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The Effect of Behavioral Factors on Corporate Investment Decisions: In Case of Selected Private Banks

By

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Statement of Declaration

I, Mahlet Amare, declare that, this thesis entitled "*The Effect of Behavioral Factors on Corporate Investment Decisions: In Case of Selected Private Banks*" in partial fulfillment of the requirement of the M.Sc. program in Corporate Finance with the guidance and support of the research supervisor.

This study is my original work and that has not been presented for any degree or master's program in this or any other university/institutions, and that all source of materials used for the thesis have been duly acknowledged.

Declared by Mahlet Amare

Signature 

Place and date of Submitted 25/6/2025

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Certification

This is to certify that the thesis prepared by Mahlet Amare entitled "*The Effect of Behavioral Factors on Corporate Investment Decisions: In Case of Selected Private Banks*" and submitted in partial fulfillment for Master's Degree of Corporate Finance complies with the regulations of the university and meets the accepted standards with respect to originality and quality.

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Examiner: Tafa Mosisa (Ph.D) **Signature** _____ **Date** 24/06/2025

Advisor: Dr. Tesfa Nega, **Signature** _____ **Date:** 24/6/2025

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Abstract

This study investigates behavioral patterns, preferences, and challenges among investors engaged in corporate investments. This study employed a quantitative research approach using a cross-sectional survey design to examine the influence of behavioral factors on corporate investment decisions in selected private banks. Data were collected through structured questionnaires administered to employees in corporate departments, and analyzed using descriptive statistics, correlation, and multiple regression techniques with SPSS. Data collected from 100 respondents reveal varied levels of participation: 29% are currently involved in corporate investments, 49% plan to participate in the future, while 22% remain unaware of share investment opportunities. The findings highlight the significant influence of past price trends and recent asset performance on investment decisions, with 51% to 61% of respondents agreeing that these factors guide their forecasts and choices. Behavioral biases consistent with Prospect Theory emerge clearly. After experiencing losses, 39% of investors exhibit risk aversion, whereas 62% display increased risk-taking following gains. Mental accounting is prevalent, as 65% of respondents segregate their finances into distinct mental accounts, 82% assign specific purposes to these accounts, and 74% track them separately. However, only 11% disregard the connections between different accounts, indicating most investors recognize the interrelated nature of their finances. Social influences significantly affect decision-making: 55% of respondents report that other investors' funding choices impact their own, and 58% consider close friends and relatives as trusted sources of investment advice. Investor preferences tend toward stability and risk management, with 43% favoring stable, low-risk investments, 35% opting for diversified portfolios, and 42% focusing on long-term growth strategies. Despite these preferences, investors face notable challenges impeding effective participation. Insufficient capital (51%), limited market knowledge (35%), fear of losses (22%), and time constraints (19%) are the primary barriers identified. These insights underscore the complex behavioral finance dynamics shaping investment behavior and highlight the need for tailored investor education, support systems, and behavioral interventions to improve financial decision-making and encourage broader market participation.

Keywords: *Behavior, corporate, finance, investor, preference theory*

CHAPTER ONE

1. Introduction

1.1. Background of the study

Behavioral finance is the study of the result of psychology on the behavior of financial practitioners and the later outcome on markets (Solomon, 2024). Behavioral Finance is of interest for the cause that it supports to clarify why and in what way market might be unproductive (Sewell 2001). According to conventional financial idea, the world and its participants are, for the most part, rational "wealth maximizes". However, there are numerous cases in point where emotion and psychology influence our decisions, affecting us to behave in unpredictable or irrational means. Behavioral finance is a relatively new field that seeks to chain behavioral and cognitive psychological theory with conventional economics and finance to deliver explanations for why people make irrational financial decisions (Leta, 2020).Behavior finance helps to understand the attitude and perception of investors on their investment decisions Gothe and Mishra, 2023).

In earlier finance theory, investor's psychology and feeling is not considered as influencing factor of investment decision and it assumes that investors are rational and make investment decision based on fundamental factor particularly on risk –return trade off model (Agegn, 2021). However, the modern theory of finance known as behavioral finance theory is emerged which oppose the assumption of earlier finance theory. behavioral finance assumes that investors are irrational and their investment decision was influenced by different psychological and cognitive bias and other factors beyond fundamental factors influence investment decision of investors and it also assumes that investors make investment decision based on the way of mental factor and rule of thumb not only directed by traditional finance rule of risk-return tradeoff model (Budhiraja et al., 2018).

In recent times, capital markets are attracting the attention of retail investors across the globe and this number is increasing due to diversified reasons like declining interest rates, insecurity and volatility amongst fixed income securities, increasing awareness about investment options, trading through the proper means, increasing role of technology in capital markets and their tech savvy investors

etc(Senthamizhselvi and Ram, 2020). However, to understand this whole process, behavioral finance acts as a catalyst and helps us as a medium both for reasons and causes for those reasons.

Any behavioral finance theories have been developed by different scholars among those the most popular theories and concerns of this study are; prospect theory, heuristic theory, and herding theory. For this study, investors are those who invest money with intention of generating return in the future (Damodaran, 2014). Behavioral factors may sometimes help individual investors during investment decision making yet they are not reliable tool because they do not include important fundamental factors which guide rational investment decision making process and leads bias on investment decision and result market inefficiency (Budhiraja, 2018) Selecting best investment option among many with the intention of future return is not an easy task, rather it needs careful evaluation and analysis of each investment alternatives in order to decide investment mix, time horizon and amount of fund (Subrahmanyam, 2008). Investors use shorcut method which is called behavioral factors due to many investment alternatives available, lack of knowledge about valuation system, time to analysis, and other constraints (Karanja, 2017). These factors may lead bias on investment decision, which consequently leads to huge financial loss, make investor out of competitor and make market inefficient (Wamae, 2013). Existing literatures evidenced that investors are usually not rational in their choice of investment alternatives instead they use their mental short cut methods rather than the looking the nature of the market and evaluate information objectively.

Many empirical studies have been done on the issues of behavioral finance and its impact on investment decision in different countries. For instance, (Bakar & Yi, 2016; Kengatharan & Kengatharan, 2014; Mahanthe & Sugathadasa, 2018; Onsomu, 2014; Rekik & Boujelbene, 2013), among others, examined the influence of behavioral factors on investment decision and their findings generally support the behavioral finance theories. Indeed, empirical studies come up with inconclusive and contradictory judgments on the actual behavioral factors influencing individual investment decision and none of them concluded it single handedly. Besides, most existing studies have focused on role of behavioral finance in corporate investment decisions with little attention to investment decision. Therefore, it is plausible to empirically examine the effect of behavioral finance corporate investment decision.

1.2. Statement of the Problem

Corporate firms make multiple decisions, including funding, the expansion of existing operations and the acquisition of new assets to achieve the underlying objective of growth (Rahayu 2019). In this context, long-term investment, specifically investment in the acquisition of fixed assets, is fundamental to ensure the long-term view of growth. Such investment decisions stem from other attached factors, i.e., rate of return, payback period, profitability index, etc. (Farooq and Subhani 2021). Industrial enterprises are mostly concerned with accomplishing such tasks through some policy tools that can help to achieve such objectives efficiently. Such policy tools are commonly known as determinants of corporate investment decisions, affecting the managerial thinking of investment structuring. Given that, there exists a stream of studies that deems to explore such determinants of investment by arranging the empirical analyses on different countries of the world (Adelino et al. 2017; Ajide 2017; Farooq et al. 2021). However, there is a scarcity in the literature on summarizing such determinants and giving a clear theoretical understanding of such determinants.

Due to positive link between investment and economic growth, increase in investment activity positively affects the development of the economy (Waruing, 2011)**.** Strong investment activity has great role on countries economy by creating employment opportunity, generate production, improve living standard of individuals and facilitate international transaction. Subsequently, investment decision of investors in different investment activity plays an important role on profitability of investment which in turn has influence on the economy.

The investment decisions of corporate investors are central to ensuring financial stability and fulfilling long-term obligations, particularly within financial institutions such as private banks. In today's dynamic economic environment, these decisions are shaped by a multitude of factors, including behavioral biases, risk perception, institutional policies, and macroeconomic conditions. While several studies have been conducted in Ethiopia on related issues, key gaps remain in the literature. For instance, Solomon Damtew (2015) and Amare Walle (2008) examined the investment behavior of banking employees, focusing on individual-level determinants such as income, knowledge, and risk tolerance. However, these studies do not extend their scope to corporate-level investment decisions, which involve more complex and strategic considerations. Getachew Mulatu (2016) explored the challenges and prospects of establishing a stock

market in Ethiopia but did not assess how the absence of such a market impacts institutional investment decisions.

Additionally, other Ethiopian studies such as those by Tewodros Gebremariam (2017) and Mesfin Hailu (2019) focused on financial decision-making in banks but concentrated primarily on credit allocation and loan management rather than on corporate investment behavior. International literature (e.g., Shefrin & Statman, 2000; Barberis & Thaler, 2003) underscores the critical influence of behavioral finance—such as overconfidence, herd behavior, and loss aversion—on institutional investors, yet these dimensions remain underexplored in the Ethiopian context. Most of the existing local research lacks comprehensive theoretical frameworks and has not systematically reviewed the relevant literature, resulting in poorly identified gaps and limited methodological rigor. Therefore, there is a pressing need for focused research on how behavioral factors influence corporate investment decisions within private banks in Addis Ababa, especially in light of emerging economic reforms and the anticipated launch of a national stock exchange.

1.3. Research Hypothesis

- ✓ **H1:** Investors show a significant preference for specific types of investments when making investment decisions.
- ✓ **H2:** Heuristic factors (such as overconfidence, representativeness, and availability bias) have a significant influence on investors' investment decisions.
- ✓ **H3:** Prospect theory factors (such as loss aversion and framing effects) significantly affect investors' investment decisions.
- ✓ **H4:** Herding behavior has a significant influence on the investment decisions of investors.

1.4. Research Objectives

1.4.1. General objective

- ➢ The general objective of the study is to examine the effect of Behavioral Factors that influence Corporate Investment Decisions: In Case of Selected Private Banks

1.4.2. Specific objectives

- ✓ To examine the preference of investors' behavioral finance for investment decision
- ✓ To examine the influence of heuristic factors on investment decision of investors.
- ✓ To examine the influence of prospect factors on investment decision of investors.
- ✓ To examine the influence of herding behavior on investment decision of investors.

1.5. Significance of the study

Behavioral finance may have the limited number of application for not developed security markets. Since the research conducted on this topic is very rare in Ethiopia, it puts the base for future research doers. The research uses as a reference of corporate investment behavior, to identify market potential area for the investors and to consider and analyze the corporate market making appropriate choices of investment. The research will provide them with a good background for their expectation of future corporate market development and giving additional reliable professional information to the investors. The study will makes significant contributions to the area of financial economics through explaining the relationship between the several economic social, cultural, demographic and behavioral factors that influence the overall investment decisions. The beneficiaries of the study result will be different enterprise who involved in financial investment either small or large, private commercial banks and microfinance. They will get information from this study about effective and profitable financial management and investment via dissemination of concerned bodies.

1.6. Scope of the study

The study focuses on determining the effect of behavioral factor in corporate investment decision in selected private commercial banks in the Ethiopian market. Prospect (Loss aversion, regret aversion and mental accounting), Market (Price changes, Market information, Past trends of shares, Fundamentals of underlying shares, Customer preference and over and under reaction to price changes and Herding effect (Buying, selling, choice of trading shares, Volume of trading shares and Speed of herding). The target populations of the study selected private banks. The statistics sampling method was be chose in this study is the systematic sampling technique. The questionnaire constituted items related to effect of behavioral finance. To Measure the quality of data, researcher was be used Cronbach's alpha test and to test the hypotheses of the study, the researcher used the tools mean scores, percentages, F test, and multiple regressions was used.

1.7. Limitation of the study

Even though the sample size was high when compared to its target population, (n= 100) and satisfy the requirements of statistical methods; on the other hand, it is advised to have a larger sample size in further research to reflect more accurately the realistic situation of share market and behavioral factors

influencing investment decision making. It may have difference in other areas studies because of operational culture and others. The using of only questionnaires" data gathering methods has some impacts on quality of the data. The other limitation of this research is due to absence of stock market in Ethiopia it was very difficult to obtain the address of individual investors registered in share investment, which has unlimited impact that limit the findings of this study.

