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A STUDY ON THE ROLE OF BEHAVIORAL FACTORS ON INVESTMENT IN SELECTED CAPITAL MARKET INSTRUMENTS

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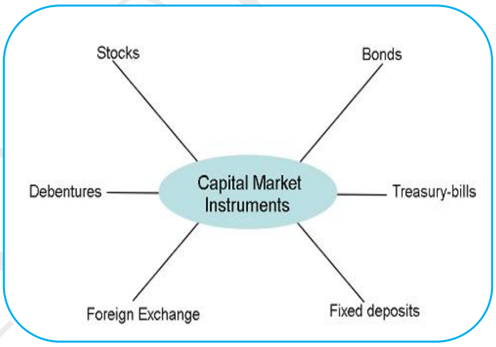
ABSTRACT:
Extreme volatility has beset financial markets worldwide since the 2008 Global Crisis. Investor sentiment has been one of the key determinants of market movements. In this context, studying the role played by emotions like fear, greed and anticipation, in shaping up investment decisions seemed important. Behavioral Finance is an evolving field that studies how psychological factors affect decision making under uncertainty. The present paper is an attempt to study the role of behavioural factors on investment decision of selected capital market instruments. The study has found that the physical, emotional and behavioural factors play an important role in investment decisions of investors with regard to the investment in capital market instruments.



KEYWORDS: *Behavioral Finance, Capital Market, Heuristics Factors, Prospect Factors, Market Factors and Herding Factors.*

1.INTRODUCTION

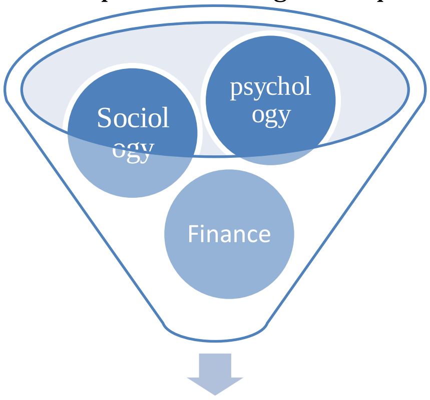
Behavioral Finance is the emerging concept in the finance field. It tries to explain how the psychological and social factors influence on individual's investment decisions. It integrates the field of Psychology, Sociology and other behavioral sciences to explain individual behavior, to examine group behavior regarding investment decisions. It will help to predict the financial market. "Behavioral Finance is the study of how psychology affects financial decision making and financial markets" (Shefrin, 2001). According to behavioral finance, investor's behavior in market is depending on psychological principles of decision making, (psychological factors) which explains why people buy and sell investments. It explores the cognitive factors and emotional issues that individuals, financial experts and trader exhibit within the security markets.

Since the mid of 1950s, the finance field has been dominated by the traditional finance model developed by the economists of University of Chicago. The main assumption of this model is that investors are rational and stock and bond markets are efficient. Over the past decade, behavioral finance has developed and considers the influence of personal and social psychological factors on financial decision of individuals.

2. STRUCTURE OF BEHAVIORAL FINANCE

Behavioral finance mainly consists of three major fields like

Psychology, Sociology and Finance. Sociology is the systematic study of human social behavior and groups, and influence of social relationship on attitude and behavior. Psychology is the scientific study of behavior and mental processes, which is affected by human's physical, mental, and external environments. Finance is the discipline concerned with determining value and making decisions. The finance function allocates capital, including the acquisition and allocation.



Behavioral Finance

3. BEHAVIORAL FINANCE AND INVESTMENT DECISION

Decision making is a difficult process which can be defined as a process of selecting a particular alternative among a number of conceivable courses of actions after careful estimation of each. Most critical challenge for an investor is to make investment decisions, having a difference in their profile, like demographic factors, socio economic factors, educational levels, age, gender, and race. Stock (capital) market in 2004 to the end of 2007 and following recession of financial market, understanding irrational investor behavior is significant as it has ever been. In current situation behavioral finance becomes essential part of decision making process due to its influence on performance of investments.

Most critical issue is market participant cannot behave rationally always, they deviate from rationality and expected utility assumption while making investment decisions. Behavioral finance helps to investors as well as market participants to understand biases and other psychological constraint in the market. Behavioral finance method tries to describe and increase understanding of reasoning patterns of investors, including the emotional processes involved and degree to which they influence the decision making process. Fundamentally, it attempts to explain the what, why and how finance and investing form human perspective. These help investors to minimize or eliminate the psychological biases in investment decisions.

