UDC 336.681.3.07 https://doi 10.31548/economics14(1).2023.002

THE INFLUENCE OF BEHAVIORAL BIASES ON FINANCIAL MANAGERS' DECISION MAKING

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Abstract. *Behavioral Finance becomes more important in connection with the massive work of financial professions, when the accounting and financial work created should ensure the uninterrupted functioning of finances in conditions of their permanent orientation to changing human needs. In conditions where the algorithms created on the basis of classical finances do not take into account the irrational moments of human behavior, behavioral tools become a means to prevent crashes of new mechanisms for finance functioning in a new digital economy.*

The purpose of the article is to study the basic theories as well as the stages of formation and development of behavioral finance as an important area of financial research and to justify the need for its further evolution in modern conditions.

The article consistently reveals the economic essence and role of behavioral finance and the principles of effective interaction of business entities in the context of behavioral economics, which should be based on the principles of trust, information transparency, coherence of interests, responsibility, compliance with ethical standards, financial inclusion, and mutual benefit. The necessity of behavioral finance study as an independent direction of modern financial research is considered. The basic theories and stages of the formation and development of behavioral finance are highlighted.

The article outlines the criteria for substantiating and choosing managerial decisions. The features of the behavioral model and factors influencing the making of an irrational decision by a business entity are revealed. The most common effects that provoke irrational behavior of economic entities are highlighted.

Some aspects of behavioral finance's influence on the decisions of enterprises' financial managers are revealed with the definition of the role of incentive motives and psychological factors in the choice of an individual's financial behavior model and their investment decision-making. The necessity of further research on individuals' behavioral strategies in modern financial research is grounded.

Keywords: *behavioral finance, management, financial management, irrationality, financial decisions, risk, business entities.*

Introduction.

The need to improve the theoretical and practical aspects of the financial management system of a business entity is due to the existing contradictions associated with the main purpose of management, which requires stability in making effective management decisions.

Behavioral finance is currently one of the new areas of research in the psychology of business entities. It considers an individual not as a rationally thinking person but as a socialized organism that makes decisions under the influence of stereotypes that take place in society and preconceived ideas or emotions [19]. Therefore, behavioral finance provides an opportunity to consider modern economic processes from the standpoint of irrationality in the behavior of financial managers, which is caused by external and internal factors. External factors are associated with management decisions made by financial managers aimed at increasing the value of the business but which result in its reduction. Internal factors are the losses of business entities caused by the mistakes of managers, due to limited cognitive resources or excessive emotionality. In the context of modern challenges, behavioral finance is an important research tool in decision-making by business entities. After all, the adoption of irrational decisions by business entities has a negative impact on the development of enterprises and companies, which requires the study and understanding of the psychology of management decision-making by financial managers and the possibility to avoid the most common mistakes.

Analysis of recent researches and publications.

The essence of behavioral finance is revealed directly through financial relations between business entities, legal entities and natural persons regarding the attraction and investment of financial resources in accordance with the needs of stakeholders.

The theory of behavioral finance has become widespread in developed countries. The main representatives of this theory are G.F. Akerlof, G. Becker and D. Kahneman, C. Loibl, J.J. Stiglitz, R. Thaler, T. Hira, R. Shiller, and others. Supporters of classical financial theory consider payable dividends and corporate profits as ideal substitutes and judge investors' preferences, stock prices, and expected returns as mutually independent concepts. However, real investment practice shows that investors' preferences and their risk sentiment are not always rational from the standpoint of traditional theory, which should be taken into account by financial managers when forming an effective dividend policy for the company.

Studies by M. Baker and J. Wurgler show that there is a stable relationship between the demand for stocks on which dividends are paid and the number of companies that pay them [1]. J. Stiglitz argued that the market is not always able to provide the necessary amount of information, so the state should develop regulations that oblige market participants to disclose certain information [2].

