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IMPACT OF BEHAVIOR BIASES IN INVESTMENT DECISION MAKING PROCESS OF INDIVIDUAL INVESTORS WITH SPECIAL REFERENCES TO INDIAN STOCK MARKET

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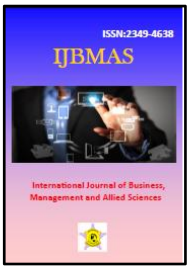

ABSTRACT

Individual investors investment decision is influenced by different various factors like perception, awareness, Psychological biases and emotional factors and so on. Out of which behavioral bias are important factors that highly impact the investment decision making process. Behavioral biases lead to bounded rationality where investors fail to evaluate the alternative available to them so as to select the optimal alternative. This is because their decision making is affected by feelings, emotions and intuitions rather than rational consideration. The present study attempted to examine the behavioral biases of individual investors during the investment decision making process and also identify the various factors influencing the investment behavior of individual investors.The study is conducted with a sample with of 100 individual equity investors in Kozhikode district in Kerala. The result shows that most of the investor depends on medias for collecting stock market information and there exist the tendencies of investors towards loss aversion, familiarity bias and optimistic bias. Herdbehavior bias is least effected to the investors. The study concludes that investors are not always rational and does not support the theories of efficient market hypothesis and capital assets pricing model.

KEYWORDS: Behavioral Finance, availability biases, self attribution bias, Loss aversion biases, Cognitive dissonance biases etc.

INTRODUCTION

Behavioral finance a branch of finance deal with human Psychology and its impact on investment decision making process. In traditional finance theory, investors are assumes to operation rationally when buying and selling of stock, investors are presumed to use all available information to form rational expectation about the future in selecting stock and collect information without emotion or any bias and act in a risk averse manner. Consequently the stock price should be accurately reflected fundamental values and will move up and down when there is unexpected positive or negative news respectively. Traditional theory concludes that financial market have stable and efficient, stock price shows random walk and overall economy tend towards a general equilibrium.

In reality, investors do not think and behave rationally they trade excessively, purchase stock without considering the fundamental values, base their decision on the past performance, buy stock which their friends are buying and retain loss making stock, while selling bullish stock. Investors often simplify their decision process and are affected to various behavioral biases so their investment choice do not maximize utility. Behavioral biases lead to bounded rationality where investors fail to evaluate the alternative available to them so as to select the optional alternative. This is because decision making is affected by feeling emotion and intuition rather than rational consideration. The present study attempt to describe why investors behave irrationally with the help of concept in behavioral fiance and also look in to various investor biases and risk related perception of investors.

STATEMENT OF PROBLEM

According to classical economic theories, investors always act in a rational manner that maximize their return. Yet a number of research shows that investors are not always so rational. They are not well educated about the investment intricacies and they are less aware about the happening in the investment scenario. The up string of various investment product and scheme have lured by the investors to jump into trading. Most of them make investment without the support of essential information and knowledge. High volatility in the market and the desire to make a huge return have paved the way of irrational judgment among investors.

The present study investigate from behavioral finance angle and investigate whether investors are biased while taking investment decision, which biases are affect them most and also the least .The study also analyze whether demographic factors have a direct impact on their investment decisions.

SCOPE AND SIGNIFICANCE OF THE STUDY

Decision making towards investment choice has been highly influence*d* by day to day emotions, individual's behavior and cognitive biases, although the traditional theories are not inclined towards investors irrationality and sub optimal decision making mechanism, to a large extent investment decision making process is highly driven by behavioral biases interrupting the investors to behave irrationally. Usually investors do not recognize while taking a decision, hence the present study focus on establishing the presence of biases among the investors and detecting the ways in which the biases can be removed. Geographically the study limited to Kozhikode District in Kerala. The present study may help financial institution and assets management companies in developing appropriate investment strategies as per the needs of investors.

OBJECTIVE OF THE STUDY

- To identify the various factors influencing the investment behavior of individual investors.
- To identify the Psychological biases exist among equity investors in Kozhikode District.
- To examine which biases are influencing the investors most and also the least while taking investment decision.

