

## BEHAVIOURAL FINANCE AND INVESTORS IN TOURISM

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**Abstract:** Behavioural finance investigates the psychological and sociological issues that influence the process of decision-making of individuals, groups, and organizations. This paper discusses the general principles of behavioural finance in tourism investors such as financial cognitive dissonance, overconfidence, prospect theory, and regret theory, which are the source of mistakes and errors in business. Those who invest in tourism (tourism companies and hotel facilities) should be aware of the biases associated with the general principles of behavioural finance to be able to resolve these "mistakes and errors" when choosing the investments matching their personality traits.

**Key words:** behavioural finance, investors in tourism, investment, decision-making

### INTRODUCTION

According to Ongkrutaraksa and Muhammad, [21, 25] there is a clearcut theoretical difference between modern finance (which emphasizes the efficient market hypothesis and the modern portfolio theory) and new finance (which "investigates the psychological and sociological issues impacting the decision-making process of individuals, groups, and organizations"). Modern finance (the negative one) can incur substantial costs because of excessive reliance on normative assumptions; can result in absurd rationalization because of the unrealistic characterization of individuals who directly affect the market operations; focuses more on the outcomes of the ideal individual decision-makers and less on the actual decision-making process itself; is normative; limits the progress in theoretical development because it tends to be more immune from falsifiability without the confirmation/disconfirmation from empirical findings and alternative paradigms. New finance (the positive one) lacks the well-structured theoretical guidance from the normative approach. [5,22]

Behavioural finance, defined as "an area of study that proposes psychology-based theories to explain market outcomes and anomalies" [1,11,14], relies on an important interdisciplinary relationship. [2,5,6,18] (Figure 1).



**Figure 1. Disciplines involved in behavioural finance**

Source: [35]

Behavioral finance principles include [3,35]: anomalies, behavioral economics, cascades, chaos theory, cognitive bias, cognitive dissonance, cognitive errors, contrarian investing, crashes, disposition effect, economic psychology, fads, fear, financial

psychology, gender bias, greed, groupthink theory, herd behavior, heuristics (anchoring, availability bias, gambler fallacy, overconfidence, representativeness), hindsight bias, irrational behavior, irrational exuberance, manias, market inefficiency, overconfidence bias, overreaction, panics, preferences, prospect theory (framing, loss aversion, mental accounting, regret aversion, self-control), regret theory, risk perception, and under-reaction.

## MATERIALS AND METHODS

The material used in this paper consists in literature on behavioral finance and on the biases associated with the general principles of behavioral finance. The research method is bibliographical.

## RESEARCH RESULTS

Tourism investors invest in tourism companies and hotel facilities. In theory, their investment management focuses on investment objectives, investment products, investment evaluation, investment strategies, portfolio construction, and performance evaluation [2,9,25,32,34,39]. In practice, the “investment management process involves the following steps: establishing investment objectives, [1,4,5,6] establishing an investment policy, selecting a portfolio strategy, selecting the specific assets, and evaluating performance” [32]

Investors make typical mistakes (i.e., behavioural biases): if the asset location is too much influenced by these mistakes, investors risk to lose money. Mistakes made by investors in tourism companies and hotel facilities can be explained by behavioural finance [7,10,11,12,15,16,18,19,21,22,28,32,37,38]:

- Anchoring is “a heuristic that describes the subconscious use of irrelevant information, such as the purchase price of a security, as a fixed reference point (or anchor) for making subsequent decisions about that security” [17,23]. That is why investors need to realize how the information is presented.

- Attention/Availability/Recency bias is “the tendency for people to overweight new information or events without considering the objective probabilities of those events over the long run”: tourism companies [26,30,31,41,42] and hotel facilities [27,29,33,36] more frequently advertised in the media are remembered more quickly by tourism investors who avoid considering bad or inaccessible information.

- Confirmation bias is “the tendency of human beings to actively search for, interpret, and retain information that matches their preconceived notions and beliefs” (Investopedia). This explains why investors avoid critical opinions and reports, considering only positive ones.