Richard Thaler, the 2017 recipient of the Nobel Memorial Prize in Economics (Mental Accounting), with the help of simple calculations proves that humans are irrational beings, but they can be "pushed" to make rational decisions. Thus, thanks to well-calculated psychological methods, government institutions can force citizens to pay taxes on time and comply with the law, and companies can better understand their customers, increase their sales, and properly stimulate their employees without affecting the individual's freedom of choice [3].

D. Kahneman and A. Tversky proved in practice that in conditions of uncertainty, people are not able to conduct a comprehensive analysis of the problem they face. Risk can be avoided, but at the same time, one can have a tendency toward it. That is, under such conditions, people behave irrationally in their actions [4].

It is important to note that in 2002 and 2017, the Nobel Committee awarded economists who directly researched behaviorism (D. Kahneman, V. Smith and R. Thaler), and in other years the Nobel Prize was awarded to scholars whose studies were related to the postulates of behaviorism.

In the Ukrainian economic sciences, a significant contribution to the development of behavioral finance theory was made by O. Tereshchenko, T. Kyzyma, V. Zymovets, S. Kuzmuk, O. Ostrovska, A. Cherniavskyi, N. Yakymova, and others.

In particular, the use of behavioral finance in controlling, which involves actions' monitoring based on the "principal – agent of conflict" concept, is sufficiently disclosed in the publications of O. Tereshchenko [5]. T. Kyzyma considers general blocks regarding the role of behavioral finance [6].

S. Orliv notes that in the modern theory of managerial decision-making, it is customary to distinguish two main theories: normative (or rational) theory, focused on the normative side of decision-making, and behavioral (or psychological) theory, which reveals and describes how management entities actually make and form decisions [12].

The publications of P. Nikiforov reveal the behavioral concept of finance. He notes that under the influence of the existentialism philosophy, the behavioral direction in the study of finance was formed [7]. Publications of V. Krykun consider behavioral economics in the study of the Ukrainian banking system [8]. Given this, it is important to study the influence of behavioral biases on financial decision-making by business entities, which will allow them to assess and predict their actions in this important process.

Purpose. The purpose of the article is to substantiate the behavioral biases inherent in the process of making financial decisions by business entities.

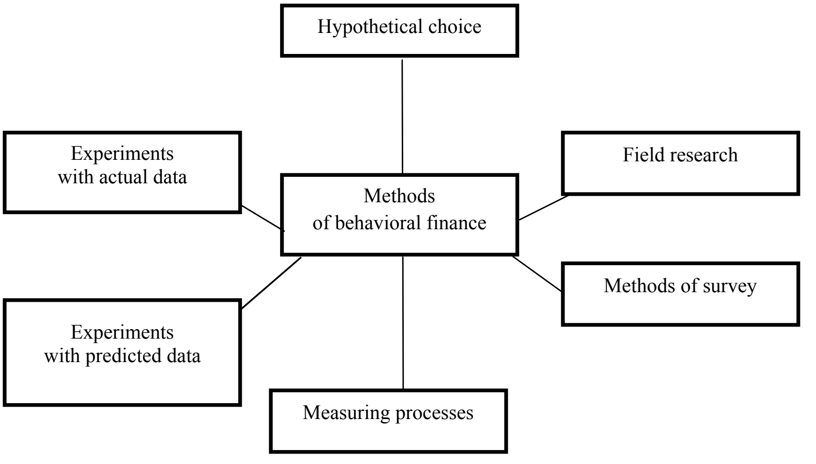

Fig. 1. Research methods in behavioral finance*

*compiled by authors on [10]

Materials and methods of research.

Analytical tools and technologies of corporate finance form a new financial model of enterprises' management, and the key vectors of their development indicate systemic transformations at the macro and micro levels of management [9].

One of the most common ideas in behavioral finance is the experimental concept of studying economic phenomena. The basis of this concept is the use of experiments as a research tool. However, the fact that behaviorists use a variety of methods makes their methodology eclectic and distinguishes them from scholars who support the experimental concept (Fig. 1).

