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A Review of Psychological Well-Being on Investment Decision Making of Investors

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Abstract: Investment decision-making is a complex process influenced by various psychological factors that shape an investor's behavior and financial choices. This review explores the relationship between psychological well-being and investment decision-making, focusing on how emotional, cognitive, and behavioral factors impact investors' ability to make sound financial decisions. Illustration from existing literature, the study examines the role of psychological attributes such as risk tolerance, stress levels, optimism, and cognitive biases in shaping investment outcomes. The review emphasizes the need for financial advisors and policymakers to consider psychological well-being as a critical factor in investor education and support programs.

Keywords: Investment, Decision-Making, Psychological Well-Being, Financial, Investor

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INTRODUCTION

Investment decision-making is a multifaceted process influenced by a combination of economic, social, and psychological factors. Among these, psychological well-being has emerged as a critical determinant of how investors perceive and respond to financial opportunities and risks. While traditional investment theories often emphasize rational decision-making, real-world scenarios demonstrate that emotions, cognitive biases, and mental health significantly impact investors' choices.

Psychological well-being encompasses emotional, cognitive, and social aspects that influence an individual's ability to think clearly, manage stress, and maintain resilience in the face of challenges. For investors, a stable psychological state is vital to making rational decisions, especially in volatile market conditions. Conversely, poor psychological health, such as high levels of anxiety or stress, can lead to impulsive actions, risk aversion, or susceptibility to herd behavior.

This review aims to explore the interplay between psychological well-being and investment decision-making, highlighting key psychological attributes such as risk tolerance, emotional stability, and cognitive biases. By analyzing existing research and theoretical frameworks, the study seeks to provide insights into how psychological factors shape investor behavior and impact financial outcomes.

INVESTMENT

An investment can be anything from a financial commitment to an outlay of time or energy with the expectation of a return. In most cases, when someone invests money, they hope to get a return on their investment. And investors aren't afraid to provide a little now in exchange for a bigger payoff later on.

When you invest, you give up some of your current wealth in exchange for a potentially larger payout in the future. Classification, mix, amount, timing, grading, etc. are all important considerations. It is the hope and expectation of future profit that motivates people to invest. The value of return could range from the lowest to the biggest, depending on the hopes. So, investing carries with it an inherent degree of risk. A potential reward is worth taking a chance on. From a macroeconomic vantage point, economic theory examines investment decisions made by individuals. According to Merikas, Vozikis, and Prasad (2004), the primary factor determining the wealth maximisation of retail investors is their consumption and investing choices.

The goal of investing is to increase one's wealth through risk-taking and speculation. Depending on the type of investment, the goal of making an investment could be to raise income in one of three ways: interest, dividends, or capital appreciation. Stocks, debentures, insurance, and certificates of deposit at the post office will all reflect this. You might think of these investing opportunities as financial wagers. From a theoretical perspective, there are multiple ways to define investment. It has multiple potential applications, to put it broadly. Returns on investment (ROI) will fluctuate often due to factors such as the nature of the investment, the length of time it has been invested, and market fluctuations. According to Sharma and Kaur (2016), the main motivation behind investing is to generate additional income. We must first discuss the features of investments before we can examine the elements that impact the decisions made by retail investors.

CHARACTERISTICS OF INVESTMENT

Figure 1: Characteristics of Investment

Return: The possibility of a return classifies all investment avenues. An increased rate of return is the primary motivation for investment. The returns could come in the form of monetary gains or an increase in the value of the investment. The likelihood of a return on investment is dependent on a number of factors, including the time until maturity, the demand for capital, the rate of economic growth, and stock market fluctuations (Sharma & Kaur, 2016). One way to determine ROI is by using the formula:

$$ROI = (GOI-COI)/ (COI)*100$$

Where, GOI = Gain from Investment COI = Cost of Investment

Risk: It represents the possibility that the actual return will differ from the expected return. Your investment's likely return is the likelihood that you will earn a profit or incur a loss. The bulk of investors prefer to stick to tried-and-true investments because they are afraid of losing their money. They are prepared to take risks, but they want maximum rewards. There are several ways to classify risk:

Systematic risk: Inherent risk existing in the stock market. This risk applies to all sectors, and it can be controlled. It is volatility risk.