LIMITATION OF THE STUDY

- ✓ The sample size of 100 may not adequately represent the national market
- ✓ Convenient random sampling is used due to time and financial constraints.
- ✓ Some of the respondents are reluctant to reveal the correct information.
- ✓ The study is limited to only one district.
- ✓ The study has taken into consideration of only limited variables in behavioral finance.

RESEARCH METHODOLOGY

Descriptive study was undertaken to known the various factors influencing the investment behavior of individual investors and the various psychological bias exist among them. The study depends on both primary and secondary data. The primary data collected by using structured questioner from active short term investors who trade frequently in stock market. The population of the study consist of entire equity investors in Kozhikode District .100 equity investors are identified through convenience sampling technique.

VARIABLE OF THE STUDY

Age, investment experience, Gender, Occupation, Over Confidence bias, availability bias, Loss aversion bias,Representative Bias etc.

LITERATURE REVIEW

1. Marcin Rzeszatek (2015) explored the impact of personality traits and susceptibility to behavioral biases among a sample of polish stock market investors. Through the research the researcher find that venture sameness was related to the degree of susceptibility towards biases among participants. A negative correlation was observed between venture sameness and susceptibility to all behavioral biases studied, that is over confidences, mental accounting and sunk cost fallacy. The study concluded that a higher level of venture sameness was linked with a lower probability of behavioral biases.
2. Y.imthyas, K.Shyam Sundar and S. Sudha Raman (2015). A study on behavioral biases of individual investors in Indian stock market, through the study the researcher analyze the various behavioral bias of individual investors during investment decision making process. The study conducted among IT/ITES software profession in Chennai.. The study reveals that majority of individual investors from IT/ITES software organization exhibit frame dependence, self control and heuristic Representativeness with cumulative mean as 4.25 and 3.97 respectively. The result of the study shows existence of behavioral bias among the individual investors.
3. Jaya mamta Prosad (2014) explore the impact of investors behavioral biases on the Indian equity market and implication on stock selection decision an empirical analysis. Through this study he found that herd behaviour is not seen in the overall market although it persist in a bull market, Indian equity market shows a pessimistic behavior for the period 2006-2013.He conclude the study by revealing that there is a strong sign for existences of over confidence and disposition effect. These biases increase the market and individual security transaction volume respectively. It is observed that men's are more overconfident and optimistic then women, herd affect the old investors and disposition effect is present in middle aged investors.
4. Dr. Minimol M.C & Dr. makesh K.G (2011) noted that the stock market investors choose to sell such subsequently outperform the stock that investors retain . The study also reveals that investors exhibit substantial amount of aversion to losses, feel more comfortable with familiar companies for investment and also use initial reference point for decision making. The study concluded that investors are not necessarily utility optimize rs and rational thinkers.
5. Ehsan VI, Hassan Maryam Shabeen in their article titled "impact of affect Heuristic, fear and Anger on the decision making of individual investor. A conceptual study . Through the study the researcher found that anger is negatively related to investors' investment decision and also angry people usually make risky decisions. The researchers opines that fear helps the investor to take precautionary to be on safer side while making the investment decision. The study sum up that anger and heuristic bias will negatively impact investors judgment and decision making. Fear will have positive impact on decision. It is difficult to do rational judgment and decision making for angry investors because anger leaves negative signs on investors mind and lead to wrong decisions.

FINDING OF THE STUDY

Socioeconomic Characteristics of Investors

- From the study it is found that out of 100 respondent 86% of the respondent are males and only 14% are females.

- The study reveals that 26% of the respondents belong to the age cluster of 21-30 years, 48% are between 31-40 years, 20% are between 41-50years and 4% are between the age group of 51-60 years and 2% are above 60 years.
- 35% of the respondents are graduate, 15% are post graduate, 20% are professional degree holders, 18% have plus two and only 12% are SSLC holders.
- Among the respondents 40% of the investors are business man and 21% are employees, 30% are professional, pensioners and other group constitute only 19%.
- Investment experience of the respondents shows that majority of the respondent ie around 46% are beginners and have only 1-2 years of experiences in stock market 29% of the respondents have 2-4 years of experience and 20% have 4-6 years of experience and only 6% have experience more than 6 years.
- 60% of the respondents choose to investment over a period of 1-2 years. 25% of respondents prefer to make medium term investment that is for a period of 3-5 years . Only 15% of the respondent choose to invest their money on a long term basis that is investing over a period of more than 5 years.
- Most of the investors (60%) saving is between Rs.50000-1 lakh s annually .
- 38% of the respondent depends internet for collecting new information about stock market 40% of them depends on news paper and other articles. 8% of the respondents believe in what their friends and family have to say. 14% dependents on their financial advisers for taking investment decisions.
- 60% of the investors belong to the annual income group Rs.2-5 lakhs and followed by Rs.5 lakhs (22%) and up to 2 lakh s 12% .Majority of investors belong to the annual income group of 2-5 lakh s.