1.8. Organization of the study

The research paper consists of five chapters. The first chapter is the introduction chapter and contains statement of the problems, research questions, objective of the study, significance of the study, and limitation of the study. Literature reviews presented in chapter two. The third chapter is the methodology that was be used in the research activity. Chapter four was focused on results and discussion as well as chapter five presents conclusion and recommendation.

CHAPTER TWO

2. Review of Related Literature

2.1 Introduction

This chapter begins with an **introduction** to the importance of understanding investment decisions within the context of behavioral finance, particularly in corporate settings such as private banks. The **theoretical literature** section outlines traditional investment theories, including the Efficient Market Hypothesis (EMH) and Modern Portfolio Theory (MPT), and contrasts them with behavioral finance theories such as prospect theory and heuristics-based models that better explain real-world investor behavior. The **empirical literature** reviews international and local studies, highlighting that while global research extensively explores heuristic biases, prospect factors, and herding behavior, Ethiopian studies have mainly focused on individual investors and lack depth in examining corporate investment behavior. The **research gaps** section identifies the limited focus on behavioral factors influencing corporate investors in Ethiopia, especially within private banks, and the absence of integrated theoretical frameworks in prior local studies. Finally, the **conceptual framework** is developed to guide the study, illustrating the relationship between key behavioral variables—heuristic factors, prospect factors, and herding behavior—and corporate investment decision-making.

2.2. Theoretical Literature

2.2.1. Behavioral Finance

Behavioral finance is discipline that deals about the influence of emotional, social and mental bias on the investment decision of investors and consequence of behavioral bias on the market. The discipline deals with the reason behind investors forget fundamental factor to make investment decision and its consequence when investors make investment decision based on behavioral bias rather than fundamental factors (Sewell, 2010)**.**

Behavioral finance integrates psychology with finance to understand how cognitive biases and emotions impact financial decision-making (Solomon, 2024). Originating from the works of Kahneman and Tversky in the 1970s, this theory challenges the rationality assumptions of traditional finance models. In

the insurance context, behavioral finance explains how psychological factors influence investment decisions, such as risk aversion, loss aversion, and herd behavior among investors and managers. Understanding these biases is crucial for insurance companies to design effective risk management and investment strategies (Barberis & Thaler, 2018).

According to Berberis & Thaler (2003) Behavioral finance is the new field of the study which opposes traditional finance theories assumptions that are; investors are rational, markets are efficient. While, this new field of finance assume that investor are irrational, market are inefficient and investors make investment decision based on emotional and psychological preference than fundamental factors such as risk-return trade of model. Shikuku (2010) defined that behavioral finance is a field of study that tries to explore the psychological and sociological factor that influence investment decision of individual investors and institutional investor in general. Behavioral finance is discipline that try to find how investor's emotion and psychology affect investment decisions. According to Ritter (2003) behavioral finance emphasis on psychological factors which guide investment decision of investors(irrationally)subjected to mental misunderstanding which departure investor from rationality cognitive illusion which affect investor decision are preference, emotion and feeling.

Behavioral finance offers valuable insights into the psychological factors that can drive investment decisions and shape market dynamics (Hirshleifer, 2015). Understanding the hidden biases and emotions that influence behavior can enhance your decision-making processes, helping you navigate financial markets more effectively. Moreover, recognizing the asymmetry in reactions to losses and gains can help you and your advisor develops strategies to manage risk and optimize returns over the long term. In an era where markets are increasingly driven by human psychology as much as economic fundamentals, the study of behavioral finance is more relevant than ever.

2.2.2. Corporate investment decisions

Corporate investment decisions are a pivotal aspect of financial management, fundamentally shaping an organization's growth, profitability, and competitive edge. These decisions involve the allocation of capital to projects, assets, or ventures expected to generate future economic benefits. In classical financial theory, investment decisions are predominantly influenced by rational analysis, grounded in objective financial metrics such as net present value (NPV), internal rate of return (IRR), and payback period. According to the propositions of Modigliani and Miller (1958), firms make investment choices based on

market efficiency and rational behavior, aiming to maximize shareholder wealth. This perspective assumes that corporate managers are well-informed and unbiased, capable of analyzing risks and returns without emotional interference. Traditional models, including the Capital Asset Pricing Model (CAPM) and Efficient Market Hypothesis (EMH), further reinforce the belief that markets reflect all available information, enabling managers to make optimal investment decisions based on systematic evaluation and forecasting. Risk assessment techniques, cost of capital calculations, and strategic financial planning are considered core elements in determining which investments are pursued, expanded, or abandoned.

However, emerging research in behavioral finance challenges these conventional theories by introducing the role of psychological and cognitive biases in corporate investment decisions. Unlike traditional views that assume rationality, behavioral finance posits that decision-makers often deviate from optimal strategies due to inherent biases and emotional influences (Shefrin, 2007; Thaler, 1985). One of the most prominent biases affecting investment decisions is overconfidence, where corporate managers overestimate their ability to predict market movements or project outcomes, leading to excessive risk-taking and suboptimal investments. For instance, CEOs with overconfident tendencies may undertake large-scale mergers or acquisitions without fully accounting for associated risks, driven by misplaced optimism in their predictive capabilities. Another significant bias is loss aversion, which suggests that the pain of losses is psychologically more impactful than the pleasure of equivalent gains. This bias can lead firms to overly conservative investment strategies, avoiding potentially profitable projects due to fear of financial loss, even when objective analysis indicates favorable outcomes.

Moreover, herd behavior is observed when firms mimic the investment patterns of industry peers, driven by the assumption that collective action reduces individual risk. This phenomenon often leads to capital allocation that is less reflective of firm-specific strategies and more aligned with broader market trends, sometimes resulting in inflated asset bubbles or synchronized downturns. Another critical concept is mental accounting, where managers irrationally separate budgets for different types of investments, disregarding the overall financial position of the firm. For example, a company might aggressively fund a new project from a "growth" budget while cutting costs in a separate "operational" budget, ignoring the net financial impact. Finally, anchoring bias plays a crucial role in corporate investment decisions, where initial information or historical reference points disproportionately influence current decision-making processes. For example, the initial cost of an asset or past performance benchmarks might anchor managerial expectations, even if market conditions or project fundamentals have significantly changed.

Understanding these behavioral influences is crucial for refining corporate investment strategies. Recognizing that decision-makers are not purely rational actors allows firms to implement safeguards, such as structured decision-making frameworks, objective performance metrics, and critical oversight, to mitigate cognitive biases. By integrating traditional financial analysis with insights from behavioral finance, companies can enhance their strategic investment decisions, optimize capital allocation, and sustain long-term growth in an increasingly complex and volatile market environment.

2.2.3. Behavioral Finance Theories

Behavioral finance explores how people actually make financial decisions, not how they should make them. This field highlights the complexities of human behavior in finance, drawing upon key concepts like bounded rationality, heuristics, and biases (Baker & Nofsinger, 2010; Monahan, 2018). These elements shape our perceptions, preferences, and ultimately our financial choices.

Bounded rationality, a concept championed by Herbert Simon, recognizes that humans have limited cognitive abilities, challenging the traditional economic assumption of perfect rationality (Egidi, 2017). Instead of thoroughly analyzing every option, we often rely on simplified mental models when faced with complex financial decisions. This reliance on shortcuts leads to deviations from optimal decision-making, as we may miss crucial information or process it inefficiently (Ajayi & Udeh, 2024a; Igbinenikaro & Adewusi, 2024d; Ingale & Paluri, 2022; Shah & Ali, 2022).

Heuristics, or mental shortcuts, are another cornerstone of behavioral finance. They allow for quick decision-making but can also introduce errors and biases (Mousavi, Gigerenzer, & Kheirandish, 2016; Ricciardi, 2008). For instance, anchoring occurs when we overemphasize initial information, while the availability heuristic leads us to judge the likelihood of events based on how easily they come to mind. These shortcuts can skew our perceptions of risk, return, and value, often leading to poor financial choices (Ajayi & Udeh, 2024c; Forbes, Hudson, Skerratt, & Soufian, 2015; Igbinenikaro & Adewusi, 2024c).

Biases, stemming from our cognitive limitations and reliance on heuristics, represent systematic departures from rational decision-making (Weyman & Barnett, 2016). Common biases like overconfidence, loss aversion, and confirmation bias can significantly influence financial behavior. Overconfidence makes us overestimate our financial knowledge, leading to excessive risk-taking. Loss aversion, on the other hand, causes us to feel the pain of losses more strongly than the pleasure of

equivalent gains, making us hesitant to pursue potentially beneficial financial activities (Kosasih, Lesmana, Judijanto, Cahyati, & Al-Shreifeen, 2024; Shukla, Rushdi, & Katiyar, 2020).

In contrast, financial inclusion is a separate but related concept focused on expanding access to financial services and promoting inclusive economic growth. The goal is to empower individuals and communities by giving them the tools to participate in the formal financial system (Singh & Yadav, 2012). This includes providing accessible and affordable savings, credit, insurance, and payment options.

However, achieving financial inclusion is challenging, facing obstacles like limited infrastructure, high transaction costs, and regulatory hurdles (Diniz, Birochi, & Pozzebon, 2012). These barriers often prevent people, particularly in underserved areas, from accessing formal financial services. Moreover, cultural factors, lack of trust, and low financial literacy reinforce these exclusionary dynamics, preventing marginalized communities from reaping the benefits of financial inclusion initiatives (Ajayi & Udeh, 2024b; Igbinenikaro & Adewusi, 2024a; Oliveira Santanna, 2019).

2.2.3.1. Heuristic Decision Process theory

Heuristic problem-solving utilizes non-algorithmic methods, tricks, and techniques to find solutions. This approach often involves trial and error, which is how investors often make decisions. They explore different possibilities to identify opportunities. Investor decision-making is not entirely rational; emotional and mental factors significantly influence the process, making it challenging to isolate purely logical considerations. Investors gather and evaluate information, but their final choices are shaped by these complex, often subjective, influences.

Key Factors in Heuristic Decision-making:

The heuristic decision-making process includes several key factors, notably:

Representativeness: This heuristic, described by Kahneman and Tversky (1972), reflects how individuals judge the likelihood of an event based on how similar it is to a stereotype or their past experiences. Investors may make decisions based on pre-existing patterns, effectively labeling an investment as "typical" without complete analysis. It involves both (i) how well an event’s characteristics match its origin and (ii) how much it reflects the process by which it was created. (Kahneman & Tversky, 1982)

Overconfidence: A study by Dittrich, Güth, and Maciejovsky (2001) found that a significant majority of participants displayed overconfidence in their judgments. Remarkably, investors who experienced losses

in investments sometimes gained even more confidence. Confidence can be beneficial, fostering courage and contributing to success. While not the sole ingredient for achievement, it is widely admired and encouraged. However, overconfidence can lead investors to overestimate their abilities and knowledge, resulting in excessive trading.

Overconfidence bias is characterized by a corporate manager's excessive belief in their own judgment and decision-making capabilities, often leading to overestimation of returns and underestimation of risks (Malmendier & Tate, 2005). Empirical studies have demonstrated that overconfident CEOs are more likely to engage in aggressive investment behaviors, such as pursuing large-scale mergers and acquisitions or expanding capital expenditures beyond optimal levels (Ben-David, Graham, & Harvey, 2013). Malmendier and Tate (2008) found that overconfident managers tend to overinvest, particularly when their firms have substantial internal funds, highlighting a deviation from traditional cost of capital considerations.

A study by Chen, Ho, and Yeo (2019) analyzed data from 500 publicly traded firms over a ten-year period, revealing that companies led by overconfident executives had consistently higher capital expenditures and lower liquidity ratios compared to their less confident counterparts. This evidence underscores the impact of managerial overconfidence on corporate resource allocation, often resulting in suboptimal investment decisions that deviate from shareholder value maximization.

Anchoring: People tend to begin estimating outcomes by relying on initial values they encounter when considering various situations. This starting point, whether a partial computation or a problem's initial framing, often leads to insufficient adjustments (Slovic & Lichtenstein, 1971). Consequently, different starting points yield different estimates. Tversky and Kahneman (1974) termed this tendency "anchoring."

