

REVIEWING THE ROLE OF KNOWLEDGE MANAGEMENT IN INVESTMENT DECISIONS BEHAVIOUR

Mohamed Ibrahim Mugableh*

**College of Administrative and Financial Sciences, Irbid National University*

P.O Box: 2600–Zip Code: 21110

Jordan

Tel: +962790956497

mugableh83@yahoo.com

mugableh83@gmail.com

Abstract

It is important to develop the knowledge management cycle with clear and detailed description of how people memory is put into use in order to generate value for individuals or groups in the practice area especially for stock investment. Knowledge creation widens the spectrum of potential choices in decision making by providing new knowledge. Decision making is situated in rational decision-making models that are used to identify and evaluate alternatives by processing the information and knowledge collected to date. The major phases in the knowledge management cycle, encompassing the capture, creation, codification, sharing, accessing, application, and reuse of knowledge involved within and between the investment decisions.

Keywords: Behavioural Finance, Knowledge Management, Stock Investment, Stock Investment

Topics: Business strategy, Organizational behavior, Social sciences and business

1. INTRODUCTION

Knowledge management (KM) has been growing in importance and popularity as a research topic and business initiative since the mid-1990s. KM as an organizational innovation has been with us for more than a decade. As a discipline, it has reached a state of maturity where we can now discern the principles, practices, and tools that make it unique. Moreover, by having knowledge (intellectual resources), people can understand how to exploit and develop its traditional resources better than its competitors can, even if some or all of those traditional resources are not unique. In the early 1960s, Drucker was the first to coin the term knowledge worker (Drucker, 1964). Senge (1990) focused on theme organizational learning as one process that can learn from past experiences stored in corporate memory systems. Barton-Leonard (1995) documented the case of Chaparral Steel as a knowledge management success story. Nonaka and Takeuchi (1995) studied how knowledge is produced, used, and diffused within organizations and how such knowledge contributed to the diffusion of innovation. The

knowledge-based economics era at the recent time sets off paradigm shift that we need new concept of strategic management related to each theoretical and practical approaches. To face the new competition era as compared to the former age, basically, knowledge and objective of the strategic change is much more needed by the managers in their decision making process (Vicente-Lorente & Zuniga-Vicente, 2008).

Behavioral finance is a relatively new but rapidly expanding field that seeks to afford explanations for people's economic decisions by combining behavioral and cognitive psychological theory with conventional economics and finance. The early behavioral finance research focused on finding, understanding, and documenting the behaviors of investors and managers, and their effect on markets. The beginning of this psychologically based financial analysis coincided with the start of many empirical findings. Later studies cut to the potential root of the problem and examined the behavior and decisions of market participants. Barber and Odean (2000) find that individual investors are loss adverse, exhibit the disposition effect (Grinblatt and Han, 2005), trade too much, biased self-attribution and overconfidence (Chui et al., 2010). Evidence also shows that even professionals such as analysts behave in ways consistent with psychological view of human behavior (Hilary & Menzly, 2006).

Nowadays there are many investors are miscalibrated by underestimating stock variances or by overestimating the precision of their knowledge. The fundamental premise in emotional finance is that knowledge of the subtle and complex way our feelings determine psychic reality may help people understand better how asset valuations and investment decisions are made, and how markets may occasionally break down. MacGregor et al. (1999) used multiple regression analysis with perceived risk as the dependent variable; found that 98 percent of an expert's risk perception is attributable to three indicators: worry, volatility, and knowledge. Goszczynska and Guewa-Lesny (2000) develop three risk dimensions for more than 60 percent of the total variance. One of the three factor labeled "familiarity of risk" incorporates risk indicators such as controllability, knowledge, and accessibility of information. Simon (1987) also considers the availability of knowledge and the quality of knowledge to be critical determinants to the decision-making process. Korniotis and Kumar (2015) conjecture that older investors would accumulate greater knowledge about the fundamental principles of investing because of their greater investment experience.

2. THE ROLE OF KNOWLEDGE MANAGEMENT IN BEHAVIOURAL SCIENCE

Peng et al. (2013) developed knowledge management research to give a scientific way for knowledge management, Peng et al. offers knowledge services during all states in knowledge management theory, including knowledge's creation, storage, organizing and sharing. Knowledge creation and storage, knowledge is created either through exploitation, exploration or codification (Chua, 2004). Users exploit knowledge by managing the course resources from many useful resource. Explored knowledge during discovery and experimentation could be recorded. Documentation and integration of knowledge promote knowledge codification. Knowledge acquisition, ubiquitous knowledge Different from traditional face-to-face communication, user of knowledge could use all kinds of intelligent digital mobile terminals to connect cloud knowledge services by many website so investors could acquire knowledge in this world everywhere in any time. Cloud services bring ubiquitous knowledge to people.

