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Review paper

OPPORTUNITIES AND LIMITATIONS OF BEHAVIOURAL FINANCE FOR EFFICIENT CORPORATE GOVERNANCE

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Abstract:

Behavioural corporate finance tends to add cognitive and psychological elements to the sophisticated mathematical and statistical models of modern corporate finance by observing and studying the behaviour of investors and managers. The theory does not offer a model for predicting the decision that will be made, but it provides the possibility to predict whether a 'riskier' or 'safer' decision will be made based on the 'exclusion from the context' through which it will determine its reference point and decision frame. The goal of this paper is to point out the limitations and reasons for the failure in modelling and concretization of scientific findings due to the limited access and the exclusion of the determination of the ultimate life purpose and expediency.

Keywords:

behavioural finance, behavioural economics, psychology in economics, corporate governance.

1. INTRODUCTION

We live in a complex and very dynamic reality where even structural changes happen unexpectedly quickly. From this arises the need for quick decision-making, both in terms of making everyday decisions and important structural ones. The reality of life has developed to such an extent that in almost every field, due to the distancing of the subject of study from the life context and a narrowly specialized professional view in work, external support is necessary for successful decision-making and management. Here we have a very interesting situation that, for the successful management of personal and family life, the support of cognitive structures which are part of psychological sciences is necessary. Although psychology has drifted away from its basic goal and broken the subject of study into segments, which it has not yet managed to unify through structural synthesis at least at the level of functional theories and thereby provide practically operational knowledge or insights for individuals, collectives and society, it undoubtedly possesses a large complex of knowledge in terms of personality behaviour, motivation, decision-making process and other things that are of great importance in teamwork, planning, organizing, decision-making and evaluation of achievements. Today, it is unthinkable to expect success in the business world and build a company based only on a business idea, personal capital and personal assessment of the market, no matter how much personal psychological knowledge, experience and intuition, and even special qualifications in the fields of psychology and economics, we might have.

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2. PSYCHOLOGY AND ECONOMICS AS THE BASIS OF BEHAVIOURAL FINANCE

To be able to understand the essence of behavioural finance, we should first start from behavioural economics, i.e. from the relationship between psychology and economics. The relationship between psychology and economics is as old as each of these scientific disciplines. At the very beginning, psychological findings and theories were present in economics and they were successfully applied on a personal level in planning and decision-making processes. Famous economists from the beginning of the creation of economics as a science applied psychological findings in various ways and modelled economic systems according to psychological matrix schemes, so it is sometimes difficult to separate those two realities in their work.

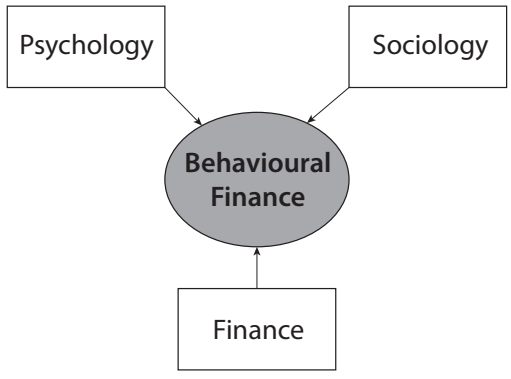
Before psychology developed as a separate science, economists considered themselves the psychologists of their time. A behavioural component has always been incorporated into economics, which has caused occasional turmoil in its history. At the beginning of the 20th century, economists and psychologists integrated the science of psychology into economics. It can be said that today behavioural economics represents a theoretical framework whose beginnings and history have been the subject of numerous research (Ricciardi & Simon, 2000). Behavioural economics can be defined "as a combination of economics and other social sciences that are more descriptive of behaviour. It arises when economists combine research and methods from economics and other social sciences with the aim of improving the descriptive value of economic theory" (Weber & Dawes, 2005). Behavioural economics researches the "way in which emotions and the mental structure of humans impact the process of making economic decisions" (Anger & Loewenstein, 2007). The essence of behavioural economics lies in its believing that it will improve the way we understand economics based on different results from empirical research (Diamond & Vartiainen, 2007).