Anchoring is a cognitive bias where decision-makers rely heavily on initial information (or 'anchors') when making subsequent judgments (Tversky & Kahneman, 1974). In corporate investment, anchoring can manifest when managers fixate on historical financial metrics or past market conditions, failing to adjust adequately to new information (Doukas, 2010). An empirical study by Dichev and Tang (2009) found that corporate forecasts of future earnings are often anchored to previous earnings levels, leading to systematic over- or under-investment during periods of economic change.

A comprehensive analysis by Cohen, Polk, and Vuolteenaho (2009) confirmed that anchoring contributes to persistent mispricing of corporate securities, as managers are slow to update investment strategies in response to market volatility or shifts in consumer demand.

Gambler's Fallacy: The gambler's fallacy occurs when a misunderstanding of probability leads to inaccurate predictions about the occurrence of events. This flawed assumption arises when investors predict market outcomes incorrectly, whether their anticipation turns out to be positive or negative.

Availability Bias: Availability bias happens when easily recalled information is given disproportionate weight. This can cause investors to overreact to market news, both positive and negative. This cognitive bias leads individuals to overestimate the likelihood of events linked to memorable or vivid experiences. Therefore, investors often place excessive emphasis on easily available information when making decisions.

2.2.3.2. Prospect Theory

Kahneman and Tversky introduced prospect theory in 1979, a model explaining the difference in how individuals perceive gains and losses. This theory suggests that people don't treat potential gains and losses equally. For example, given two equivalent choices, one framed as a potential gain and the other as a potential loss, an investor is more likely to favor the option presenting a potential gain. This phenomenon is also referred to as "loss aversion theory.

“Key concepts of this theory are outlined below:

Framing: This initial aspect of prospect theory concerns how an issue is presented, and how this presentation impacts the outcomes and contingencies related to a particular problem. The manner in which information is framed significantly influences an investor's decision. Unlike traditional expected utility theory, Kahneman and Tversky (1979) demonstrated that investors evaluate gains and losses asymmetrically. Some studies even suggest that the pain experienced from losing $1 is perceived to be twice as intense as the pleasure derived from gaining $1.

Loss Aversion: A central concept in psychology, loss aversion plays an important role in understanding economic behavior. It implies that when faced with a potential loss, an investor may become risk-seeking, while in a situation with a potential gain, the investor tends to be risk-averse. This tendency is what defines loss aversion (Venkatesh, 2002). Schmidt & Zank (2002), in their discussion of loss aversion, supported the findings of Kahneman and Tversky (1979).

Loss aversion, a concept rooted in Kahneman and Tversky's (1979) Prospect Theory, suggests that corporate managers are disproportionately sensitive to potential losses compared to equivalent gains. This aversion often results in risk-averse behavior, particularly in environments characterized by financial instability or market downturns (Baker & Wurgler, 2007). Empirical research by Jiang, Xu, and Yao (2017) indicates that firms with loss-averse executives tend to delay necessary investments or reduce capital expenditures during economic recessions, even when market conditions would favor long-term strategic investments.

A cross-sectional study by Bertrand and Schoar (2003) examined managerial styles across 800 firms, finding that loss-averse CEOs were significantly less likely to initiate expansion projects during volatile market periods, prioritizing short-term financial stability over long-term growth. These findings illustrate how loss aversion can inhibit value-generating investment activities, potentially limiting corporate growth prospects.

Regret Aversion: This arises from an investor's desire to avoid the pain of regret after making a poor investment decision. As a cognitive phenomenon, people subject to regret aversion attempt to avoid the pain arising from two types of errors: errors of commission (choosing a misdirected action) and errors of omission (forgoing or overlooking opportunities).

Mental Accounting: Thaler (1980) introduced the concept of mental accounting, later emphasizing its importance in 1999. It describes the tendency for individuals to separate their funds into different accounts, categorizing them based on diverse subjective criteria. These criteria include the source of the money and the intended purpose of each account, and this process significantly influences purchasing decisions. Mental accounting provides a framework for decision-makers to establish reference points that determine perceived gains or losses.

Mental accounting refers to the cognitive process by which individuals categorize and treat money differently depending on its origin or intended use (Thaler, 1985). In a corporate context, mental accounting can influence investment decisions when managers compartmentalize budgets, leading to inefficient capital allocation. For instance, empirical studies by Shin and Kim (2019) demonstrate that firms with rigid departmental budgets often underinvest in high-growth opportunities while overspending on low-priority projects due to mental segmentation of financial resources.

A longitudinal study conducted by Baker, Pan, and Wurgler (2012) revealed that firms practicing strict budget compartmentalization reported lower overall growth and reduced adaptability to market shifts, suggesting that mental accounting can hinder optimal investment strategies.

Self-Control: Investors are assumed to want to avoid losses and protect their investments. Thaler & Shefrin (1981) suggest that investors must demonstrate tolerance and work to improve their self-control, a concept also known as self-regulation in psychology.

2.2.3.3. Herding Theory

Herd behavior describes the tendency of corporate decision-makers to mimic the investment strategies of peer companies, often disregarding firm-specific fundamentals in favor of perceived market trends (Bikhchandani, Hirshleifer, & Welch, 1992). Empirical evidence shows that herd behavior is prevalent during periods of market uncertainty, where corporate managers align their investment choices with industry peers to avoid reputational damage or shareholder criticism (Graham, 1999).

A study by Fracassi (2016) analyzed investment patterns across 2,000 U.S. corporations, finding that firms are more likely to increase capital spending when their industry peers do the same, independent of their own financial performance. This collective movement often amplifies market bubbles and exacerbates economic downturns, as firms collectively invest or divest based on market sentiment rather than intrinsic value.

According to Shiller (2000), when a large group of people share a common judgment, they are often correct. This phenomenon, known as herd behavior, can be influenced by social and environmental interactions, leading individuals to conform to the actions of others. Examples of herd behavior can be seen in lifestyle and fashion choices, where people are pressured to imitate others (Hirshleifer, 2001).

Many scholars have studied herding behavior and its effects on decision-making. Shiller (2000) explains that people often copy the actions of those who have previously made a decision, such as choosing a hotel or college. This is especially true for investors, who may follow the actions of a larger group in order to reduce the fear of losing money or because they believe the group has more information.

There are several factors that can contribute to the extent of herding behavior, including the amount of funds invested, the type of investor, and the investor's experience. In uncertain situations, herding behavior may be exaggerated, as investors may want to feel part of a group rather than isolated.

Herding behavior can be either irrational or rational. Irrational herding occurs when investors ignore their own beliefs and analytical skills, making decisions based solely on the actions of the market and others. Rational herding, on the other hand, may occur when a manager follows the actions of another manager or when individual investors follow the actions of those who they believe have access to hidden or unpublished information.

Both irrational and rational herding can lead to biased investment decisions, as investors may not make decisions based on careful analysis and evaluation of information. Herding behavior can also cause irrational price variations of financial and real assets.

Hypothesis: Herd behaviors significantly influence the investment decisions of corporate investors.

2.2.3.4. Loss Aversion theory

Expanding on the core concepts of Prospect Theory, **Loss Aversion** is particularly influential in investment decisions. Kahneman and Tversky (1992) demonstrated that the emotional impact of losses is significantly stronger than that of equivalent gains. This aversion to loss often drives investors to hold on to underperforming stocks longer than rational analysis would suggest, hoping to 'break even' before selling a behavior that can lead to greater financial losses over time. More recent work by Ben-David and Hirshleifer (2020) provides evidence that loss aversion is also a contributing factor in panic selling during market downturns. Additionally, studies by Fang and He (2023) reveal that loss aversion is amplified in markets with high-frequency trading, as the speed of transactions magnifies emotional responses.

2.2.3.5. Framing and Disposition Effect theory

The way information is presented also plays a crucial role in financial decisions, a concept known as the **Framing Effect**. Tversky and Kahneman (1981) showed that individuals react differently to identical financial information depending on its presentation. For instance, the probability of investment success framed as '90% chance of profit' is perceived more favorably than '10% chance of loss,' despite representing the same risk level. This cognitive bias underscores the importance of narrative and presentation in financial decision-making. Recent research by Zhou and Zang (2023) emphasizes that framing effects are especially prominent in ESG (Environmental, Social, and Governance) investment disclosures, affecting investor preferences. Additionally, experiments by Cheng and Liu (2024) suggest

that framing effects are particularly strong in digital trading platforms, where graphical data presentations manipulate risk perceptions.

Finally, **Disposition Effect**, as discussed by Shefrin and Statman (1985), reveals a common investor tendency to sell winning investments too early while holding on to losing investments for too long. This behavior is driven by the desire to lock in gains quickly and the reluctance to realize losses, which are psychologically painful. Consequently, investors often miss out on potential gains from rising stocks and endure deeper losses from declining ones. Recent empirical analysis by Feng and Seasholes (2019) extends this understanding to automated trading algorithms, which also exhibit disposition-like tendencies when modeled on human trading patterns. Further studies by Iyer and Han (2024) find that robo-advisors can mitigate disposition effects through algorithmic enforcement of rational exit strategies.

2.3. Empirical Literature

Chen, Ho, and Yeo (2019) conducted a comprehensive analysis of overconfidence among corporate executives in publicly traded firms. Their study, which spanned a decade and included data from 500 companies, revealed that firms led by overconfident managers exhibited consistently higher capital expenditures and lower liquidity ratios. The researchers attributed this trend to overconfident executives' propensity to overestimate returns on investment and underestimate associated risks. This misjudgment often led to aggressive capital allocations, even when financial metrics suggested a more cautious approach would be prudent. Chen et al. also noted that overconfident managers tend to rely less on external financing, believing that internal resources are sufficient to fuel expansive projects. This behavior not only increased capital expenditure but also strained corporate liquidity, sometimes resulting in cash flow constraints that could impact long-term sustainability.

Jiang, Xu, and Yao (2017) explored the implications of loss aversion in investment decision-making within financial institutions. Their empirical study demonstrated that corporate executives, driven by fear of losses, tend to postpone necessary investments during market downturns. This aversion to perceived financial risk often overrides logical investment timing, resulting in missed opportunities for strategic growth. Jiang et al. found that this behavior was particularly evident in sectors heavily influenced by economic cycles, where market volatility heightened executives' risk sensitivity. The study also suggested that firms led by loss-averse managers are less likely to engage in capital-intensive projects, opting instead for conservative strategies that prioritize short-term financial stability over long-term capital appreciation.

Fracassi (2016) analyzed herd behavior in U.S. corporations, focusing on how firms tend to mirror the investment activities of their industry peers. His research encompassed 2,000 corporations and highlighted that during periods of market expansion, firms increased capital expenditures in alignment with their competitors, regardless of their own financial health or market positioning. This mimetic behavior often amplified market cycles, contributing to industry-wide booms and busts. Fracassi argued that corporate executives are influenced by a desire to avoid reputational risks associated with deviating from market norms, leading to synchronized investment strategies that are not always grounded in firm-specific fundamentals. His findings illustrate the role of social conformity in corporate finance, particularly in speculative markets.

Shin and Kim (2019) investigated the influence of mental accounting on corporate investment decisions, focusing on capital allocation strategies within large firms. Their research found that companies practicing rigid budget compartmentalization often underinvest in high-growth opportunities while overspending on low-priority projects. Shin and Kim attributed this to mental segmentation, where financial resources are allocated based on predefined budget categories rather than dynamic market analysis. This segmentation led to inefficiencies, with some departments experiencing capital surpluses while others faced shortages, despite clear investment potential. Their study underscores the need for flexible budget frameworks that allow for adaptive reallocation of resources in response to market shifts.

Dichev and Tang (2009) examined the anchoring bias in corporate investment, focusing on how firms base their investment decisions on historical financial metrics. Their research identified a tendency among executives to rely heavily on past earnings and market conditions as benchmarks for future investments. This anchoring effect led to systematic mispricing and suboptimal capital allocation, particularly during periods of economic change. Dichev and Tang argued that executives' reliance on historical performance metrics often resulted in delayed responses to emerging market trends, constraining corporate growth. Their findings suggest that overcoming anchoring bias could enhance firms' strategic agility and improve investment outcomes.

