only eight CSE branches island-wide, including Kurunegala area, and the above-mentioned reason is the primary motivation to employ this single area for the study.

Moreover, deriving the differences of respondents in terms of demographic factors towards their investment decisions adds more meaning to the results. Owing to those contradictions plus with motivations in the empirical findings and significance, this study addresses “Is there any impact of behavioral factors on investment decisions of individual equity investors of CSE in Kurunegala area?” As a behavioral study, this would help to identify the real picture of the mindsets of investors on their decision-making practices.

2. Literature Review

Statman (2008) has emphasized that behavioral finance interprets the standard finance differently. Investors are “normal”; markets are not efficient; investors build their portfolios according to the behavioral portfolio theory, and the behavioral asset pricing model follows expected returns. Ritter (2003) stated that behavioral finance has two parts; cognitive psychology consists of the thinking patterns of individuals, and it may cause systematic errors when they are making a decision. Moreover, it limits arbitrage that predict conditions or situations that arbitrage will be effective and ineffective.

Pahlevi and Oktaviani (2018) investigated determinants of individual investor behavior in stock investment decisions concerning modern investment theory, and results revealed that overconfidence has a significant positive impact on the attitude of investors. Weerawansa and Morage (2018) revealed that heuristics have a strong negative relation with investment decision making; the availability heuristic is also covered under the heuristic factor in this study. Keswani, Dhingra, and Wadhwa (2019) show individual investment decisions of investors in the National Stock Exchange were influenced by three behavioral factors at high levels: Market, Prospect, Heuristic. The study of Farook, Afzal, Sohail and Sajid (2015) in Pakistan revealed that heuristic has a positive and significant impact on investment decision-making. Table 1 denotes the most relevant previous studies that are in line with current studies and the theories concerned.

Table 1. Summary of Empirical Research Findings

Study	Theories	Findings
Kengatharan and Kengatharan (2014)	Behavioral Finance Theory	Herding, Heuristics, Prospect and Market factors influence on investment decisions of individual investors at the CSE
Manike, Dunusinghe and Ranasinghe (2015)	Prospect Theory	Behavioral factors influence the decisions of individual investors at the CSE
Bakar and Yi (2015)	Modern Portfolio Theory, Arbitrage Pricing Theory	Overconfidence, conservatism, and availability heuristic have significant impacts on the investors' decision-making, and the herding effect has no significant impact.
Alquraan, Alqisi and Shorafa (2016)	Modern Portfolio Theory	Behavioral factors (Loss Averse, Overconfidence and Risk Perception) have a significant impact on investment decisions, and the herding effect has an insignificant effect.

3. Methodology

Following the studies of Nada (2013), Keswani, Dhingra, and Wadhwa (2019), many others assumed that there is an impact of behavioral factors on investment decisions. The hypotheses of this study are;

H_1: There is an impact of behavioral factors on investment decisions of individual equity investors at CSE in the Kurunegala area**.**

H_{1a}: There is an impact of representativeness on investment decisions of individual equity investors at CSE in the Kurunegala area**.**

H_{1b}: There is an impact of overconfidence on investment decisions of individual equity investors at CSE in the Kurunegala area**.**

H_{1c}: There is an impact of availability heuristic on investment decisions of individual equity investors at CSE in the Kurunegala area**.**

H_{1d}: There is an impact of herding effect on investment decisions of individual equity investors at CSE in the Kurunegala area**.**

The target population of this study is all individual equity investors of the Colombo Stock Exchange in the Kurunegala area. There are approximately 5,000 individual equity investors registered in the North Western Province; nevertheless, not all actively participate. Therefore, the current study employed a convenient sampling technique to collect data from 100 individual investors through a structured questionnaire since the details of investors are not accessible. The data were collected within three months. The reliability of the questionnaire was at a satisfactory level since all the Cronbach's alpha values of variables were greater than 0.7. Subsequently, collected data were statistically analyzed by using descriptive analysis, correlation analysis, and regression analysis. Table 2 shows the descriptive statistics of the variables.

Table 2. Descriptive Statistics

	Max	Min	Mean	SD	Skewness	Kurtosis
Representativeness	4.80	1.00	3.598	0.750	-1.681	2.919
Overconfidence	4.86	1.43	3.390	0.715	-0.441	-0.257
Availability Heuristics	4.67	1.67	3.492	0.663	-0.849	0.261
Herding Effect	5.00	1.25	3.290	0.819	-0.212	-0.732
Investment Decisions	5.00	1.00	3.456	0.748	-0.811	0.639

4. Results and Discussion

According to Table 3, there is a weak positive relation between representativeness and individual investment decisions(r = .367, p < .05). On the other hand, the Correlation between overconfidence, availability heuristic and herding effect with individual investment decisions reported a significant and moderately positive relation (.617, .664, and .607), respectively.

Table 3. Correlations

Variable	ID	RP	OC	AH	HE
ID	1.000				
Sig. (2-tailed)	.000				
RP	.367**	1.000			
Sig. (2-tailed)	.000				
OC	.617**	.399**	1.000		
Sig. (2-tailed)	.000	.000			
AH	.664**	.462**	.702**	1.000	
Sig. (2-tailed)	.000	.000	.000		
HE	.607**	.292**	.660**	.681	1.000
Sig. (2-tailed)	.000	.003	.000	.000	

** Correlation is significant at the .05 level (2-tailed)

Table 4. Regression Results

Variable	Coefficient (*B*)	Std. Error	*t*	Sig.
Constant	0.492	0.328	1.499	.137
Representativeness	0.063	0.082	0.778	.438
Overconfidence	0.218	0.114	1.916	.058
Availability Heuristic	0.382	0.130	2.936	.004
Herding Effect	0.202	0.096	2.109	.038

Note: r = .715; r^2 =. 511; SE = 0.534

Table 4 indicates that 51.1 percent of the variation in individual investment decisions can be explained by the behavioral factors considered in this study. As shown in Table 5, the results indicate that the representativeness (B = 0.063, p = .438) and overconfidence (B = 0.218, p = .058) do not significantly affect individual investment decisions. This finding is aligned with Rekik and Boujelbene (2018). The availability heuristic has a significant positive impact on individual investment decisions (B = 0.382, p = .004). Bakar and Yi (2016), based on the Malaysian stock market, proved this result. Finally, the results showed that the herding effect positively impacts individual investment decisions (B = 0.202, p = .038). This regression result confirms the results revealed by Keswani, Dhingra and

Wadhwa (2019). Therefore, the ultimate results of the study concluded that there is a partial impact of behavioral factors on the investment decisions of individual equity investors of CSE in the Kurunegala area.

5. Conclusion

This study investigates the impact of behavioral factors on investment decisions of individual equity investors of CSE in the Kurunegala area. The regressions results show that representativeness and overconfidence have no significant impact on individual investment decisions of equity investors at CSE. Meanwhile, the availability heuristic and herding have a significant impact on individual investment decisions of equity investors at CSE. Therefore, it can be concluded that behavioral factors partially impact the investment decisions of individual equity investors of CSE in the Kurunegala area.

The study contributes to the body of knowledge of behavioral factors on investment decision-making in the Colombo Stock Exchange. The findings contribute to increasing the rationality of investment decisions. It will assist in conducting seminars and programs to enhance investors' knowledge regarding behavioral factors, and policymakers can update policies based on the investors' knowledge of behavioral factors. This study can be expanded to cover the entire country and also institutional investors. Furthermore, it can be expanded to examine other behavioral factors in the CSE such as anchoring, conservatism, gambler's fallacy, loss aversions and regret aversions.

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