INVESTMENT BEHAVIOUR: TOWARDS AN INDIVIDUAL-CENTRED FINANCIAL POLICY IN DEVELOPING ECONOMIES

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INVESTMENT BEHAVIOUR: TOWARDS AN INDIVIDUAL-CENTRED FINANCIAL POLICY IN DEVELOPING ECONOMIES

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Preface

Behavioural finance has emerged as a new concept in the research arena in recent times. Within this framework, many countries in the world take effective steps to develop the capital market to achieve good economic growth. Under this concept, it is presumed that information structure and characteristics of capital market participants (individual/retail investors) systematically influence their own decisions as well as the market outcomes. The information content of the market and the changes of economic climate of a country systematically influence individuals' investment decisions as well as market outcomes. The output of a research work depends on various important factors such as choice of countries, variable selection, the time period studied, methodology used, etc. It is difficult to generalise the results because each market is unique in terms of its own rules, regulations and type of investors. Moreover, the results of those researches relating to the developed countries are debatable in the context of an emerging economy like India due to differences in socioeconomic conditions and prevailing regulatory environment of the country and many other things. This type of studies is on a sensitive area from the perspective of both the individual investor and also from the brokerage firms. They may not give the vital information for the lack of trust and familiarity with the researcher. There may have a scope to doubt the quality of the responses from the side of the respondents as responses depend upon their level of conceptualisation. There is a scope of collecting response from more diversified and more number of respondents. Always there is a scope to use more variables and better methodology to ensure the robustness of the result. In the previous studies mentioned above, sometimes the sample size is not enough to represent the entire stock market of the country. The contradictory findings and gaps of the research works are the motivation for conducting this study on the effect of demographic factors, awareness and perceived risk attitude on investment behaviour in stock market in the context of individual investors of stock market. The findings of this study provide a comprehensive understanding of the relationship between demographic factors, awareness and perceived risk attitude of the individual investors of stock market with their investment behaviour in stock market. At the same time, a better understanding

of behavioural processes and outcomes is important for financial planners because an understanding of how investors generally respond to market movements would help investment advisors to recommend appropriate asset allocation strategies for their clients. For companies, identifying the most influencing factors on their investors' behaviour would affect their future policies and strategies and it would also affect their future financial plans. For government, identifying the most influencing factors on investors' behaviour would affect the required legislations and the additional procedures needed in order to satisfy investors' desires. The book is a good reference of stock-investment behaviour for the investors to consider and analyse necessary information regarding stock market before making suitable decisions of investment. The research provides a good understanding to the brokers and sub-brokers about the effect of different components of demographic factors, awareness and perceived risk attitude on different components of investment behaviour of the individual investors and it will help them to give more reliable consultant information to their clients. In developed countries, behavioural finance is applied widely in comparison to less develop or developing countries to explore the behaviours that impact the investment decisions. This study is also done with hope to confirm the suitability of using behavioural finance in developed, developing and under developed countries and in all types of stock markets. Thus, such a study is worth doing to provide a good chance to understand more about the individual investor behaviour in stock market as well as the theories of behavioural finance. The book can help to guide portfolio allocation decisions, both by helping us to understand the kinds of errors that investors tend to make in managing their portfolios, and also by allowing us to understand better how to locate profit opportunities for investment management. Moreover, understanding the psychological foundation of human behaviour in financial markets facilitates the formulation of financial policy.

List of Abbreviations

BSE	Bombay Stock Exchange
CFA	Confirmatory Factor Analysis
EFA	Exploratory Factor Analysis
KMO	Kaiser-Meyer Olkin
NSE	National Stock Exchange
SEBI	Securities and Exchange Board of India
SEM	Structural Equation Modelling
SPSS	Statistical Package for Social Sciences
Edu	Education
Occ	Occupation
Ay	Annual Income
Exp	Experience
Obj	Objective
Sol	Social Learning
Fia	Financial Awareness
Aff	Affect
Cog	Cognition
Heu	Heuristics Bias
Pros	Prospect Bias
Mkt	Market Bias
Hrd	Herding Bias

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Chapter 1

Introduction

1.1. Background of the Study

Investment is the deployment of funds on assets with the aim of earning income or capital appreciation. It has two attributes, namely, time and risk. Present consumption is sacrificed by the investor to get a return in the future. The sacrifice that has to be borne is certain, but the return in the future may be uncertain. This attribute of investment indicates the risk factor. The risk is undertaken with a view to reap some return from the investment. For a lay person, investment means some monetary commitment. A person's commitment to buy a flat or a house for personal use may be an investment from his/her point of view. This cannot be considered as an actual investment as it involves sacrifice but does not yield any financial return.

