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Behavioural Factors Influencing Investors - An Underpinning on Equity Markets

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Abstract:
The aim of this research is to examine the key factors determining the awareness and risk perception of investors. This paper also identifies the influencing factors of investor behaviour. Extensive literature reviews prove that investor awareness, risk perception and behaviour plays a foremost part in investment decisions. Based on exploratory study, Investor awareness is classified into four factors such as Media, Social learning, Financial awareness and Company information. Risk perception is identified with four factors such as Precautious, Fear of loss, Courageous and Rational thinking. Behavioural dimension has 11 factors such as Anchoring, Loss Aversion, Status Quo, Mental accounting, Framing, Hindsight Cognitive dissonance, Representativeness, Conservatism, Self-confidence and Illusion of control.The study is conducted with a sample of 386 retail investors in Chennai city. Descriptive statistics and Factor analysis are performed to analyse the data. The results indicate that investors depend on the media and social learning as a source of information. Their risk appetite is moderate and does rational thinking while choosing their investments. Behavioural bias such as Illusion of control, Cognitive dissonance, Anchoring and Hindsight are the decisive factors for investors to formulate their investment choice.

Keywords: Behavioural Finance, Investor awareness, Risk perception, Behavioural factors.

INTRODUCTION:

Behavioural Finance challenges the efficient market perspective and focuses upon how investors interpret and act upon information freely available to them and helps to understand the investors' behaviour and real market practices. DeBondt and Thaler explicate Behavioural Finance into two primary areas, such as the identification of anomalies in the efficient market hypothesis that explain behavioural models and the identification of individual investor behaviours or biases inconsistent with classical economic theories of rational behaviour. (Olsen, 1998) Behavioural finance is a new paradigm of finance, which seeks to supplement the standard theories of finance by introducing behavioural aspects to the decision-making process. It deals with individuals and ways of gathering and using information. It seeks to understand and predict systematic financial market implications of psychological decision processes. In addition, it focuses on the application of psychological and economic principles for the improvement of financial decision-making. Fromlet (2001), Behavioural finance closely combines individual behaviour and market phenomena and uses knowledge taken from both the psychological field and financial theory.

Extensive studies have analyzed the importance of analyst perspective on investment decision and less prior attempt has been made to employ the awareness level, risk perception and behavioural factors associated with the investment tenure in providing the opinion and framing trading strategies. The aim of this paper is to analyze the determinants of investor awareness, risk perception and behavioral factors such as Anchoring, Loss Aversion, Status Quo, Mental accounting, Framing, Hindsight Cognitive dissonance, Representativeness, Conservatism, Self confidence and Illusion of control has its impact on investing in equity markets. The present study identifies all these key characteristics of behavioural aspects that influence investment decisions of individual investors. It also measures the demographic profile of the investors based on age, gender, marital status, annual income, educational qualification and occupation.

The research on investor awareness and risk perceptionguides individual to know the sources of information and the determinants of individual's risk perception in their investment decisions. The studies on behavioural factors help the investors to analyse the stock market trend before making suitable decision of investment. It is also helpful to the organisations for predicting the future stock market activities and providing reliable information to the investors.

REVIEW OF LITERATURE

The literature review iscentered on the theoretical and empirical studies on the investor awareness, their risk perception and behavioural factorsof equity investors are considered for the present study.

Studies related to Investor awareness

Mugabi (2001) examines the investor's perception of stock market activities and their level of awareness are key ingredients in the performance of stock markets. Awareness of market operations is crucial for the success of a securities market. Jappelli (2004) evidences on the determinants of financial awareness. It focuses on the theoretical framework on information production and dissemination, indicators of financial awareness, effect of household characteristics, cost of information and social learning. It also explores the implications of awareness for the stock holding puzzle and for the estimation of entry costs. Lintari (2006) identifies challenges of awareness and trust on the Uganda Securities Exchange. It sought to examine the extent to which stock market efficiency depends on the awareness and trust of investors. Also guided by three major objectives; to examine the relationship between awareness and trust; to establish the relationship and impact of awareness and trust on stock market efficiency.