Unsystematic risk: This risk is unique to a specific company. It is also classified as specific risk or residual risk.

Safety: A secure investment is one that promises a return within the time allotted. Retail investors anticipate a security element in their investments. On maturity, investors anticipate receiving their initial cash together with guaranteed returns. A steady stream of profits is what investors seek.

Liquidity: The ease with which assets can be turned into cash is known as liquidity. Consideration of liquidity is given when the investment is made to address potential financial emergencies. Investment & savings accounts in money markets are the most liquid.

DECISION MAKING

The capacity to mentally narrow down a set of potential actions to a single, optimal one is known as decision making. Rather than being based on pure chance, it is tailored to each person's specific requirements, background information, life experiences, values, & worldview. Achieving one's objectives requires constant engagement with one's surrounding environment. There are three stages to the managerial decision-making process, as Simon (1977) outlines. Discovering the need to make a decision, considering all of the available options, and settling on one are the first, second, and third stages of this process, respectively.

Decision making is shown to be a procedure of methodical information collection in Behling, Gifford, & Tolliver (1980) and Henderson and Nutt (1980). Afterwards, assessing the collected data in relation to the desired outcomes. Decisions are sometimes based on logic and reasoning, while other times they are based on intuition, or the evaluator's emotional state. The decision, according to Butler (1992), is the best way to carry out the proposed task since it is a chosen option from all the accessible possibilities. According to Leonard, Scholl, and Kowalski (1999), decision making is a crucial activity for any organisation. Beyond that, if the managers' decision-making is of high quality, the organisation will succeed & expand; otherwise, it will fall.

Decision making is an ongoing process that involves identifying all of the potential possibilities, selecting one, and then evaluating the results of that choice (Minecemoyer and Perkins, 2001). Interweaving excellent decision-making requires skills, and those are:

a) Defining the Problem.

b) Identifying all the possible alternatives.

c) Recognising their risks and consequences.

d) Selecting an alternative, after analysis their risks and consequences.

According to Bierman (2005), the information process is the conceptual basis of decision making. Intuition can be a powerful tool for making important decisions. There are two stages to making a decision based on emotions. Two types of knowledge are involved in this process: implicit knowledge, which is based on past decisions' outcomes & explicit knowledge, which is the emotional weight of this implicit knowledge.

According to Wang and Ruhe (2007), decision making is the mental process of selecting one course of action from a set of possible alternatives using predetermined criteria. The process of selecting one option among several to achieve an objective is known as decision making (Baiocco, Laghi, & D'Alessio, 2009). Albert (2011) state that the ability to make decisions is defined as the skill of being able to recognise and weigh the pros and cons of different options.

Omotola (2012) went on to say that uncertainty regarding the next step is what makes decision making so difficult. This action is deliberate and planned with the future in mind. Before making a final call, decision makers must go through a lengthy process. The ability to choose the optimal course of action from a set of alternatives is what decision making is all about, according to Subasree and Nair (2014). The capacity to investigate and weigh the benefits and drawbacks of options, and then to firmly accept responsibility for the outcomes of those decisions. The ability to make wise choices regarding one's life, such as a job path, marriage partner, food kind and quantity, etc., is granted to teenagers by this.

The cognitive process of decision making, according to Çiftçi (2015), involves reasoning, thinking, analysing, and controlling, and it gets more complex with time. Everyday life, according to Prezenski (2017), involves a series of decisions that are influenced by the feedback from previous decisions. Thinking, paying attention, and remembering are the three pillars of decision making, which is a highly cognitive process. Decision making is a cognitive ability that is associated with social motivation, reward sensitivity, & environmental distractions, according to Ciranka (2019).

