The impact of behavioral factors on investment decision making of investors: Special reference to study on Colombo Stock Exchange

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Abstract

The theory of traditional finance presumed that investors are rational decision makers in stock exchanges and concerning the risk return trade-off and maximizing the utility of their investment. However, behavioral finance studies exposure that human do not behave rationally and there is an impact of the psychology on the financial practitioners and the subsequent effect on markets. This study investigated the impact of behavioral factors on investment decision making of investors in CSE. Four factors, i.e. mental accounting, cognitive dissonance, conservatism bias and familiarity, were used as the independent variables while investment decision making was taken as the dependent variable. A structured questionnaire was distributed among 62 investors in the Colombo Stock Exchange and the sample was selected by using convenient sampling technique from the investors in Anuradhapura district. Multiple regression analysis is used as the main analytical tool to test the hypothesis and Cronbach's alpha was applied to measure the internal consistency of the questionnaire. The findings of the study suggest that conservatism bias and familiarity have a positive and significant impact on investment decision making. Moreover mental accounting and cognitive dissonance does not have a significant impact on investment decision making. The results of this study are important for investors in their decision-making process and are able to provide insights into the behavioral factors such as conservatism bias and familiarity that have a significant effect on investment decisions. The findings of this research would be used by investors, investment managers and policymakers as a guideline for better decision-making and provide future research directions for scholars.

Keywords: *Cognitive dissonance, conservatism bias, familiarity, investment decision making, mental accounting.*