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An Empirical Investigation into the Psychological Determinants of Irrational Investment and Spending Patterns among Young Adults

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ABSTRACT

This paper looks at psychological factors that may influence how young adults spend, save and invest their money. Money decisions are often assumed to be well thought through and the best option chosen, however in reality they can be influenced by factors such as confidence, fear of loss, the influence of others, emotions and ease of digital payments. This study looks at behavioural factors such as overconfidence, loss aversion, mental accounting, anchoring and herding. It also takes into account financial literacy and digital influences. This study taken a descriptive quantitative approach to look at young adults of approximately 18-25 years old. This focused on undergraduate and postgraduate students within the Mumbai Metropolitan Region. The questionnaire would look at how young adults spend their money, their saving and investment decisions, how they feel about their money and peer influences. The results could then be summarised using percentages and descriptive statistics. Suitable statistical tests could be used where possible. As there are no completed results within this presentation, no made up percentages will be reported. No claims will be made that either hypothesis has been accepted. This will give background to the topic, the research framework, methodology and potential practical applications.

Keywords: *Behavioural Finance, Young Adults, Financial Literacy, Loss Aversion, Mental Accounting, Impulse Spending, Investment Decisions.*

Introduction

Making decisions about your money is a part of daily life. Young adults may have to make decisions about saving a portion of their income, buying something they saw online, following a friends investment idea or avoiding an investment due to a worrying story. Although these decisions can appear straightforward, there can be many influencing factors. These can include feelings, habits, peer pressure and how information is presented.

Behavioural finance can be used to understand why people may not always make the most rational decisions. It draws from psychology to understand how people make decisions with their money. It looks at how people respond to gains and losses, how they perceive risk and why they may have habits.

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This topic is particularly relevant to young adults as many are still building up their financial habits. With the rise of digital payment services, shopping apps and easy access to online investment platforms, financial transactions are now easier. Whilst this can be a positive, it can mean less thinking time is spent. Peer advice from friends, influencers or online communities may also influence financial decisions.

This study looks at psychological factors that may be linked to irrational investment and spending behaviours in young adults. This isn't to suggest young adults are reckless with their money, but to understand situations where a persons judgement may be influenced by predictable mental shortcuts and emotions. Also looking at how financial education could help.

Review of Literature

- Prospect Theory & Loss AversionProspect theory was introduced by Kahneman and Tversky (1979). This looks at how people make decisions involving risk. It was shown that people don't always make neutral consistent decisions. This means that if a situation is framed as a loss or a gain, it can be perceived differently. This can help to understand why investors may feel strongly about their investment dropping in value or why they may be more influenced by the fear of losing money than gaining the same amount.
- Mental AccountingMental accounting is how people categorise their money in their heads (Thaler, 1985). For example, someone may be more careful with money they have saved for their college fees, but be more generous with money they have received as a gift or bonus. This can help people plan their budgets but can cause inconsistent decisions.
- Overconfidence & Peer Pressure Overconfidence is when people are overly confident in their knowledge or judgement. This can cause people to trade or invest without doing enough research. Herding is when people follow others decisions. Young adults may become interested in an investment due to their friends talking about it or lots of people online making money from it.Whilst this doesn't necessarily mean they will make the wrong decision, it can become an issue when popularity is prioritised.
- Financial Literacy & Behavioural Education: Financial literacy is having the knowledge and skills to understand concepts such as interest, inflation, risk, saving and diversifying. Having knowledge can help people make comparisons. Whilst knowing the correct concept may not always be applied under pressure. The OECD (2018) look at how behavioural insights can be used to improve financial literacy and investor education. This suggests that education would be more useful if it included financial knowledge and practical ways to identify emotional triggers and habits.

These concepts can be used to understand how young adults handle their money. This project looks at well known concepts and applies them to a student focused scenario. It looks at investment decisions and everyday spending. This project aims to look at these factors together in a local context.

