The Objective of Behavioral Study

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Abstract. *Behavioral finance offers an alternative to the foundations of standard finance. This field of research delves into the intriguing field of behavioral finance, exploring how psychological factors influence financial decision-making processes. Behavioral finance seeks to understand why people make irrational financial decisions, despite being aware of the consequences. It bridges the gap between economics and psychology, providing insights into human behavior that traditional financial models often overlook. Behavioral finance investigates the influence of psychology on those who make financial transactions, as well as on subsequent market behavior. Behavioral finance is an interesting topic because it helps explain why and how financial markets are less efficient. Unconscious mental processes are ubiquitous. However, to date, little attention has been paid in the financial literature to how people's unconscious fantasies, needs, and desires contribute to their investment decisions and, more generally, to the markets. This article attempts to respond to these expectations from the perspective of highlighting relevant aspects that help define the object of study of behavioral finance.*

Keywords: finance, behavioral finance, general objective, specific objectives

JEL Classification: G02, G40

1. Introduction

The purpose of BEHAVIORAL FINANCE is to help prepare a finance specialist (executive practitioner, management practitioner, analyst, consultant and even researcher) because it provides an overview or expertise in this field of finance, it is true a more recent field of finance.

Behavioral finance is the study of how psychology influences the behavior of financial practitioners. In this article, you will learn about the wide range of decision biases and information processing errors that influence our financial decision-making.

This vision is consistent with that specific to prestigious universities in other countries where this discipline is still taught, and I would like to highlight some of these universities in this regard: **University of Melbourne (Australia):** ("This course provides students with knowledge about major trends in this interdisciplinary research field that combines elements of both psychology and finance. The course introduces methods for examining the psychological mechanisms that underlie human decision-making and how these mechanisms can explain anomalies in financial behavior that cannot be easily explained by existing methods in the finance discipline");

Corporate Finance Institute, CFI CMSA course: ("This course aims to explain what behavioral finance is and how it differs from modern finance and its impact on financial markets. It describes the most common cognitive biases, their causes, and potential steps you can take to prevent them. It helps to understand cognitive errors and explores their root causes with real-life examples. … It also studies the tendency of social factors to distort decision-making.");

Copenhagen Business School: ("The course will provide students with an understanding of how human psychology leads to biases and errors in financial decisions. By becoming aware of these biases and errors, students will be better able

to mitigate them as professionals in the financial industry, managers of firms, and investors of their own money. The course will also provide students with tools to understand how people process information and under/over-react in regular and crisis periods, as well as the consequences for financial markets and individuals");

University of Southampton (UK): ("This course enables the understanding of: the implications of the limits of arbitrage for financial markets, how behavioral biases affect risk-taking decision-making, the basic principles of behavioral finance and how they compare to key principles of traditional finance, subject-specific intellectual and research skills, understanding the limitations of normative financial theory, understanding common pitfalls that can hinder effective financial decision-making, creating a link between academic research and investment practice, etc.");

Maastricht University (Netherlands): ("The aim of this course is to provide an understanding of the psychological bases of individual behavior and the effect they have on financial markets and financial decision-making processes in corporations.");

Duke University (USA): ("The course follows the study of errors and dozens of other financial decisions that can be avoided if we are familiar with the biases that cause them. The course examines these predictable errors and discovers where we are most susceptible to these errors. This course is intended to guide participants towards better financial choices. The course helps us improve our spending, saving and investing decisions for the future.");

University of Queensland (Australia): ("This course provides an introduction to behavioral finance, a discipline that integrates ideas from psychology into the study of finance. Emphasis will be placed on understanding the psychological underpinnings of financial decision-making, as well as the frictions that may allow these psychological mechanisms to influence economic outcomes. Applications include asset pricing relative to fundamental value, trading strategies, managerial behavior, and individual saving and investment decisions.")