In addition to the methods shown in Fig. 1. in the study of behavioral finance, the method of functional magnetic resonance therapy is also used, which is carried out to measure hemodynamic reactions (changes in blood flow) caused by neural activity of the brain or spinal cord and demonstrates the response of the latter to various kinds of stimuli (including visual ones). That is, psychological phenomena have a significant impact on financial activities because financial decision-making is usually accompanied by risk and uncertainty.

Results of the research and their discussion.

The need to improve the theoretical foundations of the financial management system of business entities is due to the existing contradictions arising from the impossibility of adapting the main goal of management, which requires strengthening the effectiveness of management decisions. One of the new directions of modern financial science is the study of behavioral finance theory. Traditionally, behavioral finance studies the relationship between financial decisions and psychology at the macro level. It helps to understand why individuals buy or sell financial instruments, ignoring the results of fundamental analysis, and behave irrationally in making financial and investment decisions.

Behavioral finance makes it possible to understand the causes of the irrational behavior of business entities through the prism of a person's limited cognitive abilities (as a result of a number of behavioral effects) and their affective states.

Transformations taking place in the modern world cause qualitative changes in understanding the dynamics of economic processes, which are often non-stationary and, as a result, poorly controlled. In such conditions, neoclassical economic theory, based on the postulate of economic agents' rationality, does not provide a correct explanation of the processes taking place. This is also true for corporate finance, most of whose management models are based on the assumption of investors' rational behavior on the market.

To adopt effective decisions, it is necessary to clearly define the basic system of decision-making models at the enterprise. Management decision is an instrument of influence on the management object and its individual subsystems, is an important link in the formation and implementation of management relations in the organization, and forms the basis for the implementation of each management function in the enterprise.

Modern conditions of decision-making are characterized by dynamism, which means a quick reaction to changes and the ability to adjust the relevant management decisions, as well as a significant increase in the volume and complexity of information, growing resource shortages and environmental problems, increasing the probability of losses due to incorrect management decisions, etc.

In management theory, there are three main models of managerial decision-making at the enterprise [11]:

− classical model;

− behavioral model;

− irrational model.

The classical model is based on the rationality of managerial decision-making: in this process, the management entity has complete initial information, understands all possible alternatives for this action, and knows the consequences after the implementation of a certain variant. Such decisions are formalized and made under conditions of complete certainty.

The classical model has certain characteristics related to a decision-maker; this person:

1) has a clear decision-making objective;

2) has complete information about the decision-making situation;

3) has complete information about all possible alternatives and the consequences of their implementation;

4) has a rational system of ordering preferences by the degree of their importance;

5) has the goal to always make a choice that maximizes the result of the organization's activities [13].

The classical model of making and implementing a management decision involves the following stages: preparation, adoption, and implementation of the decision. When managing the implementation of a management decision, it is advisable to adhere to the following principles that allow effectively accomplish the tasks:

− the number of goals on which attention is focused should be limited;

− availability of inter-objective links;

− the basis for the decisions' implementation should be the chosen strategy and the corresponding organizational structure;

− availability of horizontal and vertical coherence;

− compliance of management decisions with the existing organizational structure of enterprise management;

− development of criteria by which the results are analyzed;

− the possibility of teamwork.

The behavioral model assumes limited rationality or satisfaction. When adopting decisions, the management entity does not have complete initial information for this action and cannot predict the consequences of each alternative. That is, this process is characterized by complete or partial uncertainty.

The behavioral model has certain characteristics related to a decision-maker; this person:

1) does not have complete information about the decision-making situation;

2) does not have complete information about all possible alternatives;

3) is unable or unwilling (or both) to predict the consequences of each possible alternative.

H. Simon explained making (or choosing) a decision as a process by which at any given time only one of many available alternatives is chosen for implementation [14].

