CHAPTER I

INTRODUCTION

1.1 Research Background

The investment decision made by an investor will most likely seem reasonable to the investor himself, though it might not be the same in the perspective of other investors. The news and information covering the financial market industry is objectively accessible to anyone. Investors generally receive and consume their news and information from similar sources, but the investment decisions they make based on the same news may differ. Behavior finance interprets that the investment decision-making of an individual is clouded by psychological biases and tendencies that could lead to the investor making investment decisions that are not optimal (Hirshleifer, 2015).

The financial market provides a lot of assets for people to choose from. There are assets such as gold, various commodities, stocks, contracts, etc. These assets have been a part of the financial market for a long time and prove to be solid options for rewarding investments. However, with the innovation and advancement of technology, a new form of asset and investment was made possible through cryptography technology. This specific asset is cryptocurrency and it is quite a popular choice of investment as it is known for boasting huge returns on investment.

Cryptocurrency is a form of investment that is relatively new compared to other assets that are available in the financial market. Initially created as a form of decentralized currency that could act as a proxy for regular transactions, cryptocurrency has stolen the attention of many investors that seek to make huge returns by investing in the cryptocurrency market (Chowdhury & Mendelson, 2013). The value of cryptocurrency surged significantly as investors poured money into it believing that cryptocurrency could potentially be the future of digital currency and assets, though

many investors were skeptical and doubted the fundamental value of cryptocurrency at the time (Cheah & Fry, 2015).

The accessibility and popularity of cryptocurrency has attracted investors of all age and backgrounds, with or without prior experience in the financial market. Mostly enticed by news and stories of Bitcoin holders becoming millionaires when Bitcoin spiked in price, these people who caught wind of the opportunity presented by cryptocurrency dived into the cryptocurrency market headfirst securing themselves the title of noise traders. Paired with the fact that cryptocurrencies are specifically designed to be decentralized and under no control from any parties, the influx of demand has caused the price of cryptocurrency to bubble on numerous occasions (Shu et al., 2021).
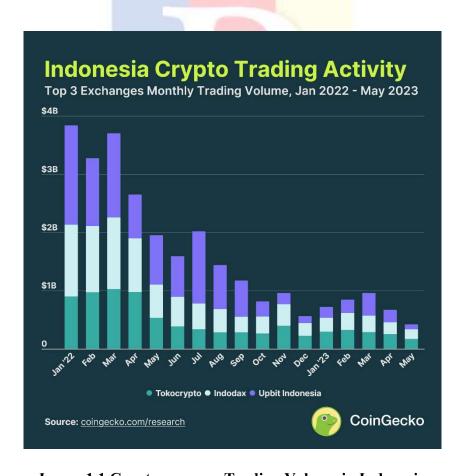

Image 1.1 Cryptocurrency Trading Volume in Indonesia

Source: CoinGecko

Following the previous rally of the cryptocurrency market nearing the end of 2021. Indonesia's top 3 cryptocurreny brokers recorded billions of dollars in trading volume. Listed on CoinGecko, a reputable cryptocurrency ticker app that tracks the real time prices, volume and market cap of cryptocurrencies, the trading volume of these three Indonesian based broker almost touched the 4 billion USD mark in cryptocurrency trading volume during the heights of cryptocurrency rally. Although the volume did slow down significantly as the Bitcoin bubble crashed, the lowest volume was still recorded at above half a billion dollars. It is also important to keep in mind that these volume represents only a fraction of Indonesia's cryptocurrency market as there are investors who use other Indonesian based brokers and investors who prefer to use foreign brokers.

According to estimates from Bappebti, the government party responsible for regulating cryptocurrency in Indonesia, there are currently 19 million cryptocurency investors in Indonesia. Indonesia undeniably has a major presence in the global cryptocurrency market, but the volume of cryptocurrency traded periodically shows a peculiar pattern. During months where cryptocurrency increased in value, trading volume fluctuated excessively. This proves that a huge portion of cryptocurrency investors in Indonesia are noise traders. These individuals who are classified as noise traders are the ones making irrational investment decisions fueled with biases and speculations (Al-mansour, 2020).

The involvement of behavior finance towards investing in an asset is indeed inevitable. For an investor to make up the decision to risk a sum of money towards an asset that could increase or decrease in value, it requires the resolve of several factors affecting the investor at a psychological level (Hirshleifer, 2015). There are assets such as gold, foreign currencies and blue chip stocks with strong fundamental value and have been a part of the economy for a long time so it is understandable as to why a person would select those options as an investment. Meanwhile, there also exists cryptocurrency, an asset surrounded by skepticism, has mixed opinions from investors and a questionable fundamental value (Kukacka & Kristoufek, 2023). It would not be

so simple to understand why someone would invest in this specific asset, but this specific asset is a pretty popular choice of investment among investors.

The ecosystem in the cryptocurrency market is undoubtedly unique compared to other sectors of the financial market. With the presence of many unsophisticated investors in the cryptocurrency market, irrational decisions made by these investors could start a financial bubble at any time as they see an opportunity or at least convince themselves that there is an opportunity to profit off the market. On the other hand, experienced investors that would like to test their chances in the cryptocurrency market would have to yield to the volatile environment that the cryptocurrency market has formed.