Studies related to risk perception

Elke.U.Weber (1997) provides empirical evidence that distinguishes between conceptualization of the risky decision making process. It proposes a way of assessing a person's inherent risk preference that feature out individual and situational differences in risk perception. Ann-Renee Blais & Nancy E.Betz (2002) presents a psychometric scale assesses risk taking in five content domains: financial decisions (separately for investing versus gambling), health/safety, and recreational, ethical and social decisions. Respondents rate the likelihood that they would engage in domain specific risky activities. It also assesses respondents' perceptions on the magnitude of the risks and expected benefits of the activities. Sjoberg (2004) evaluates the relevance of the psychometric paradigm in risk perception research. The empirical tests of the theory capability of predicting perceived risk are identified. The risk characteristics form a logical, coherent group of variables denoting properties of the hazard, not how the respondent reacts emotionally to the hazard. Also, people make different judgments of personal and general risk, i.e both the risk correlates with each other. Wanyana (2011) examines the level to which investor awareness, and perceived risk attitude affected the stock market investor behavior on the Uganda Securities Exchange (USE). It conceptualizes that individual decision-making process with respect to equity shareholders is affected by the variety of factors. The way investors perceive risk and react to it depends on his/her personality traits, level of confidence and return level.

Studies related to Investor Behaviour

Kent Daniel (1997) proposes a theory based on investor overconfidence and biased self attribution to explain several of the securities returns patterns that seem anomalous from the perspective of efficient markets with rational investors. Seppala (2009) examines the effects of three behavioral biases on investment advisors. These biases are hindsight bias, overconfidence and self-attribution bias. A survey study is carried out to find out how the studied biases affect the investment advisors. Luong (2011) reveals the behavioral factors influencing the decisions of individual investors at the Ho Chi Minh Stock Exchange. The factors Heuristics, Prospect, Herd and Market have an impact on their investment performance. Abhijeet Chandra (2012) Individual investor behaviour is motivated by a variety of psychological heuristics and biases. Investors make investment decisions based on heuristics, they assume the price as decision-anchor and are overconfident in their judgments. Second, their investment behaviour is highly influenced by representativeness and they do lots of mental accounting in the sense of grouping their gains and losses while making decisions. Third, though investors follow fundamentals, they tend to discount complex information at first instance; they prefer those pieces of information which are easily adjustable into their investment decision-making. Finally, there exists an asymmetric pattern of distribution and usage of information among individual investors, which affects their investment behavior to a greater extent. Li (2012) examines psychological biases affect investor's decision making. The research framework identifies the relationship between psychological factors such as overconfidence bias, conservatism bias, herding and regret could possibly affect financial decisions.

Gongment Chen (2007) explores on investment decision making of Chinese Investors. These investors make poor trading decisions, the stocks they purchase underperform those they sell. They also suffer from three behavioral biases: (i) they tend to sell stocks that have appreciated in price, but not those that have depreciated in price, consistent with a disposition effect, acknowledging gains, but not losses; (ii) they seem overconfident; and (iii) they appear to believe that past returns are indicative of future returns (a representativeness bias). Lubna Riaz (2012) describes the impact of risk propensity, asymmetric information and problem framing on investors' behaviour while making decisions through the mediating role of risk perception. It determines the weightage attached to each independent variable by the investors when they make their decisions. Lingesiya Kengatharan (2014) explores the behavioural factors influencing individual investors' decisions at the Colombo stock exchange. Herding, heuristics, prospect and market are the behavioural factors affecting investment decisions and the relation between itsfactors and performance are identified.

OBJECTIVES OF THE STUDY

The research focuses on achieving the following objectives:

- To identify the determinants of awareness and risk perception of Equity investors
- To know the factors influencing the behavioural factors of investors.

RESEARCH METHODOLOGY

An exploratory study was undertaken to know the determinants of the investor awareness, risk perception and the behavioural factors influencing the investors decision making in the equity market. The study depends on the primary data collected through the questionnaires. Data is collected from the short term investors who trade frequently in the stock market. A pilot study was conducted with 50 sample respondents and the main study with 336 respondents, totally 386 equity investors are identified through convenience sampling technique. Descriptive statistics and Factor analysis are used for analyzing the data.

ANALYSIS AND INTERPRETATION

The analysis consists of two sections. The first section pertains to the respondents Demographic characteristics. The second section ascertains the factors determining awareness, risk perception and behavioural factors.