Choi and Li (2020) conducted a comprehensive analysis of how behavior finance impact investment strategies within insurance companies. Using quantitative methods, they examined data from a diverse set of insurers to assess the adjustments made in asset allocation in response to regulatory shifts. The study found that stringent regulatory requirements often led insurers to adopt more conservative investment approaches, focusing on safer assets to comply with regulatory standards and mitigate risks associated

with market volatility. Recommendations from the study emphasized the importance of maintaining flexibility in investment policies while enhancing risk management frameworks. This approach allows insurers to navigate regulatory uncertainties effectively while optimizing portfolio performance to meet both regulatory requirements and investor expectations.

Hartwig (2019) focused on scenario analysis to explore the effects of economic uncertainties on asset allocation strategies in insurance companies. By simulating various economic scenarios, the study evaluated how insurers adjusted their investment portfolios to mitigate risks and maintain financial stability during periods of economic turbulence. Findings indicated that insurers with robust liquidity management practices and diversified portfolios were better equipped to withstand economic downturns. The study recommended enhancing liquidity buffers and implementing dynamic asset allocation strategies tailored to different economic scenarios to optimize investment returns while safeguarding policyholder interests.

Eisenhardt (2021) applied agency theory to examine governance structures influencing investment decisions of firms. The study focused on the role of board oversight and executive incentives in aligning managerial behavior with the interests of policyholders and shareholders. Through qualitative analysis of governance practices across insurers, the study highlighted the significance of effective governance mechanisms in promoting transparency and accountability in investment decision-making. Recommendations included strengthening board independence, enhancing performance-based incentives, and fostering a culture of ethical leadership to mitigate agency conflicts and optimize investment outcomes.

A recent study by Ali et al.(2023), published in the journal Risks, provides updated insights into the influence of behavioral biases on investment decisions within the insurance and financial sectors. The researchers identified key biases—such as overconfidence, herd behavior, and anchoring—that significantly affect investors' decision-making processes, often leading to suboptimal investment outcomes. The study emphasizes that these cognitive distortions can impair rational judgment, especially in dynamic and uncertain market conditions. As a remedy, the authors recommend incorporating behavioral interventions and training programs aimed at increasing awareness and reducing the influence of such biases to improve investment strategies and performance.

A recent study by Purwidianti et al. (2023) investigated the influence of overconfidence and herding biases on investment decisions among small and medium enterprise (SME) owners in Indonesia. Utilizing

a survey of 118 SME owners and analyzing the data with Partial Least Squares Structural Equation Modeling (PLS-SEM), the researchers found that both overconfidence and herding biases positively affect risk perception, which in turn significantly influences investment decisions. However, the study did not find evidence that risk perception mediates the relationship between these biases and investment decisions. These findings underscore the direct impact of behavioral biases on investment choices and highlight the importance of addressing such biases to enhance decision-making processes among SME investors.

2.4. Research gaps

Both theoretical and empirical studies indicate that corporate investors' investment decisions are influenced by psychological biases. These psychological factors, as categorized by existing theory and empirical research, fall into three primary areas: heuristics (including representativeness, availability bias, and overconfidence bias), prospect theory biases (such as mental accounting, loss aversion, and regret aversion), and herding behavior. This suggests that corporate investors often deviate from rational decision-making due to the influence of these psychological biases.

Facing constraints such as limited time and knowledge for objective analysis, individual investors often resort to using rules of thumb when making investment decisions. When confronted with complex investment choices, they simplify the task by relying on these shortcut methods. Consequently, their responses to identical situations can vary significantly depending on whether the situation is framed as a potential gain or a loss. The problem arises when individual investors, facing difficulties in processing extensive information due to various constraints, base their investment decisions on incomplete and unsophisticated information.

While numerous studies have explored this phenomenon in financial and real estate markets, there is a lack of local research addressing the specific behavioral factors that influence corporate investment decisions. This research aims to fill this gap by investigating the influence of these factors on individual investor decisions, employing a multinomial logistic regression model. Specifically, the study examines how behavioral factors influence investment decisions across different sectors, including manufacturing, service, and trade.

2.5. Conceptual framework of the study

Building upon the behavioral factors identified in the preceding literature review and supported by empirical findings, a conceptual framework has been developed to guide the present study. This framework emphasizes two primary dimensions of behavioral influence: prospect theory-related factors and herding behavior. These dimensions are central to understanding how cognitive and emotional biases shape individual investment decisions. The framework is visually represented in the figure below, which outlines the specific behavioral factors under examination. A total of seven key factors have been selected based on their theoretical relevance and empirical significance. These include three heuristic-based biases—availability bias, representativeness bias, and overconfidence bias—alongside three prospect theory constructs: loss aversion, regret aversion, and mental accounting. In addition, herding behavior is incorporated as a distinct social influence factor. Collectively, these behavioral components are hypothesized to play a crucial role in shaping how individual investors perceive, process, and act upon financial information. Extensive research across diverse contexts, including both developed and emerging markets, has consistently demonstrated that these biases can significantly influence investor behavior, often leading to deviations from rational decision-making models. Therefore, this framework serves not only as a theoretical foundation but also as a practical tool for investigating the psychological mechanisms underlying investment choices.

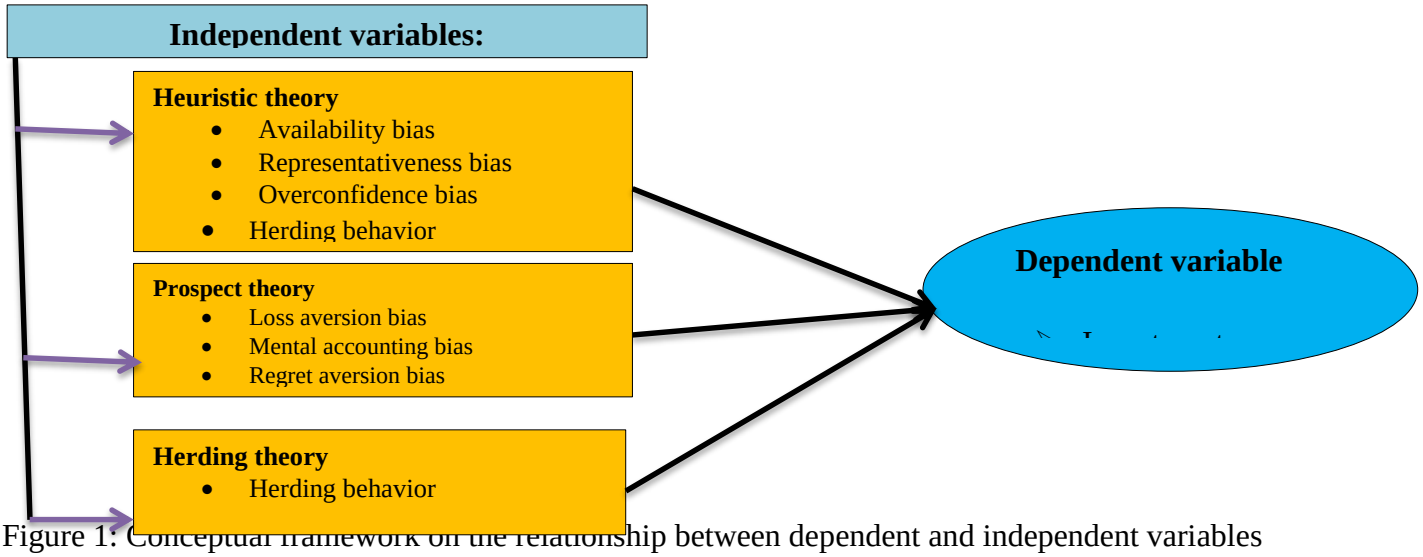

Figure 1: Conceptual framework on the relationship between dependent and independent variables

Source: Kengatharan & Kengatharan (2014)

CHAPTER THREE

3. Research Methodology

3.1. Description of selected study area and private banks

This study was conducted in Addis Ababa, the capital city of Ethiopia and the country's primary economic and financial hub. As the center of major commercial and administrative activities, Addis Ababa hosts the headquarters of numerous financial institutions, including the majority of the country's private banks. The city was selected due to its strategic importance and the high concentration of corporate investors and financial professionals, which makes it an ideal setting for examining behavioral factors influencing investment decisions.

The study specifically targeted private commercial banks operating in Addis Ababa. These banks play a vital role in Ethiopia's financial sector by mobilizing savings, providing credit, and facilitating investment. A selection of prominent private banks included to gather diverse and representative data. These institutions were chosen based on their scale, customer base, and accessibility for data collection. The study population consisted of bank employees, financial advisors, and clients engaged in investment-related activities. These participants were considered appropriate respondents for examining the influence of behavioral biases on investment decision-making within the context of Ethiopia's growing financial market.

The Ethiopian banking sector is supported by key private banks that drive financial inclusion, technological innovation, and economic growth. Awash Bank, the largest by assets and branches, leads with customer-focused services. Bank of Abyssinia and Dashen Bank emphasize digital banking and innovation. Hibret Bank offers diverse financial products with strong customer service, while Cooperative Bank of Oromia focuses on supporting cooperatives and agriculture. Zemen Bank stands out with a tech-driven single-branch model. Newer banks like Abay Bank and Enat Bank prioritize accessible services and women's empowerment, respectively. Wegagen Bank and Nib International Bank provide broad financial services with robust digital platforms and international banking focus. Collectively, these banks form the backbone of Ethiopia's private financial sector.

3.2 Research Approach

There are two basic research approaches; quantitative and qualitative. The quantitative approach involves generalization of data in quantitative form. Qualitative approach is concerned with subjective assessment of attitude, opinion and behavior of research in such situation is function researchers new insight Kothari (2004). Therefore, an appropriate research for this study was quantitative approach. Because the types of data was collected is quantitative via the measurement of likert scales. The quantitative approach was preferred for this study because it allows for the systematic measurement and analysis of numerical data, which is essential when using Likert scales to assess investors' attitudes and behaviors. This method enables the researcher to quantify the influence of behavioral factors on investment decisions, test hypotheses statistically, and generalize findings across the selected population. Additionally, quantitative research provides objectivity, consistency, and the ability to identify patterns and relationships among variables, making it well-suited for studying the impact of heuristic factors, prospect theory, and herding behavior on investment choices.

3.3 Research Design

The ultimate objective of the study is to examine the effect of behavioral factor in corporate investment decision of corporate investment decision in case of selected private banks. Therefore, the researcher was considered this in mind and recognizes the nature of research design of the study. In parallel concept, Kothari (2004) defined research design as it is arrangement of condition for collecting and analyzing data in a way that find to combine relevance of research purpose to the economy in the procedure.

Additionally, this is noted that research design is conceptual structure or the blueprint for collecting, measuring and analyzing relevant data for the study. In this study, Explanatory design adopted to offer insight the research objective and test behavioral finance theory by collecting data and made conclusion based on collected data regard to the effect of behavioral finance in corporate investment decision (causal relationship between behavioral factors and investment decision) of individual investors by selecting a cross sectional sample of population at single point on time.

3.4. Population and Sampling Design

The target population for this study consisted of employees from selected corporate departments of private commercial banks because these individuals are directly involved in or influence corporate investment

decisions. Their roles typically include financial analysis, risk assessment, portfolio management, and strategic planning, making them key informants with relevant knowledge and experience regarding investment behaviors. Focusing on these employees ensures that the data collected accurately reflects the factors influencing corporate investment decisions within the banking sector.Specifically, the study focused on ten private banks: Awash Bank, Abyssinia Bank, Dashen Bank, Hibret Bank, Cooperative Bank of Oromia, Zemen Bank, Abay Bank, Wegagen Bank, Nib Bank, and Enat Bank. These banks were purposefully chosen based on several key criteria. First, they are among the most established and experienced private banks in Ethiopia, with most of them operating for over a decade and some for more than two decades. Their long-standing presence in the Ethiopian financial sector has equipped them with extensive institutional knowledge, matured investment operations, and a solid client base, which is critical for studying patterns in investment decision-making.

Second, these banks play a leading role in corporate and retail banking services, including investment-related activities, which aligns with the objectives of this study. Third, their operational size and national coverage provide a diverse and relevant pool of respondents. Although there are more private banks in the country, these ten were selected to ensure representativeness while maintaining a feasible scope for data collection and analysis.

3.5. Sampling techniques and sample size determination

There are certain reasons why the researcher has selected the focus area of this study. There are number of methods in determining sample size including census in small number of population, mimicking a sample size of similar studies and formula to calculate sample size that are recommend by previous researchers and developed by different authors. There are number of factors to be considered to determine appropriate sample size include level of accuracy, representativeness of sample size, margin of error term and population size. The researcher used sample size formulae of Yamane (1967). The sample size was calculated using the following formula.