2. Behavioral finance content

Behavioral finance is a relatively recent branch of finance that seeks to explain, through psychological tools, certain aspects of financial activities (Sewell, 2007; Barberis & Thaler, 2002; De Bondt et al., 2008; Ackert & Deaves, 2009; Shefrin, 2010; Statman, 2010). This is especially the case for complex situations where the rationality of individuals is questioned and for which classical methods of analysis do not find convincing answers.

The concept of behavioral finance emerged from the studies of Tversky and Kahneman (1974). At that time, expectations dominated utility theory and the efficient market hypothesis in financial and economic theories, in which individuals would make strictly rational decisions and maximize the utility of each decision (Barberis & Thaler, 2003). Tversky and Kahneman (1974) showed that individuals often arrive at decisions from simplified decision-making processes, called heuristics, and are susceptible to cognitive biases. According to Barberis and Thaler (2003), behavioral finance is a new approach to the study of financial markets that emerged as a reflection of the difficulties encountered by traditional theories, since some financial phenomena can be better understood using models in which agents are not completely rational. Pompian (2006) defined behavioral finance as an application of psychology to finance.

Much of the financial literature focuses on the decisions of auditors and managers and the behavior of investors in trading decisions, leading to the publication of a large number of experimental studies in the 1960s and 1970s (Libby et al., 2002).

Furthermore, the tools of the experimental method—the ability to directly observe, control, and manipulate variables—are appropriate for research in behavioral finance because many variables are unobservable and difficult for researchers to measure or control, see examining data from real financial markets (Duxbury, 2015).

Behavioral finance studies the application of psychology to finance, with a focus on cognitive biases at the individual level. It describes the sources of reasoning and decision biases, how they affect transactions and market prices, the role of arbitrage and the flows of wealth between more rational and less rational investors, how firms exploit inefficient prices and incite distortion, and the effects of managerial reasoning. biases. More theory and testing of the effects of sentiment on financial decisions and aggregate outcomes is needed. In particular, it is considered that the time has come to move beyond behavioral finance to social finance, which studies the structure of social interactions, how ideas spread and evolve, and how social processes affect financial outcomes (David Hirshleifer, 2015).

Finance is in the midst of a paradigm shift, from a neoclassical framework to a psychologically based framework. Behavioral finance is the application of psychology to financial decision-making and financial markets. Behavioral finance advocates the process of replacing neoclassical assumptions with behavioral counterparts. In doing so, it identifies possible directions for the behavioralization of frameworks used to study beliefs, preferences, portfolio selection, asset pricing, corporate finance, and financial market regulation. The intention is to provide a structured approach to behavioral finance in terms of underlying psychological concepts, formal framework, testable hypotheses, and empirical findings. A key theme of this paper is that the future of finance will combine the realistic assumptions of behavioral finance with the rigorous analysis of neoclassical finance (Hersh Shefrin, 2009).

Behavioral finance does not assume rational agents or markets without transaction costs. It suggests that the institutional environment is extremely important. The starting point is bounded reason. Paul Slovic (1972) writes that “a full understanding of human limitations will ultimately benefit the decision maker more than naive trust in his infallible intellect.” The fact that economic and financial intuition is fragile may conflict with our aspirations for humanity, but it seems more plausible than the opposing view that investors and advisors (both bankers and managers) know exactly what they are doing.

Behavioral finance studies how psychology affects financial decisions in households, markets, and organizations. The main question is: What do people do and how do they do it? Research methods are mostly (but not exclusively) inductive. Researchers collect “facts” about the behavior of individuals (based on experiments, surveys, field studies, etc.) and organize them into a number of “super-facts.” The psychology of decision-making can be explored through several methods. A quarter of a century ago, much of the effort was directed toward cognition. Consider, for example, the heuristics and biases literature pioneered by Tversky and Kahneman (1974) and Kahneman and Tversky (1979). Their focus was primarily on questions such as: How do people think? How do they make decisions? Current work continues to be based on cognitive research. In addition, it studies emotion (state, affect) and social psychology (especially the herd effect).