Given these definitions, it's clear that decision making means picking the greatest option from a set of possibilities. Age is a factor in the development of this cognitive capacity. The ability to think, reason, relate, & comprehend has a significant impact on an individual's decision-making aptitude. In the course of a typical day, one must make a decision. In one's life, every choice, no matter how large or small, plays a crucial significance. When deciding between multiple options, one's knowledge, experience, reward sensitivity, and even feedback from past decisions all play a role. The process of decision-making is clearly illustrated in figure 2.

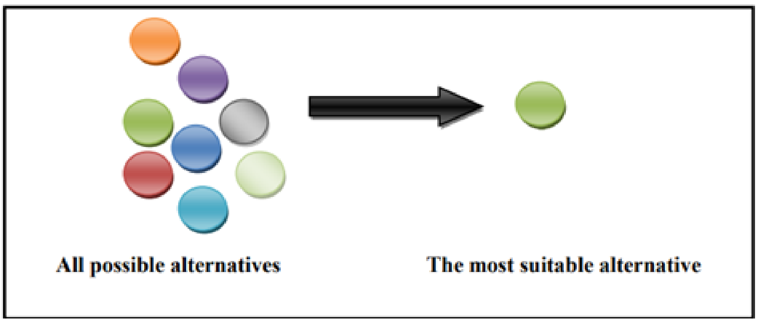

Figure 2: Decision making

Process of decision making

The scientific process of decision making entails the following steps: defining the problem or issue that needs resolving, collecting relevant information from all available sources, brainstorming potential solutions, weighing the benefits and drawbacks of each option, selecting one based on the analysis, putting the solution into action, or finally, reflecting on the decision and its outcomes.

Since an individual's decision ultimately results in a resolution to an issue, it is also thought of as problem-solving. Achieving one's objectives requires constant engagement with one's surrounding environment. The decision-making process, as shown in figure 3: The process of decision-making is clearly illustrated in figure.

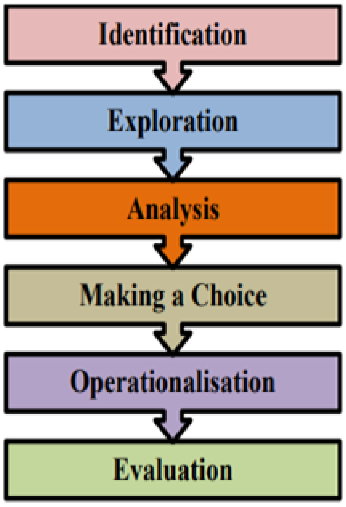

Figure 3: Process of decision making

Factors affecting decision making

The many aspects that impact a person's decision-making process must be understood in order to fully grasp the decision-making process itself. Figure 4 and the following discussion provide examples of the factors that Dietrich (2018) identified as having an effect on people's decision-making processes:

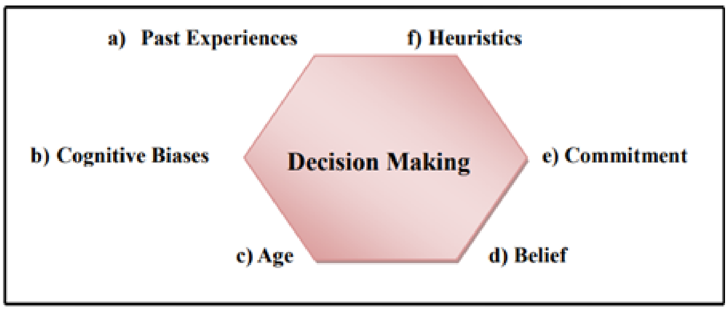

Figure 4: Factors affecting decision making

Characteristics of decisions making

A person, an object, or a location can be described by its unique traits. The following are some of the commonalities shared by all decision-making processes, as stated by Singh and Ahuja (2018) and illustrated in figure 5:

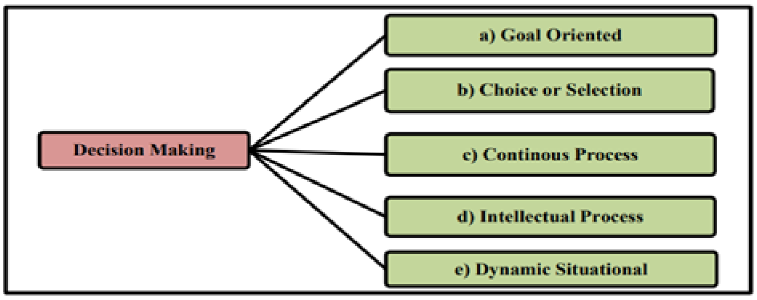

Figure 5: Characteristics of decision making

Decision making styles

Individuals differ in the decision-making processes they employ. It is the predominance of one quality that defines a style. Immature, illogical, and emotionally dominant decision-making is a hallmark of adolescence. The maturation of the brain continues throughout adolescence. Both the amygdale and the pre-frontal cortex are still in the process of maturation. Thought, logic, and problem-solving are centred in the pre-frontal cortex, while emotional processing takes place in the amygdale. Two main ways of making decisions emerge as a result of different stages of brain development. The two decision-making styles were also thoroughly described by Pilipczuk (2014). What follows is a discussion of the two primary styles:-

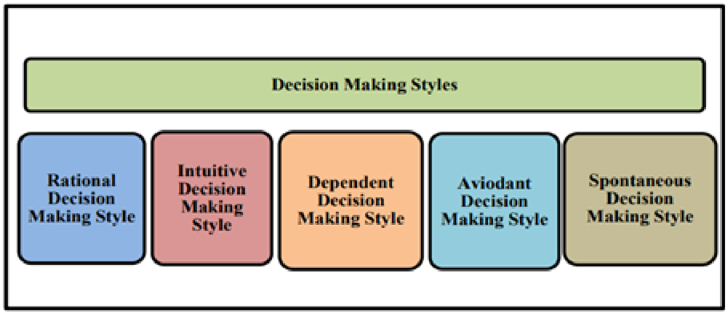

Figure 6: Decision making styles

PSYCHOLOGICAL WELL BEING

When one is mentally healthy, they are able to assess and accept their own strengths and weaknesses, know what they want out of life and how to get it, have strong relationships with others, understand their surroundings, and are prepared to face life's challenges head-on by maximising their own potential in all areas of behaviour, emotion, and performance. Mental health is a multi-faceted concept that includes hope, self-control, enjoyment, curiosity, and a lack of negative emotions and social isolation (Sinha 1992). Bhogle (1995) state that a person's psychological well-being is characterised by the following: a sense of purpose in life, high self-esteem, contentment, self-control, social support, absence of suicidal thoughts and feelings, and overall competence. The wide concept of psychological well-being encompassed by Diener, (1999) includes both positive and negative aspects. Positive well-being includes feelings of joy, mental health, & happiness. Negative well-being includes feelings of shame, worry, stress, and depression. Life satisfaction includes contentment with one's home life, job, health, finances, and self-esteem.

Dimensions of psychological well being

A construct's dimensions are the many different ways it can be described. There are five aspects to one's mental health, say Sisodia (2012). The effective functioning of one's life is influenced by each dimension in its own unique way. Every one of these things is crucial for a person's growth in self-awareness & environmental literacy, as well as for overcoming the obstacles that pop up in everyday life. When taken as a whole, the following criteria constitute psychological wellness. The components of psychological wellness are also shown in Figure 7.