$n= N/1+N(e)^2$

Where
n= required sample size

N= total population,

e= margin of error (0.05)

$n= N/1+N (e)^2 = 133/1+133(0.05)^2 = 133/1+133(0.0025) =99.8\approx100$

In this study total of 100 respondents and 10 respondents from each sample banks.

The population size for this study is 133 employees from selected corporate departments. Even though the population is relatively small and manageable, sampling is still preferred to ensure efficient use of resources, reduce time and costs, and maintain focus on a representative subset. Sampling also helps in applying statistical techniques more effectively, allowing for generalizable and reliable conclusions without needing to survey every individual. This approach balances accuracy with practicality in data collection and analysis.

3.6. Data source and type

Data was collected from primary and secondary sources. Both quantitative and qualitative data types were collected from primary sources. The study utilized both primary and secondary sources of data. Primary data were collected directly from employees of selected corporate departments in private commercial banks through structured questionnaires designed in both English and Amharic to accommodate respondents with different language proficiencies. This ensured that participants who are not fluent in English could respond comfortably and accurately. The data collected were mainly quantitative, comprising nominal and ordinal data for demographic and personal information, and interval data obtained through 5-point Likert scale items measuring attitudes and perceptions related to investment decisions.

3. 7. Data Collection Procedure

In order to succeed the research aim, the study was implemented quantitative research approach specifically survey method through personally administered questionnaires including close-ended and open-ended questions. Self-completion questionnaire is one of the best methods of quantitative studies. “Through a self-completion questionnaire, respondents" response questions by completing the questionnaire by them. This method was chosen for the reason that as the research questions defined clearly, questionnaires the best choice to have standardized data, which is simply to process, and analyze. Especially, as no interviewers existing once the questionnaires are completing, the interviewers may not affect the outcomes (Bryman & Bell, 2007).

Moreover, it is inexpensive than other methods. The option for this research was distributed the questionnaire to each respondent and collected right after he/she finished it.

The questionnaire was primarily pre-tested to confirm the effectiveness of the questions while data collection carried out. The questionnaires were distributed where the researcher visit respondents at their places of work, manage the questionnaire and where likely collected them within three days. This means majority of them return it in one day and the rest 2 to 3 days.

3.8. Data Validity and Reliability

3.8.1. Data Validity

Validity concerns how well a tool assesses what it is intended to assess. Data should be not only dependable but also precise and correct. When a measure is valid, it is inherently reliable, Joppe (2000). The validity of the content in the data gathering tool was established by consulting with specialists in the research area, particularly the researcher's advisor. The insightful feedback, modifications, and recommendations provided by the research professionals helped in confirming the validity of the tool.

3.8.2. Data Reliability

Dependability denotes the consistency, stability, or trustworthiness of data. A dependable measure is one that, when repeated, yields the same results as initially obtained. Should the outcomes differ, it indicates that the measurement lacks reliability (Mugenda & Mugenda 2008). To evaluate the reliability of the tools used for data collection, an internal consistency method was be applied using Cronbach's alpha (Mugenda, 2008). Cronbach's alpha serves as a reliability coefficient that provides an impartial estimate of how data can be generalized (Zinbarg, 2005). A coefficient of 0.75 or above suggests that the collected data is trustworthy, given its relatively high internal consistency, allowing it to represent the views of all members in the target group (Zinbarg, 2005). Consequently, the scales anticipated for this research exhibit strong reliability.

3.9. Ethical Consideration

The ethical considerations as regards this research would and has being followed strictly the ethical guidelines provided by the National guidelines of the university. All information was gotten for the

purpose of this research was deemed confidential. Section of the questionnaire was helped to clarify any doubts concerning the anonymity of the participants and their responses.

3.10. Data Analysis method

This study employed quantitative data analysis techniques, involving the organization, interpretation, and summarization of numerical data to describe the characteristics of the population based on the sample. Both descriptive and inferential statistical methods were utilized. Descriptive statistics such as frequencies, percentages, means, and standard deviations were used to summarize and present the data clearly. Inferential statistics included correlation analysis and multiple regression to examine the relationships and influence of behavioral factors on investors' investment decisions. Data collected through a five-point Likert scale—ranging from strongly disagree (1) to strongly agree (5)—were coded and entered into SPSS version 27 for analysis. These methods together enabled a comprehensive understanding of the behavioral determinants affecting investment decisions.

Model Specifications

This study employs a multiple linear regression model to examine the influence of behavioral factors on corporate investors' investment decisions. The model can be specified as follows:

$$Y=\beta0+\beta1X1+\beta2X2+\beta3X3+\epsilon$$

Where:

- Y = Investment decision (dependent variable)
- X1 = Heuristic factors (independent variable)
- X2 = Prospect factors (independent variable)
- X3 = Herding behavior (independent variable)
- $\beta0$ = Intercept
- $\beta1,\beta2,\beta3$ = Coefficients measuring the effect of each independent variable
- ϵ= Error term

Description and Measurement of Variables

- **Investment Decision (Dependent Variable):** Measured through a composite score derived from responses on a 5-point Likert scale assessing the respondents' investment preferences and choices.
- **Heuristic Factors:** These include cognitive shortcuts such as overconfidence, representativeness, and availability bias, measured by Likert-scale items indicating the extent to which these heuristics influence investment decisions.
- **Prospect Factors:** Based on prospect theory concepts like loss aversion and framing effect, measured using Likert-scale items that capture investors' attitudes toward gains and losses in their decisions.
- **Herding Behavior:** Assessed by Likert-scale items that reflect the tendency of investors to follow the behavior of peers or market trends when making investment decisions.

All variables are measured using a 5-point Likert scale ranging from 1 (Strongly Disagree) to 5 (Strongly Agree), allowing for quantification and statistical analysis.

CHAPTER FOUR

4. Results and Discussion

4.1 Response Rate and Reliability Test

A total of 108 questionnaires were distributed to the selected respondents, out of which 100 were fully completed and returned. This corresponds to a response rate of approximately 92.6%, which is considered excellent for survey-based research. Such a high response rate enhances the reliability and generalizability of the study findings by minimizing non-response bias. The strong participation reflects the respondents' engagement and the effectiveness of the data collection process.

The reliability test results show that all variables have good internal consistency, with Cronbach's Alpha values ranging from 0.79 to 0.88, all above the acceptable threshold of 0.70. This confirms that the questionnaire items measuring heuristic factors (0.82), prospect factors (0.79), herding behavior (0.85), and investment decisions (0.88) are reliable.

4.2. Socio-economic characteristics of respondents

The demographic profile provides a structured breakdown of the respondents based on five key variables: Gender, Age, Marital Status, Educational Background, and Monthly Income Estimation (Table 1). These categories offer insights into the composition of the sample population, highlighting significant trends and distributions.

Table 1: Demographic Profile Summary

Category	Subcategory	Frequency	Percent (%)	Valid Percent (%)	Cumulative Percent (%)
Gender	Female	31	31.0	31.0	34.0
	Male	66	66.0	66.0	100.0
	Valid	3	3.0	3.0	3.0
	Total	100	100.0	100.0	100.0
Age	18-27	31	31.0	31.0	33.0
	28-37	50	50.0	50.0	83.0
	38-47	10	10.0	10.0	93.0
	48-57	7	7.0	7.0	100.0
	Valid	2	2.0	2.0	2.0

	Total	100	100.0	100.0	100.0
Marital Status	Married	46	46.0	46.0	46.0
	Unmarried	54	54.0	54.0	100.0
	Total	100	100.0	100.0	100.0
Educational Background	Degree	58	58.0	58.0	58.0
	Diploma	2	2.0	2.0	60.0
	Masters	40	40.0	40.0	100.0
	Total	100	100.0	100.0	100.0
Monthly Income Estimation	10001-20000 birr	29	29.0	29.0	29.0
	2001-5000 birr	15	15.0	15.0	44.0
	5001-10,000 birr	15	15.0	15.0	59.0
	Above 20000 birr	41	41.0	41.0	100.0
	Total	100	100.0	100.0	100.0

Source: Survey data, 2025

Gender Distribution

The sample comprises 66% male and 31% female respondents, with a remaining 3% recorded under 'Valid' (an undefined category). This indicates a male-dominant representation in the survey, reflecting either the nature of the study or the sampling technique employed.

The larger proportion of male respondents may influence the generalizability of the findings, especially in areas where gender differences are significant. The undefined 3% suggests a need for clearer categorization or improved data collection methods.

Age Distribution

The age distribution of the respondents is as follows: 50% are within the age range of 28-37 years, marking it as the predominant age group. 31% fall between 18-27 years, representing the younger demographic. Meanwhile, 10% are aged 38-47 years, indicating a smaller presence of middle-aged participants. Furthermore, 7% belong to the 48-57 years category, reflecting limited engagement from older adults. A final 2% are marked as 'Valid,' suggesting either data error or unspecified categorization.

This age distribution highlights a concentration in middle age ranges, with a notable presence of younger participants. The significant portion within the 28-37 bracket could reflect the workforce's active age group or the targeted demographic of the survey.

Marital Status

A nearly balanced split is observed in terms of marital status, with 54% unmarried and 46% married. This distribution suggests a well-rounded representation of both single and married individuals within the survey. Such a balance may contribute to more diverse perspectives in relation to household dynamics and personal responsibilities. The closeness of the two categories may also indicate social or economic factors that influence marital decisions within the demographic group.

Educational Background

The educational attainment of respondents is considerably high. A majority of 58% hold a degree, indicating a well-educated sample, while 40% possess a master's degree, further highlighting advanced educational qualifications. A small portion (2%) holds a diploma.

This data underscores a predominantly well-educated population, which may influence perspectives and insights within the survey. The strong representation of degree and master's holders may reflect targeted sampling or the demographic's socio-economic background.

Monthly Income Estimation

The monthly income distribution among respondents shows a well-spread financial background. 41% earn above 20,000 birr, representing the highest income bracket. Following this, 29% fall within the 10,001-20,000 birr range. The lower income brackets are evenly split at 15% each for the ranges of 2,001-5,000 birr and 5,001-10,000 birr.

This distribution reflects a significant portion in higher earnings, with fair representation across other income levels, indicating economic diversity. The high percentage in the upper bracket may suggest financial stability or represent a sector of skilled professionals.

Overall, the demographic analysis provides critical insights into the representation and economic status of the respondents. The diverse backgrounds across age, gender, education, and income levels contribute to a well-rounded understanding of the survey's reach and potential impact.Overall, the demographic analysis highlights a predominantly male, middle-aged, well-educated population with diverse income levels, making the sample representative of various socioeconomic backgrounds.

4.3. Descriptive analysis

4.3.1. Investment Decision factors

The survey results provide valuable insights into individuals' status regarding investment in corporate companies. The data reveals three distinct groups: current investors, those unfamiliar with corporate investments, and those planning to invest in the future (Table 2).

Table 2: Status of Investment in Corporate Companies:

Investment Status	Frequency	Percent (%)	Valid Percent (%)	Cumulative Percent (%)
I am partaking in the corporate companies now	29	29.0	29.0	29.0
I do not know about share companies' investment	22	22.0	22.0	51.0
I have plans to participate in the corporate companies	49	49.0	49.0	100.0
Total	100	100.0	100.0	100.0

Source: Survey data (2025)

Firstly, 29% of respondents are currently partaking in corporate company investments. This segment reflects an active participation in the market, indicating a foundational base of investors who are engaged and presumably knowledgeable about corporate investment opportunities. Their involvement also suggests existing trust and interest in corporate ventures.

Secondly, 22% of respondents admitted to not knowing about share company investments. This is a significant portion of the surveyed population, highlighting a gap in awareness or understanding of corporate investment opportunities. This lack of knowledge could be a barrier to market growth,

suggesting that educational initiatives and awareness campaigns could be beneficial in bridging this gap and bringing more potential investors into the fold.

The largest group, comprising 49% of respondents, indicated that they have plans to participate in corporate companies in the future. This shows a strong interest in corporate investments that has yet to be realized. The presence of this substantial segment signals growth potential for corporate investment markets provided there is sufficient guidance and accessible information to facilitate their entry.

