

THE PSYCHOLOGICAL DETERMINANTS OF FINANCIAL DECISION-MAKING IN SMEs: AN EMPIRICAL ANALYSIS OF COGNITIVE BIASES AND RISK PERCEPTION

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Abstract

This study examines the psychological determinants influencing financial decision-making within Small and Medium Enterprises (SMEs), focusing on cognitive biases and risk perception. Drawing from an interdisciplinary framework that integrates economic theory with cognitive psychology, the research aims to elucidate how biases—such as overconfidence, loss aversion, and anchoring—shape financial decisions in entrepreneurial settings. Utilising a mixed-methods approach, including a survey of 350 SME owners and managers, and advanced statistical techniques such as structural equation modelling (SEM), this study empirically investigates the impact of psychological factors on financial behaviours such as investment choices, risk management, and capital structure decisions. The findings suggest that cognitive biases significantly skew financial decision-making, often leading to suboptimal choices that undermine long-term financial stability. Furthermore, the perception of risk, influenced by both personal experience and heuristic processing, is found to be a critical determinant in shaping SMEs' approaches to financial uncertainty. This paper contributes to the extant literature by offering a nuanced understanding of the psychological underpinnings of financial decisions in SMEs, with significant implications for both academic research and practical interventions aimed at improving financial decision-making in the SME sector. Implications for policy design and financial education programs are discussed, advocating for tailored interventions that address the cognitive biases and distorted risk perceptions prevalent in entrepreneurial finance.

Keywords

cognitive biases, financial decision-making, risk perception, small and medium enterprises, behavioural finance, investment decisions, entrepreneurial behaviour.

JEL Classification

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