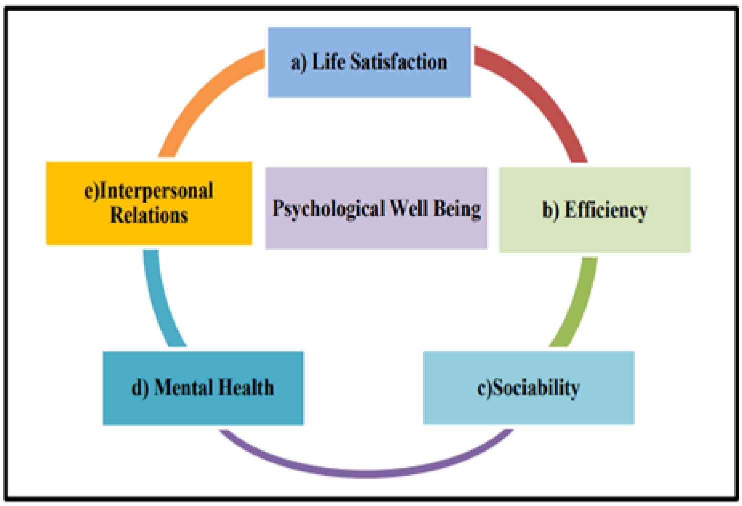

Figure 7: Dimensions of psychological well being

Characteristics of psychological well being

A person or thing's characteristics are the traits that define them. A theoretical model of psychological well-being was established by Ryff and Keyes (1995). The following are some of the features of psychological wellness that this model predicts, as seen in figure 8:

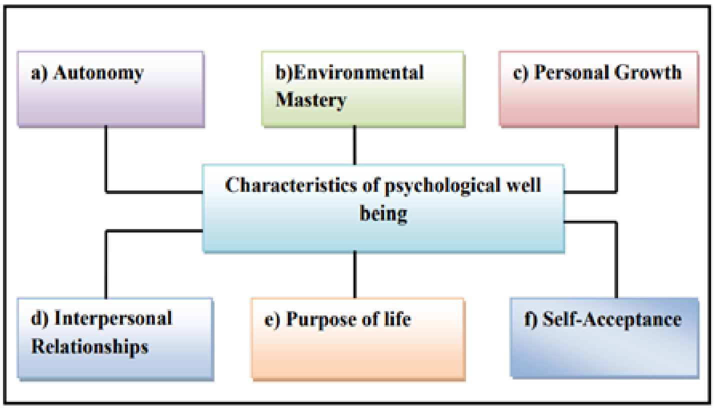

Figure 8: Characteristics of psychological well being

LITERATURE REVIEW

The Rise of Behavioural Finance

The "economic man model" and other theories put forth by the greatest economists of all time laid the groundwork for economic theory, which in turn led to the development of many other models, such as the

Efficient Market Hypothesis, the Markowitz Efficient Frontier, the Capital Asset Pricing Model, and many more. The reason these models were so easy to use was because they assumed that humans, the most variable and unpredictable part of the study, were logical and mechanical and not likely to exhibit any abnormal behaviour. The ability to maximise outcomes through the use of full knowledge and thorough consideration of different alternatives is what we mean when we talk about rationality. This process ensures that human investors do not make any mistakes or ambiguities. Bhalavastava (2004)

In their 1974 first research publication on the subject, Daniel Kahneman " Judgement under Uncertainty: Heuristics and Biases," challenging the assumption of human rationality that had been dominant for many decades. In addition, the new "Prospect Theory" put out by Kahneman and Tversky (1979) in the journal Econometrica further questioned the rationality argument and radically altered the perspective on investment decision making. Prospect Theory uncovered patterns of behaviour that rational decision-makers had never seen before. Two human failings, according to Kahneman (1979) remarkable study, are emotions & lack of comprehension or cognitive limitations. An important and noteworthy discovery in the Israeli psychologists' Prospect theory was the disparity between the way people make decisions involving gains and ones involving losses. A person who is risk averse when making a decision with potential benefits might switch to a risk taker when faced with a decision with potential losses, according to research by Kahneman and Tversky. The extraordinary finding by Kahneman and Tversky brought them immense fame. That is why, in 2002, Kahneman's work on Prospect Theory was honoured with the Nobel Prize in Economics. Since the esteemed prize cannot be bestowed after death, Tversky's untimely demise in 1996 prevented him from sharing in the honour with another deserving individual.