Behavioural psychology is only one of the directions within the psychological scientific system and its subject of research, which is limited to a certain extent to the study of behaviour as a visible and measurable manifest form of existence, cannot even conceptually encompass the economic reality. The contribution of behavioural psychology and its discoveries in the field of behaviour, both for psychology and for other scientific disciplines, is unquestionable. But that's just a drop in the ocean. Psychology has a much larger complex of discovered laws of human behaviour and theories and it is simply unnatural that the relationship between psychology and economics is designated as behavioural, despite the fact that the Nobel Prize was awarded in the domain of psychological study of the economic model. American psychologist Daniel Kahneman and economist Vernon Lomax-Smith, winners of the Nobel Prize in Economics in 2002, laid the foundations of behavioural economics as a scientific field by pointing out the necessity of psychology in predicting and explaining human behaviour. Another winner of the Nobel Prize for achievements in this field in 2017 was Richard Thaler, a professor at the University of Chicago. By studying the effects of bounded rationality, social preferences, and lack of self-control, Thaler showed how given traits influence certain decisions and outcomes in the market.

3. BEHAVIOURAL FINANCE

Irregularities observed in the market that are not in accordance with the standard economic model that encouraged the development of the behavioural economics, are most represented in the financial sector. Behavioural finance is the most developed area of behavioural economics. Unlike traditional finance that relies on rational decision-making, behavioural finance introduces the component of irrationality, leading to the emergence of a new paradigm known as behavioural finance (Kumar & Chandel, 2018). In order to make more effective decisions in the financial market, it is necessary to get into the essence of behavioural finance, which combines cognitive psychological theories with conventional economics and finance (Sharna & Sarma, 2022). They aim to improve the understanding of financial markets and their participants using the behavioural sciences (Baltussen, 2009). The starting point for defining behavioural finance is defining psychology, sociology and finance and looking at their relationship, Figure 1.

Figure 1. Interdisciplinarity of behavioural finance



Source: (Ricciardi & Simon, 2000)

It has already been highlighted that psychology is a science that includes the systematic study of the psychological life of humans and animals based on the scientific study of objective behaviour and direct experience.

Sociology is a general science of society that studies "the origin, development, organization types, structure and dynamics of society as a whole, as well as individual social organizations and institutions" (Trebješanin, 2008). Sociology is closely related to psychology, but it should be emphasized that they have a different angle of observation in the study of the same subject: sociology investigates the connection of certain social and psychological events, and psychology the subjective aspect of social phenomena. Finance is defined as the science of money management. They cover three main areas: investment, financing and asset management planning (Van Horne & Wachowicz, 2007).

Elements of psychology in behavioural finance: cognitive psychology, perception, heuristics, thinking and expectation. Cognitive psychology is an area of psychology focused on understanding and explaining psychological processes. It emphasizes the importance of cognitive structures and functions for all aspects of human experience and behaviour (Trebješanin, 2008). Perception is the process of sensation, organization and interpretation of stimuli with the aim of determining their meaning (Robbins & Judge, 2010). Its determinants are physical, physiological and psychological in nature. It is not only a simple and passive reflection of reality, but also involves connecting sensory data with previous experience, categorizing them and giving them meaning. Heuristics is a part of scientific methodology and represents the ability to find the truth or new facts and insights. Thinking, in a broad sense, includes any cognitive process of processing ideas, representations, images, symbols and concepts. Critical thinking is "an opinion that is based on a systematic, impartial and careful examination of facts, premises, evidence and conclusions. Critical thinking is based on reason and facts and is independent of any authority" (Trebješanin, 2008), while in philosophy or science it is non-dogmatic, free from emotions, passions, prejudices, common sense and stereotypes. The expectation is the degree of belief in the possibility of achieving the desired goals with the help of the undertaken activity, i.e. "a cognitive-mental-motor attitude, an attitude of orientation towards what will come, which is anticipated based on past experience" (Trebješanin, 2008).