In summary, the survey results reflect a healthy mix of current investors, potential newcomers, and a segment in need of awareness. Targeted financial education and strategic engagement could help transition the interested and unaware groups into active participants, significantly expanding the investor base in corporate companies.

Table 3: Investment Decision Factors Summary

Statement	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree	Mean	Std. Deviation
Media Advertisements	7 (7.0%)	21 (21%)	15 (15%)	48 (48%)	7 (7%)	3.17	1.23
Easily Accessible Information	3 (3.0%)	11 (11%)	13 (13%)	54 (54%)	14 (14%)	3.43	1.19
Recent and Easily Accessible Information	6 (6.0%)	18 (18%)	8 (8%)	43 (43%)	23 (23%)	3.39	1.30
Familiar Investment Alternatives	6 (6.0%)	7 (7%)	18 (18%)	47 (47%)	22 (22%)	3.44	1.28

The summarized results reveal key insights into the factors influencing investment decisions among respondents (Table 3). A significant portion of the respondents (48%) agreed that their investment decisions are influenced by information frequently advertised in the media, such as radio and television, while 7% strongly agreed with this statement. This finding aligns with research by Barber and Odean (2008), which indicated that media exposure often shapes investor behavior by increasing the visibility of certain investment options. Despite this, 21% disagreed, and 7% strongly disagreed, indicating some level of skepticism toward media-driven information.

In terms of accessibility and recall of information, 54% of participants agreed that easily accessible information influences their investment decisions, with an additional 14% strongly agreeing. This supports the **Availability Heuristic** theory proposed by Tversky and Kahneman (1974), which suggests that individuals tend to rely on information that is readily available when making decisions, perceiving it as more representative or important. Only a small portion (11%) disagreed with this notion, reflecting a strong consensus on the impact of accessibility.

Similarly, when asked if recent and easily accessible information is considered more reliable for decision-making, 43% agreed and 23% strongly agreed. This finding is consistent with the **Recency Effect**, which implies that more recent information is weighted more heavily in decision-making processes (Kahneman, 2011). This tendency might lead investors to make decisions based on short-term market movements or recent news headlines, even if long-term trends suggest otherwise.

Regarding familiarity with investment alternatives, 47% agreed and 22% strongly agreed that familiar and well-known investment options are perceived as less risky compared to unfamiliar ones. This is reflective of the **Familiarity Bias**, where investors prefer known entities over unknown ones due to perceived safety and reduced uncertainty (Huberman, 2001). The relatively low disagreement rate (7%) underscores the widespread reliance on familiarity as a risk mitigation strategy.

Overall, the results indicate that media exposure, information accessibility, recency of information, and familiarity with investment options are influential factors in investment decision-making. These findings are supported by established behavioral finance theories, highlighting the cognitive biases that shape investor choices. Addressing these biases through financial literacy and more diversified information sources could contribute to more rational investment behaviors.

4.3.2 Heuristic Factors

The survey results show that a majority of respondents rely on past price trends and previous market experience to guide their investment decisions, reflecting persistent reliance on historical data in financial decision-making (Table 4). For instance, 79% of respondents (51% agree and 28% strongly agree) consider past trends of the cost of products or services when making investment decisions. This aligns

with recent findings by Park and Irwin (2021), who note that technical analysis, which heavily depends on historical price patterns, remains widely used among investors despite ongoing debate about its efficacy.

However, when asked whether past price trends reliably predict future prices, only 55% (47% agree and 8% strongly agree) endorsed this view, while a substantial 30% (28% disagree and 2% strongly disagree) expressed skepticism. This division reflects a growing awareness of market complexity and unpredictability. Lo's (2017) Adaptive Markets Hypothesis helps explain this skepticism, suggesting that while some patterns exist, market efficiency varies over time as investors adapt, making it difficult to fully rely on past trends for future forecasting.

Respondents were somewhat more confident in forecasting future changes based on recent prices, with 66% (53% agree and 13% strongly agree) expressing belief in their forecasting ability. Yet, 11% (9% disagree and 2% strongly disagree) remain doubtful, and 23% were neutral, highlighting that many investors remain cautious about the reliability of these predictions. Behavioral finance research by Barberis and Thaler (2019) supports this finding, showing that investors often use heuristics like anchoring on recent price movements to make decisions, despite the imperfect nature of such strategies.

Moreover, 75% of respondents (61% agree and 14% strongly agree) rely on previous market experiences in their decision-making, underscoring the importance of experiential learning in investment behavior. This is consistent with Shefrin's (2020) work emphasizing how personal experience and behavioral biases heavily influence financial choices, often more than pure rational analysis.

Finally, regarding the ability to forecast asset price changes based on recent prices, 66% of respondents (57% agree and 9% strongly agree) showed confidence, though 18% expressed disagreement and 16% were neutral. This pattern mirrors the complex reality described by Tetlock et al. (2021), who argue that external shocks and market noise frequently limit forecasting accuracy, validating the cautious attitude held by a significant minority.

Overall, the survey findings depict investors who generally value historical price information and experience but remain aware of its limitations. This blend of confidence and skepticism reflects modern financial thought, which advocates for adaptive, informed strategies that balance technical tools with an understanding of market unpredictability.

Table 4: Investment Decision-Making Based on Price Trends and Market Experience

Statement	Agree (Freq./%)	Disagree (Freq./%)	Neutral (Freq./%)	Strongly Agree (Freq./%)	Strongly Disagree (Freq./%)	Total (Freq./%)	Mean	Std. Deviation
1. I consider past trends of cost of products or service to make my investment decision	51 (51.0%)	10 (10.0%)	11 (11.0%)	28 (28.0%)	— (0.0%)	100 (100.0%)	3.66	1.03
2. I am consistent with the thinking that the past price trend of products or service represents future prices	47 (47.0%)	28 (28.0%)	15 (15.0%)	8 (8.0%)	2 (2.0%)	100 (100.0%)	2.91	1.19
3. I forecast changes in product and service prices in the future based on the recent prices	53 (53.0%)	9 (9.0%)	23 (23.0%)	13 (13.0%)	2 (2.0%)	100 (100.0%)	3.33	1.10
4. I rely on previous experiences of the market to make my investment decision	61 (61.0%)	7 (7.0%)	16 (16.0%)	14 (14.0%)	2 (2.0%)	100 (100.0%)	3.56	1.04
5. I can forecast the change in asset prices in the future based on the recent asset prices	57 (57.0%)	16 (16.0%)	16 (16.0%)	9 (9.0%)	2 (2.0%)	100 (100.0%)	3.39	1.12

Source: Survey data (2025)

4.3.3. Prospect Factors

The survey results reveal important behavioral patterns related to risk-taking and emotional reactions following financial gains and losses (Table 5). About 39% of respondents (28% agree and 11% strongly agree) reported becoming more risk averse after experiencing a prior loss. This response aligns with the concept of loss aversion, a central idea in prospect theory, which posits that individuals feel the pain of losses more intensely than the pleasure of equivalent gains (Kahneman & Tversky, 1979). However, a notable 25% of respondents disagreed with this, and 36% remained neutral, suggesting that not all investors uniformly react to losses with increased caution. This heterogeneity in responses mirrors findings from recent studies (e.g., Kuhnen & Knutson, 2011) that highlight individual differences in loss sensitivity and risk behavior.

Conversely, a clear majority of respondents, 62% (52% agree and 10% strongly agree), reported becoming more risk tolerant after a prior gain. This supports the behavioral finance notion of the house money effect (Thaler & Johnson, 1990), where investors feel emboldened to take greater risks when playing with gains perceived as ‘extra’ or ‘house money.’ This pattern reflects an optimistic shift in risk preferences driven by prior success, which can sometimes lead to overconfidence and increased exposure to risk (Kahneman & Lovallo, 1993). Recent research by Barberis and Thaler (2019) further confirms that such risk-seeking behavior after gains is common among retail investors, contributing to market momentum effects.

Emotional responses to financial outcomes are also evident in the data. Over half of the respondents (51%) agreed that they experience greater stress from losses than happiness from gains of equal size, reinforcing the loss aversion effect documented extensively in psychology and finance literature (Tversky & Kahneman, 1991). This emotional asymmetry can lead to suboptimal investment behaviors, such as premature selling to avoid losses or reluctance to realize gains. The presence of 29% who either disagreed or were neutral indicates that some investors may have more balanced or different emotional reactions, possibly due to experience, training, or personality factors (Frey et al., 2017).

Overall, the findings provide strong empirical support for well-established behavioral finance theories while also emphasizing investor heterogeneity. The mix of risk aversion, risk-taking, and emotional stress responses observed in this study reflects the complex interplay between cognitive biases and affective processes that shape investment decisions. Recent advances in neurofinance and behavioral economics continue to explore how these factors influence market outcomes and investor welfare (Glaser & Weber, 2021).

Table 5: Respondents' Risk Attitudes and Emotional Responses Following Prior Gains and Losses

Statement	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	Total	Mean	SD
After a prior loss, I become more risk averse than usual	11 (11.0%)	28 (28.0%)	36 (36.0%)	23 (23.0%)	2 (2.0%)	100 (100.0%)	3.23	1.01
After a prior gain, I become more of a risk taker than usual	10 (10.0%)	52 (52.0%)	15 (15.0%)	21 (21.0%)	2 (2.0%)	100 (100.0%)	3.27	1.01
I stress more about losses than happiness from equal gains	0 (0.0%)	51 (51.0%)	24 (24.0%)	20 (20.0%)	5 (5.0%)	100 (100.0%)	3.01	

Source: Survey data(2025)

The results reflect common behavioral biases related to the disposition effect the tendency of investors to sell winning assets too early and hold on to losing assets too long (Table 6). In this study, 51% of respondents (43% agree and 8% strongly agree) indicated they readily sell assets that have increased in value and performed well. This aligns with Shefrin and Statman's (1985) foundational work on the disposition effect, which has been repeatedly confirmed in recent empirical studies (Feng & Seasholes, 2005; Weber & Camerer, 2021). Such behavior can lead to suboptimal timing and reduced returns.

Regarding reluctance to sell losing assets, 39% of respondents (34% agree and 5% strongly agree) admitted to avoiding selling assets that have decreased in value, preferring to hold on to them. This

reflects loss aversion and the psychological pain associated with realizing losses (Kahneman & Tversky, 1979). The avoidance of realizing losses, also known as the "hold-on-to-losing-stocks" behavior, is widely documented (Odean, 1998) and has important implications for investor performance and market dynamics.

Emotional regret also plays a significant role, with 61% (52% agree and 9% strongly agree) reporting feeling sorrow when their chosen investment is less profitable than alternative options they did not select. This relates to the concept of regret aversion (Bell, 1982), where investors experience distress over missed opportunities, which can affect future decision-making and risk preferences. Recent research by Zeelenberg and Pieters (2021) highlights how regret influences investors to be more cautious or impulsive depending on prior outcomes.

Together, these findings support the view that emotional and cognitive biases heavily influence investor behavior, often leading to inconsistent and suboptimal financial decisions. Understanding these tendencies is crucial for designing better investment education and tools that help mitigate such biases (Barberis & Thaler, 2019).

Table 6: Respondents' Behavioral Biases in Selling and Holding Assets and Emotional Reactions to Investment Alternatives

Statement	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	Total	Mean	SD
I readily sell assets that have increased in value and those performing well	8 (8.0%)	43 (43.0%)	17 (17.0%)	27 (27.0%)	5 (5.0%)	100 (100.0%)	3.22	1.09
I avoid selling assets that have decreased in value and hold on to them	5 (5.0%)	34 (34.0%)	19 (19.0%)	32 (32.0%)	10 (10.0%)	100 (100.0%)	2.92	1.17
I feel more sorrow when my selected investment is less profitable than forgotten alternatives	9 (9.0%)	52 (52.0%)	28 (28.0%)	11 (11.0%)	0 (0.0%)	100 (100.0%)	3.59	0.88

Source: Survey data (2025)

The results from the table reflect significant mental accounting practices among respondents. Mental accounting, a concept introduced by Thaler (1985), describes how individuals separate their money into different accounts based on subjective criteria, such as the source of the money or its intended use, even if the economic outcome is the same. This behavior is evident as 73% of respondents (65% agree, 8% strongly agree) indicated that they separate their finances into different mental accounts based on content and time (Table 7). This is consistent with studies showing that people often segment their savings,

investments, and expenditures into mental "buckets," influencing their spending and saving decisions (Prelec & Loewenstein, 1998; Barberis & Huang, 2001).