To the economist, investment is the net addition made to the nation's capital stock that consists of goods and services used in the production process. A net addition to the capital stock means an increase in the buildings, equipments or inventories. These capital stocks are used to produce other goods and services. Financial investment is the allocation of money to assets that are expected to yield some gain over a period of time. It is an exchange of financial claims such as shares and debentures for money. They are expected to yield returns and experience capital growth over the years. The financial and economic meanings of investment are interrelated because the savings of the individual flow into the capital market as financial investment, to be used in economic investment. Even though they are related to each other, only financial investment made on securities is of interest to us.

Investors are the backbone of the capital market. An economy needs an increasing amount of savings to flow into the corporate enterprises. The level of equity market participation of the retail investors has been rising over the past few years. Investment is the flow of capital which is used for productive purposes. There is a great emphasis on investment for being the primary instrument of economic growth and development for a country. There are a large number of investment instruments available today. Some of them are marketable and liquid while others are non-marketable and illiquid. There are instruments

which are highly risky while others are almost risk free. The investors choose avenues, depending upon their specific need, risk appetite and returns expected. Investment avenues can broadly be categorised into two spheres, namely, economic investment and financial investment. Purchasing a physical asset such as a building or equipment is an economic investment. Such investments contribute to the net additions to the capital stock of a society. Financial investments, on the other hand, refer to investment in financial instruments such as shares, debentures, insurance policies and mutual fund units. Financial investments help in creating the capital stock of the country. In the long term, investment is important for improving productivity and increasing the competitiveness of an economy. Without investment, an economy could enjoy high levels of consumption, but this creates an unbalanced economy. The countries having more commitments to investment are more progressive. As investments have a 'multiplier' effect, they generate income and employment and create demand and consumption.

1.1.1. Behavioural Finance

Behavioural finance has emerged as a new concept in the research arena in recent times. Within this framework, many countries of the world take effective steps to develop the capital market to achieve good economic growth. Under this concept, it is presumed that information structure and characteristics of capital market participants (individual/retail investors) systematically influence their own decisions as well as the market outcomes. For example, in country like India, the information content of the market and the change of economic climate have systematic effect on individuals' investment decisions and also on outcomes of the market. Initially, the behavioural finance was not widely accepted (Kim & Nofsinger, 2008), and DeBondt and Thaler's study was no exception as it was doubted and faced a lot of arguments (DeBondt & Thaler, 1995). Barberis and Thaler (2003) are considered among the famous writers for providing an excellent study about various types of behavioural biases that affect decision-making as well as financial markets. Behavioural finance papers are mainly based on the data of stocks that do not match well with the theories of market efficiency and asset pricing model. They are criticized as being late-comers and unconvincing to a sceptical readership. This limitation is eliminated by using individual brokerage data. In many studies, it has been shown that individual investors are affected by

different behavioural biases (Kim & Nofsinger, 2008). These behavioural biases have been tested by many researchers, one of them being Hirshleifer (2001), who provides empirical evidence regarding asset pricing. Nonetheless, only a few experiments have been performed to test behavioural finance theories, although the environment can be easily controlled by well-designed experiments (Kim & Nofsinger, 2008). However, an investor's investment decision to invest in a market, say the stock market, tends to rely highly on his/her behaviour derived from psychological principles of decision-making as only such principles can explain why people buy or sell a particular stock. Therefore, financial planners, companies, government and so on need a better understanding of the behavioural processes and outcomes. Such an understanding of how investors generally respond to market movements will help in devising appropriate asset allocation strategies, future financial plans, required legislations and macroeconomic policy, respectively. Hence, the book focuses on the effect of demographic factors and awareness and perceived risk attitude on investment behaviour in the stock market, and the study is related to the context of individual investors in the stock market.

1.1.2. Investment Behaviour

Investing in various types of assets is an increasingly popular activity that attracts people from all walks of life irrespective of their occupation, economic status, education or family background. When a person has more money than he requires for current consumption, he would be coined as a potential investor. The investor who has extra cash could invest it in securities or in any other assets such as gold or real state or could simply deposit it in his bank account. The companies that have extra income may like to invest their surplus in extending the existing firm or commencing a new venture. All of these activities in a broader sense mean investment. The investment behaviour of individual investors is somewhat different from that of institutional investors. Individuals tend to invest relatively more in non-tradable assets such as real estate, hedge funds or structured products. The term 'institutional investor' is generally used to describe an organisation that invests on behalf of others, such as a mutual fund, pension fund or charitable organisation.

