The subject of behavioural finance is not of very recent origin. Some of the concepts of this subject, in a rudimentary form though, saw the light of the day during late seventies when the academic journal 'Econometrica' was published which perhaps for the first time described the terms 'risk' and 'uncertainty' and gave an idea of how people managed it. It was also for the first time that psychological approach was merged with economics and financial theory which gave birth to a new field of Finance commonly known as 'Behavioural Finance'. This branch of Finance, as a rapidly growing field, gained popularity since early nineties which is not a standalone financial concept but emanate from psychology, sociology and even anthropology. The uniqueness of this subject is its integration of different schools of thought and the multi disciplinary relationships between psychology, sociology, economics and finance.

Behavioural Finance deals with the study of psychological influence on the behaviour of financial practitioners (could be even common people dealing in finance) and the effect that it has on markets. The subject basically, attempts to explain why and how people who are otherwise intelligent and sensible sometimes make irrational and illogical decisions when it comes to spending / investing / saving / borrowing money. These decisions made by them are often triggered by their emotions and the state of their mind prevailing at the time of making such decisions. While traditional finance presupposes that every investor is expected to take a rational decision objectively after due consideration of risk and return, behavioural finance is based on the premise that emotions and 'herd' instincts play an important role in influencing decisions and their perceptions of risk and return are also significantly influenced by the way they take decisions.

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Some of the principles on which the edifice of behavioural finance is built are prospect theory, regret and cognitive dissonance, over confidence, over-and-under reaction, herd behavior etc. In 'herd' behavior, for instance, most individuals tend to emulate the actions (rational or irrational) of a large group though individually everyone may not necessarily make the same choice. It is interesting to note that the heard behavior is not restricted to individuals only; a group of people collectively living in one country may even mimic the actions of a group of people living in some other country. Consequently, the behavior of financial market in a particular country may have an impact on the behavior of markets in another country. On 22nd September, for example, the BSE SENSEX tanked 700 points based on 'weak global cues' while it bounced back and soared close to 500 points on 27th September based on 'firm global cues'.

Although every individual is expected to act rationally, while making an investment decision, more often than not, there happens to be a departure from this thought process as people have a tendency to 'anchor' their thoughts to a particular point albeit that may not be logical or prudent from financial stand point. For instance, a person may feel that the price of a particular stock may increase (or decrease) over a period of time and may buy (or sell) the same purely based on his individual perception. Again, an investor may take an investment decision based on certain preconceived notions even though the decision could nowhere be near logic or rationality from financial stand point. This is what is known as 'confirmation bias'. A case in point is the tendency among the Indian older generation (mostly senior citizens) to confine their investments only to post offices or FD's in nationalized banks.

Another important principle of behavioural finance is the 'over reaction' or 'under reaction' where either too much or too less weightage is attached on recent news. A person, for example, may decide to buy or sell shares of a particular company based on news about merger / demerger of that company and thereby either over reacting or under reacting in the process. The 'regret' theory speaks about people's emotional reactions regarding an error in judgement which they might have made at some point of time. An investor may avoid selling stocks that have decreased in value to avoid the regret of having made a bad investment decision or embarrassment of incurring loss. Thus, instead of looking for an opportunity to minimize the loss, he would rather prefer to hold them justifying the 'regret' theory.

To conclude, I deem it appropriate to admit that the cover theme of this issue is mainly of academic interest not having much bearing on the accounting profession in general and cost accounting profession in particular. Yet we decided to go ahead with this theme in view of the rapidly growing importance of the subject as an important branch of finance and the major research work that is being carried out in this area by the researchers and the academic fraternity across the globe. The articles published in this issue may have more of a theoretical perspective, nonetheless I am sure, they will make a good reading and will enhance the knowledge base of the esteemed readers.

We wish you a happy reading!