Chapter 1

Fundamentals of Investor Behavior: Concepts, Types, and Psychological Factors[1]

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Abstract

This section examines the concept of investment, the fundamental characteristics of investors, and the factors shaping investment decisions using a behavioral finance approach. Unlike the fully rational individual model assumed by classical finance, the investment process has a multidimensional structure shaped by psychological tendencies, cognitive biases, emotions, and social influences. In this context, investor types are categorized as individual and institutional investors, but it is emphasized that individual investors' decision-making processes are more susceptible to psychological factors.

Individual investor profiles are explained through their association with behavioral biases and risk perceptions. Personal, financial, and environmental factors influencing investment decisions are evaluated within the framework of variables such as knowledge level, expectations, income status, social environment, and cultural background. The impact of these factors on investment behavior, along with cognitive limitations and psychological tendencies, is explored to explain why investors make different decisions under similar circumstances.

Finally, basic financial investment instruments are introduced, and the reasons investors choose these instruments are linked to psychological tendencies. This demonstrates that the search for security, perception of uncertainty, and past experience are as important as economic returns in determining investment instrument selection.

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Introduction

It is well known that financial decisions are not simply the logical choices of fully rational individuals, as assumed by classical economic theories. In reality, investors engage in a complex decision-making process driven by their access to information, risk perception, past experiences, emotions, social environments, and cognitive limitations. Therefore, the phenomenon of investment represents not only the pursuit of maximizing monetary returns, but also a dynamic field that intersects with all dimensions of human behavior.

The fact that investors possess different profiles, such as taking significant risks for the sake of high returns or prioritizing the drive to preserve capital, demonstrates the decisive role of behavioral factors in decision-making. Even with the same information, individuals may make different investment choices under the same circumstances due to their risk aversion levels, expectations, perceptions, and psychological tendencies. This elevates the concept of investment beyond being merely a technical financial term to the core of human behavior.

Research in behavioral finance has revealed that investors exhibit systematic cognitive biases. Tendencies such as overconfidence, herd behavior, loss aversion, framing effect, familiarity bias, and representativeness heuristics; The choice of investment instruments directly shapes portfolio allocation and risk-taking behavior. Therefore, examining investor types, profiles, and the factors influencing investment decisions is seen as a fundamental starting point for understanding many anomalies and irrational behaviors observed in financial markets.

This section explains the theoretical foundations of investment and investor concepts, transcending the distinction between individual and institutional investors to explore the psychological underpinnings of investor behavior. Furthermore, individual investor profiles are evaluated in light of behavioral finance literature, and the personal, financial, and environmental factors that shape investment decisions are explained within a holistic framework. Finally, while introducing basic financial investment instruments, the psychological dimension of investors' motivations for pursuing these instruments is also discussed.

Understanding investor behavior is crucial not only for understanding the functioning of financial markets but also for helping individuals manage their decision-making processes more effectively. This chapter aims to provide the reader with both a theoretical and practical framework by examining the fundamental concepts of the investment process from a behavioral perspective.

1.1. Investment Concept

It can be said that financial decision-making processes have a multidimensional structure that is not limited to the assessment of current economic conditions but also takes into account future uncertainties, risks, and expectations. In this process, individuals and institutions feel the need to make rational choices to optimally allocate available limited resources. It is precisely at this point that the concept of "investment" comes to the fore as a strategic form of behavior employed by economic actors with the aim of maximizing expected future returns. In this context, a review of the literature to better understand the concept of investment reveals many different definitions. Although the definitions made by researchers differ from each other in some aspects, it is possible to say that almost all of them have the same basic point. Some definitions in the literature related to the concept of investment are as follows:

The Turkish Language Association defines investment as "investing money in income-generating, movable or immovable property; deposit, placement" (TDK, 2025), the IMF defines it as "current expenditures for the production of goods or services for future consumption".

Turhan (1998) defines investment as any expenditure made in advance to obtain tangible or intangible benefits, profits, or gains. The amount of expenditure expressed in this definition may be limited to a single asset or may be made across multiple assets at different time periods.

Coşkun (2010) defines investment as "the investment of one's money in income-generating financial assets in order to protect its current value or to increase the value of one's money."

Dekastros (2013) defines investment simply as the act of putting money into a process or activity that will generate profits in the future.

Reilly and Brown (1999), individuals both earn and spend income throughout much of their lives. However, the balance between income earned and consumption desires is rarely achieved. Therefore, while some individuals may have more money than they want to spend, at other times, they may have consumption desires that cannot be met by their current income. This imbalance leads individuals to either borrow or save to maximize the benefits they will receive from their income. Reilly and Brown define such savings, intended to grow in value over time, as investments. On the other hand, the investor can be an individual, a government, a pension fund, or a corporation. Similarly, investments made by companies in facilities and equipment, and investments made by individuals in stocks, bonds, commodities, or real estate, are also considered investments. (Reilly & Brown, 1999, p. 5)

Aren (1969), investing is a method of saving money to preserve its value. Aren also mentions that investing can also generate profits, and he also mentions that some individuals invest borrowed money. He explains that these individuals invest the borrowed money and profit from the income they earn from the investment, plus the remaining interest they pay on the loan.

Based on the definitions provided, several important factors stand out for the investor. One of these is the planned investment amount. Indeed, the total available assets form the basis of the investment and directly shape the decisions made throughout the investment process. The responsibility for determining the investment amount primarily rests with the investor. However, investment advisors and those around the investor also have a certain degree of influence in this process.

The concept of investment, which is addressed from different perspectives in the literature, generally refers to the allocation of current resources to generate future economic returns. These definitions demonstrate that investment can be directed not only at financial instruments but also at real assets, knowledge, and human capital. However, understanding the investment process is not limited to simply defining the concept; it also requires considering the actors who shape this process, namely investors, and their classification based on their different characteristics. In this context, the next section will address the concept of investor and its types.