1.2. The Research Problem

In conventional financial theory, investors are assumed to be rational wealth maximisers, who follow basic financial rules and base their investment strategies purely on the risk-return consideration as the factors expected to influence investment behaviour. Traditional economic theory assumes that people are rational agents who make decisions objectively to take advantage of the opportunities available to them. Investors think of themselves as rational and logical. But at the time of investment, their emotional inclinations, ingrained thought patterns, psychological biases and other factors may affect their investment behaviour. This study seeks to enquire into the effect of demographic factors, awareness and perceived risk attitude on investment behaviour in the stock market and is related to the context of individual investors in the stock market.

1.3. Objectives of the Study

Given the foregoing background, the principal objective of the present study is to enquire into the effect of demographic factors, awareness and perceived risk attitude of individual investors on their investment behaviour in the stock market. The principal objective can be split into the following specific objectives:

- to enquire the impact of demographic factors on investment behaviour in the stock market;
- to examine how awareness affects investment behaviour in the stock market; and
- to explore the effect of perceived risk attitude on investment behaviour in the stock market.

1.4. Hypotheses of the Study

The principal objective of the present study is to enquire into the effect of demographic factors, awareness and perceived risk attitude of individual investors on their investment behaviour in the stock market. For this purpose, demographic factors, awareness and perceived risk attitude of individual investors have been used as independent variables whereas their investment behaviour in the stock market has been considered as dependent variable.

Hypothesis I.

H_0. There is no impact of demographic factors on the investment behaviour in the stock market.
H_1. *H_0* is not true.

Hypothesis II.

H_0. Awareness does not affect investment behaviour in the stock market.
H_1. *H_0* is not true.

Hypothesis III.

H_0. There is no effect of perceived risk attitude on investment behaviour in the stock market.
H_1. *H_0* is not true.

1.5. Scope of the Study

Research in behavioural finance has important applications. A better understanding of behavioural processes and outcomes is important for financial planners because an understanding of how investors generally respond to market movements should help investment advisors to recommend appropriate asset allocation strategies for their clients. For companies, identifying the factors most influential on their investors' behaviour would affect future policies and strategies, and it would also affect their future financial plans. For governments, identifying the most influential factors on investors' behaviour would affect the required legislations and the additional procedures needed to protect the investors' interests. The research is a good reference of stock investment behaviour for the investors to consider and analyse necessary information regarding stock market before making suitable decisions of investment. The research provides consultancy organisations such as securities brokers and sub-brokers with a good understanding of the effect of different components of demographic factors, awareness and perceived risk attitude on investment behaviour of the individual investors, and it will help them in giving more reliable information to their clients. In developed countries, behavioural finance is applied widely in

comparison to less developed or developing countries to explore the behaviours that impact investment decisions. This study also hopes to confirm the suitability of using behavioural finance in developed, developing and underdeveloped countries as well as in all types of stock markets. Thus, such a study enables a good chance to understand more about the individual investor behaviour in the stock market as well as the theories of behavioural finance. The research can help to guide portfolio allocation decisions, both by helping us to understand the kinds of errors that investors tend to make in managing their portfolios, and also by allowing us to understand better how to locate profit opportunities for investment management. Moreover, understanding the psychological foundation of human behaviour in financial markets facilitates the formulation of macroeconomic policy.

1.6. Outline of the Study

The book consists of six chapters, and each of the chapters contains several sections and subsections. Chapter 1 contains an introduction, which gives the background of the research topics, provides a very brief introduction to the research elements and focuses on the necessity of this research work followed by the objectives of the study. This chapter also states the necessary hypotheses that will be tested to obtain answers to the research questions. The final section of the chapter is the scope of the study.

Chapter 2 describes the different variables that we have used in the research work, and the entire study is based on these variables: some independent variables and one dependent variable. The study enquires the effect of the independent variables on the dependent variable.

Chapter 3 is a review of the related empirical and theoretical literature. This chapter highlights the earlier research works in this area nationally and internationally. Thus, this chapter lays down the theoretical foundation of our empirical investigation and carves out the area of research within the existing literature. Through this review of literature, the research gap is identified.

Chapter 4 outlines a detailed exposition of the research design that covers the selection and description of variables used in the study, the study period, the data sources and so on. Apart from these, it also provides an overview of the research methodology employed in the study, that is, the statistical and econometric tools and techniques used in the study, and also a scheme of investigation.

Chapter 5 provides the analysis and reports the empirical findings of the investigation. The final section of the chapter interprets the key results.

Finally, Chapter 6 summarises and concludes the study and also provides an outline of the significant contribution of the research work, recommendations for policy implications and suggestions for further studies.

A bibliography, subject index and author index are provided at the end of the study.