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Behavioural finance: corporate social responsibility approach

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Abstract

This research presents the majority of classical financial theories and models are based on the assumption of a rational investors' behaviour in the market regarding modern business, focusing on socially responsible activities is determined by general trends, where individuals and business companies realize their responsibility towards all those who are affected by the outcomes of their activities. The conducted research has proved that when making decisions under the uncertainty and risk conditions, people experience the effect of different illusions, emotions, false perception of information and other "irrational" factors.
Corporate social responsibility reflects a new role of business in society. Recently, the corporate social responsibility tradition has started to spread quite rapidly in both large international corporations and small and medium-sized enterprises. The spread of socially responsible business ideas has encouraged the need to invest in companies which apply such a business practice.

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1. Introduction

The emerging discrepancy between the efficient market hypothesis and reality encouraged a deeper insight focused on psychology, as an important factor in financial theory. Behavioral finance was formulated - a new branch of theory, combining the knowledge of psychology, sociology and other social sciences (Buss, 2009, Bernheim, Douglas, 2008). Due to the integration of various scientific knowledge behavioral finance better explains market anomalies and financial behavior of individuals. An efficient market theory hypothesis maintains that

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investors, while competing for big profits, establish fair prices. In order to better understand an individual financial behavior, the behavioral theory of psychology, sociology and anthropology is applied. An efficient market is associated with the theory of rational expectations, including the assessment of all information about property. However, if there are many irrational investors and their financial behavior does not correlate, and their transactions invalidate each other and have an impact on prices, the question arises on a far too poor assessment of the irrational investors' impact on the market. If investors are irrational, their financial decisions determine prices, although do not change the value of financial assets. As a result, rational investors can sell overvalued or buy undervalued assets, thus gaining profit, until the asset price converges with its value (Berg, Gigerenzer, 2010, Guesnerie, 2005, Marcet, Sargent 1992).

Behavioural finance study the effects of social, cognitive, and emotional factors on the economic decisions of individuals and institutions and the consequences for benefit and the resource allocation. Behavioral finance does not take the characteristics of the decision-maker as fixed, the focus is on the non-equilibrium processes, actions of diverse agents with bounded rationality who may learn from experience and interactions.

Socially responsible investing is characterized by a desire to not only to generate additional financial returns, but also to develop public welfare. Socially responsible investors seek to increase the profitability of a company, while taking into account the effect of their investment on the environment and the public. The most common choice of this strategy does not reduce the economic benefits to investors, and such a strategy creates additional investment risks controlling mechanisms that reduce the overall risk of the total investment.

The aim of the study is to develop theories and models, designed to provide the investor with tools necessary for successful investment strategies.

2. Method

The main research methods used are comparative and structural as well as the qualitative analysis of scientific economic literature, graphical presentation and results, modelling and logical analysis.

For development of Gaussian function regarding rationality or utilitarian and emotional benefit a normal distribution were used (refer with: Eq.1, Eq.2).

$$F(x)=\frac{1}{\sigma\sqrt{2\pi}}\int_{-\infty}^{x} e^{-\frac{(x-m)^2}{2\sigma^2}}dx \tag{1}$$

$$p(x)=\frac{1}{\sigma\sqrt{2\pi}}e^{-\frac{(x-m)^2}{2\sigma^2}} \qquad x\in R \tag{2}$$

Combining the impact of psychology and economic sciences in order to discover the underlying reasons for irrational solutions of investment two-dimensional Gaussian function of utilitarian and emotional benefit of investment was used (refer with: Eq.3), the coefficient A is the amplitude, x_0,y_0 is the centre and σ_x, σ_y are the x and y spreads.

$$F(x,y)=A\exp\left(-\left(\frac{(x-x_0)^2}{2\sigma_x^2}+\frac{(y-y_0)^2}{2\sigma_y^2}\right)\right) \quad x\in R \tag{3}$$

$$U(c)=\begin{cases}\dfrac{c^{1-\eta}-1}{1-\eta} & \eta>0,\eta\neq 1\\ \ln(c) & \eta=1\end{cases} \tag{4}$$