An even larger proportion, 87% (82% agree, 5% strongly agree), reported assigning different tasks to each account, underscoring the structured way in which individuals manage financial goals. This is supported by research from Heath and Soll (1996), which found that people mentally budget for categories like savings, investments, and daily expenses, which impacts their willingness to spend or save within those mental boundaries.

Monitoring these mental accounts separately and differently was also prevalent, with 85% (74% agree, 11% strongly agree) of respondents affirming this behavior. This segmented monitoring may reduce cognitive overload and help individuals track progress toward specific financial goals, as indicated by findings from Benartzi and Thaler (1999) who noted that investors tend to evaluate their portfolios more frequently when they are mentally segregated.

Interestingly, when asked if they ignore the connections between each account, 56% (53% disagree, 3% strongly disagree) rejected this notion, suggesting that while respondents segment their finances, many still recognize interdependencies across accounts. This contrasts with some mental accounting theories that propose people often ignore correlations between financial categories (Thaler, 1999). The 25% who were neutral and the 17% (11% agree, 6% strongly agree) who admitted to ignoring connections might represent a segment prone to decision errors, such as under-diversification or inefficient allocation of resources (Shefrin & Statman, 2000).

Overall, the findings provide strong empirical support for mental accounting practices and highlight how these behaviors can influence financial decision-making. Recent literature continues to explore these cognitive framing effects and their implications for savings, investments, and consumption behavior (Barberis, 2018; Abeler & Marklein, 2017).

Table 7: Respondents' Mental Accounting Practices and Financial Segregation Perceptions (

Statement	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	Total
I separate my finance into different mental accounts based	8 (8.0%)	65 (65.0%)	20 (20.0%)	7 (7.0%)	—	100 (100.0%)

on content and time						
I assign different tasks to each account	5 (5.0%)	82 (82.0%)	10 (10.0%)	3 (3.0%)	—	100 (100.0%)
I monitor them separately and differently	11 (11.0%)	74 (74.0%)	10 (10.0%)	3 (3.0%)	—	100 (100.0%)
I ignore the connection between each account	6 (6.0%)	11 (11.0%)	25 (25.0%)	53 (53.0%)	3 (3.0%)	100 (100.0%)

4.3.4. Herding Behavior

The results from the table indicate a significant influence of peer behavior and social networks on individual investment decisions, aligning with the principles of herd behavior and social learning theory in financial markets (Table 8).

The findings reveal that 54% of respondents (46% agree, 8% strongly agree) acknowledge that other investors' decisions regarding certain investment types influence their own investment choices. This reflects the concept of herd behavior where individuals mimic the actions of a larger group, especially in uncertain market conditions (Bikhchandani & Sharma, 2000). Studies have shown that when investors observe others making certain investment choices, they infer that these decisions are based on information they do not possess, leading them to follow suit (Banerjee, 1992). This tendency can lead to market trends that are disconnected from fundamental values, as seen in asset bubbles and sudden crashes.

Additionally, 63% of participants (55% agree, 8% strongly agree) stated that the amount of funds others invest impacts their own investment decisions. This suggests a susceptibility to social influence and reference points, where investors gauge their financial decisions based on observed behaviors of their peers (Hong, Kubik, & Stein, 2004). It is also indicative of cascading effects, where early decisions by a few investors set a precedent that others follow, amplifying the overall market movement (Bikhchandani, Hirshleifer, & Welch, 1992).

The role of close friends and relatives as reference points in decision-making is particularly strong, with 71% (58% agree, 13% strongly agree) of respondents considering their input reliable. This emphasizes the impact of social networks and trust in financial decision-making, as outlined in research by Shiller (2015), which found that personal networks often serve as primary sources of investment advice. This social

reliance can both mitigate information asymmetry and perpetuate biases if the information shared is not grounded in sound financial analysis (Granovetter, 2005).

Interestingly, 50% of respondents (41% agree, 9% strongly agree) indicated that they tend to react quickly to changes in other investors' decisions, signifying a form of emotional contagion and reactionary behavior. This rapid response can be linked to market volatility, as collective reactions often amplify price swings and contribute to irrational market behavior (Scharfstein & Stein, 1990). Herding is particularly evident in speculative markets, where fear of missing out (FOMO) and anxiety over losses drive synchronized behavior (Spyrou, 2013).

The overall findings support existing behavioral finance literature that emphasizes the critical role of social influence in investment decisions. Herd behavior, peer effects, and social learning significantly impact how individual investors perceive market opportunities and risks (Choi, Laibson, & Madrian, 2009; Sias, 2004).

Table 8: Respondents' Perceptions of Peer Influence on Investment Decisions

Statement	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	Total
Other investors' decisions of choosing certain investment types influence my investment decisions	8 (8.0%)	46 (46.0%)	27 (27.0%)	17 (17.0%)	2 (2.0%)	100 (100.0%)
Other investors' decisions of the amount of fund invested have impact on my investment decisions	8 (8.0%)	55 (55.0%)	12 (12.0%)	22 (22.0%)	3 (3.0%)	100 (100.0%)
I consider information from my close friends and relatives as reliable reference to my investment decision	13 (13.0%)	58 (58.0%)	17 (17.0%)	12 (12.0%)	—	100 (100.0%)

I usually react quickly to the changes of other investors' decisions and follow their reactions	9 (9.0%)	41 (41.0%)	31 (31.0%)	15 (15.0%)	4 (4.0%)	100 (100.0%)

The table 9 presents the distribution of investor preferences regarding behavioral finance investment strategies. The findings reveal notable trends aligned with recent literature on investor behavior and decision-making.

The most preferred investment approach among respondents is stable, low-risk investments (42.9%), closely followed by a long-term growth strategy (41.8%). This preference for stability and long-term growth corresponds with findings by Barberis and Thaler (2020), who emphasize that many investors tend to prioritize safety and steady wealth accumulation over time to mitigate market volatility and uncertainty.

Additionally, a significant portion of respondents (34.7%) prefer a diversified portfolio across multiple sectors, which aligns with modern portfolio theory advocating diversification to reduce risk (Markowitz, 1952). This reflects a rational approach where investors seek to optimize risk-adjusted returns by spreading investments across different sectors.

Interestingly, opportunistic, prioritizing rapid growth preferences were selected by 24.5%, indicating a considerable segment of investors who are willing to accept higher risk for potentially higher returns. This supports research by Odean (2019), which notes that some investors demonstrate overconfidence and preference for short-term gains, especially in volatile markets.

Preferences such as focused investments in familiar companies (18.4%) resonate with the behavioral bias of familiarity bias, where investors prefer to invest in companies they know well, as discussed by Gennaioli et al. (2015). This bias can sometimes lead to suboptimal diversification but provides a psychological comfort level to investors.

The lower percentages for short-term profit maximization (10.2%), risk-averse, capital preservation (16.3%), and data-driven decision-making (12.2%) indicate that while these strategies are present, they are less dominant. The relatively modest preference for data-driven decision-making might suggest either limited access to quantitative tools or a reliance on heuristics and social influences, consistent with

Kahneman and Tversky's (1979) prospect theory highlighting heuristics in decision-making under uncertainty.

Overall, these preferences reflect a mixture of rational and behavioral influences, supporting the notion that investment decisions are not purely driven by classical economic models but are strongly shaped by psychological factors and individual risk attitudes.

Table 9: Preferences of Investors on Behavioral Finance Investment Strategies

Preferences on Behavioral Finance Investment	Frequency (N)	Percent of Responses (%)	Percent of Cases (%)
Stable, low-risk investments	42	21.3	42.9
Diversified portfolio across multiple sectors	34	17.3	34.7
Focused investments in familiar companies	18	9.1	18.4
Long-term growth strategy	41	20.8	41.8
Short-term profit maximization	10	5.1	10.2
Risk-averse, prioritizing capital preservation	16	8.1	16.3
Opportunistic, prioritizing rapid growth	24	12.2	24.5
Data-driven decision-making	12	6.1	12.2
Total	197	100.0	201.0

4.4 Regression Analysis

The correlation matrix reveals several significant positive relationships among the behavioral biases studied (Table 10). Availability bias is moderately correlated with representativeness bias ($r = 0.45$, $p < 0.01$) and overconfidence bias ($r = 0.38$, $p < 0.01$), indicating that individuals who rely on readily available information also tend to exhibit these other biases. Representativeness bias shows moderate positive correlations with overconfidence bias ($r = 0.41$, $p < 0.01$), loss aversion bias ($r = 0.29$, $p < 0.05$), mental accounting bias ($r = 0.25$, $p < 0.05$), regret aversion bias ($r = 0.28$, $p < 0.05$), and herding behavior ($r = 0.20$, $p < 0.05$), suggesting these biases often co-occur.

Loss aversion bias is significantly correlated with mental accounting bias ($r = 0.50$, $p < 0.01$) and regret aversion bias ($r = 0.45$, $p < 0.01$), which reflects the interconnectedness of emotional responses related to losses and decision framing. Mental accounting bias is also positively associated with regret aversion bias ($r = 0.42$, $p < 0.01$) and herding behavior ($r = 0.33$, $p < 0.05$), while regret aversion bias correlates with herding behavior ($r = 0.30$, $p < 0.05$).

Overall, these correlations indicate that the cognitive and emotional biases influencing investment decisions are interrelated, with herding behavior showing weaker but still significant associations with other biases. This pattern underscores the complexity of investor psychology where multiple biases often interplay rather than act independently.

Table 10: Correlation Matrix of Independent Variables

Variables	1	2	3	4	5	6	7
1. Availability Bias	1.00						
2. Representativeness Bias	0.45**	1.00					
3. Overconfidence Bias	0.38**	0.41**	1.00				
4. Loss Aversion Bias	0.22*	0.29*	0.30*	1.00			
5. Mental Accounting Bias	0.18	0.25*	0.24*	0.50**	1.00		
6. Regret Aversion Bias	0.20*	0.28*	0.21*	0.45**	0.42**	1.00	
7. Herding Behavior	0.15	0.20*	0.18	0.35*	0.33*	0.30*	1.00

The table 11 revealed that VIF values for all independent variables Availability Bias (1.23), Representativeness Bias (1.30), Overconfidence Bias (1.40), Loss Aversion Bias (1.25), Mental Accounting Bias (1.35), Regret Aversion Bias (1.40), and Herding Behavior (1.50) are well below the commonly accepted threshold of 5 (and even the more conservative threshold of 3). This indicates that there is no significant multicollinearity among the predictors in the model. Therefore, each variable provides unique information in explaining variations in the dependent variable, Investment Decision, without redundancy or distortion caused by high inter correlations. The model's estimates can thus be considered stable and reliable for interpretation.

Table 11: Multicollinearity Diagnostics of Independent Variables (Variance Inflation Factor - VIF)

Variables	VIF

1. Availability Bias	1.23
2. Representativeness Bias	1.30
3. Overconfidence Bias	1.40
4. Loss Aversion Bias	1.25
5. Mental Accounting Bias	1.35
6. Regret Aversion Bias	1.40
7. Herding Behavior	1.50

The model summary results indicate a strong explanatory power of the regression model used in predicting investment decision behavior (Table 12). Specifically, the coefficient of determination (R^2) is 0.534, suggesting that approximately 53.4% of the variation in investment decisions among respondents is explained by the behavioral variables included in the model. Moreover, the adjusted R^2 value of 0.495 reflects a reliable fit, taking into account the number of predictors and sample size. This adjustment provides a more accurate estimate of the model's generalizability to the broader population, indicating that the model retains a good level of explanatory strength even when controlling for potential over fitting.

Table 12: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.731	0.534	0.495	0.614

The ANOVA (Analysis of Variance) or model fitness table further supports the statistical validity of the model (Table 13). The regression sum of squares is 41.328 with 7 degrees of freedom, while the mean square value is 5.904. The resulting F-value is 15.67, which is statistically significant at the 0.000 level. This implies that the collective impact of the independent variables on the dependent variable is statistically significant. In other words, the behavioral biases included in the model meaningfully predict investment decision-making, and the model performs significantly better than one without any predictors.