Knowledge integration and organization, user had all the files are well organized. User could organize all their files by themselves. But in group, all the users should develop systems and the group can access the group knowledge. Knowledge transfer and sharing, Knowledge sharing is an important way to transfer knowledge from one part or individual in the organization to other parts. This process accumulates and refines the group knowledge by storing new knowledge. Sharing knowledge bridges the gap of communication between group members and enhances the activity and performance of members and the whole organization. Andersson et al. (2009) shows that the forecasting performance of football experts and laypeople varies. For simple tasks, they tend to predict equally well, partly because laypeople might use well-adapted heuristics. Once the prediction tasks become more complex, the experts may take advantage of their domain-specific knowledge and produce forecasts that excel those of the laypeople.

3. KNOWLEDGE CREATION IN FINANCIAL BEHAVIOUR

In fact, Forbes and Kara (2010) contend that individual investors' self-confidence mediates how investment financial knowledge influences investors' investment efficacy. Overconfidence may also affect the impact of information on individuals' investment behavior. Abreu and Mendes (2012) Stated the more often individual investors invest in information, the more they trade in financial products. Abreu and Mendes results also confirm previous findings that overconfident investors, who show a better than average bias, trade more frequently. The strong and positive relationship between investment in information and intensity of trading in financial assets is sensitive to the sources of information used by investors, and that this influence is different for overconfident and non-overconfident investors. Abreu and Mendes confirms positive correlation between actual knowledge and portfolio turnover. Söderberg and Wester (2012) showed that citizens who have more knowledge and are more interested in a specific topic will have a risk perception that is more similar to experts in the field.

4. KNOWLEDGE ACQUISITION AND INTEGRATION IN FINANCIAL BEHAVIOUR

There are many factors can explain the variation in actual portfolio and trading choices. Dorn and Huberman (2005) stated that risk aversion is the single most significant determinant of both portfolio diversification and turnover, investors who report being more risk tolerant hold a smaller amount diversified portfolios and trade more aggressively. Less knowledgeable investors also tend to churn poorly diversified portfolios. The effect of perceived knowledge on portfolio choice is less clear cut, investors who think themselves knowledgeable about financial securities indeed hold better diversified portfolios, but those who think themselves more knowledgeable than the average investor churn their portfolios more. Hilgert and Hogartt, (2003) explored the connection between knowledge and behaviour—what consumers know and what they do— focusing on four financial management activities. In this study, the correlation between sources of financial knowledge and financial practices was found to be significant.

Individuals make flawed and biased decisions and that one solution to this problem is to increase knowledge and make lay people less emotional and more literate on matters of risk. Pixley (2010) showed although knowledge are not fully controllable, behavioural finance proves conclusively that knowledge are involved in decisions, its early tendency to focus on

biases and errors in probability gave little space to the problem that it is not possible to predict the future. It highlighted decision-making in the short-run too much. The ‘bias ‘towards ‘over-confidence’ among experts is a very useful finding, and includes opinions about a grim future. Knowledgeable investors who make informed choices are essential to 360 develop effective and efficient marketplace. In classical economics, informed investors provide the checks and balances that keep dishonest sellers out of the market. For example, buyers who know the full range of mortgage interest rates and terms in the marketplace, who understand how their credit-risk profile and personal situation fit with those rates and terms, and, consequently, who can define which investment is best for them make it difficult for unfair or deceptive investors to gain a position in the marketplace. Evidence of a positive link between financial knowledge and financial behaviour, and how a lack of basic financial literacy among investors has also been documented Gerardi et al. (2010). Söderberg and Wester (2012) concluded that investors think it is important to have knowledge of the field of finance that perceive such high risks that they decide to buy and sell all their investments or completely change bank. Instead of informing all citizens about general consumer protection in a financial crisis situation, it might make more sense to identify the group that is most likely to act rashly and direct relevant financial knowledge more specifically toward it. This finding is an important argument of the requirement for the improvement of financial knowledge programs.

5. KNOWLEDGE TRANSFER IN FINANCIAL BEHAVIOUR

Stock market experts seem to be very confident of their knowledge and skills irrespective of positive or negative economic conditions. The results collected in, Zaleskiewicz (2011) research disclosed that the financial analysts were more confident than the amateurs when making both the stock market and the exchange market forecasts. In addition, the variations in confidence were much greater than changes in accuracy and even if the difference in accuracy was not significant, the confidence level among the experts was still higher. These outcomes are in contrast with the assumption that making judgments during a financial crisis decreases confidence. Most efficient market models of capital markets presumed market place were either consist of and controlled by rational traders who, by definition, prized securities based on the net present value of future earnings flows discounted by the investment’s risk characteristics (Bromiley & James-Wade, 2003). Rational in this usage refers to an economics sense of rationality in which actors choose from all available alternatives the one that maximize expected value or utility. Finally, these models assumed markets were in equilibrium, meaning no trader could act individually to improve his expected returns above an expected market return.

