

The Impact of Behavioral Biases on Stock Investment Decisions: Evidence from Kaluthara District in Sri Lanka

M.N.M. Fernando¹, A.L. Gunasekara²

Department of Finance, University of Kelaniya, Sri Lanka^{1,2}
nisharamalkifd@gmail.com, gunasekaral@kln.ac.lk

Abstract

Introduction: This research investigates the impact of behavioral biases on individual investors' decisions within the Colombo Stock Exchange, focusing on the Kalutara district in Sri Lanka. The study employs behavioral finance to uncover biases such as anchoring, overconfidence, disposition effect, and herd behavior, examining their collective influence on decision-making. The research addresses a gap by specifically exploring investor biases in the Kalutara district, considering the unique features of the Colombo Stock Exchange.

Methodology: Guided by a positivist research philosophy and employing deductive research logic, the study utilizes a quantitative approach. The conceptual framework includes biases like the disposition effect, overconfidence, anchoring, and herding. The target population consists of individual investors actively participating in the Colombo Stock Exchange, with a representative sample of 103 investors selected through simple random sampling and carefully stratified based on demographic variables. Reliability testing indicates acceptable internal consistency (Cronbach's alpha = 0.634), while validity assessment suggests room for improvement (Cronbach's alpha = 0.490). With an 88% response rate, the demographic profile reveals a predominantly younger investor population, male dominance in stock investment, and a well-educated and diverse sample.

Findings: The analysis of behavioral biases through a rating scale demonstrates a moderate level of explanatory power, with 23.4% of the variability in investment decisions explained by considered biases. The regression model highlights the significance of predictors, with disposition effect and anchoring exhibiting strong associations. Contrary to expectations, overconfidence bias has only a marginal effect, emphasizing the importance of exploring contextual variations. Anchoring bias emerges as the most influential factor, underscoring the need for preferential consideration when examining behavioral biases in the Colombo market.

Conclusion: The study challenges existing literature by identifying anchoring bias as the sole significant factor in investment decisions, emphasizing the importance of tailoring analyses to specific market conditions and demographics for a comprehensive understanding of investor behavior in the Kalutara district.

Keywords: Behavioral Bias, Investment Decision, Stock Market, herding bias, overconfidence bias, anchoring bias, disposition effect