- Disposition effect. Disposition is “the act of selling or otherwise ‘disposing’ of an asset or security” (Investopedia). In this case, “gains are realized too early and losses are realized too late.” A possible explanation for this bias is mental accounting.

- Favourite long-short bias is “an investing strategy that takes long positions in stocks that are expected to appreciate and short positions in stocks that are expected to decline” (Investopedia): investors “bet on the long shot because it promises very high returns, ignoring that the likelihood of the long shot winning makes profit impossible.”

- Framing bias / effect is “a powerful communication tool used to convince people to take an action based on their emotional response, rather than on the facts of the proposal” (Investopedia): investor’s decision “is based largely on how facts are presented in statistical terms,” ignoring that “Four out of ten are winners” (optimistic perspective) is the same as “Six out of ten are losers” (pessimistic perspective).

- Gambler's / Monte Carlo fallacy is "the erroneous thinking that a certain event is more or less likely, given a previous series of events" (Investopedia): the effective probabilities are greatly underestimated (assuming that "prices are about to drop, the investor sells too soon") or overestimated ("assuming that prices are about to recover soon, the investor sells too soon").

- Get-even bias. Get even means "inflict trouble or harm on someone similar to that which they have inflicted on oneself" [24, 40]: once the investor has lost money, he takes a greater risk to make up for it, potentially losing even more money.

- Hindsight bias is "a psychological phenomenon that allows people to convince themselves after an event that they accurately predicted it before it happened" (Investopedia): the investor has a post factum explanation for everything, which keeps him from learning from his own mistakes.

- Home bias is "an investor's preference to invest primarily in domestic equities rather than diversifying with foreign investments" (Investopedia): the investor prefers to buy a hotel facility from a company in his home country because it seems more trustworthy (partially due to local media).

- Loss aversion is "a phenomenon where a real or potential loss is perceived by individuals as psychologically or emotionally more severe than an equivalent gain" (Investopedia): if the investor checks his stock performance too often, he may see he has lost money and sells everything off. The more he can keep his curiosity at bay (checking his stock performance less often), "the more likely he is to turn a profit with his investments, on condition that his portfolio is broadly diversified."

- Mental accounting refers to "the different values a person places on the same amount of money, based on subjective criteria, often with detrimental results" (Investopedia): the investor makes distinctions that do not exist financially: he "is too quick to sell when he earns a profit and he is too slow to sell when he sustains a loss."

- Overconfidence bias is "a cognitive error that leads individuals to overestimate their abilities and knowledge, leading to poor decision making" (Investopedia): most often, an investor overestimates his own abilities, thinking he is above average, particularly when the market is on the rise.

- Regret avoidance is "the tendency for people to make emotional, rather than logical decisions in order to avoid feeling regret" (Investopedia): if one invests in a niche company or facility that does not perform as the investor hoped, he regrets this "more than the failure of a blue-chip stock" ("stock issued by a large, well-established, financially-sound company with an excellent reputation" – Investopedia) because other investors "have made the same mistake and, therefore, his decision to buy no longer seems that wrong."

- Representativeness bias. Representativeness is "the state or quality of being accurately representative of something" [43]: the investor "tends to think in terms of schemes and stereotypes from the past, which makes him arrive at a result too quickly, based on imprecise information."

## CONCLUSIONS

The conclusions of the literature presented above are:

- There is a clearcut theoretical difference between modern finance (emphasising the efficient market hypothesis and the modern portfolio theory) and new finance (investigating "the psychological and sociological issues impacting the decision-making process of individuals, groups, and organizations");

- Market outcomes and anomalies (mistakes and errors) can be explained based on psychology and sociology, i.e., on behavioural finance;
- Investment management focuses on investment objectives, investment products, investment evaluation, investment strategies, portfolio construction, and performance evaluation;
- Investment management process involves “establishing investment objectives, establishing an investment policy, selecting a portfolio strategy, selecting the specific assets, and evaluating performance”;
- Behavioural finance relies on numerous principles, most of which represent biases;
- Tourism investors should be aware of the biases associated with the general principles of behavioural finance to be able to resolve “mistakes and errors” when choosing “the investments that match their personality traits.

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