Humans' irrational behaviour had been the subject of hushed discussions amongst a handful of researchers prior to the Prospect Theory. One of the most notable is ambiguity aversion, a phenomena in behaviour postulated by Daniel Ellsberg in 1961. It states that individuals will rather take risks based on known probability than unknown ones. But it was the Prospect Theory that got academics to pay attention.

Academic economists Richard Thaler (1999), David Bell (1996), Meir Statman (1995), and others were inspired by the groundbreaking Prospect Theory to launch a new area of study called Behavioural Finance. "Behavioural Finance examines how financiers struggle to find their way via the give and take between risk and return, one moment utilising pleasant computation and the next yielding to emotional impulses," writes Peter Bernstein, founder and editor of The Journal of Portfolio Management, in his remarkable landmark book "Against the Gods The Remarkable Story of Risk" published in 1996. A capital market that doesn't always act in accordance with what theoretical models anticipate is the end outcome of this amalgam of the rational and the irrational.

Behavioural finance advocates have gathered a plethora of intriguing, scientifically proven hypotheses to back up their claims that people act in a quasi-rational manner. In their 1984 Journal of Financial Economics article "Explaining Investor Preference for Cash Dividends," professors Meir Statman and Hersh Shefrin of the University of Santa Clara first delved into the concept of "mental accounting" as it pertains to behavioural finance. Two schools of thought inside the human mind, one focused on the future and the other on the here and now, were postulated by Statman and Shefrin.

In their influential study titled "Does the Stock Market Overreact?", Richard Thaler and Werner DeBondt

(1985) showed that investors do not unbiasedly consider new information, but rather give more weight to new information and less weight to prior and longer-term data, leading to an overreaction. The study was presented at the Annual Meeting of the American Finance Association in December 1985. "Quasirationality is neither fatal nor immediately self-defeating," asserts Richard Thaler (1999).

Investment Behaviour of Individual Investors

Research on individual investors' market behaviour is extensive & covers a wide range of topics, including but not limited to: investment attitudes, planning and forecasting, adviser roles, post-investment behaviour, etc. The function of both past & future emotions in investment behaviour is examined experimentally in a study by Bosman Ronalld (2001). This work lends credence to the idea that risk-taking decision-making is systematically impacted by both expected and experienced emotions. Taking less risk is motivated by acute emotions caused by the decision circumstance owing to the presence of a salient danger, according to the results of the researchers' global risk experiment.

David Hirshleifer (2001) conducted research on the effects of imperfect memory on the best possible policy continuity. Individuals & businesses alike can recollect what they did in the past, but they can't always put their finger on why they did it. The study concludes that in a steady state, when faced with such memory loss, participants exhibit excessive inertia and opt to stick with previous policies or behaviours. In a volatile setting, though, the player may behave rashly and revert to an earlier course of action.

Researchers Ackert, (2003) looked into how emotions play a part in the stock market and found that, contrary to what most people think and what financial economists believe, emotions really help people make better, more rational decisions. Researchers found that there is a lot of evidence that people with happy moods are better able to organise & absorb information, and that they are also more likely to come up with creative solutions to problems.

The investment decision of a person faced with two uncertain investment projects, one with liquid assets & other with illiquid ones, was examined by Ludwig Alexander (2004) as part of their investigation on investing behaviour under uncertainty. The two projects had similar expected returns. People would rather have investments that can be quickly converted into cash than ones that are not, according to conventional opinion. But the study's authors found that gloomy decision-makers who use a pessimistic update-rule to revise their views would rather have illiquid assets than liquid ones. By taking into account decision-makers who maximise expected utility with regard to non-additive beliefs, the Chouquet Expected Utility (CEU) theory which encompasses ambiguous attitudes the researchers are able to explain this outcome. According to CEU theory, in sequential decision-making scenarios, the decision-maker's preferences do not remain static but rather evolve in response to fresh information. He chooses to sign contracts that ensure there will be no early liquidation of the uncertain long-term investment project because the pessimistic guy knows that his outlook will only worsen as more information becomes available.