1.2. Investor Concept

Investment stands out as a fundamental tool in helping individuals leverage their savings and achieve their long-term financial goals. However, investment activities represent a complex field with a wide range of dynamics. To make sound decisions in this area, it is beneficial to first conceptually examine the concept of "investor" and the fundamental categories under which investors are classified. Factors such as investors' risk perception, knowledge level, investment duration, and objectives directly determine the strategies and tools they use. This section will outline a general framework for the investor's identity and provide a detailed overview of investor types.

The concept of investor is addressed from various perspectives in the economics and finance literature and is generally defined as actors who allocate capital for the purpose of generating economic or financial returns. The Turkish Language Association (2025) defines an investor as "a person or organization that allocates capital for the purpose of generating economic or financial gain". While this basic definition is functional and comprehensive, it largely overlaps with other approaches in the literature. Gitman and Joehnk (2002) define an investor as an individual who directs savings to various assets with the aim of achieving higher future returns, while Bodie, Kane, and Marcus (2014) define the investor as someone who forgoes current consumption to benefit from the future cash flows of an asset. In this context, it is considered more accurate to describe the investor as an individual who simply transfers funds or capital to the system; it is also considered an economic actor who makes timely investment decisions and has future expectations.

Another important point emphasized in the literature is that investors are not solely motivated by economic motivations but also exhibit various behavioral and strategic differences. Menteş (1975) defines investors as individuals or legal entities who aim to generate income by directing surplus funds into existing investment instruments, while stating that investors' primary goal is to generate reasonable and regular returns. However, a key element of this definition is that not all investors are interested in fixed-income instruments; some may also engage in speculative behavior aimed at profiting from short-term price fluctuations. This distinction reveals that investors differ in terms of risk tolerance, time horizons, and investment strategies. Reilly and Brown (2012) also support this view, defining investors as individuals or institutional actors who allocate funds considering the balance of risk and return, adding a strategic dimension to the investment decision process.

In this context, the investor is considered not only as a person who directs funds but also as an actor who manages the decision-making, evaluation, and analysis processes. Gürbüz (2004) defines investors as individuals or legal entities who carry out, monitor, and analyze investment activities. He further classifies individuals who invest their personal savings as individuals, and public or private sector institutions that invest surplus funds as institutional investors. This approach reveals that investors can differ not only based on their individual characteristics but also on their organizational structure and level of involvement in the investment process.

Consequently, the concept of investor is addressed in the literature from both functional and analytical perspectives. The fundamental commonality among definitions is that an investor is a decision-maker who allocates available resources to various assets, taking a certain amount of risk, with the aim of generating returns. However, while some definitions limit this approach to the decision-making process to fund allocation, others expand it to encompass analysis, monitoring, and management functions throughout the investment process. Furthermore, the differences in investors' risk perception, goals, and strategic tendencies demonstrate that the investor is not only an economic but also a behavioral and structural category.

in the literature regarding the definition of an investor highlight not only the economic aspects of investment but also the investor's personal characteristics, strategic approach, and institutional structure. This diversity demonstrates that treating investors as a homogeneous group would be inadequate. Indeed, factors such as investors' risk perception, perspective on investment duration, level of knowledge, and return expectations necessitate categorization. To more accurately analyze investors and interpret market behavior, various classifications are made, such as individual, institutional, speculative, and conservative (Fabozzi, 2007).

1.3. Investor Types

The fact that investors are not merely a homogeneous group of fund providers, but rather individuals and institutions with diverse characteristics and strategies, has led to various classifications of investor types in the literature . These classifications are generally shaped by the investor's structure, risk propensity, time preference, and investment strategy (Fabozzi, 2007). The most fundamental distinction at this point is between individual and institutional investors (Reilly & Brown, 2012; Gitman & Joehnk, 2002; Fabozzi, 2007).

1.3.1. Individual Investors

Individual investors are individuals who operate on their own behalf in financial markets, possess limited resources, and make investment decisions individually. Capital Markets Legislation defines these investors as individuals authorized to direct their surplus funds into various investment instruments; this authority is granted provided they possess the legal capacity to exercise their civil rights (Turhan, 1998, p. 14). Orçun (2010) defines individual investors as individuals who manage their own portfolios without professional financial advice or with limited support, making choices among investment instruments to generate periodic returns.

The literature on investment behavior reveals that individual investors' decision-making processes are often shaped by limited knowledge, experience, and analytical capacity. Gitman and Joehnk (2002) emphasize that while individual investors have smaller trading volumes compared to institutional investors, their sheer numbers have a significant impact on overall market activity and trading volume. In this respect, individual investors not only contribute liquidity to capital markets but also play a significant role in spreading capital to the public (Arslan & Keskin, 2024, p. 2).

Individual investors make investment decisions not only by considering financial returns but also by considering factors such as security, flexibility and personal control.

However, behavioral biases often play a significant role in shaping these decisions . Within the framework of behavioral finance theories put forth by Kahneman and Tversky (1979), individual investors' investment decisions are often influenced by psychological factors such as overconfidence, framing effects, and loss aversion. Furthermore, it has been observed that individual investors tend to overtrade, which negatively impacts their return performance (Barber & Odean, 2000, p. 786).

On the other hand, since investment decisions are made entirely by the investor, the resulting profit or loss is the responsibility of the individual investor. This situation causes individual investors to be both more cautious and more vulnerable in their decision-making processes. Investment decisions are directly influenced by individual factors such as income level, knowledge level, and investment objectives, as well as external factors such as market volatility, economic crises, and political developments (Menteş, 1975).