Behavioural finance brings psychology, sociology, and other research methods to the study of investment behaviour to explain how investors process information and take certain actions (Zhang & Zheng, 2015). This is in stark contrast to the traditional financial paradigm, which attempts to explain financial decisions by assuming that markets and many of their participants and institutions are rational (Baltussen, 2009). In a broader sense, behavioural finance "is the study of how psychology affects finance, that is, how human behaviour affects the price of assets" (Schinckus, 2011).

The fact is that many of the fundamental models of modern finance are based on assumptions about the rationality of investors and efficient markets. The assumptions for rational decision-making are: the problem is clear and unambiguous; one, well-defined goal should be achieved; all alternatives and consequences are known; priorities are clear, permanent and stable; there are no time and cost restrictions (Robbins & Coulter, 2005). Rational investors are the basic prerequisite for efficiency. However, modern capital markets are exposed to constant changes and risk that lead to anomalies in the behaviour of market actors, and investors make their decisions in conditions of limited rationality. Heuristics are simple, generally accepted, unwritten and untested rules, judgements, guesses and mental short-cuts, among which stand out: "1) representativeness – reasoning based on stereotypes and analogies, 2) availability – reasoning based on the most available information and 3) anchoring – reasoning based on initial assessments" (Todorović, 2011). The framing effect refers to the way the problem is formulated. For example, if a decision is framed as a gain, people will show risk aversion, and if the same decision is framed as a loss, they will show a tendency to risk. Instead of assessing the fundamental value of stocks, "investors try to guess future stock prices, diversify too little, trade too much, hold losing stocks and sell winning stocks, etc." (Todorović, 2010). The two basic elements on which behavioural finance is developed are cognitive psychology (people are not rational) and the previously explained limitations of arbitrage (markets are not efficient). Behaviourists in corporate finance are considering a setting in which managers believe and think that when making financial and investment decisions they are working to maximize the fundamental value of the company, but due to psychological traps, they do not do that in reality. Managers' beliefs and preferences are often not logical, nor are these beliefs converted into decisions in a consistent and rational manner (Todorović, 2011).

It was highlighted that behavioural finance refers to decision-making regarding investment, financing and asset management planning. The study of decision-making processes and problems is the subject of decision-making theory. Theories of decision-making can be defined most simply as theories about decisions that define a set of general rules for making decisions in all spheres of life (Hansson, 2005). Decision-making theories can be normative and descriptive (behavioural). Normative theory deals with the concept of rationality and the logic of making decisions, as they should be, while descriptive theory deals with the discovery of these concepts in practice, as they are. The basic concept of normative theory is the concept of a perfectly rational decision-maker who has the ability to precisely formulate a problem and define the alternatives by which they can solve it in order to maximize

their well-being. Descriptive decision-making theories are concerned with describing the way decision-makers think, solve the problems they face, and the reasons why they decide on certain solutions. Descriptive theories of decision-making have their origins, to the greatest extent, in the field of experimental psychology.

The task of descriptive decision-making theories is to describe events in a real decision-making situation, while avoiding giving any value judgements about the quality of the decision that was made. Among the many descriptive decision-making theories, the most important are: behavioural decision-making theory, social choice theory, expected utility theory, naturalistic decision-making theory and image theory (Bell, Raiffa, & Tverski, 1988). Very often, behavioural decision-making theory is equated with descriptive decision-making theories, despite the fact that it represents only one of a large number of descriptive theories. Behavioural decision-making theories are based on the view that people have limited information processing abilities and that they lack the ability and motivation to perform the set of important calculations on which rational choice models are based (Gilovich & Griffin, 2010).