Criticizing the approach of "comprehensive rationality", H. Simon offered the method of "limited rationality", which takes into account the incompleteness of the resources available in the decision-making process and emphasizes the expediency of choosing an acceptable alternative, rather than the best one. He considered rationality a choice of desirable alternatives of behavior arising from a certain system of values, with the help of which it is possible to assess the consequences of actions [15].

Supporters of the behavioral concept also drew attention to the fact that the decision-maker's brain can be filled with a significant amount of information. However, it can only process a limited quantity of it with a small number of alternatives. This is true even if the decision-maker wants to be rational, because there are numerous constraints on their rationality. Decisions are made when much less is known than can be known in principle.

The irrational model involves decision-making without exploring alternatives, the process is under conditions of complete or partial uncertainty.

The irrational model is mainly used:

1) to find fundamentally new, unconventional solutions in difficult situations;

2) to solve problems under time pressure;

3) when a financial manager or a group of managers have enough power to "impose" their decision.

The irrational model also includes sociological and psychological approaches based on the influence of human consciousness and relationships on the decision-making process. Sociologists study the decision-making process as a group interaction. Within the framework of the sociological approach, there are three main groups of theories that describe managerial decision-making: political interaction, collective learning, and corporate culture [12, p. 449].

The discovery of behavior stereotypes that have never been noticed by supporters of rational decisions belongs to the conclusions of the "Prospect Theory" [16], which, in our opinion, is the key theory of behavioral finance.

According to this work, scholars D. Kahneman and A. Tversky proved that under conditions of uncertainty it is impossible to think rationally, because in such circumstances a person sees only a part of the whole (i.e., the assessment of the probability of an event is invariably wrong). The authors also showed that a person is not able to conduct a comprehensive analysis of the problem encountered. That is, risk can be avoided, but at the same time, one can have a predisposition to it. In other words, under such conditions of uncertainty, a person will behave irrationally.

Another conclusion that can be drawn from the "Prospect Theory" scientific work is that people are more willing to take more risk to avoid losses than to get an additional profit for more risk. This, by the way, can explain the position of investors not to sell stocks that are falling in price but to sell those that are growing in price.

The behavioral phenomena that accompany decision-making by business entities include [17]:

– overestimation of probable losses and benefits – a widespread practice of buying lottery tickets or insurance policies, the average cost of which exceeds the income;

– disposition effect – the tendency to hold stocks that are falling in price and sell those whose price is rising;

– asymmetric price elasticity – the elasticity of a price increase is higher than its decrease by the same amount;

– rejection of bad news – ignoring news about the expectation of adverse changes and a permanent level of consumption.

The prospect theory divides a decision-making process into two stages: editing and evaluation. In the first one, risky situations are simplified when different choice heuristics are used. In the second one, risky alternatives are evaluated using various psychological principles.

Also, the "theory of risk and decision-making" (Allais paradox), which became the starting point for the analysis of uncertainty, the criterion of rationality in modern neoclassical economic theory, was recognized. Its author, M. Allais, the 1988 Nobel Memorial Prize in Economic Sciences winner, discovered a phenomenon during his research on decision-making processes that reflects the impossibility of applying the theory of maximizing expected utility under risk and uncertainty. The paradox demonstrates that an economic agent considers it rational to choose the behavior of achieving absolute reliability rather than the behavior of maximizing expected utility [18]. Actually, the Allais paradox, in our opinion, calls into question the rationality of the individual and the possibility of developing a rational economic theory.

It should be noted that the works of most scholars were largely focused on the problems of the theory of choice under conditions of risk and uncertainty, identifying the factors and mechanisms by which individuals process, evaluate the information they possess, forming on its basis qualitative and quantitative judgments, opinions and, ultimately, make their choice among the numerous available alternatives, which further allows to determine the strategic directions of formation and implementation of financial behavior. Moreover, almost each of the mentioned scholars substantiated in the works their own point of view on the process and procedure of decision-making by business entities, which largely contradicted the generally accepted scholarly views and provisions at that time.