From another perspective, the role individual investors play in the markets is not limited to individual benefit. For the healthy functioning of capital markets, the informed and informed participation of individual investors is as crucial as their participation. It can be argued that the way to increase the effectiveness of individual investors is to reduce information asymmetry and promote financial literacy. Furthermore, to balance individual investor behavior, institutional investors must also play an active role in the market. This balance both ensures market stability and helps prevent irrational price movements (Reilly & Brown, 2012).

With the increasing participation of individuals in financial markets, the influence of individual investors on investment decisions and market dynamics is becoming increasingly important. Individual investors contribute to economic growth by investing their small savings and also support companies' capital acquisition processes. Furthermore, qualified individual investors are known to promote market discipline, prevent potential bubbles, and help create a more balanced market structure. For clarity, this situation can be expressed quantitatively. According to data from the Turkish Capital Markets Association (TSPB) as of the end of 2024, the total investment amount in the BIST100 exceeded 3.6 trillion TL. 1.82 trillion TL of this amount, or approximately 50%, belongs to individual investors. According to Central Registry Agency (MKK) data, the total number of individual investors exceeds 6.5 million.

Despite their significant presence in the markets, individual investors differ from institutional investors in terms of trading volume, professional analytical capacity, and market influence. Institutional investors appear to play a more active and guiding role in capital markets, particularly when considered in terms of the rationality of investment decisions, access to information, and portfolio diversification opportunities (Reilly & Brown, 2012). Therefore, understanding the dynamics of individual investors, as well as examining the structure and impact of institutional investors on the market, is crucial for a holistic analysis of capital markets.

1.3.2. Institutional Investors

It's well known that many individual investors seeking to invest in financial markets lack sufficient technical knowledge and equipment. However, professional financial analysis is essential for transforming savings into sound investments. Institutional investors can be defined as specialized financial institutions that collectively manage the savings of small investors and pursue specific objectives. In other words, institutional investors are financial institutions that transfer the savings of individual investors to those in need and manage the established investment portfolio more effectively from a single center (Erdoğan & Özer, 1998, p. 3).

Institutional investors are legal entities that engage in large-scale investment activities in capital markets, have professional management, and generally manage the funds of others. This investor group encompasses various types of financial institutions, such as pension funds, mutual funds, insurance companies, portfolio management companies, foundations, and banks (Reilly & Brown, 2012). The presence of institutional investors is crucial for the deepening and development of capital markets, both because of the liquidity and stability they provide and because their investment decisions are based on analysis and expertise. The OECD supports this statement by stating that institutional investors contribute to price stability by adopting long-term strategies in the markets they invest in (OECD, 2011).

Gürbüz (2004) defines institutional investors as investment professionals who work for a fee to manage other people's money. The key difference between institutional investors and individual investors is that their decision-making processes are based on systematic analysis and that transactions are generally conducted within the framework of corporate governance principles.

Institutional investors, through their expert teams, invest large amounts of funds obtained from various sources in capital market instruments in line with the return and risk expectations of the resource holders (Zor & Aslanoğlu, 2005, p. 185). While institutional investors possess significant capacity to diversify risk due to their large-scale portfolio management capabilities, individual investors often fall short in this diversification. In this context, institutional investors can be said to have the ability to operate with a wide range of investments across various sectors, regions, and asset classes (Gitman & Joehnk, 2002).

Institutional investors also hold strategic importance in terms of shaping market behavior and directly influencing corporate governance. Indeed, large-scale stock purchases and sales influence both the prices of the underlying securities and the management policies of the companies. In this respect, institutional investors are considered not only financial but also governance market players (Clark & Hebb, 2005).

On the other hand, it's safe to say that the institutional investment sector, a key indicator of economic development, is closely linked to per capita income and income distribution. Increases in per capita income and improvements in income distribution fuel growth in the institutional investment sector. Therefore, institutional investors play a critical role in the economic development of countries with high per capita income. (Zor & Aslanoğlu, 2005, p. 185)

In light of all this information, although the fundamental investment principles of institutional and individual investors are similar, institutional investors generally manage large amounts of other people's funds. Furthermore, institutional investors are not only actors who manage large amounts of capital; they are also key factors in enhancing the reliability of the financial system, strengthening market discipline, and ensuring a more efficient allocation of resources. Therefore, it can be said that institutional investors are more advanced financial actors than individual investors in terms of their knowledge and the methods they employ (Bayar, 2012, p. 11).

1.4. Individual Investor Profiles

Investment decisions vary depending on individuals' risk perception, financial knowledge, and expectations. These differences lead to various investor profiles. Individual investors are often classified according to their risk tolerance, and this classification forms the basis of investment strategies.

Although the exact origin of the concept of risk is unknown, it is thought to have been transferred into Turkish from the French word "risque" (danger) and the Arabic word "ةءرج" (courage, audacity) (Etymology, 2025). From the perspective of risk, it can be argued that all social and economic decisions involve a certain level of risk. In this context, risk is seen as a significant determinant in shaping investment decisions (Bernstein, 1996, p. 48).

Individual investors trading in financial markets do not exhibit homogeneous behaviors toward risk. Each investor develops their risk perception differently, depending on their personal and economic circumstances. This difference shapes the path investors follow in their financial decisions and also categorizes them into distinct investor profiles. In the literature, individual investors are generally classified according to their risk-bearing capacity. This classification is associated not only with psychological predisposition but also with numerous personal and environmental factors such as income level, age, family size, spending habits, and general lifestyle. For example, it can be assumed that an individual with a higher income level exhibits greater flexibility in taking risks (Ranganatham, 2006, pp. 18-19).

Within this framework, financial risk is defined as the possibility of a deviation between expected and actual returns. In other words, the inability to predict with certainty the future return of an investment is the fundamental uncertainty facing investors. Investors' attitudes toward this uncertainty distinguish them as risk-averse, risk-preferring, or risk-indifferent. Therefore, risk is not merely a financial concept; it is also considered a fundamental determinant of individual investor behavior (Karan, 2004, p. 122).