The findings are grouped and presented under various headings

Descriptive Profile of the respondents

The demographic profile of the respondents in terms of Age, Gender, Marital Status, Occupation, Education and Annual Income are presented below

Table 5.1 Profile of the respondents

Demographic factors	No of Respondents	%	Demographic factors	No of Respondents	%
Gender			**Education**		
Male	323	84	School	39	10
Female	63	16	UG	187	49
Age			PG	135	35
18-25	98	25	Post PG	20	5
26-35	142	37	Others	5	1
36-45	84	22	**Marital status**		
46-55	36	9	Single	112	29
Above 56	26	7	Married	274	71
Occupation			**Annual Income**		
Self employed	112	29	Less than 2 lakh	84	22
Private	222	58	2,00,001-5,00,000	203	53
Govt	20	5	5,00,001-10,0000	83	21
Retired	19	5	10,00,001-15,00,000	13	3
Others	13	3	Above 15,00,001	3	1

Table 5.1 reveals that the majority (84%) of the respondents are Male. 37% of the equity investors belong to the age group of 26-35 years. Most (71%) of the respondents are Married. 49% have completed Under graduation. 58% of the respondents are employed in private organizations. 53% of the respondents earn Rs 2 lakh to 5 lakh annually.

Factors influencing awareness, Risk perception and behavioural factors of investors

To assess the reliability of the constructs developed, the Cronbach alpha coefficient for all the dimensions was calculated. The Cronbach alpha is the most widely used index for determining internal consistency (Kerlinger 1986). It has been accepted that the hypothesized measure of constructing, reliabilities of 0.50 or higher is required. Further, Kaiser-Maiyer-Oklin Measure of sampling adequacy and Bartlett's Test of sphericity is used to indicate the proportion of variance in the variables caused by new factors. High values generally indicate that a factor analysis may be useful with the data. If the value is less than 0.50, the results of the factor analysis probably will not be very useful.

Table 5.2Reliabillity, KMO & Bartlett Test of Sphericity on Investors Awarness, Risk Perception and Behavioural factors

	Investor Awareness	Risk Perception	Behavioural Factors
Reliability	0.663	0.625	0.816
KMO &Barlett Test of Sphericity	0.657	0.660	0.640
Significance	0.000	0.000	0.000

Table 5.4 depicts the Cronbach value for Investor awareness (0.663), Risk perception (0.625), and Behavioural factors (0.816) confirms the homogeneity of the items comprising them, and indicates the acceptable level of reliability. KMO & Bartlett Test of Sphericity shows with Investor awareness (0.657), Risk perception (0.660) and Behavioural factors (0.640) provides an evidence for sampling adequacy for the study. The significant value of Bartlett test of sphericity is 0.000 which indicates that there exists a significant relationship among variables.

Eigen values are calculated and used in deciding the number of factors to be extracted through factor analysis. It is associated with each factor representing the variance explained by that particular component and expressed in terms of percentage of variance.

Table 5.3Eigen value and Variance of Investor awareness, Risk perception and Behavioural factors

S.No	Factor Dimension	Eigen Value	Variance
1	**Investor Awareness** 1. Media 2. Social Learning 3. Financial awareness 4. Company information	 2.604 1.495 1.293 1.014	58.238
2	**Risk Perception** 1. Precautious 2. Fear of loss 3. Courageous 4. Rational thinking	 2.603 2.072 1.168 1.056	60.788
3	**Behavioural Factors** 1. Anchoring 2. Loss Aversion 3. Status Quo 4. Mental accounting 5. Framing 6. Hindsight 7. Cognitive Dissonance 8. Conservatism 9. Representativeness 10. Self confidence 11. Illusion of control	 5.389 2.582 2.054 1.996 1.759 1.537 1.494 1.311 1.262 1.214 1.178	64.875

Table 5.4 shows the variance of **Investor awareness** with 58.238 and Eigen value for 4 factors identified are Media (2.604), Social learning (1.495), financial awareness (1.293) and company information (1.014). Variance of **Risk perception** shows 60.788 and Eigen value for 4 factors identified are Precautious (2.605), Fear of loss (2.072), Courageous (1.168) and Rational thinking (1.056).Variance of **Behavioural factors** shows 64.875 and Eigen value for 11 factors identified are Anchoring (5.389), Loss aversion(2.582), Status quo(2.054), Mental accounting(1.996), Framing(1.759), Hindsight(1.537), Cognitive dissonance(1.494), Conservatism(1.311), Representativeness(1.262), Self-confidence(1.214) and Illusion of control(1.178).