Behavioural economics has a wide range of applications. The results of numerous researches that had as their subject the rationality of investment decision-making have showed that this decision-making process is influenced by: gender and level of income (Kumar & Goyal, 2016); age, profession and frequency of trade (Prosad, Kapoor, & Sengupta, 2015); portfolios of older age groups and female investors achieve better performance (Talpsepp, 2010); male and female investors differ radically in terms of the disposition effect, herd effect tendency, and self-confidence when making investment decisions (Lin, 2011); investor beliefs and preferences (Sahi, Arora, & Dhameja, 2013); personality traits (Durand, Koh, & Tan, 2013); sources of information (Tauni, Fang, & Iqbal, 2016); emotions (Shen, Najand, Dong, & He, 2017); extroversion (Andreas, Stefan, Florian, & Matthias, 2018). Also, the perception of realised past portfolio returns affects individual and institutional risk-taking (Khan, Tan, & Chong, 2017). The aforementioned differences in investment decision-making should be taken into account when formulating a corporate governance model in order to make optimal decisions based on a holistic approach. Newer behavioural financial concepts have also been developed in this direction.

4. IN SEARCH OF A MODEL OF EFFECTIVE CORPORATE GOVERNANCE

The understanding of economics and our thinking depends on the current paradigm, which is part of the overall paradigm of understanding the world at a certain point in time.

The hologram paradigm, by changing the angle of observation and breaking the blockage of the mind, is a generator of the development of scientific thought. From the holographic paradigm, which says that the part is in the whole and the whole in the part" (Van Daele, 2018), the dimensionality of the connection and conditioning of the part and the whole is indicated, which initiates the need to change the way of thinking. It basically says that the change of any little part of the community in the direction of decomposition will lead to the change of other elements of the community and its decline. The accumulation of wealth in one part and the impoverishment of other elements is a manifestation of destruction and leads to system imbalances, fractures and its breakdown.

By comparing the function of inter-structural changes in social reality and the correlation index of changes in scientific fields along the lines of paradigm shift, we can say that the capacity of classical psychology has been used to the greatest extent in economics and that the rest of the capacity potential is not a function of systematic and structural changes in the economy.

The effect of gradual building through quantum leaps is a natural pattern present in almost all life processes. It is interesting that this quantum leap effect is also encountered in the processes of social development. For the sake of illustration, we can refer to the process of civilisational development, i.e. the development of civilisations that, after the phase of initial gradual development of the construction of fundamental structures and their connections, enter the phase of dynamic development with the opening of crisis lines through which crisis situations come as an expression of alienation from the natural order and existential purposefulness in order to warn the society about the re-examination of basic life settings that are in the function of sustaining life and are united in a moral system that represents the soul of a civilisational being at the level of civilisation. The graphs of the development of civilisation represented by the coordinate system show the correlation of technological-technical and moral development in an inverse proportion. The maximum of one is followed by the minimum of the other and at that tipping point is where civilisations suddenly disappear. Looking at the current civilisation, periods of cyclical deepening of crises of universal segmental connection can be observed. There are talks about the economic crisis, the family crisis, the crisis of the education system, the crisis of the health

system, the crisis of identity, the crisis of morals, and there are large intercontinental paradoxes that keep warning us. Let us mention one of the paradoxes – the largest percentage of capital is owned by a very small part of the population. This paradox reflects all the illusory and dysfunctional nature of theoretical multidisciplinary knowledge that is claimed to be scientific. Societies are surrounded by shamelessness and immorality, which penetrate into the very essence of life and its sustainability. And we will take it as the starting point for considering the holographic paradigm, which implicitly indicates that we are all parts of the whole and that the whole is in each of us.