1.4.1. Risk-loving Investors

Risk-loving investors prefer investment instruments with higher risks but higher returns than risk-averse investors. (Ranganatham & Madhumathi, 2009, pp. 18-19).

For risk-averse investors, the expected return from investing is greater than the expected return from not investing. A risk-averse investor's utility curve has a convex shape because the value he places on each additional gain increases (Türko, 2002, p. 385).

Figure 1.1. The benefit curve of the risk-loving investor (Civan, 2010)

1.4.2. The Risk-Averse Investor

Risk-averse investors dislike uncertainty and avoid taking risks. Therefore, between two investments with the same expected returns, they prefer the one with the lower risk. Risk-averse behavior is based on the investor's decreasing value for each additional gain. This leads to a concave (concave) utility curve. In other words, these investors receive less marginal utility from their increased capital, which in turn leads them to less risky investments (Anbar & Eker, 2009, p. 131).

Figure 1.2. The benefit curve of the risk-averse investor (Civan, 2010)

1.4.3. The Investor Indifferent to Risk

Risk-neutral investors don't care about the amount of risk an investment carries as long as the return remains the same. This group of investors doesn't care about the investment instrument they choose. This is because they have no preference or bias between risk and return. Consequently, these investors' utility curves exhibit a linear structure (Fabozzi, 2007, p. 184).

Figure 1.3. Investor indifferent to risk (Civan, 2010),

While classifying investors based on their risk perceptions allows us to understand their investment behavior in general terms, grasping the deeper dynamics behind this behavior requires a multidimensional approach to the factors influencing individual investment decisions.

1.5. Factors Affecting the Investment Decision of Individual Investors

Individual investors are influenced by various socioeconomic factors when making investment decisions. These factors can sometimes directly and sometimes indirectly affect the investor. The level and intensity of this interaction varies depending on the investor's personal and environmental circumstances. Differences among individual investors stem from their cultural background, knowledge and education levels, and psychological characteristics (Aksulu, 1993, pp. 4-5).

1.5.1. Personal Factors

Personal factors can be considered the most important factors influencing individual investors' investment decisions. These can be categorized as knowledge level, time, age, health status, expectations, income level, lifestyle, and psychological makeup. These factors directly influence investors' risk perception, investment preferences, and decision-making processes (Usul, Bekçi & Eroğlu 2002, p. 136).

1.5.1.1. Knowledge Level and Time

One of the key factors shaping individual investors' investment decisions is their level of knowledge, and the other is the time they can dedicate to the investment process. While an investor's financial literacy and market knowledge increase their capacity to conduct accurate analysis and make informed decisions, time constraints can directly impact how they use this information and their preferred investment instruments (Kavas & Kesebir, 2023, pp. 109-119).

An investor lacking sufficient financial knowledge will be unable to analyze securities when considering them and will therefore tend to choose investment instruments that require little or no information. Conversely, even if an investor possesses the necessary knowledge, they may not have the time to conduct these analyses or develop investment strategies. In such cases, individual investors will either seek support from a financial advisor or choose investment instruments that do not require constant monitoring (Mishkin, 1989, p. 89).

While investors' knowledge and the time they can allocate to investments are among the important personal factors that affect their decision-making processes, another factor that affects this process is the investor's age and health status.

1.5.1.2. Age and Health Status

Age and health status are among the key demographic factors influencing individual investment decisions. Investment objectives and risk perceptions vary depending on life stage. As individuals age, they tend to be more cautious and tend toward lower-risk investment instruments. Similarly, health-related uncertainties increase the search for security and liquidity during the investment process (Grable & Lytton, 1998, p. 65).

Young investors invest to increase their assets to secure their future, while older and less healthy investors prefer to hold their savings in cash or to convert them into cash immediately (Fosback, 1985, pp. 43-47). According to investment experts, there are several differences between young and older investors in terms of evaluating their investments. These differences can be listed as follows (Jagannathan & Kocherlakota, 1996, pp. 11-23).

Time Horizon: Older investors often avoid long-term investment plans because they perceive themselves as having a limited time horizon. Younger investors, on the other hand, tend to create longer-term investment plans because they perceive themselves as being at an earlier stage in life.

Investment Awareness and Research Inclination: Investment resources generally become more significant in the middle stages of individuals' lives. During this period, clarifying financial goals, conducting market research, and making informed decisions become more important. However, older investors are less willing to engage in such research and analysis than younger investors.

Tendency to Cope with Risk and Maintain Investment: Young investors are more likely to embrace the risks they may encounter during the investment process and hold their investments for the long term. Older investors, on the other hand, generally prefer to avoid risk and adopt a more cautious approach.

Approaches to Risk: While younger investors seek ways to eliminate or reduce risks, older investors either remain distant from efforts to change these risks or prefer low-risk, effortless investment instruments.

While the investor's age and health status affect many of his or her choices, from risk-taking propensity to investment duration, these preferences ultimately shape the investor's future expectations and goals.

1.5.1.3. Investor Expectations

Investors make investment decisions based not only on historical data but also on their future expectations. These expectations encompass the investor's target return, acceptable risk, investment duration, and liquidity needs. The investment behavior of individuals trading in financial markets is largely shaped by risk-return expectations, market perceptions, and forecasts regarding economic indicators. Therefore, investor expectations are central to the entire financial decision-making process, from portfolio choices to asset allocation (Gitman & Joehnk, 2008, pp. 9-12).

On the other hand, investors generally prefer investments that provide regular income. Therefore, before choosing a security, investors want to see its past performance. In doing so, investors compare the future income a security will provide with their own expectations. If the return a security will provide exceeds investors' expectations, investors are more likely to choose that security (Larson, 1990, p. 679).

An investor's expectations for the future are directly related not only to market conditions but also to his income level and the lifestyle he adopts.

