Influence of Behavioral Finance on Decision Making in the Business World

Zixi Li
University of Dayton, stander@udayton.edu

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Zixi Li

Advisor: Dr. Ting Zhang, Department of Finance and Economics

What is Behavioral Finance?

• Propose psychology-based theories to explain stock market anomalies
• Assume information structure influences individual’s investment decisions & outcomes
• Potential implications of psychological factors affecting investor behavior in financial markets

Aim

Aim 1: Summarize different types of behavioral finance, analyze the reasons and connotations behind each type of behavioral finance, and discuss the methods of how to avoid and overcome it.

Aim 2: Illustrate the influences and consequences with regard to the investor behaviors in the real business world.

Key Concepts of Behavioral Finance

REPRESENTATIVENESS

• A heuristic process by which investors base expectations upon past experiences, applying stereotypes.
• “If this has happened, then that will happen”

FAMILIARITY

• Employers must always also be cognizant of their employees’ tendency to invest in securities with which they are familiar.
• “If I buy a stock, I will always buy a stock I am familiar with!”

OVERCONFIDENCE

• People tend to place too much confidence in their ability to predict.
• “I am so smart! I will never lose!”

ANCHORING

• Refers to the individual’s reluctance to accept a loss.
• "I hate lost!"

LOSS AVERSION

• Investors have a psychological need to have some sort of justification for their decisions.
• “I want to rely on something to justify my decisions!”

Research Strategy

• Consulted related books, articles, and journals about behavioral finance
• Summarized key concepts and influences with regard to the investor behaviors in the real business world.

References