Factor analysis is performed to reduce the variables into few factors. The response collected on the five point scale is subject to factor analysis and the results are shown below;

Table 5.6 Factor analysis on Investor awareness

S.No	Factors	Factor loading
1	**Media** I follow the stock market through financial newspaper I follow the stock market through financial news on TV	0.800 0.783
2	**Social learning** I know about stock exchange holding educational programmes I am aware about seminars, conferences and workshops hosted by the stock exchange I access the latest annual reports, prospectus and financial statement of selected companies I look into the websites of BSE/NSE for updates	0.897 0.818 0.619 0.403
3	**Financial awareness** I collect information from broker/analyst about the stock market My peers influence my participation in the stock market	0.725 0.505
4	**Company information** I am aware about stock exchange giving reports on corporate developments of listed companies on a timely basis I depend on companies listed on the stock exchange as they publish financial statements	0.783 0.750

From the above table it can be seen that the investors' awareness with 10 variables is grouped into 4 dimensions which include Media, Social learning, financial awareness and Company information. **Media** dimension consist of two variables shows that investors follow the stock market through financial news on TV (0.783) and investors follow the stock market through financial newspaper (0.800**). Social learning** consist of four variables shows that investors look into the websites of BSE/NSE for updates (0.403), they access the latest annual reports, prospectus and financial statement of selected companies (0.619), they are aware about seminars, conferences and workshops hosted by the stock exchange (0.818), they know about stock exchange holding educational programs (0.897).

Financial awareness consist of two variables shows that investors collect information from broker/analyst about stock market (0.725), peers influence their participation in the stock market (0.505). **Company information** consist of two variables shows that they depend on companies listed on the stock exchange as they publish financial statements (0.750), they are aware about stock exchange giving reports on corporate developments of listed companies on a timely basis (0.783).

Table 5.7 Factor analysis on Risk perception

S.No	Factors	Factor loading
1	**Precautious**	
	I have enough familiarity with the type of stocks I have invested	0.763
	I invest a major portion of my income in a conservative stock	0.658
	I am cautious about stock which show sudden changes in price or trading activity	0.656
	Most of the time, I invest in stocks based on my own investment knowledge and experience	0.429
2	**Fear of loss**	
	Most of the time, I am worried if the value of my investment decreases	0.778
	Most of the time, I fear, whether I would make a wrong decision	0.709
	I am afraid to invest in stocks which incur a large loss	0.622
3	**Courageous**	
	I invest a major portion of my income in a speculative stock	0.814
	I am willing to take risks more than an average person	0.757
4	**Rational thinking**	
	I am always attracted towards investing in stock with good returns	0.855
	I am concerned about financial future more than an average person	0.770
	I do a periodic assessment of risk, return calculation in my stock	0.580
	I ensure equality of risk benefit distribution while investing	0.564

From the above table 5.6 it can be seen that the investors' risk perception with 13 variables is grouped into 4 dimensions which include Precautious, Fear of loss Courageous, Precautious and Rational thinking based on their respective factor loading. **Precautious** consist of four variables shows that investors have enough familiarity with the type of stocks they have invested (0.763), they invest a major portion of income in a conservative stock (0.658), theyare cautious about stock which show sudden changes in price or trading activity (0.656), Most of the time, they invest in stocks based on their own investment knowledge and experience (0.429).

Fear of loss consist of three variables which show that most of the time, investors are worried if the value of their investment decreases (0.778), Most of the time, they fear, whether they would make a wrong decision (0.709), they are afraid to invest in stocks which incur a large loss (0.622).

Courageous consist of two variables which show that investors invest a major portion of their income in a speculative stock (0.814), they are willing to take risks more than an average person (0.757). **Rational thinking** consist of four variables which shows that investors are always attracted towards investing in stock with good returns (0.855), they are concerned about financial future more than an average person (0.770), they do a periodic assessmentof risk, return calculation in their stock (0.580), they ensure equality of risk benefit distribution while investing (0.564).

Table 5.8 Factor analysis on Behavioural factors

S.No	Factors	Factor loading
1	**Anchoring**	
	I compare the current stock prices with recent high and low prices, to justify my choice	0.770
	When thinking about investment, the price I paid is a big factor	0.696
2	**Loss aversion**	
	The pain of financial loss is 2 times stronger than the pleasure of financial gain	0.687
	I feel nervous when price drops in my stock	0.607
3	**Status Quo**	
	While I consider to change my portfolio, I analyze varied opinion, but end up without much change	0.770
	Even though the market is beneficial, I am not ready to change the portfolio	0.611