BEHAVIORAL BIASES AND ITS EFFECT ON INVESTORS

Over confidence Bias:

Overconfident traders tends to believe that they are better than others in choosing the best stock and predicting best time to enter and exit in a position .This type of people tend to place too much confidence in their ability to predict and make investment decision.

To test for overconfidence bias respondents were asked whether on an average they feel they can predict the future share price better than others. 52% agree with this statement and 48% disagree with this statement. It shows that 52% of the respondents are susceptible to this bias.

Loss aversion Bias:

loss aversion is the tendency of individuals to reluctance to accept a loss.Individuals often shows greater sensitivity to losses than to gain ie the mental penalty associated with a given loss is greater than the mental reward from a gain of same size.

To test for loss aversion bias respondent were asked two optional statement like

1. Have a 50% chance of gaining Rs 10000 and a 50% chance of gravity nothing.
2. Have a 100% chance of gaining Rs 5000/- rational response is first one but loss averse investors are likely to select the second option as they want to avoid a loss of Rs. 5000 79% of the investors are loss avert.

Representative Bias

Representativeness is a heuristic process by which investors base expectations upon past experience .It can lead investors to make incorrect projection based upon stereotypes. 48% of the respondents opines that they consider the recent return and bonus matters in the company for taking invest decisions. 28% are disagree with this statement and 22% are highly disagree to this, which shows that they are affected by this bias. Menes are more affected by this bias as compared to women.

Cognitive dissonance bias

This is the mental conflict that people experienced when they are presented with evidence that their belief or assumption are wrong. Cognitive dissonance bias test with two variables. 86%

agree that their future decision may go wrong due to decline in the market. Investors whose experience is less than 2 years are more found to exhibit this bias.

Optimistic bias.

This is the tendency of the investors to adopt an inside view in lieu of the outside view that is often more appropriate when making financial decision. Investors opting investment opportunities close to home are susceptible to optimistic bias, 60%of the respondents are found to be optimistic.

Conservatism basis.

Conservatism refers to the inability of investors to fully incorporate the impact of new information on their decision making. The basis tested with the help of two variables. It is found that 58% of the investors rarely change their portfolios and 46% are not ready to make any new changes in their portfolios .They are susceptible to conservative bias.

Herd behavior Bias

Herd behavior is the tendency of individual to mimic the actions of a large group .Investors following a group of experts' advice for investing are found to be exhibit herd bias. Only 20%of the respondents are affected by this bias. From the survey it can be interpreted that majority of the investors are not affected by herd behavior and those who are exhibiting, found to possess experience less than 2 years.

CONCLUSION

Behavioral finance represent a revolution in financial theory .This is a relatively young and promising field of modern finance and this branch shows remarkable progress in the last decodes. Behavior finance, is a study of the markets that draws on psychology , throwing more light on why people buy or sell the stock and even why they do not buy stock at all. This theory also explain how emotion and cognitive errors influence investors investment decision making process. The present study has tested certain behavioral biases identified by behavioral finance expert on stock market performance.The main objective of the present study was to examine whether investors were susceptible to various behavioral biases. It was found that there exist the tendencies of investors towards loss aversion bias, familiarity bias and optimistic bias. The study conclude that investors are not always rational and does not support the theories of efficient market hypothesis and capital assets pricing model.

RECOMMENDATIONS

- Individual investors in the stock market should allow professionals to manage their portfolio. This will reduce personal biases in the management of the portfolio.
- Capital market analyst and information providers in Indian Security market should try to release correct information at correct time about the market to the public as this may reduce investors' decision making biases.
- Practitioners and investors can also do diagnostic tests on behavioral biases expressed by the investors in order to devise appropriate investment strategies which, would maximize the wealth of the investors.

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