Psychological Factors Affecting Individual Investment Behaviour

According to a survey of studies conducted by psychologists, the branch of social psychology known as economic psychology did not gain traction for a very long time. The Behavioural School of psychology was largely responsible for the first recorded studies in the field. Notable members of this school include Ivan

Pavlov (1846–1936), Edward Thorndike (1874–1949), John B. Watson (1878–1958), and B. F. Skinner (1904–1990). The Psychoanalytical School, an approach to treating mental disease and abnormal behaviour, was established by Sigmund Freud (1856–1939). The unconscious, the treatment of mental illness, the importance of intrinsic drive, and the impact of formative experiences on adulthood were central to Freud's theories. He proposed a three-part model of personality: id, ego, and superego. Aspirations may have just as much, if not more, of an impact on our mental development as our formative years of childhood, according to Carl Jung (1875-1961), Freud's most renowned pupil, in his 1912 remarkable work, The Psychology of the Unconscious. In his new theory of personality, he also divided people into eight categories according to their inclination towards sensing, reasoning, feeling, or intuiting, with extroversion and introversion occupying one side of the spectrum and these four qualities the other. The original personality type system was developed by Carl Jung.

Midway through the twentieth century, a group of psychologists who felt that psychoanalysis and behaviourism were overly reliant on biological reductionism and determinism established the Humanistic School. This method, which has Abraham Maslow, Carl Rogers, and Rollo May as its progenitors, prioritised self-actualization, wellness, originality, and one's inherent qualities. "Life is what you make it" was a central tenet of the Humanistic tradition. Cognitive psychologists, who followed the Humanistic School, viewed psychology as the study of human cognition and knowledge acquisition. In spite of the fact that the first known works in cognitive psychology are from the sixteenth century (e.g., Sir Francis Bacon (1561-1626), Galileo Galilei (1564-1642), and René Descartes (1560-1650), the true innovator in the field should be credited to George Miller. Miller stated in his 1956 article The Magical Number Seven, Plus or Minus Two - Some limits on our Capacity for Processing Information that humans can consolidate information so that they can process more in less time. In 1957, B F Skinner, who had previously worked as a behaviourist, published a paper titled "Verbal Behaviour" in which he analysed the way people appeared to communicate through writing and speaking. In his 1967 book on the subject, Ulric Neisser often seen as the field's progenitor described in great detail the ways in which human cognition governs behaviour. Attention, pattern recognition, information, memory, language, logic, and problem solving have been the primary subjects of study at this school.

The study of "personality" is also an important part of the field of psychology. Karl Rogers and Abraham Maslow's humanistic approach; Allport, Cattel, Zuckerman, et al.'s personality traits approach; Carl Jung's Neo-Freudianism; Karen Horney and Alfred Adler's Neo-Freudianism; Carl Rogers and Abraham Maslow's Psychoanalytical Approach; and Bandura, Rotter, Skinner, and others' learning theories (2009) are all well-known methods in the study of human personality.

Demographic Factors Affecting Individual Investment Behaviour

A person's demographic situation, together with their attitudes, personality, emotions, etc., greatly influences their investment decisions and actions. Men are more likely to take bold financial risks, according to a 2001 article by Brad Barber and Terrance Odean published in the Quarterly Journal of Economics titled "Boys will be Boys: Gender, Overconfidence and Common Stock Investment." The authors also touched on gender-specific financial practices. According to an intriguing study conducted by Myers (2002), women are more process driven than males, have a lower risk tolerance, and are less likely to over-confidence. In contrast, men are more result-oriented, goal-directed, and single-minded.