Research Problem and Rationale

Young adults face many financial decisions throughout their lives. They won't have much experience with budgeting, saving or investing. Some decisions may be influenced by fear of loss, overconfidence, peer pressure or ease of digital transactions. However this may not apply to all young adults the same. Factors such as financial knowledge, personal experiences, income and situation may influence decisions differently.

Research Objectives

- To identify any psychological factors linked to irrational spending and investment behaviours in young adults.
- To Investigate how overconfidence, loss aversion and peer pressure may influence financial decisions.
- To Understand how budgeting habits and mental accounting can influence how young adults use their money.
- To Consider how financial awareness and practical education can encourage more thoughtful financial decisions.

Research Questions

- To what extent are cognitive biases such as anchoring and herding associated with everyday investment and spending decisions?
- How is financial literacy related to the relationship between emotional state and financial risk taking?
- How are digital features such as one click payments and rewards through apps related to impulsive financial behaviours?
- What types of financial education can help young adults identify behavioural biases and be more careful with their money?

Research Hypotheses

H_0 **Null Hypothesis –** There will be no statistically significant relationship between psychological factors and irrational investment and spending behaviours in young adults.

H_1 **Alternative Hypothesis –** There will be a statistically significant relationship between psychological factors (overconfidence, loss aversion & peer influence) and irrational financial behaviours.

These hypotheses will need to be tested using the completed data from the survey. Until data has been collected and analysed neither hypothesis can be said to be supported or rejected.

Research Methodology

- **Research Design**

This study would take a descriptive approach using quantitative methods. Using a structured questionnaire would allow comparisons to be made between answers. If each participant completes the questionnaire once it would be a cross-sectional study. This can identify patterns and relationships but cannot prove causation.

- **Population & Sample**

The target population would be young adults aged approximately 18-25. This would focus on undergraduate and postgraduate students studying commerce, management and accounting within the Mumbai Metropolitan Region. Approximately 250 participants would be targeted.

Convenience and purposive sampling could be used to ensure participants are easily accessible and fit with the criteria. As this is a non-probability method the results should only be seen to represent those who participated.

- **Data Collection**

Primary data would be collected using a structured questionnaire. This could be completed online (e.g. Google Forms) or physically. Using closed questions and a consistent Likert scale can help participants answer how often they experience a behaviour or how much they agree with a statement. Questions could include impulse spending, peer and social media influence, confidence in financial knowledge, reaction to losses in investments, budgeting habits and use of digital payments.

Secondary information would be gathered from academic books, peer reviewed articles and credible reports from institutions about behavioural finance and financial education. Participants should be informed about the purpose of the study, they should complete it voluntarily and their answers should be kept confidential. The questionnaire shouldn't ask for unnecessary personal information.

- **Data Analysis**

Once data has been collected it can be checked to see if there are any missing or inconsistent answers. It can then be analysed using Microsoft Excel or SPSS. Categorical questions would be best represented using frequencies and percentages. Multi-item scales could be represented using means and standard deviation. Depending on the variables and if assumptions are met correlation, chi square or regression could be considered. The type of test should depend on the data.

Data Interpretation & Results

As there are no completed results within this presentation the data interpretation slide has prompts for the percentages of peer influence, impulse spending and fear of loss. Therefore honest results cannot be reported. This should be completed once questionnaire responses have been collected and analysed.

In order for percentages to be correctly applied, you should use the number of valid responses to each question as your denominator. Not all questions may have the same amount of valid responses if there are some missing responses. Any graphs in your final paper should also include a clear title, axis labels, quantity of responses and the percentage/scale being shown.

Decision on hypothesis based on statistical evidence.