1.5.2.4. Investor's Income and Lifestyle

Another important factor shaping investors' financial decisions is their income level and lifestyle. High-income individuals generally have a higher risk tolerance and prefer more diverse and long-term investment instruments. Lower-income investors, on the other hand, tend to gravitate toward more liquid, less risky investment options. Furthermore, individuals' lifestyles and spending habits directly impact their savings rates and, consequently, their investment strategies. For these reasons, an investor's income and lifestyle play a critical role in their financial decision-making (Smith & Johnson, 2019, pp. 12-14).

On the other hand, an investor's lifestyle and income play a significant role in determining their expectations for securities and the amount of funds they will allocate for investment. An investor with a higher-than-standard income may limit their short-term expectations and choose investment instruments that offer higher long-term returns. Such investors are more likely to accept high-risk investments than those in lower-income groups. The amount of funds allocated for investment by high-income investors represents a lower percentage of their total income. This ensures that those with higher incomes face less financial difficulty than those with lower incomes in the event of a risk (Aksulu, 1993, pp. 16-18).

In addition to concrete factors such as income level and lifestyle that shape investment decisions, the psychological characteristics of the investor also play a decisive role in the decision-making process.

1.5.1.5. Psychological Structure of Investors

The fundamental paradigm in asset pricing is undergoing a significant shift. Over time, purely rational approaches are being replaced by a broader approach based on investor psychology. In this new approach, expected returns on securities are determined not only by risk factors but also by potential misvaluations. (Hirshleifer, 2001, p. 1533)

Investors' investment decisions are influenced by various psychological and socio-psychological factors, including their personality structures, needs and motivations, and their perception and learning abilities. For example, when making investment decisions, investors determine the level of risk they are willing to accept by behaving in a way that aligns with their personalities. Some investors take on more risk to achieve greater returns, while others prefer less risky investments out of fear of losing what they have gained. (Özaltın, Ersoy & Bekçi, 2015, p. 403)

Investors not only often have limited access to information, but the way they process it is also subject to systematic biases. Behavioral biases such as overconfidence, representativeness bias, framing effects, and herd mentality in investment decisions can distort both investors' risk perceptions and return expectations. These psychological factors can lead to systematic distortions and persistent mispricing in markets (Hirshleifer, 2001, pp. 1535-36).

While the impact of personal factors on the decision-making processes of individual investors is important, another fundamental element that shapes these decisions is the financial factors the investor faces.

1.5.2. Financial Factors

Before making an investment decision, individual investors consider three basic factors. These are (Gitman & Joehnk, 2008):

- Desire to protect capital
- Desire to increase value
- Desire to earn a steady income

These three factors are considered together with the investor's risk perception, financial objectives and market conditions in shaping investment decisions.

1.5.2.1. Desire to Protect Capital

Individual investors, seeking to protect and increase their limited capital, make investment decisions based not only on rational analysis but also on psychological, social, and cognitive factors. Behavioral finance theory suggests that investor behavior can often deviate from rationality and that these deviations can be systematic (Thaler, 1999, pp. 35-44). In this context, individual investors' decision-making processes are shaped by cognitive biases such as loss aversion, overconfidence, the framing effect, and the herd mentality (Kahneman & Tversky, 1979, p. 263).

Because investors generally tend to be risk averse, they tend to choose low-risk, liquid instruments in their investment choices. This becomes particularly evident during periods of economic uncertainty (Barberis & Thaler, 2003, p. 1053).

1.5.2.2 Desire to Increase Value

One of the most prominent motivations in the investment choices of individual investors is the expectation of increasing the value of their capital, that is, long-term growth. Individual investors, particularly those who choose mutual funds, appear to prioritize the appreciation of their investments over time, rather than the desire for short-term income. This is linked to investors' efforts to ensure future financial security, protect their savings against inflation, and achieve their long-term goals. Therefore, the desire for value growth is a prominent factor in individual investors' investment decisions (Thomas, 2020, p. 171).

Besides time, another important factor is the risk constraint. Individual investors focus on the balance between the expected increase in economic value and the risk involved in achieving that increase. Therefore, the relationship between economic value and risk must be based on a meaningful and rational basis. Investors often make investment decisions with this balance in mind. Indeed, the expectation of an increase in economic value is considered one of the fundamental economic and financial factors influencing individuals' investment decisions (Karan, 2004).

1.5.2.3. Desire to Generate Continuous Income

The primary motivations of investors is the desire to generate regular and sustainable income from their investments. This desire is particularly important for risk-averse individual investors. Furthermore, this desire is based on reasons such as providing financial security, maintaining quality of life, and reducing future uncertainty. The expectation of constant income leads investors to seek more stable and lower-risk instruments, and these preferences directly shape their investment strategies (Akgün, 1996, p. 265).

Another important factor influencing individual investors' investment objectives is their desire to generate regular and consistent income from their investments. This, along with high income expectations, highlights investors' search for security (Usul et al., 2002, p. 140).

1.5.3. Environmental Factors

It is known that environmental factors, in addition to personality and financial factors, directly influence individual investors' investment decision-making processes. Environmental factors can be classified as follows (Özaltın et al., 2015, p. 404):

- Socio-Cultural Environment
- Reference Groups
- Close Circle and Family

It is known that investors' decision-making processes are not limited solely to individual tendencies and psychological factors; their socio-cultural structure, the reference groups they interact with, and their immediate environment and family also play a decisive role in this process. Individuals often act in accordance with the influences of their social environment rather than making decisions based on economic rationality. Therefore, in order to evaluate investor behavior from a holistic perspective, it is important to examine and explain these environmental factors separately.