In a 2007 article titled "Investment Decision Making: An exploration of the Role of Gender" published in Decision, the journal of IIM, Calcutta, Yesh Pal Davar and Suveera Gill (2007) drew the conclusion from a thorough statistical investigation that females, in comparison to males, are less knowledgeable, have less self-assurance, and are less able to handle risk. As a result, they are more hesitant to invest in risky equity securities in the future, particularly when funds are scarce.

Using controlled studies, Besedes Tibor, Deck Cary, Sarangi Sidipta, and Shor Mikhael (2009) investigated how people make decisions when given several options. There was an objectively ideal alternative in each of the multiple-attribute choice tests given to the subjects, who ranged in age from eighteen and up. Subjects were merely asked to prioritise more money over less money, rather than their risk preferences, in order to rate the options. The experimenters made sure there was always the right answer for every activity, but they changed the amount of qualities and possibilities so the subjects couldn't see what it was. According to the results, the likelihood of choosing the best option decreased with increasing number of possibilities, and this drop was most noticeable for older individuals. Older participants were more likely to use less-than-ideal decision-making heuristics, according to the study's findings.

Risk aversion and ambiguity aversion were investigated by Borghans Lex, Golsteyn Bart H H., Heckman James J., and Meijers Huub (2009), who found that there are gender and psychological differences for these two phenomena. Ambiguity refers to the uncertainty that comes with not knowing the probability of future events, whereas risk is related to known probabilities. Students from a Dutch high school (ages 15–16) were the subjects of the study. Women are less likely to take risks than men, according to the study. In contrast to males, women do not necessitate additional compensation for the introduction of ambiguity beyond an initial range. There is no gender gap when ambiguity levels are high. Those who are less amiable, less neurotic, and more ambitious tend to be less risk adverse, according to the study. But ambiguity aversion is not linked to personality attributes.

Juan-Camilo Cardenas, Anna Dreber, and Essen Emma Von, Ranehill (2010) compares gender disparities in risk-taking and competitiveness among 9–12-year-olds in Sweden and Colombia, two nations with very different gender equality indices. The study evaluated competitiveness using four tasks: sprinting, skipping, math, and word search. Interestingly, the study reveals that both boys and girls in Columbia are equally competitive across all tasks. In Sweden, on the other hand, girls show greater performance shift competitiveness in certain tasks, while boys are more inclined to compete overall. While boys in both nations shown a greater propensity for risk taking than girls, the disparity between the sexes was more in Colombia than in Sweden.

From 2003 to 2009, Pelger Ines (2011) examines the investment habits of SMEs in Germany. According to the data, businesses with female owners are less inclined to invest, and when they do, they invest at a lesser rate on average than businesses with male owners. It is worth noting that women-owned enterprises do not have significant challenges when it comes to obtaining external financing, as seen by their low sensitivity to cashflow for investment. A review of the companies' declared investment objectives reveals that women-owners have lower levels of ambitious and growth-oriented goals, such as increasing sales, innovating, conducting research and development, and implementing new products. In 2012, researchers Andreu Laura and Puetz Alexander looked at how different levels of professional education influenced the investing strategies of professional investors. This study compares equity mutual fund managers with dual qualifications (CFA and MBA) to those with just one of these credentials, focussing on performance, risk, and investing style. Although the two degree holders do not differ in terms of performance, the data does demonstrate that their risk levels and investing approaches are more moderate and consistent.

CONCLUSION

The review underscores the significant influence of psychological well-being on the investment decision-making process. Psychological factors such as emotional stability, optimism, and cognitive clarity play a pivotal role in enabling investors to assess risks accurately, maintain discipline, and achieve their financial goals. Conversely, poor psychological well-being, characterized by stress, anxiety, and cognitive biases, can lead to irrational decisions, increased risk aversion, or excessive risk-taking, often culminating in unfavorable investment outcomes. By acknowledging the interplay between psychological well-being and investment behavior, this study advocates for a more nuanced understanding of investor needs, paving the way for enhanced financial decision-making and long-term investment success.

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