The key to understanding lies in understanding our personalities and discovering the matrix of meaning and purpose. The solutions to the existing crises cannot be found within the existing systems of knowledge and morality, but exclusively in the return to primordial values or in the application of the existing paradigms that are a cry for help and an expression of the cosmic regulatory system as an attempt to predefine basic values and change the direction of movement. It is interesting that the power of the paradigm, in this case the holographic one, is very visible in biology, neurology, physics, mathematics. The universality of the holographic paradigm is reflected in the applicable possibilities for solving the most significant crises in all the mentioned areas and beyond. If we look back at the basic crisis points in the economic science and in the society, we will notice the failure of structural solutions and the exhaustion that leads to indifference and loss of will while surrendering to life processes that lead to the complete devaluation of life and its extinction.

The key elements of management are: who manages; what they manage; on whose behalf they manage; ownership structure of life; laws of successful management. We can find all these elements in the model of the bee colony, and modelling the behaviour and organisation of the bee colony can serve as a basis for creating an economic model of successful management in the function of sustainable development. The basic characteristics of the bee colony are: the collective above the individual; clear division of roles; selflessness; dedication, clear communication; efficiency; creating values of universal application; the medicinal value of the product; creating shared prosperity; community work rhythms aligned with cosmic cycles; environmental friendliness; integration into the planetary purposefulness and the service of sustaining life.

After understanding the hologram paradigm and insight into the mechanism of the emergence of new higher cognitive structures in the function of restoring biological balance and balancing all other aspects of the life of a social being and community, we can freely express the opinion that the quantum economics has been conceived and that its anatomy is slowly taking shape. It is a cosmic response to destructive processes and the alienation of life from the source of life by moving towards total materialism, sickness and autism of civilisation, which ultimately leads to destruction.

In the work of a prominent economist of our time, "Economics of Good and Evil" authored by Tomas Sedlacek, we notice a clear connection between the economics and the value system of morality. (Sedlacek, 2011): “Economics is nothing but a hidden value system.” It is a big mistake to believe that economics is devoid of value. It is actually filled with values and nothing related to economics is without value. Every business decision, every consumer decision is actually a moral decision. Sedlacek observes the essential connection between morality and economics and points to the primary problem of today's global crisis, which is not in the global financial institutions that model the economic flow, but in ourselves and the acceptance of value systems that form a consumer society oriented towards consumerism whose function lies in us losing our economic and, consequently, personal freedom. Also, it indicates the need to re-examine our beliefs, which clearly speaks in favour of the thesis for a fundamental change in the value system and the liberation of the enslaved mind.

Let us outline the principles of quantum psychology, which are applicable in economics and offer the possibility of creating a model of optimal quantum management of all forms of economic systems that would be part of wider life systems united in the cosmic information field. It is interesting that by creating this model, we would also get a diagnostic apparatus for the economic system and economic processes that would objectively point out the nodal points of communication interruptions within it and blockages that lead to disturbances and turbulence in the monetary system. It is analogous in the human structure. The interruption of communication between cells leads to energy stagnation and disorder which, if not removed, develops into a disease of the organ, and later of the organism and system. By developing the quantum principle in psychology, medicine, biology, linguistics, and hopefully economics soon, humanity is being offered transformation and healing through regeneration.

5. CONCLUSION

By looking at economics as a scientific discipline that deals with the study of rules of behaviour and economic laws in economic activities, one loses sight of the entirety of life's reality and the problem of discerning the meaning and purpose of the life process and life activities, both at the individual level and at the level of groups, subgroups and communities. This paper and opinions here given do not diminish the importance of such a narrowly understood

economics, but give the perspective of its connection with the matrix form of life manifestation and the possibility of synthesizing previous scientific knowledge along the lines of the overall purposefulness of life activities. Life is a complex energy field and wave-particle structure in which the part is in the whole and the whole in the part. Injustice to someone is transmitted to the whole system and is a destructive process of decomposition.

This paper can be seen as a small contribution to the creation of the quantum economics and the understanding of the basic knowledge flows that offer solutions to today's intractable problems. Economic energy is a manifest form of life energy that regulates the proper distribution of material goods and their proper use for the sake of harmonised and balanced development of the individual, local and wider community and society while preserving and improving the natural environment.

6. LITERATURE

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