1.5.3.1. Socio-Cultural Environment

It's a well-known fact that individual investors are influenced by their social environment and the cultural fabric of their society when making investment decisions. Individual investors can make or abandon investments based on the influence of their social environment. In fact, an individual may make a financial decision they hadn't previously considered based solely on positive comments about the success of that investment from those around them. This demonstrates the indirect but powerful influence of the social environment on investment decisions (Usul et al., 2002, p. 140).

On the other hand, the values, traditions, religious beliefs, and social norms of the society to which investors belong can directly shape their risk perceptions and investment preferences. Especially in societies with a collectivistic culture, individuals tend to seek approval from their social circles when making investment decisions. The attitudes of family members, friends, and even the local community appear to play a significant role in investors' decision-making processes. This can be said to make individuals vulnerable to cognitive distortions and group influence in their investment behavior (Hoffmann, Post & Pennings, 2013, p. 177).

It is now widely accepted that investment decisions are closely related not only to the individual's economic conditions but also to the cultural environment they live in. In an empirical study by Breitmayer, Hasso & Pelster (2019), it was found that cultural values influence investors' " disposition" It has been demonstrated how culture affects one's sensitivity to the "emotional impact" . For example, in cultures focused on short-term success, individuals tend to act more emotionally in investment decisions. In contrast, in cultures focused on the long term, investors remain more rational and patient. This shows that culture is a powerful external factor shaping investment behavior (Breitmayer, Hasso & Pelster, 2019, pp. 3-5).

1.5.3.2. Reference Groups

A reference group is a group of people who influence a person's attitudes and behaviors. This group serves as a reference point for evaluating a person's behavior, as individuals consult the reference group's knowledge on a topic and draw guidance from their opinions. For example, individual investors seeking to invest in securities often seek investment advice from more experienced investment experts or individuals with greater knowledge and experience (Aksulu, 1993, p. 31).

Reference groups are said to be a powerful factor in shaping individuals' decisions and values. Investors, in turn, can develop their behaviors in accordance with the norms and expectations of these groups. A study on individual investors stated that "reference groups are one of the environmental factors that influence an individual's behavioral tendencies". This statement demonstrates the function of reference groups in providing both information and social approval. According to the study, individual investors are directly influenced by the opinions and behaviors of those around them, such as family, friends, and colleagues, when making investment decisions (Uslu, & Bağcı, 2018, p. 287). Similarly, Risi et al. (2021) emphasize that the families of high-income investors, in particular, directly influence their investment decisions. Therefore, reference groups appear to play an important role in investor behavior as both a source of information and a mechanism for social approval (Risi, Paetzold & Kellers, 2021, pp. 25-26).

1.5.3.3. Close Circle and Family

A group is a group of people consisting of at least two people and whose members communicate face-to-face. The group's influence on an individual is based on the norms, values, and beliefs it embraces. The family is also a fundamental group where face-to-face relationships predominate, and its influence on an individual is known to be stronger than that of other groups. Individual investors, when they make investment decisions because they live within a group or family, have an undeniable influence on their investment decisions. This is because individuals, when left alone in the decision-making process, worry about making mistakes, feel insecure, and need the approval of their group or family. Conversely, individuals who had not previously considered investing have been observed investing or changing their investment vehicle choice because they see it in their families or in a group (Usul et al., 2002, p. 141).

It is known that family is the most influential social reference source for individual investors when making investment decisions. It has been observed that 67% of investors share their investment decisions with family members, and their family's views are directly reflected in these decisions (Uslu, & Bağcı, 2018, p. 287). This data demonstrates that the immediate environment plays a critical role in both information sharing and providing social approval. Similarly, in their comprehensive socio -economic analysis, Risi et al. (2021) emphasized that the expectations of families, particularly of high-income individuals, are decisive in socially responsible investment decisions.

1.6. Basic Financial Investment Instruments

A variety of investment instruments are available in the financial markets for individuals and institutions considering investing. These instruments vary in terms of risk levels, return potential, and maturity structures. Investors are expected to choose among these instruments based on their expectations, financial knowledge, and risk profiles. Basic financial investment instruments offer significant advantages in terms of both liquidity and returns when investing in individuals' savings. A thorough understanding of these instruments can contribute to more informed and effective investment decisions.

1.6.1. Deposits

According to the Central Bank of the Republic of Turkey (2022), deposits are funds accepted by banks and promised to be repaid at a specified maturity date or on demand. Deposits are categorized into types such as demand, term, notice, and precious metal deposits. Term deposits, in particular, hold a significant place in financial markets as a low-risk, fixed-return investment instrument. The security and government guarantee provided by deposits make them an attractive choice, especially for risk-averse investors (Karan, 2004, pp. 26-27). According to the Banking Law, money accepted by banks for a written or verbal payment to be repaid at a specified maturity date or on demand is considered a deposit (Aksoy & Tanrıöven, 2007, p. 357).

Deposits are critical not only for individual investors but also for the banking sector's liquidity management. Banks contribute to the financing of economic activities by converting the deposits they collect into loans. In this context, deposits are not only a means for individuals to invest their savings but also constitute one of the fundamental building blocks of the financial intermediation function (Güloğlu & Altay, 2012, p. 211). The systematic collection and management of deposits is a strategic tool for central banks in terms of money supply control and monetary policy implementation. Furthermore, supporting deposits with deposit insurance systems increases the confidence of depositors and helps maintain stability in financial markets.

1.6.2. Foreign Exchange

Foreign currency, in its narrow sense, is defined as a document representing foreign currency. The word "foreign exchange" is known to have entered Turkish from the French word "devise" Generally speaking, foreign currency encompasses all payment instruments used in international payments (Etimology, 2025).

