Chapter 14
Behavioral Finance and Cryptocurrency Market

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ABSTRACT

With the unprecedented growth of technological development and digitalization across the globe, cryptocurrency has emerged to attract investors. It all started in the year 2013 when there were large fluctuations in the financial market. The novelty of this emerging asset class has led researchers to devise anomalous trade patterns and behavioral fallacies in the crypto market. This chapter will help researchers, academicians, and investors in understanding the importance of cognitive and emotional biases in the cryptocurrency market concerning investment decision-making. Moreover, the reader will be able to gain an understanding of the existing market and the challenges of cryptocurrency and financial technologies.

INTRODUCTION

The advances in the technological environment have led to the opening of the doors for creative new ideas and opportunities which led to changes in the economic environment. With this unprecedented growth of technological development and digitalization, Cryptocurrency has emerged to attract investors. It all started in the year 2013 when there were large fluctuations in the financial market. The newness of this emerging asset class has resulted in scholars, researchers, and investors devising abnormal investment patterns and behavioral anomalies in the cryptocurrency market (Shretryia & Kalra, 2021). Cryptocurrencies, Blockchain technology, and other potential applications are the relevant concept that has emerged in the "new economy". The instability in the stock market led to new prospects for investors. For this reason, a new asset class called cryptocurrency came into existence whereby individuals, as well as institutional investors, can invest. This led to the hype in the cryptocurrency market whereby Bitcoin was the most watched currency. Later on, other currencies came like Dogecoin, Ethereum, etc.

That is why it is important to understand Cryptocurrencies and blockchain technology and the impact of the investor's sentiment on Fintech markets.

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A GENERAL PERSPECTIVE OF THE CRYPTOCURRENCY MARKET

According to the "European Central Bank" (2012), computer-generated money known as Cryptocurrencies is explained as "a type of digital money that is issued (released) by its developers and generally controlled by them, accepted and used among members of a particular virtual community" (p. 16). Due to dealing in encoded form and decentralized nature, it is known as Cryptocurrency.

Cryptocurrencies are electronic notes which use encoded techniques for the authentication and verification of a transaction (Khan et al. 2020). The cryptocurrency market is a rapidly evolving and highly volatile space that refers to "the decentralized digital currencies that use encryption techniques to regulate the generation of units and verify the transfer of funds" (Shretryia & Kalra, 2021). It is a relatively new market that has emerged over the past decade as a result of advances in computer technology and cryptography. Cryptocurrencies like Bitcoin, Litecoin, Dogecoin, Ripple, and Ethereum have received worldwide acceptance and have gained the attention of global players. This attention is due to the volatility of the exchange rates in terms of the distribution of world currency (Zhu et al, 2021). Therefore, cryptocurrencies are a kind of digital assets which are managed by a network. In general terms, these currencies utilize "distributed ledger technology" (DLT) to log, control, and for verifying a transaction they use encoded code which leads to the generation of new units of currency (Trivedi et al., 2021; Zhu et al, 2021). Like various physical currencies, these newly created currencies in the form of coins are used as a medium of exchange. The return yields from cryptocurrency investments are only generated via price rise. As a result, these assets are drawn from speculation which can be seen in the high capriciousness rate (Zhu et al, 2021).

The cryptocurrency market is characterized by various features:

1. **Decentralization:** Cryptocurrencies work on scattered networks. It is neither controlled by any central authority nor government authority.
2. **Volatility:** Cryptocurrency prices are known to be highly volatile and can experience significant fluctuations in a short period. This makes the market highly attractive to speculative investors.
3. **Lack of Regulation:** The cryptocurrency market is largely unregulated, which has led to concerns about market manipulation, fraud, and other illicit activities.
4. **Technological Advancements:** Cryptocurrencies are based on cutting-edge technology, including blockchain and distributed ledger systems. This has led to the development of new financial instruments and investment opportunities in the market.
5. **Limited Adoption:** Despite its growth, cryptocurrency usage is still relatively limited and has not yet achieved widespread adoption. This limits the market's liquidity and stability.

Despite its volatility, the cryptocurrency market has seen significant growth in recent years. The overall market capitalization of cryptocurrencies is currently valued at over USD 2 trillion as of April 2023, up from just a few hundred billion dollars in 2020. This growth has been fueled by increased adoption by businesses and individuals, as well as the development of new use cases for cryptocurrencies, like "decentralized finance" and "non-fungible tokens" (Trivedi et al., 2021).

However, the market is too subject to risks. One of the biggest risks is the potential for fraud and hacking. The decentralized nature of the market makes it difficult to regulate and secure, and there have been several high-profile incidents of exchanges being hacked and millions of dollars worth of crypto-

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