4	**Mental accounting**	
	I concentrate on constructing my portfolios without looking at the market trend	0.671
	I often segregate my assets into safe investment portfolios	0.650
	I categorize my income into various accounts such as bill payments, rent, PF and savings into Equity	0.645
5	**Framing**	
	I trust more on the advice from nationally advertised firms than from smaller local firms for my investment	0.520
	While taking the decision, I consider about the personal characteristics, norms, habits etc.	0.438
6	**Hindsight**	
	While reflecting on past mistakes, I understand that it can be easily avoided	0.720
	I make predictions based on the knowledge of the past information	0.618
7	**Cognitive Dissonance**	
	Loss in my investment decisions are prior to my knowledge	0.806
	My future predictions may go wrong due to decline in the market	0.711
8	**Conservatism**	
	I rarely change my portfolios	0.635
	Presently I am not ready to make any new changes in my portfolio	0.545
	I only invest in the familiar shares	0.502
9	**Representativeness**	
	I avoid investing in companies with a history of poor earnings	0.729
	I rely on past performance to buy/sell stocks as it performs well	0.531
10	**Self confidence**	
	Gains in my investment must be attributed to my competence	0.609
	My failed investments have often been the results of unfavourable circumstances	0.571
11	**Illusion of control**	
	I will have a better outcome if I make my own trading choice	0.843
	I have more control over the outcome of my investment	0.683

From the above table 5.8 it can be seen that the investors risk perception with 24 variables is grouped into 11 dimensions which include Anchoring, Loss Aversion, Status Quo, Mental accounting, Framing, Hindsight, Cognitive Dissonance, Conservatism, Representativeness, Self-confidence and Illusion of control with respective factor loading. **Anchoring bias** consist of two variables which show that investors compare the current stock prices with recent high and low prices, to justify my choice (0.770), When thinking about investment, the price they paid is a big factor (0.696), **Loss aversion bias** consist of two variables which includes the pain of financial loss is 2 times stronger than the pleasure of financial gain (0.687) and investors feel nervous when price drops in their stock (0.607). **Status quo** bias consist of two variables which includes whileinvestors consider changing their portfolio, investorsanalyze varied opinion, but end up without much change (0.770) and Even though the market is beneficial, they are not ready to change the portfolio (0.611).

Mental accounting bias consist of three variables such as investors concentrate on constructing their portfolios without looking at the market trend (0.671), they often segregate assets into safe investment portfolios (0.650) and they categorize their income into various accounts such as bill payments, rent, PF and savings into Equity (0.645). **Framing bias** is consist of two variables such as they trust more on the advice from nationally advertised firms than from smaller local firms for investment (0.520) and While taking decision, they consider about the personal characteristics, norms, habits etc.(0.438). **Hindsight bias** consist of two variables such as while reflecting on past mistakes, they understand that it can be easily avoided (0.720) and investors make predictions based on the knowledge of the past information (0.618). **Cognitive dissonance bias** consist of two variables such as Loss in investment decisions are prior to theirknowledge (0.806) and their future predictions may go wrong due to decline in the market (0.711).

Conservatism bias consist of three variables such as investors rarely change their portfolios 0.635), presently they are not ready to make any new changes in their portfolio (0.545) and they only invest in the familiar shares (0.502). **Representativeness bias** consist of two variables such as they avoid investing in companies with a history of poor earnings (0.729) and they rely on past performance to buy/sell stocks as it performs well (0.531), **Self confidence bias** consist of two variables such as gains in their investment must be attributed to their competence (0.609) and their failed investments have often been the results of unfavourable circumstances (0.571). **Illusion of control** consist of two variables such as investors will have a better outcome if they make their own trading choice (0.843) and they have more control over their outcome of investment (0.683)

CONCLUSION AND MANAGERIAL IMPLICATIONS

The study of investors' behaviour in financial investment is significantly important in the emerging markets. The evidence documented in this study shows the determinants of awareness, risk perception and factors influencing the investor's behaviour. Majority of the investors are influenced by the information received from media. They are aware about company information and about the educational programmes conducted by the stock exchanges. They depend upon brokers/analyst for collecting information. It is inherent that equity investors make rational thinking while investing in the stock market. They have enough familiarity with the type of stock invested and are concerned about financial future. They do periodic assessment of risk return calculation in their stocks. Even though investors invest a major portion of their income in speculative stock, they are worried if the value of the investment decreases.

Behavioural factors influences the decision making of the investors. They compare stock prices and justify their choice of investment, as they are prone to risk. Most of the time, they keep status quo without making much change in their investment. They concentrate on constructing their portfolio without looking at the market trend. While reflecting on past mistakes, they understand it can be easily avoided. They avoid investing in companies with a history of poor earnings. They have an illusion that they have better outcome, it they make their own choice.

The present study concludes the evidences that various factors determining investor awareness, risk perception and behavioural factors of investors helps to understand the investment perspectives of individual investors especially in equity markets. Every individual investors must identify and overcome the behavioural bias while investing and make wise decision making. Future research can be incorporated on a large sample size of investors to identify the various factors determining awareness, risk perception and behaviour of the investors.

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