4. OBJECTIVE

The objective of the study is to analyze the influence of behavioral factors on the investment decisions.

5. METHODOLOGY

The present research is an analytical study where the influences of behavioural factors on investment decisions are studied. The primary data was collected using convenient sampling technique. The sample size selected for the study was 100 but only 79 responses were obtained. The sampling unit includes the investors from Bangalore city who have invested in capital market instruments.

6. LIMITATION OF THE STUDY

- This study is restricted to investors from Bangalore city only.
- This study considers only few behavioral factors for evaluating the investor's behavior towards capital market instruments.
- This study selected only few capital market instruments for analysis.

7. DATA ANALYSIS AND DISCUSSION

The analysis of impact of Behavioral Factors on Individual's Investment is done by using the different Behavioral factors which influence the individual's investment decision namely Heuristics Factors, Prospect Factors, Market Factors and Herding Factors.

1. Heuristics Factors

- Overconfidence
- Anchoring and Availability bias

A.Variable of Overconfidence

Table 1.1: Respondents' opinion on whether they believe in their skill and knowledge to outperform in the market

Opinion	Percentage
Agree	74%
Disagree	4%
Neutral	22%

The data shown in the table 1.1 is regarding the variable of overconfidence. The variable is market knowledge and skills of investors which can help them in outperforming the market. 74% of respondents agreed, 4% of respondents disagreed and 22% of respondents are neutral about this statement. Thus, it can be said that 74% of respondents believe that their knowledge and skills of market will help for outperforming in the market. It means investors consider their previous experience and knowledge of market before the investment. 4% of respondents have not agreed this factor because the market is always fluctuating and previous experience may not be helpful and remaining 22% of respondents are neutral about this variable; because market knowledge may or may not help for better performance due to the external and internal factors of the market.

B. Variables of Anchoring and Availability bias

Table 1.2: Respondents' opinion on the preference of investment on local stock rather than international; as the information of local stock is more available

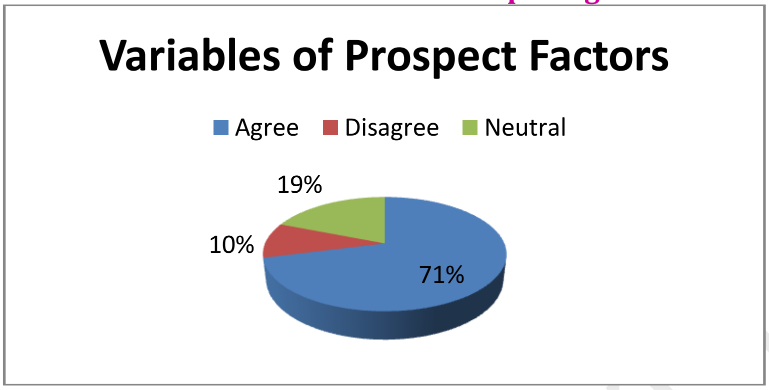
Opinion	Percentage
Agree	59%
Disagree	13%
Neutral	28%

The data shown in table 1.2 is regarding the variables of anchoring and availability bias. The variable is whether the investor chooses local stock rather than international stock; due to lack of information availability. 59% of respondents agreed, 13% of respondents disagreed and 28% of respondents are neutral about this statement.From the analysis, it can be said that most of the respondents agreed that they are choosing the local stocks rather than international stock. For every investor, information is very important for their investment. If the stock is belonging to international company or international market there is a possibility of limited availability of information in the local market; so most of the investors are not interested in the international stock. 13% of respondents are opposing to this statement and 28% of respondents are neutral about this variable; because information for international stock may be or may not be available in the local or domestic market.