Thus, the dominant finance models assumed rational investors competed in an efficient market where information transfers extremely quickly. All market participants will have ability to gain full knowledge of publicly available information. These conditions lead to a probability that no rules could exist that would provide above average risk-adjusted returns. Within the capital asset pricing model, the assumptions lead to the prediction that risk, measured by beta, would provide the primary, if not only, explanation for systematic differences in stock returns (Bromiley & James-Wade, 2003). A clear distinction must be made between information, which is basic, and true knowledge assets, which can only arise within the framework of an intelligent system. Today’s investment environment is more complex because we now need to attend daily to the increase in the number of subjective knowledge items. Knowledge management represents one response to the challenge of trying

to manage this complex system, information-overloaded investment environment. Simon (1976) first offered bounded rationality theory as a limited or constrained rationality to explain human decision making behaviour. When challenged with a highly complex world, the mind constructs a simple mental model of reality and tries to work within that model. It is important to develop the KM cycle with clear and detailed description of how people memory is put into use in order to generate value for individuals or groups in the practice area especially for stock investment. Knowledge creation widens the spectrum of potential choices in decision making by providing new knowledge. Decision making is situated in rational decision-making models that are used to identify and evaluate alternatives by processing the information and knowledge collected to date. Effective knowledge management necessitates user to recognize, generate, acquire, diffuse, and capture the benefits of knowledge that deliver a strategic advantage to the Investor.

6. CONCLUSIONS

Financial knowledge was found to be statistically significant for particular financial practices (Hilgert, 2003). The relationships between specific financial knowledge scores and the corresponding financial practices indexes were statistically significant. Knowing investment and financial stuff was correlated with having higher index scores for credit management, saving, and investment practices respectively. This pattern may indicate that increases in knowledge and experience can lead to improvements in financial practices; one way to increase knowledge is to gain experience. This research describes how the major phases involved in the knowledge management cycle, encompassing the capture, creation, codification, sharing, accessing, application, and reuse of knowledge within and between the investment behaviour. This more representative view put forward investors ought to recognize market inefficiencies and develop best practices that enable effective knowledge creation, storage, organizing and sharing and transfer, thereby empowering their profit and competitive advantage.

REFERENCES

- Barber, B. M., & Odean, T. (2000). Trading is hazardous to your wealth: The common stock investment performance of individual investors. *Journal of Finance*, 55(2), 773–806.
- Barton-Leonard, D. (1995). *Wellsprings of knowledge—building and sustaining sources of innovation*. Boston: Harvard Business School Press.
- Chui, A. C. W., Titman, S., & Wei, K. C. J. (2010). Individualism and momentum around the world. *Journal of Finance*, 65(1), 361–392.
- Drucker, P. (1964). Knowledge worker: new target for management. *Christian Science Monitor*. Retrieved On May 17, 2004, <http://drucker.cgu.edu/DruckerArchives/data/search/ArticlesBkReviews.asp?clrress=y>.
- Goszczyńska, M., & Guewa-Lesny, E. (2000). General and specific characteristics of risk perception in financial investment. *Polish Psychological Bulletin*, 31(4), 301–313.
- Grinblatt, M., & Han, B. (2005). Prospect theory, mental accounting, and momentum. *Journal of Financial Economics*, 78(2), 311–339.
- Hilary, G., & Menzly, L. (2006). Does past success lead analysts to become overconfident?. *Management Science*, 52(4), 489–500.
- Korniotis, G. M., & Kumar, A. (2015). Do older investors make better investment decisions?. *Review of Economics and Statistics*, forthcoming.

Advances in Business-Related Scientific Research Conference 2015 in Rome
(ABSRC 2015 Rome)
October 14–16, 2015, Rome, Italy

- MacGregor, D. G., Slovic, P., Berry, M., & Evensky, H. R. (1999). Perception of financial risk: A survey study of advisors and planners. *Journal of Financial Planning*, 12(8), 68–86.
- Nonaka, I., & Takeuchi, H. (1995). *The knowledge-creating company: how Japanese companies create the dynamics of innovation*. New York: Oxford University Press.
- Senge, P. (1990). *The fifth discipline: the art and practice of the learning organization*. New York: Doubleday.
- Simon, H. (1976). *Administrative behavior: a study of decision-making processes in administrative organization*. 3rd Ed. New York: Free Press.
- Simon, H. A. (1987). *Bounded rationality*. In *The new Palgrave: A dictionary of economics*, ed. John Eatwell, Murray Millgate, and Peter Newman, 267–268. London: Macmillan.
- Vicente-Lorente J. D., & Zuniga-Vicente, J. A. (2008). *Research on the Antecedents and Outcomes of Strategic Change: Past, Present and Future Challenges*, In: *Global Management: Strategy, Challenges and Uncertainties*, Nova Science Publishers, Inc.