1. The theories of behavioral finance and their brief characteristics*

Theories of behavioral finance	Brief characteristics
Prospect theory	It was formulated by many researchers as a critique of expected utility theory and the theory of rational expectations. The theory is descriptive, but it is based on the results of hundreds of experiments in which participants were asked to choose an alternative under conditions of uncertainty and risk. A significant number of striking experiments by D. Kahneman and A. Tversky has demonstrated that individuals are rather inefficient processors of information flows, as they make quick and incoherent decisions rather than those based on careful logic.
Theory of investor behavior	The essence of the theory lies in the insufficiently fast reaction of investors to new information (both positive and negative) provided by the market regarding issuing companies. American economist A. Shleifer explained this pattern by conservatism of thinking and misuse of probability theory models in practice. The effect of conservatism is manifested in an insufficient reaction to negative information, which is often observed in situations where the information does not correspond to one's own ideas about the issuing company. Delayed or limited reactions lead to losses. Incorrect work with probability theory models is also a consequence of inadequate perception of information. Based on a series of positive indicators, the investor assumes that the trend will continue in the future, which leads to an overestimation of financial instruments and a decrease in the income of their owner.
Theory of risks and decision making	According to the theory, an enterprise operating under uncertainty should be guided in its activities by two categories: the size of its expected profit and the extent of its possible deviations. The entrepreneur's behavior, according to this theory, is determined by the concept of maximum benefit. This means that if it is necessary, for example, to choose one of two options for investment that give the same profit, then the variant where the fluctuation of profit is less is chosen.
Theory of noise trading	This theory is a result of the constant presence on the market of unverified data, rumors, and advice from so-called "experts" referred to as "noise traders." In these conditions, operations are often carried out not on the basis of timely and reliable information but on the basis of "noise." As a result, rational market participants ("information traders") compete on the market with irrational participants ("noise traders") and earn additional income from them. However, these profits would not exist if transactions were made solely on the basis of reliable information.
Theory of trader's operations efficiency	Studies conducted in the US and Canadian markets have established a correlation between the psychological qualities of a trader and the success of their professional activity. Based on this, conclusions were drawn about the need for a potential market participant to have the following character traits: no tendency to conquer the market and start controlling it; ability to feel the individual barrier of acceptable risk and the limit of capital that can be risked; understanding of the selectivity of perception and memory; ability to recognize the state of stress and develop protective mechanisms against rash actions; ability to abstract from their own emotions and concerns; ability to take into account the impact of negative attitudes, preferences, and behavior; no psychological dependence on trading. Such characteristics generate "trader optimism," which is a necessary and sufficient condition for successful activity on the stock market. However, trader optimism develops only as the number of successful transactions increases during the course of financial and investment activity.

*compiled and expanded by the authors [9]

The theories of behavioral finance and their brief characteristics are given in Table 1.

In contrast to the features of rational behavior on which classical financial theories are based, behavioral finance represents the following characteristics of irrational behavior inherent in modern stock market participants [9]:

1. According to the theory of efficient markets, investors do not follow passive strategies. They are very active in selling and buying stocks, often using inaccurate or outdated information, following the advice of so-called "experts," using a variety of models to predict future market prices, and insufficiently diversifying their market portfolios.

2. Investors do not evaluate risky activities according to the principle of expected utility maximization. They biasedly assess the likely characteristics of expected outcomes due to loss aversion and overestimation of desired outcomes. Moreover, the final outcome is considered not in terms of the final welfare level but in terms of gains and losses compared to some threshold value that varies depending on the specific situation.

3. Investors forecast future uncertain values (for example, the income flow generated by a certain stock), develop statistical and probabilistic models based on information relating to a short-term previous period, which can in no way serve as a basis for applying the tools of probability theory and mathematical statistics.