2. Prospect Factors

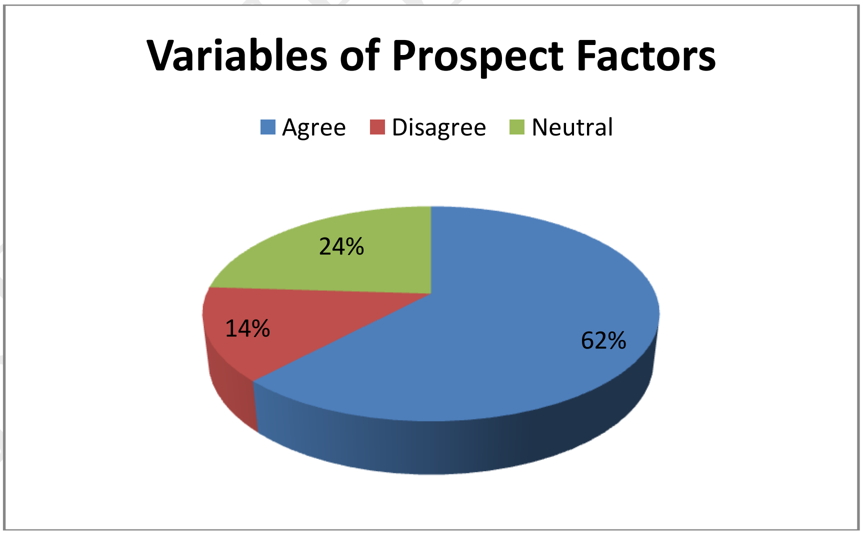
A. Variables of Prospect Factors

Graph 2.1: Respondents' opinion on whether they are ready to seek more risk than usual after a prior gain



The data shown in the graph 2.1 is regarding the prospect variables. The variable is whether theinvestors are ready to take risk prior to gain. 71% of respondents have agreed, 10% of respondents disagreed and 19% of respondents are neutral about this statement.From the analysis, it can be said that most of the investors are ready to take risk once they are earning in the market, because they believed that high risk will give high return and it's a human tendency that always seeking opportunity for earning. 10% of respondents have disagreed; may be because of market is not constant and is always fluctuating, so there is mean of always getting profit. And remaining 19% of investors are neutral about this statement; may be because of with the help of previous knowledge investor can earn profit or he may lose the money by taking high risk due market fluctuation.

Graph 2.2: Respondents sell shares that have decreased in value & readily sell shares that have increased in value



The data shown in the graph 2.2 is regarding the prospect variables. The variable is whether investors avoid selling the stock that has decreased in value and ready to sell the stock that has increased the value. 62% of respondents agreed, 14% of respondents disagreed and remaining 24% of respondents are neutral about the statement.From the above analysis, it can be said that majority of investors are avoiding selling the stocks that have decreased in the value and ready to sell the stock which have increased in the value; because they don't want to make any losses and they want to maintain efficient portfolio. 14% of respondents disagreed and 24% of respondents are neutral.

3. Market Factors
A. Market Information

Table 3.1: Respondents opinion on whether the market information is important for their investment

Opinion	Percentage
Agree	87%
Disagree	6%
Neutral	7%

The data shown in the table 3.1 is regarding the market variables. The variable is whether market information is important for investors. 87% of respondents agreed, 6% of respondents disagreed and 7% of respondents are neutral about this statement.From the analysis, it can be said that majority of the respondents have agreed that, market information is important for their investment. Every investor requires market information for fundamental analysis of their investment. Market information plays an important role in buying and selling of stocks in the market. 6% of respondents are saying that they do not depend on market information; may be because of they are not actively participated in the market or they are not trading regular basis. 7% of respondents are neutral about this variable.

B. Price Changes in Market

Table 3.2: Respondents opinion on whether they consider carefully the price changes of stocks that they intend to invest in carefully

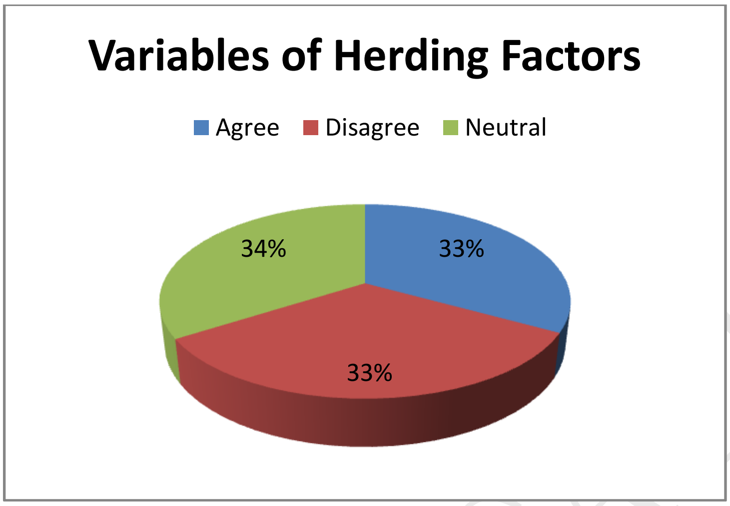
Opinion	Percentage
Agree	76%
Disagree	9%
Neutral	15%