Table 13: ANOVA / Model Fitness Table

Model	Sum of Squares	df	Mean Square	F	Sig. (p-value)
Regression	41.328	7	5.904	15.67	0.000**
Residual	36.072	92	0.392		
Total	77.400	99			

The multiple linear regression analysis reveals significant insights into how behavioral biases influence investment decision-making (Table 14). Consistent with prior studies, availability bias emerged as a significant positive predictor, indicating that investors often rely on readily available or recent information when making decisions, which can lead to biased judgments (Tversky & Kahneman, 1974; Barber & Odean, 2008). Similarly, representativeness bias showed a positive association, reflecting investors' tendency to base decisions on stereotypes or perceived patterns rather than objective analysis, a finding supported by recent behavioral finance literature highlighting the persistence of this bias in financial markets (De Bondt & Thaler, 1985; Bhabra & Dhillon, 2020).

Interestingly, overconfidence bias did not significantly predict investment decisions in this sample, which contrasts with several studies suggesting that overconfidence often leads to excessive trading and risk-taking (Barber & Odean, 2001; Glaser & Weber, 2007). This divergence might reflect contextual or demographic factors unique to the sample studied or suggest that overconfidence's influence is more nuanced, possibly moderated by other variables.

From the perspective of prospect theory, loss aversion bias significantly negatively affected investment decisions, consistent with Kahneman and Tversky's (1979) assertion that losses weigh more heavily than equivalent gains, causing investors to be more risk-averse following losses. This finding aligns with recent empirical research that emphasizes loss aversion as a critical factor shaping cautious investment behaviors (Kumar, 2009; Benartzi & Thaler, 1995). Conversely, mental accounting bias positively influenced investment decisions, supporting the notion that investors mentally separate funds into different accounts and allocate resources accordingly, which can sometimes lead to suboptimal decisions but reflects a structured approach to managing finances (Thaler, 1999; Shefrin & Statman, 1985).

Specifically, availability and representativeness biases, grounded in heuristic theory, showed significant positive effects, supporting findings by Khalid et al. (2019) and Sharma and Sharma (2020) that investors rely on accessible or familiar information when making decisions. From the prospect theory perspective, loss aversion had a strong negative impact, consistent with Younas et al. (2022) and Nguyen and Nguyen (2020), who found that investors are more sensitive to potential losses than to equivalent gains. Mental accounting also positively influenced decisions, reinforcing the argument by Chavali and Mohanraj (2021) that investors categorize funds subjectively, affecting rationality. Although regret aversion bias had a

negative but non-significant effect, recent studies like Kourtidis et al. (2021) and Talwar et al. (2022) suggest that its influence may be indirect or context-dependent. Notably, herding behavior emerged as the strongest positive predictor, aligning with Qasim et al. (2019) and Hossain et al. (2023), who argue that in uncertain or information-scarce markets, investors often mimic others' actions, underscoring the collective nature of decision-making in such environments.

Lastly, herding behavior demonstrated the strongest positive effect on investment decisions, emphasizing the significant role of social influence and collective behavior in financial markets. This finding is congruent with extensive research indicating that investors often mimic the actions of peers to avoid missing out or due to uncertainty, which can contribute to market inefficiencies or bubbles (Banerjee, 1992; Bikhchandani et al., 1998; Sias, 2004).

Table 14: Multiple Linear Regression Analysis Predicting Investment Decision

Predictor Variables	B (Unstandardized Coeff.)	SE (Standard Error)	β (Standardized Coeff.)	t-value	p-value
Constant	1.245	0.523	—	2.38	0.019*
Heuristic Theory					
Availability Bias	0.315	0.112	0.278	2.81	0.006**
Representativeness Bias	0.210	0.105	0.185	2.00	0.048*
Overconfidence Bias	0.145	0.098	0.132	1.48	0.142
Prospect Theory					
Loss Aversion Bias	-0.362	0.120	-0.301	-3.02	0.003**
Mental Accounting Bias	0.255	0.107	0.223	2.38	0.019*
Regret Aversion Bias	-0.195	0.111	-0.170	-1.76	0.081
Herding Theory					
Herding Behavior	0.403	0.115	0.352	3.50	0.001**

CHAPTER FIVE

5. Summary, Conclusion and recommendation

5.1. Summary

This study aimed to investigate the impact of behavioral factors—specifically heuristics, prospect theory biases, and herding behavior on investment decisions among individual investors in selected private banks in Addis Ababa. Focusing on ten well-established corporate private banks known for their extensive market experience, the study used a systematic random sampling method to collect data from 100 respondents through structured questionnaires. Key behavioral biases examined included availability bias, representativeness bias, overconfidence, loss aversion, mental accounting, regret aversion, and herding behavior.

Multiple linear regression analysis revealed that these behavioral factors collectively explain 53.4% of the variance in investment decision-making. Significant positive predictors included availability bias, representativeness bias, mental accounting, and herding behavior, highlighting the influence of accessible information, stereotypes, mental categorization, and social cues on investor behavior. Loss aversion bias showed a significant negative effect, indicating investors' sensitivity to losses. Overconfidence and regret aversion biases, however, did not significantly predict investment decisions, suggesting their effects may be context-dependent. Overall, herding behavior emerged as the strongest factor, underscoring the importance of social influence in investment choices within the Addis Ababa private banking sector.

5.2. Conclusion

The results of this study reaffirm the complex interplay between cognitive biases, behavioral heuristics, and social factors in shaping investor decisions in corporate markets. The reliance on past price trends and recent asset performance by more than half of the participants shows that past market data heavily influences investor expectations despite inherent market uncertainties. The study confirms that behavioral

biases play a crucial role in shaping investment decisions among individual investors in Addis Ababa's private banking sector. Factors such as availability bias, representativeness bias, mental accounting, and herding behavior significantly influence how investors evaluate and choose investment options. The strong negative impact of loss aversion underscores investors' tendency to prioritize avoiding losses over seeking gains. Meanwhile, the non-significant effects of overconfidence and regret aversion suggest that some biases may vary in influence depending on the specific investment context. Importantly, herding behavior emerged as the most powerful predictor, highlighting the impact of social dynamics on investment choices. These insights emphasize the need for financial institutions and policymakers to incorporate behavioral considerations when designing investment education and decision-making frameworks to enhance investor outcomes. Such influences can both positively and negatively shape market dynamics. Preferences for conservative strategies like low-risk investments and portfolio diversification further reflect a general risk-averse attitude prevalent among investors. Despite these inclinations, barriers such as capital inadequacy, limited market knowledge, and emotional fears reduce investor confidence and participation, underscoring the need for interventions that address both informational and psychological dimensions of investing.

Collectively, these insights emphasize the necessity for an integrated approach that combines financial education, behavioral coaching, and social support systems to foster more informed, confident, and rational investment decisions.

5.3. Recommendations

Based on the comprehensive analysis of investor behavior, preferences, and challenges, the following recommendations are proposed to enhance investor participation and decision-making effectiveness:

- ✓ **Comprehensive Investor Education:** Develop structured programs focused on increasing financial literacy, particularly targeting gaps in market knowledge and understanding of investment fundamentals. Education should cover the interpretation of past price trends, risk assessment, and portfolio management to empower investors with critical analytical skills.
- ✓ **Behavioral Finance Awareness:** Integrate behavioral finance principles into investor training to help individuals recognize cognitive biases such as loss aversion, mental accounting, and herd behavior. Providing tools to identify and mitigate these biases can promote more rational decision-making and reduce emotional-driven mistakes.

- ✓ **Encourage Holistic Financial Management:** While mental accounting is useful for organizing finances, investors should be educated about the interdependencies between different accounts and assets to avoid siloed thinking that could hinder overall portfolio optimization.
- ✓ **Leverage Social Networks Positively:** Recognize the strong influence of social interactions on investment decisions by facilitating peer learning groups, mentorship programs, and reliable advisory channels. Trusted community networks can serve as effective conduits for accurate information and behavioral guidance.
- ✓ **Improve Access to Reliable Platforms and Resources:** Address practical barriers by expanding access to trustworthy investment platforms with user-friendly interfaces, real-time data, and educational content. This can reduce time constraints and simplify investment processes.
- ✓ **Enhance Risk Management Support:** Provide investors with tools such as risk profiling, scenario analysis, and automated alerts to better understand and manage exposure, helping alleviate fears related to market volatility and loss.
- ✓ **Tailor Financial Products to Preferences:** Financial institutions should design investment products that cater to the diverse preferences identified, including options for low-risk stable investments, diversified portfolios, and long-term growth strategies, accommodating varying investor profiles.

By implementing these recommendations, stakeholders including policymakers, financial educators, and investment firms can build a more inclusive and effective investment environment. This will empower investors to make informed choices, reduce behavioral pitfalls, and ultimately contribute to healthier, more resilient financial markets.

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Appendix: Questionnaire

Part one: - General Information

1. **Gender** male ☐ Female ☐
2. **Age**

18-27	28-37	38-47	48-57	Above 57

3. Marital status

Married	Unmarried	Divorced

4. Educational background

None	1-8	High school	Diploma	Degree	Masters	PHD	Religious education

5. Monthly Income Estimation

Below 1,000 birr	1,000-2000 birr	2,001-5000 birr	5,001-10,000	10001-20,000	Above 20,000

6. Describe your status regarding investment in corporate company

I am partaking in the corporate companies now ☐

I have plans to participate in the corporate companies ☐

I do not know about share companies" investment ☐

Part 2: - Behavioral Factors influence your Investment Decisions.

1. State the extent to which the following statement explains your behavior and action when making investment decision to invest in given alternatives. Where 1-Strongly Disagree, 2-Disagree, 3 Neutral, 4 Agree, 5 Strongly Agree

	Influencing factors					
Level of investment decision		Very high/high/medium/low/very low				
1.1.Heuristic factor **Availability bias**		Level of influence				
1	I make my investment decision based on information which are frequently advertised in media(Radio, Television)	1	2	3	4	5
2	I make my investment decision based on information easily accessible and recalled	1	2	3	4	5
3	I tend to rely more on recent information that I get easily and consider it as reliable reference to make my investment decisions	1	2	3	4	5
4	familiar and well known investment alternatives are less risky than unfamiliar investment alternatives	1	2	3	4	5
	Representativeness bias					
1	I consider past trends of cost of products or service to make my investment decision	1	2	3	4	5
2	I am consistent with the thinking that the past price trend of products or service is representative of the future price	1	2	3	4	5
3	I forecast changes in product and service prices in the future based on the recent prices	1	2	3	4	5
4	I rely on previous experiences of the market to make my investment decision	1	2	3	4	5

5	I can forecast the change in asset prices in the future based on the recent asset prices	1	2	3	4	5
	Overconfidence bias					
1	My knowledge regard to each investment alternatives guide my investment decision	1	2	3	4	5
2	I certainly capable to expect the end of good or bad about the future	1	2	3	4	5
3	I have ability to choose the investment option which its performance will be better than market performance	1	2	3	4	5
4	I feel more confident in my investment decision opinion over opinion of my colleagues or friends	1	2	3	4	5
5	I use my predictive skills to time the market and to make my investment decision	1	2	3	4	5
1.2.Prospect factor **Loss aversion bias**						
1	After a prior loss, I become more risk averse than usual	1	2	3	4	5
2	After a prior gain, I become more of a risk taker than usual	1	2	3	4	5
3	I stressed more about losses as compared to the happiness you derive from gain of equal amount from investment	1	2	3	4	5
	Regret aversion bias					
1	I readily sell assets that have increased in value and those that have been performing well	1	2	3	4	5
2	I avoid selling assets that have decreased in value and hold on to them	1	2	3	4	5
3	I feel more sorrow when my investment alternative selected is less profitable than forgotten investment alternatives	1	2	3	4	5
	Mental accounting bias					

1	I separate my finance in to different mental account based on content and time	1	2	3	4	5
2	I assign different task to each account	1	2	3	4	5
3	I monitor them separately and differently	1	2	3	4	5
4	I ignore the connection between each account	1	2	3	4	5
	1.3.Herd behavior					
1	Other investors' decisions of choosing certain investment types influence my investment decisions	1	2	3	4	5
2	Other investors' decisions of the amount of fund invested have impact on my investment decisions	1	2	3	4	5
3	I consider information from my close friend and relatives as reliable reference to my investment decision	1	2	3	4	5
4	I usually react quickly to the changes of other investors' decisions and follow their reactions.	1	2	3	4	5

2. What are your preferences on behavioral financing investment?

3. What is your most challenge to participate on investment?