4. Investors can make different investment decisions depending on the form of the problem statement ("forming effect"). The most common example is the choice between stocks and bonds as a long-term investment. If, assessing the profitability of bonds, the investor compares them with long-term stocks, they make a decision in favor of the latter, based on the results obtained over a significant period of time. If the object of an alternative investment option is a short-term investment in shares, then, as a rule, bonds seem to be the most preferable.

5. Due to their inherent conservatism and using the heuristic rule of representativeness, investors show either an insufficient or excessive reaction, which affects the formation of prices for financial assets and, as a result, the amount of income received by investors.

Irrational behavior is especially evident in situations of uncertainty and risk, in which all entrepreneurial, investment, and financial activities take place. Very important is the fact that absolutely everyone is exposed to the influence of the identified subjective factors, regardless of professional training, field of activity, and work experience. In difficult life situations associated with uncertainty and risk, people behave the same way, making the same mistakes. Taking into account the identified factors of behavioral finance will significantly increase the efficiency of financial strategy and tactics among market participants.

Regularities that are characteristic of the capital market participant behavior can be largely used to study the financial relations of economic entities. Among the most common effects that provoke irrational behavior of economic entities are the following:

– "the effect of conservatism," the essence of which is manifested in a person's too slow change of own beliefs under the influence of new information. This means that when a person has a certain pre-formed opinion about a particular object, new information that contradicts the established ideas is initially greatly underestimated or ignored altogether. Therefore, it takes at least 2-5 new pieces of evidence (depending on the situation) of the same nature to change this opinion;

– "loss aversion" is a behavior that indicates that the negative emotions of a person, such as regret for the loss of a certain income, are much greater than the positive emotions associated with the feeling of satisfaction from winning. In practice, this means that when making decisions, the results of which are uncertain, investors (especially conservative ones) tend to choose options for the development of events so that the chance of avoiding possible losses is the highest;

– "the competence effect," which proves that investors tend to take more risks in areas where they believe they are more competent, regardless of whether their knowledge and professionalism can somehow influence the probability of a particular outcome;

– "trap effect" is a situation when an investor, having invested money and spent some effort and time in a project, decides to continue to do so for the sake of the initial investment, although the prospects have significantly deteriorated. Trying to keep assets that do not bring profit in their portfolios for too long and selling potentially profitable assets too quickly is also typical for investors, especially beginners.

That is, understanding the psychology of financial decision-making and having the ability to avoid the most common mistakes associated with this process are important tasks for financial managers of business entities.

However, most issues of behavioral finance are overlooked, and studies of this theory at the level of business entities are fragmentary. Without a doubt, the foundation of management is objective development procedures and methods to determine their content, which must be coordinated by activities of management staff. Several basic approaches to defining the essence of management can be traced. In particular, this process is considered the highest type of information interaction with a certain system of principles and methods. The various interpretations of this concept that have been studied are inextricably linked to financial aspects.

The review of literature sources has shown that the most common formulation of the "financial management" essence is defined as:

– a system of rational management of the processes of financing the economic activity of the enterprise;

– a system of effective management of financial resources;

– a process of managing the formation, distribution, and use of financial resources of an economic entity and optimization of its cash turnover;

– a system of principles and methods for developing and implementing management decisions related to the formation, distribution, and use of financial resources of an enterprise as well as organization of its cash turnover [21].

As it can be seen, in the majority of cases, the essence of the concepts is defined only as a system of management of processes and resources of the enterprise, which significantly narrows the scope of these definitions.

Based on the above, we can say that the approach to financial management of enterprises is narrowed to a system of principles and methods for the development and implementation of management decisions, while the question of by whom and on what basis such decisions are made is almost never disclosed. That is, most authors study the rational decision-making process; they do not consider the possibility that management, under the influence of various factors, can make irrational decisions, the impact of which on the results of the enterprise may be unpredictable. Therefore, when studying the essence of financial management, it is necessary to use the principles of behavioral finance, since the application of this method to traditional management approaches will provide more complete information about the peculiarities of human behavior, complement economic theory, adequately reveal the process of making management decisions, and thereby deepen the understanding of behavioral strategies in the operational management of business entities.