The data shown in the table 3.2 is regarding the market variable. The variable is, do investors consider the price changes of stocks that they intend to invest. 76% of respondents agreed, 9% of respondents disagreed and remaining 15% of respondents are neutral about this statement.From the above analysis, it can be said that most of the investors regularly observe the price changes of the stock that they intend to invest, because price fluctuationhas a direct impact on earning capacity of the investment and efficiency of the portfolio. With the help of price changing information, investorscan earn profit and maintain their portfolio efficiently. 9% of the respondents disagreed with this factor; may be because of they believed that price changes cannot effect investment in long term. 15% of respondents are neutral about this factor; because of price fluctuations will have an impact on investment up to some extent and in long term it may not be affected.

4. Herding Factors

A. Buying and Selling behaviour

Graph 4.1: Respondents' opinion on whether their decisions of buying & selling have an impact on their investment decision



The data shown in the graph 4.1 is regarding herding variable. The variable is does other investors' buying & selling have impact on individual investor's investment decision. 33% of respondents agreed, 33% of respondents disagreed and remaining 34% of respondents are neutral about this statement.From the analysis, it can be said that 33% of respondents agreed that their investment decision is depending up on the other investors buying & selling decisions; because they believe that if other investors are buying & selling means they would have already done a research and they are having proper market knowledge. Sometimes investors thinking that if most of the investors are following one particular way, if not by the individual it will impact on their investment.33% of respondents disagreed with this factor because they believed in their own market knowledge and analysis. Reaming 34% of respondents are neutral about this factor; because sometimes investors need to follow the other investors' decisions and sometimes they need to analyses the market with the help of market knowledge.

Statistical Test

Hypothesis 1:

H_0: There is no association between age and risk bearing capacity among the respondents.

H_1: There is association between age and risk bearing capacity among the respondents.

Descriptive Statistics

	N	Mean	Std. Deviation	Minimum	Maximum
Age	79	1.47	.860	1	4
Risk bearing capacity of investors	79	2.65	1.144	1	5

Test Statistics

	Age	Risk bearing capacity of investors
Chi-Square	94.924[a]	38.152[b]
Df	3	4
Asymp. Sig.	.000	.000

a. 0 cells (.0%) have expected frequencies less than 5. The minimum expected cell frequency is 19.8.

b. 0 cells (.0%) have expected frequencies less than 5. The minimum expected cell frequency is 15.8.

From the above analysis it can be interpreted that significance value is .000 which is less than .05. Hence the null hypothesis is rejected and it can be concluded that is there is a significant association between age and risk bearing capacity of respondents.

Hypothesis 2:

H_0: There is no association between emotional factor and over reaction towards market price changes.
H_1: There is association between emotional factor and over reaction towards market price changes.

Descriptive Statistics

	N	Mean	Std. Deviation	Minimum	Maximum
Emotional factors impact on investment	79	1.27	.524	1	3
Investors are overreact to stock prices	79	1.19	.533	1	3

Test Statistics

	Emotional factors impact on investment	Investors are overreact to stock prices
Chi-Square	71.190[a]	103.696[a]
df	2	2
Asymp. Sig.	.000	.000

a. 0 cells (.0%) have expected frequencies less than 5. The minimum expected cell frequency is 26.3.

From the above analysis it can be interpreted that significance value is .000 which is less than .05. Hence the null hypothesis is rejected, that is there is a significant association between emotional factors and overreaction to price changes of capital market instruments of respondents.

Hypothesis 3:

H_0: There is no association between occupation and preferable investment avenues.
H_1: There is association between occupation and preferable investment avenues.

Descriptive Statistics

	N	Mean	Std. Deviation	Minimum	Maximum
Occupation of Respondents	79	2.13	1.275	1	4
Preferable investment avenues for investors	79	2.56	1.448	1	5

Test Statistics

	Occupation of Respondents	Preferable investment avenues for investors
Chi-Square	28.494[a]	55.873[b]
df	3	4
Asymp. Sig.	.000	.000

a. 0 cells (.0%) have expected frequencies less than 5. The minimum expected cell frequency is 19.8.

b. 0 cells (.0%) have expected frequencies less than 5. The minimum expected cell frequency is 15.8.

From the above analysis it can be interpreted that significance value is .000 which is less than .05. Hence the null hypothesis is rejected, that is there is a significant association between occupation and preferable investment avenues for investment of respondents.