1.2 Problem Statement

The cycle of bubbles and crashes in the cryptocurrency market is a recurring cycle that continues to expand alongside the increased acquisition of Bitcoin and cryptocurrencies (Shu et al., 2021). The financial bubble that often happens in the cryptocurrency market have the unsophisticated investors to blame for, followed by the decentralized system that the majority of cryptocurrency emphasizes on. When news or issues regarding cryptocurrency is announced or brought up, a lot of these less experienced investors who were already eager to invest their capital would jump in on the opportunity (Al-mansour, 2020). As a particular cryptocurrency receives a spotlight and its price begin to rise, it would trigger herding behavior from investors while consecutively bubbling in value waiting to crash at any moment. This sort of volatile market may not be the most suitable sort for investment, but unfortunately this is a common occurrence in the cryptocurrency market.
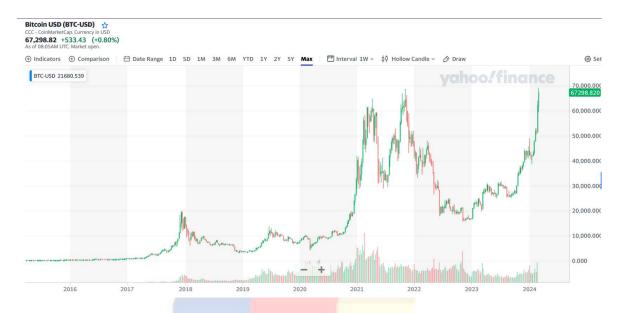
Image 1.2 Bitcoin USD Price Chart

Source: Yahoo! Finance

Over the years since Bitcoin first entered the financial market, Bitcoin has bubbled periodically on certain years where there are major news in the market regarding cryptocurrency. These news act as a catalyst for investors, especially noise traders to invest in cryptocurrency. This would cause Bitcoin and the cryptocurrency market to rally and multiply in price for an indefinite amount of time that is soon followed by a crash. This cycle of bubbles and crash consistently repeats itself in the market as cryptocurrency grows in popularity.

It is important to understand that the cycle of bubbles and crashes that happens in the market is caused by the investment decision made by investors in the market. Consequently, this means that the behavior finance of investors such as herding behavior and heuristics are the major factors that contribute to the volatility of the cryptocurrency market. With the growing popularity of cryptocurrency and the constant influx of new inexperienced investors into this specific market, irrational and unorthodox investment decisions are becoming more common, which contributes to problems such as:

- Increased volatility in the cryptocurrency market.

- Financial bubbles that grows in size as more investors pour money into the market.
- Irregular movement of cryptocurrency prices or irrational investment decisions being made in the cryptocurrency market

1.3 Research Purpose

The purpose of this research is to investigate the influence of behavioral finance towards the investment decision of investors regarding cryptocurrency which covers:

- The influence of herding behavior on the investment decision of investors in the cryptocurrency market.
- The influence of prospect factors on the investment decision of investors in the cryptocurrency market.
- The influence of heuristics on the investment decision of investors in the cryptocurrency market.

1.4 Research Benefit

This research conducted on the behavior finance of investors regarding their investment decision on cryptocurrency provides the following benefits:

- Providing insight on the herding behavior displayed by investors investing in the cryptocurrency market.
- Understanding the prospect factor that encourages investors to invest in the cryptocurrency market.
- Recognizing the influence of heuristics on the investment decision of investors in the cryptocurrency market.

The information accumulated from this research may help provide investors with the insight on how behavior finance affects them and other individuals while finalizing their investment decisions in the cryptocurrency market. This

research may also provide investors with resourcefulness when navigating the cryptocurrency market.

1.5 Research Gap

This research is conducted through Discord, a software utilized by many to create communities, forums and chat rooms online. This software is popular among people to gather online for various activities which includes discussing and sharing their thoughts and experiences regarding specific topics, cryptocurrency included. The population and sample of this research are cryptocurrency investors that takes part in cryptocurrency related Discord communities that resides in Indonesia. Majority of investors in these communities are most likely retail investors that have limited capital and experience in the market, but nonetheless a big part of the cryptocurrency market as lot of retail investors make up the cryptocurrency market.

Previous studies that this research referenced from were conducted in regions such as UAE, Kuwait and Qatar. The samples obtained were from snowball sampling, Al-mansour (2020) stated that the respondents were hard to come by. Evidently, those previous researches did not specify if the respondents were retail investors or institutional investors. This research has narrowed down the respondents to retail investors that invest with their personal capital and limited experience.

This research also utilizes more advanced and in-depth understanding of herding behavior. Unlike previous researches that share the similar definition of herding behavior as simply imitating the investment decision of other investors, this research broaden the understanding of herding behavior while including dimensions and indicators that could determine reasons behind herding behavior or investors imitating investment decisions of others.