- **Suggested Results Table**

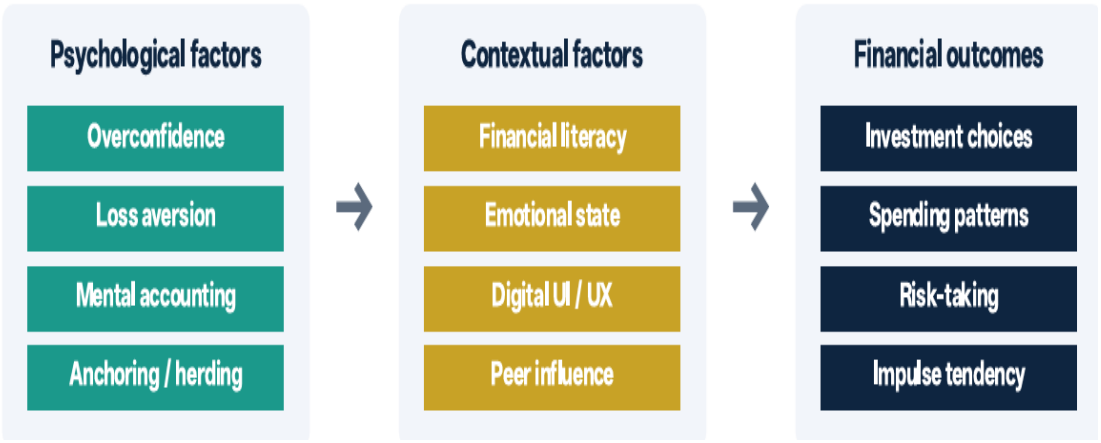
Measure	Number of Responses	Percentage	Interpretation
Peer/friend/social-media influence	To be entered	To be calculated	Describe how common reported influence was.
Unplanned or impulse spending	To be entered	To be calculated	Discuss the frequency of unplanned purchases.
Fear of investment loss	To be entered	To be calculated	Describe reported reactions to possible or actual losses.
Budgeting / planning habits	To be entered	To be calculated	Compare reported planning habits across respondents.

- **Discussion**

Your discussion should highlight the most common responses and what they may imply. For example if there was a high quantity of responses stating that peer influence played a large role, this may mean that there is an aspect of social context to consider within financial education. However this does not necessarily mean that poor financial decisions were caused by peer influence. As well as identifying correlations such as financial literacy and spending behaviours, the relationship must be described rather than concluding causation unless there is evidence from your research design.

Discussion & Practical Implications

From the theories covered in this paper there are several possible implications. Loss aversion could be used to understand why they may react strongly to a potential loss. Mental accounting could impact how they allocate money to spend or save. Overconfidence and herding may impact how they perceive investment information. The use of digital payment methods could make them feel that transactions are quick and easy therefore they may not stop to think before spending. Whilst these are all possible reasons to investigate, they are not proven until the survey has been completed.



To practically apply this, you could educate individuals on financial concepts and how to make decisions in everyday life. Students may learn how to compare information from multiple sources, ensure they are aware of the risks involved when investing, create a budget and reflect on any impulsive purchases. Additionally financial education could help them to understand common biases with relatable examples. This can help improve their decision making, however it does not mean that all spontaneous purchases and risky decisions are irrational.



Limitations

- Convenience and purposeful sampling may not be representative of the general population of young adults.
- Self-reporting can be biased due to memory, personal interpretation and/or wanting to provide socially acceptable answers.
- As this is a single survey, you will not be able to identify cause and effect but will be able to identify patterns and correlations.
- These conclusions will depend on the final sample size, how clear the questionnaire is and the quality of the measurements.
- Until the data has been analysed you will not be able to make any claims regarding how prevalent certain behaviours are.

Conclusion

Making financial decisions isn't always done with careful consideration. Psychological habits, emotions, confidence, loss aversion and social influence can all play a role in how someone spends/invests their money. Using behavioural finance can help you understand these influences without assuming everyone will act the same.

This paper suggests completing a survey with young adults, specifically students in the Mumbai Metropolitan Region. It combines ideas surrounding overconfidence, loss aversion, mental accounting, peer influence and financial literacy. By analysing the data you will be able to identify patterns in responses and see how certain factors relate to each other.

Once the questionnaire has been completed and the real data has been added in place of the placeholder results, the findings can be discussed. From this you will be able to decide if there is evidence to support the null/alternative hypothesis. Overall the key practical implication is understanding how we make financial decisions is an important step to making them more intentional.

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