Hypothesis 4:

H_0: There is no significant difference between gender and investment objective among the respondents.
H_1: There is significant difference between gender and investment objective among the respondents.

ANOVA Test

Descriptives

Gender

	N	Mean	Std. Deviation	Std. Error	95% Confidence Interval for Mean Lower Bound	95% Confidence Interval for Mean Upper Bound	Minimum	Maximum
capital appreciation	12	1.08	.289	.083	.90	1.27	1	2
future income	45	1.22	.420	.063	1.10	1.35	1	2
Safety	19	1.32	.478	.110	1.09	1.55	1	2
tax exemption	3	1.00	.000	.000	1.00	1.00	1	1
Total	79	1.22	.414	.047	1.12	1.31	1	2

ANOVA

Gender

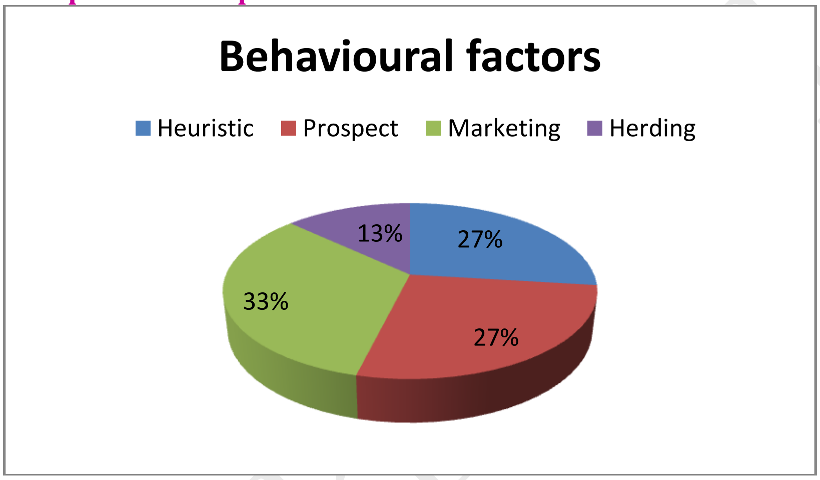
	Sum of Squares	Df	Mean Square	F	Sig.
Between Groups	.542	3	.181	1.059	.372
Within Groups	12.800	75	.171		
Total	13.342	78			

From the above analysis it can be seen that the significance level is .372 which is greater than .05. Hence the null hypothesis is accepted. Hence it can be interpreted that there is no significant difference between gender and investment objectives. From the selected sample of 79 investors the investment objectives are same between male and female investors.

Table 6: Overall opinion of respondents' on behavioral factors influence on investment

Behavioral Factors	Percentage (%)
Heuristics Factors	27
Prospect Factors	27
Marketing Factors	33
Herding Factors	13

Graph 6: Overall opinion of respondents' on behavioral factors influence on investment



From the above analysis it can be interpreted that Marketing Factors are highly influential on the individual's investment behavior. Thus it can be said that the investors are more dependent on the market factors in order to make investments. Following the market for investment is a very rational decision on the part of the investors which helps in yielding good amount of return.

FINDINGS

- From the study it has been found that investor's preferred sector for investment is financial sector.
- As per the study, majority of the investors are overconfident on their market knowledge and skills.
- Majority of the investors' preference is local stocks rather than international stocks due to limited availability of information.
- After a prior gain in the capital market most of the investors are ready to take more risk than the usual.
- From this study it has been found that majority of investors are believed in the market information for their investment.
- Majority of the investors are agreed that price fluctuation plays an important role for investment decisions.
- Some of the investors are saying like their investment decisions are depending upon the other investors' buying and selling activities and some investors are express their opinion like their investment decision cannot be influenced by other investors' decisions.
- Most of the investors are agreed that their emotional factors influence on investment decisions.
- Marketing factors are highly influence on individual's investment dictions on capital market instruments.

CONCLUSION

From the study of role of behavioral factors on selected capital market instruments it is found that in present scenario young and middle age group are investing more in capital market instruments. Few years ago people were considered that stock trading as a secondary source of income; but nowadays the perception of investors towards stock market has been changed and they are considering stock trading as a primary source of income. The study reveals that the findings clearly indicate that there is a significant relationship between behavioral factors and individual's investment decisions. Positive behavioral factors lead to the effective and efficient portfolio management. And also observed that female investors are very less compare to male investors, so female should be encouraged more so that they can get knowledge about the trading and they can also start trading.

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