What has been learned? The central vision of behavioral finance is described in Barberis and Thaler (2003), Daniel et al. (2002), De Bondt (2002, 2005, 2008), Dreman (1995), Shefrin (2001a, 2002) and Thaler (1993).

Behavioral finance argues that some financial phenomena can be plausibly understood using models in which some agents are not fully rational. The field has two strands: the limits of arbitrage, which argues that it may be difficult for rational traders to undo the dislocations caused by less rational traders; and psychology, which catalogs the kinds of deviations from full rationality that we might expect to see (Nicholas Barberis and Richard Thaler, 2002). Overconfidence has been shown to be “one of the most consistent, powerful, and widespread cognitive biases.” Overconfidence causes the trader to overestimate the accuracy of his private information, as well as his ability to obtain information. Our work shows that

overconfidence hurts the retailer's profits and may even eliminate the benefits of information. Conversely, the supplier can benefit from the retailer's overconfidence. It is demonstrated that this bias, with an endogenous information acquisition effort, can coordinate the supply chain to reach its first reference point (Jialu Li, Meiying Yang, 2018).

3. Characteristics of Behavioral Finance

Efficient market theory reached the height of its dominance in academic circles around the 1970s. Belief in the theory was eroded by a succession of anomaly discoveries, many in the 1980s, and by evidence of excessive volatility in returns. The financial literature of this decade and beyond suggests a more nuanced view of the value of efficient market theory and, beginning in the 1990s, a flourishing of research on behavioral finance. Some important developments since the 1990s include feedback theories, models of the interaction of smart money with ordinary investors, and evidence of obstacles to smart money (Robert J. Shiller, 2003).

Behavioral Finance and Efficient Market Hypothesis have different types of perceptions on the financial literature. While the efficient market hypothesis claims that people are rational investors who are an important part of the financial market, behavioral finance, which is an alternative model, accepts that people are normal and can be irrational. When considering the efficient market hypothesis, it is assumed that the price in the financial market will reach equilibrium because prices are informationally efficient. However, behavioral finance claims that investors tend to have some psychological and emotional biases that lead to irrationality. Both new and old concepts try to find solutions to economic and financial problems. Therefore, the hypotheses and research for these two different models play a crucial role in understanding and preventing financial crises. Otherwise, it will be difficult to solve the basic problem of economic and financial crises. Therefore, behavioral finance and the efficient market hypothesis, which play an essential role in every branch of finance, will be compared (Hakan YILDIRIM, 2017).

Creating and protecting financial wealth is one of the most important roles of modern societies. People will commit to working hard and saving for future generations only if they can be sure that the efforts they make every day will be rewarded with a better standard of living. This, however, can only be achieved with a well-functioning financial market. Unfortunately, a breakdown of the financial system as in the great financial crisis of 2007 and 2008 destroys confidence in this important social arrangement. To avoid such crises, we need to improve our understanding of financial markets, which, until now, have been built on completely unrealistic assumptions about the behavior of the people who act in them. The most fundamental and at the same time the most questionable in modern economic theory is the assumption of the complete rationality of economic agents who are assumed to maximize their utility functions according to their individual constraints or, in mathematical language, solve well-defined and precisely formulated. constrained optimization problems (Evstigneev, Hens and Hoppe, 2016).

4. The general objective and specific objectives of behavioral finance

The general objective of Behavioral Finance is to provide an understanding of the financial mechanisms that govern the financial behavior of economic organizations (entities) starting from the explanation, from a psychological perspective, of aspects susceptible to irrationality in investor behavior, including the study of the potentially irrational dimension of the evolution of financial markets.