Conclusions.

During the entire period of its development, the theory of decision-making and the concept of rationality, which underlies the economic choice of the agent, have undergone significant transformations due to the development of scientific economic thought, social and psychological sciences, and changes in the place and role of a person in the socio-economic space. Classical economic theory is based on the assumption that individuals (homo economicus) act rationally in their own interests. Despite the significant shortcomings of the rational economic agent model, some scholars still defend its correctness, while others argue that the standard model is easier to formalize and more relevant in practice. Empirical and experimental evidence refute the reliability of such a factor as unlimited rationality. The flaws of the standard approach arise from the fact that it does not take into account the systematic psychological biases that affect all human judgments and decisions. Behavioral models include more adequate characteristics of economic agents [15]:

− limited computational capabilities (the desire to satisfy, not maximize value);

− strong influence of social networks and dominant social norms;

− interaction and charity;

− lack of self-control;

− devaluation of future benefits in favor of those that can be obtained now;

− rejection of losses and risk;

− dependence of behavior on circumstances.

Scholars have proven that psychological ideas can be formalized and turned into reasonable predictions. In decision-making, it is necessary to determine how the agent's behavior differs from the standard model and to show the importance of such behavior in the economic context. Human behavior and creative thinking (the ability to make informal, unconventional decisions and actions) are the primary driving forces behind effective socioeconomic development in modern times.

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Давиденко Н.М., Василєвська Н.С., Ключка О. В. (2023).
ВПЛИВ БІХЕВІОРИСТИЧНИХ УПЕРЕДЖЕНЬ НА ПРИЙНЯТТЯ РІШЕНЬ ФІНАНСОВИМИ МЕНЕДЖЕРАМИ.
BIOECONOMY AND AGRARIAN BUSINESS, 14(1): 24-37.
https://doi 10.31548/economics14(1).2023.002

Abstract. *Анотація. Поведінкові фінанси набувають більшої важливості у зв'язку з масовою роботизації фінансових професій, коли створені алгоритми облікової та фінансової роботи повинні забезпечити безперебійне функціонування фінансів в умовах їх постійної спрямованості до мінливим людським потребам. Метою статті є дослідження основних теорій, а також етапів становлення і розвитку поведінкових фінансів як важливого напряму фінансової науки та обґрунтування необхідності їх подальшого розвитку в сучасних умовах.*

У статті послідовно розкриваються економічна сутність і роль біхевіористичних фінансів, засади ефективної взаємодії суб'єктів господарювання в умовах поведінкової економіки, яка має базуватися на принципах довіри, інформаційної відкритості, узгодженості інтересів, відповідальності, дотримання етичних норм, фінансової інклюзії та взаємної вигоди. Розглянуто необхідність дослідження поведінкових фінансів як самостійного напрямку сучасної фінансової науки. Висвітлено основні теорії та етапи становлення і розвитку поведінкових фінансів.

У процесі написання цієї статті окреслено критерії обгрунтування та вибору управлінських рішень. Розкрито особливості поведінкової моделі, фактори впливу на прийняття суб'єктом господарювання ірраціонального рішення. Виділено найбільш поширені ефекти, які провокують ірраціональну поведінку суб'єктів господарювання.

Виявлено окремі аспекти впливу поведінкових фінансів на рішення фінансових менеджерів підприємствами з визначенням ролі спонукальних мотивів і психологічних факторів під час вибору індивідами моделі фінансової поведінки та прийнятті ними інвестиційних рішень. Обґрунтовано необхідність подальшого дослідження поведінкових стратегій індивідів у сучасній фінансовій науці.

Ключові слова: *біхевіористичні фінанси, управління, фінансовий менеджмент, ірраціональність, фінансові рішення, ризик, суб'єкти господарювання*