Foreign exchange refers to all foreign currencies other than a country's national currency, as well as all types of securities representing these currencies (checks, bonds, bills, etc.). Foreign exchange, the primary instrument of international trade and capital movements, is also an important financial investment instrument for investors. Foreign exchange transactions are conducted through buying and selling in foreign exchange markets and are known to have a direct impact on a country's economic stability, foreign trade balance, and monetary policy. Both individual and institutional investors engage in foreign exchange transactions to benefit from fluctuations in exchange rates. Furthermore, due to its high liquidity, foreign exchange stands out as an attractive tool for investors seeking a safe haven, especially during periods of economic uncertainty (Karan, 2004, p. 122; TCMB, 2022).

1.6.3. Gold

Gold is a precious metal that has been used throughout history as both a medium of exchange and a store of value. Its physical structure, rarity, and easy portability make it a significant asset among traditional investment instruments. It is considered a "safe haven" due to its resilience to economic fluctuations and crises. Gold's use as an investment instrument occurs physically in the form of jewelry and ornaments, or in financial markets through gold accounts, gold-backed investment funds, and exchange-traded vehicles (ETFs). Especially during periods of uncertainty, investors turn to gold to protect their capital and achieve value gains (Korkmaz, 2010, p. 172; TCMB, 2023).

Gold has long been considered a symbol of wealth and power. It is an undeniable fact that gold has been the oldest and most important of the traditional investment instruments most frequently used by investors throughout history. Its ease of availability almost anywhere in the world and its ability to be quickly disposed of are among the key advantages that make gold attractive (Ceylan, 1995, p. 68; Ateş, 2007, p. 85).

1.6.4. Repo

A repo is defined as a repurchase agreement. A repo refers to the sale of an asset to another entity with the commitment to repurchase it on a specific date and at a pre-agreed price (Uludağ & Arıcan, 2001, p. 138). According to Fabozzi (2007), a repo is the sale of a security (usually government bonds or bills) to be repurchased on a specific date and at a specific price. The party conducting the repo temporarily obtains short-term funds by selling the asset and repurchases it at the pre-agreed price at maturity.

A repo is a short-term financial transaction that involves the sale of a security along with a commitment to repurchase it at a predetermined date and price. It generally involves a party in need of liquidity selling its securities to temporarily secure funds and buying them back at a predetermined maturity. This transaction offers a short-term, low-risk return opportunity for both individual and institutional investors. Repo maturities typically range from 1 to 90 days, and low-risk securities such as government bonds or treasury bills are used in repo transactions. Repo, an effective liquidity management tool particularly in money markets, is also a method frequently employed by central banks within the scope of open market operations (Karan, 2004, p. 33; SPK, 2023).

1.6.5. Stock

A stock is defined as “a document prepared in accordance with legal forms by a joint stock company or a limited partnership company whose capital is divided into shares and which can issue shares in the form of negotiable instruments in return, and which represents a certain percentage of the capital and provides partnership rights to its owners in that proportion” (Aydın, 2004, p. 110). According to another definition, a stock is expressed as “a document representing a part of the capital of a joint stock company from equal shares and which is prepared in accordance with legal formal requirements, having the force of a legally valuable instrument” (Halkbank, 2025).

Stocks, also known as shares, are defined as securities issued by joint-stock companies and limited partnerships whose capital is divided into shares, representing a certain share of the joint-share company’s capital and issued in accordance with legal formal requirements (Domaniç, 1988, p. 881). Stocks can be said to be a high-risk investment instrument most preferred by individual investors (Ceylan & Korkmaz, 2003, p. 422). These stocks grant their holders rights such as a share of the company’s profits, voting rights, and, in the event of liquidation, a share of the company’s assets.

On the other hand, a company’s profitability, management policies, and market performance cause fluctuations in the value of its stock. Therefore, stock investors are directly affected by the company’s activities. Therefore, while stock investments offer high returns, they also carry a risk of capital loss, making them among the riskier investment instruments. Furthermore, their high liquidity and ability to be bought and sold quickly and easily on stock exchanges are seen as significant advantages for investors (Karan, 2004, p. 27; SPK, 2023).

1.6.6. Investment Funds

Investment funds are defined as an investment vehicle that arises when investors invest their surplus funds in various securities held in the fund’s portfolio through financial institutions (Gündoğdu, 2010, p. 4). Another definition defines investment funds as collective assets created by directing funds collected from the public in exchange for participation shares into capital market instruments such as stocks, bonds, and precious metals. These assets are managed according to the principles of fiduciary ownership and risk diversification. Negotiable instruments documenting participation in the relevant funds and indicating ownership are called "participation certificates". Participation certificates do not carry a nominal value, but the unit share price is calculated by dividing the fund's total portfolio value by the number of outstanding shares (Korkmaz, Aydın & Sayılgan, 2021, p. 64).

By purchasing participation certificates, fund investors become shareholders in a specific portion of the fund's portfolio. This allows them to share in the income generated by the fund's securities, such as interest, dividends, and capital appreciation. The price used to purchase and sell participation certificates is recalculated each business day and applies to the following day's transactions. These calculations take into account the current market value of the assets in the portfolio. The unit price of a relevant fund is calculated by dividing the total value, after adding the fund's receivables and subtracting its liabilities, by the number of shares.

Mutual funds are divided into two types: Type A and Type B, based on their structure. At least 25% of the portfolio of Type A funds must consist of stocks of domestic companies. There is no such requirement for Type B funds. Therefore, Type A funds have a higher risk profile than Type B funds due to their higher stock ratio. (Korkmaz et al., 2021, p. 64).

Mutual funds are institutions that allow individual savers to diversify their investments across various assets, diversifying risk and providing expert services that investors cannot provide on their own. More precisely, mutual funds pool the small savings of individual investors to facilitate large-scale investments. Their size advantage and the professional expertise they employ enable more rational, effective, and cost-effective portfolio management (Karacabey, 1998, p. 40).

1.6.7. Bonds

Bonds are debt instruments issued to the market by the state or private sector companies in order to provide medium and long-term funds by borrowing (SPK, 2025).