A first specific objective is to present the differences between behavioral finance and traditional finance. In this sense, this book emphasizes the fact that in behavioral finance, for example, the impact of emotions on financial decisions is studied and

aspects such as market psychology, the limits of rationality, market equilibrium and the limits of arbitrage are emphasized. On the other hand, within this first specific objective of this article, it is aimed to highlight the fact that behavioral finance has both strengths and weaknesses.

Behavioral studies have four major advantages.

First, they have proven to be productive. For example, they have led to a number of new empirical findings.

Second, with its focus on impediments to optimal decisions, behavioral finance brings a pragmatic approach to the study of financial decisions. For example, behavioral finance perspectives help to understand the relationship between a firm's investors and its managers. Certainly, the behavioral approach suits business schools whose goal is to educate managers and improve expertise.

Third, behavioral finance brings a new type of discipline to the social sciences, which involves synthesizing data from multiple sources.

The fourth strength of behavioral finance is the simple fact that it stimulates education. People and Money: What could be more fascinating? Behavioral finance is probably a social science but with strong social as well as scientific emphases.

Behavioral finance also has weaknesses:

A first weakness of behavioral finance is that it lacks the core of neoclassical finance, and thus lacks discipline. Indeed, a number of recent papers have identified limitations of the theory in explaining real-world investor behavior.

The second weakness can be described by analogy. Just as a study of the economic function of payments and settlements cannot tell us much about the practical organization of the payment system, psychological mechanisms cannot provide an adequate interpretation of economic and financial events.

Third, behavioral finance should go beyond typical studies. Otherwise, too much behavioral research would remain unintelligible.

A second specific objective of Behavioral Finance aims to identify and present to what extent cognitive errors (conservatism, confirmation bias, representativeness or investment stereotyping, cognitive dissonance, illusion of control, anchoring and adjustment, mental accounting, information availability) as well as emotional errors (loss aversion, regret aversion and the status quo effect, overconfidence, mood effect, herding behavior) can affect the financial behavior of institutional investors and beyond. Behavioral aspects in human risk management are also highlighted.

A third specific objective of Behavioral Finance is to develop a practical component, namely that of behavioral analysis. The study of behavioral analysis is tested through multiple topics such as investor behavior on the capital market, identifying fiscal behavior at national and international levels, testing behavioral significance in the lending process, determining the investor's risk profile.

A fourth specific objective of Behavioral Finance is to highlight a practical component in the field of fundamental analysis that involves evaluating the intrinsic values of financial assets through the study of economic and financial indicators at both the micro and macroeconomic levels (including highlighting the factors influencing interest rate risk, currency risk or dividend policy) in order to reveal so-called financial anomalies.

A fifth specific objective of Behavioral Finance is to provide a practical component in the field of technical analysis, which is based on the study of past values of financial asset prices in order to identify useful trends for substantiating investment decisions (for example, determining trends associated with moving averages, through whose extrapolation future values of prices can be predicted. Obviously, the success of investments using technical analysis contradicts the weak form of the Efficient Markets Hypothesis).

A sixth specific objective of Behavioral Finance is to signal and incite readers,

obviously from a didactic point of view, regarding the role and importance of financial education - the path to personal development, suggesting that they pay increased attention to planning multiple financial objectives and strategies throughout the investor's life stages.

5. Final conclusions

Regarding the corroboration of the content of Behavioral Finance with the expectations of stakeholders, I can mention that this content was finalized following investigations carried out both in the national and international literature and practice of behavioral finance, but also as a result of documentation carried out on the way this discipline is taught in prestigious international universities.

The in-depth objectives of behavioral finance allow us to ensure that after completing this article you will be able to:

- Understand what behavioral finance is, how it differs from modern finance and how it affects financial markets;
- Describe the most common self-deception biases, their causes and potential measures you can take to prevent them;
- Understand cognitive biases and explore their root causes with real-life examples;
- List the most common emotional biases and discuss their causes with examples;
- Understand loss aversion and other biases that contribute to its effect;
- Study pasture-related biases and other social factors that distort decision-making.

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