In Turkish law, according to Article 420 of the Turkish Commercial Code (TTK), bonds are defined as "debt securities of equal par value and identical wording issued by joint-stock companies to raise funds". As the law suggests, bonds are debt securities issued in series by joint-stock companies to borrow money to meet their funding needs. Therefore, individual debt securities issued by the partnership to individual individuals or organizations are not considered bonds (TTK, m.420).

Bonds do not grant the holder ownership rights in a company. Instead, they grant the holder a creditorship. The bondholder is a long-term creditor of the issuing institution. This relationship terminates upon repayment of the bond at maturity.

On the other hand, companies cannot distribute dividends to their shareholders unless they pay their debts to bondholders. Furthermore, in the event of liquidation, bondholders have priority over stockholders in collecting their receivables. Even if the company incurs losses, bondholders have the right to demand their receivables and pursue legal action if they are not paid.

Bonds are considered lower risk than stocks. This is because both the interest and principal returns are predetermined and they are less sensitive to market price fluctuations. The primary advantage of these fixed-income securities is that they provide regular interest income over a set term.

Another point about bonds is that bond prices move inversely to market interest rates. When interest rates fall, bond prices rise, while when interest rates rise, they decline. Investors armed with this knowledge can achieve capital gains by buying and selling bonds at the right time. Furthermore, some bond types offer tax advantages.

While bonds are generally long-term instruments, their maturity periods can vary depending on the issuing institution's structure and economic conditions. In Turkey, bond maturities can be freely determined, legally speaking, to a minimum of one year. However, it should be noted that as the maturity period extends, risks related to interest and principal payments, as well as value fluctuations due to changes in market interest rates, may increase (Korkmaz et al., 2021, pp. 47-48).

1.6.8. Bond

Bonds are securities issued and sold by issuers as debtors, with a commitment to repay the nominal value to the investor at maturity, and with a maturity of not less than 30 days and not more than 364 days (SPK, 2025).

Bonds are short-term debt instruments in which the issuer promises to pay a fixed amount at the end of a specified period. Also known as "commercial papers" these securities are issued by both governments and private companies to meet their short-term liquidity needs. In this context, bonds issued by the government are called "treasury bills" while bonds issued by the private sector are called "financing bond" bonds are often issued with maturities of 3, 6, or 12 months and are generally sold below their face value and repaid at full value at maturity. This difference constitutes the investor's return (Mishkin & Eakins, 2018, pp. 107-108; Korkmaz et al., 2021, pp. 47-48).

Bonds are considered low-risk investment instruments due to their short-term nature. They also have high liquidity. While government-issued treasury bills are considered "risk-free" privately issued commercial papers have a variable risk profile depending on the company's credit rating. The effectiveness of bonds in international markets is important due to their sensitivity to changes in interest rates and their use as a tool of monetary policy (Fabozzi, 2013, pp. 38-39). Furthermore, these instruments, actively used by central banks in the implementation of monetary policies, are sensitive to changes in interest rates and play a critical role in market stability (Saunders & Cornett, 2020, pp. 152-153).

1.6.9. Lease Certificate (Sukuk)

Lease certificate is defined as a security issued by an asset leasing company in order to finance all kinds of assets and rights, and which enables its owners to have rights in proportion to their shares of the income obtained from these assets or rights (SPK, 2025).

Lease certificates are issued by joint-stock companies, known as "asset leasing companies" which are established by brokerage firms, banks, or other joint-stock companies to issue lease certificates. Lease certificates are issued to finance the assets purchased or leased by the asset leasing company and grant investors rights to the income generated by these assets in proportion to their share. Lease certificates are also known as lease sukuk (Aydın, 2004, p. 117).

A lease certificate is an investment instrument that grants ownership rights over a real asset or pool of assets and grants investors a share of the income generated by those assets. Simply put, they are documents or certificates representing ownership of an asset. They grant investors a share of the asset, along with the profits and risks associated with that ownership (Yean, 2009, p. 2). Green sukuk is another financial product developed to maintain sustainability and finance environmental projects. This financial instrument was introduced in 2017 and began to be used in Islamic finance (Sumer & Yanik, 2021, pp. 211-212).

CONCLUSION

Investment is a complex process intertwined with the fundamental dynamics of human behavior, going beyond simply maximizing financial returns. The concept of investment, types of investors, individual investor profiles, and factors influencing decision-making discussed in this section demonstrate that investment decisions are not only based on economics, but also on psychological and sociological foundations.

While classical finance theory has long maintained the assumption that investors make rational, consistent, and informed decisions, recent findings in behavioral finance have proven this approach inadequate in explaining the real world. Individuals' risk perceptions, emotional tendencies, cognitive limitations, past experiences, and social environments can be as influential as economic variables in shaping investment choices.

In this context, classifying investor types and profiles not only provides a categorical distinction but also helps us understand the reasons for observed differences in investment behavior. When considering risk-loving, risk-averse, and risk-neutral investor profiles, along with cognitive biases and psychological motivations, it becomes clearer why financial markets sometimes exhibit irrational fluctuations.

Furthermore, the personal, financial, and environmental factors examined in this section reveal the multidimensional nature of investment decisions. Income level, knowledge, lifestyle, social environment, and cultural factors influence investor behavior both directly and indirectly, shaping portfolio choices. The introduction of basic investment instruments provides an opportunity to assess, from a behavioral perspective, why investors choose certain investment options and under what circumstances they avoid risk or seek opportunities.

Consequently, understanding investor behavior is critical for explaining irrational behavior in financial markets, improving investment strategies, and enabling individuals to make more informed decisions. The conceptual framework presented in this chapter allows the reader to consider the fundamental components of the investment process from a holistic, behavioral perspective and provides a solid foundation for the more in-depth behavioral models explored later in the book.

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