

ROLE OF BEHAVIOURAL BIAS IN INDIVIDUAL INVESTMENT DECISION MAKING IN STOCK MARKET

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Abstract: Behavioural biases are irrational beliefs that influence decision making process. Much of traditional economic and financial theory is based on the assumptions that individuals act rationally and consider all available information in the decision-making process and that markets are efficient. Behavioural finance challenges these assumptions and explores how individuals and markets actually behave. Why do investors behave as they do? Investor behaviour often deviates from logic and reason. Emotional processes, mental mistakes, and individual personality traits complicate investment decisions. Thus, investing is more than just analysing numbers and making decisions to buy and sell various assets and securities. . This study aims to investigate the impact of cognitive and emotional biases particularly Recency bias, Overconfidence, Loss aversion, Familiarity, Endowment biases on the individual investor's decision-making process and also aims to find the factors affecting investor's decision making process.

Key words: Behavioural Bias, Investment Decision Making, Stock Market.

Introduction:

Bias is a human tendency that affects behavior and perspective based on predetermined mental notions and beliefs. Biases appear across many areas of life and are extremely present in investing. Investor behavior deviates from logic and they display many behavior biases that influence their decision-making process. When investors act on a bias they don't explore the full issue and can be ignorant to evidence that contradicts their initial opinions. These behavioural biases prevent investors from taking rational decisions. Investing is more than just analyzing numbers and making decisions to buy or sell various assets and securities. Studies have proven the fact that psychological factors have relationships and impacts on the decision making of investors in stock market.

Biases come in both emotional and cognitive flavors. Emotional biases allows an investor's judgement to be clouded because of emotions. Cognitive biases cause investors to make poor decisions because of objective errors in their thinking or reasoning process.

Investors who suffer from self-attribution bias tend to attribute successful outcomes to their own actions and bad outcomes to external factors. They often exhibit this bias as a means of self-protection or self-enhancement. Investors afflicted with self-attribution bias may become overconfident, which can lead to overtrading and underperformance. Confirmation bias suggests that investors seek out information that confirms their existing opinions and ignore contrary information that refutes them. When researching an investment, investor might look for information that supports his or her beliefs about the investment and fail to see information that presents different ideas. Overconfident investors may overestimate their ability to identify winning investments. Investors with too much confidence in their trading skill often trade too much, with a negative effect on their returns. Loss aversion refers to people's tendency to prefer avoiding losses to acquiring equivalent gains. The individuals with loss aversion bias associate more pain with losses, compared to the pleasures of the gains. For this reason, they tend to stay away from losses, and affect their financial decisions. By avoiding behavioural biases investors can more readily reach impartial decisions based on available data and logical processes.

Significance and scope of the study

Behavioural finance, a sub field of behavioural economics, proposes psychology-based theories to explain stock market anomalies, such as severe rises or fall in stock price. The purpose is to identify and understand why people make certain financial choices. Within behavioural finance, it is assumed the information structure and the characteristics of market participants systematically influence individual's investment decisions as well as market outcomes.

This study aims to find out the impact of various behavioural biases affecting an individual investor's decision-making process. The study is conducted among 80 investors in Kottayam and the results of the same will help investors to become aware of the effect of their psychological factors on investment decisions and thus helps them to reduce their influence thereby taking rational decisions

OBJECTIVE

1. To analyse the profile of the respondents.
2. To analyse the various factors affecting behavioural biases.
3. To analyse the impact various behavioural biases.

1.Profile of the Respondents

Table 1.1

		Frequency	Percentage
AGE	21-30	41	51.3
	31-40	19	23.8
	41-50	6	7.5
	51-60	10	12.5
	Above 60	4	5.0
GENDER	Male	62	77.5
	Female	18	22.5
EDUCATIONAL QUALIFICATION	Below Graduation	2	2.5
	Graduation	34	42.5
	Post-Graduation	30	37.5
	Professional	14	17.5
OCCUPATIONAL STATUS	Business	17	21.3
	Professional	25	31.8
	Govt/Pvt employee	20	25.0
	Agriculture	7	8.8
	Others	11	13.8
MONTHLY INCOME	Below 20,000	26	32.5
	20,000-50,000	27	33.8
	50,000-100,000	17	21.3
	Above 100,000	10	12.5

FINANCIAL DECISION MAKING	Myself Spouse Jointly Other elder	39 2 26 13	48.8 2.5 32.5 16.3
INVESTMENT DECISION MAKING	Myself Spouse Jointly Other elder	41 4 23 12	51.3 5.0 28.8 15.0
TRADING EXPERIENCE	<3 years 3-5 years 5-10 years >10 years	48 6 11 15	60.0 7.5 13.8 18.8
PROFESSIONAL ADVICE	Yes No	47 33	58.8 41.3
PROPORTION OF INCOME INVESTED	0-10% 11-20% 21-30% Over 30%	36 27 10 7	45.0 33.8 12.5 8.8

Out of the 80 respondents, more than half that is, 51.3 percentage belongs to the age group of 21-30, 23.8 percentage belongs to 31-40 and the least belongs to above 60 category and majority of the respondents (77.5%) are males. With regard to the educational qualification of the respondents, 42.5 percentage are graduated and the least of them i.e., 2.5% are below graduated. Occupational status of the respondents reveals that major part of them are professionals (31.8%) and the least of them are engaged in agriculture. (8.8%). Of the respondents a major portion (33.8%) earns in between 20,000 and 50,000 and the least earns above Rs 100,000 (12.5%). Nearly half of the respondents takes financial (48.8%) and investment (51.3%) decisions by themselves. About 58.8% of the investors seeks professional advice before making an investment decision and 45% of the respondents invests below 10% of their income and the least 8.8% invests above 30% of their income.

2. Factors affecting investment decision making

Table 2.1

Factors	Mean	Std. Deviation	t	P value	Rank
Prior market gain	2.9750	.98051	-.228	.820	III
Experience	2.6875	1.00119	-2.792	.007	VI
Guaranteed return	2.7500	1.10808	-2.018	.047	V
Low price volatility	2.9000	.93592	-.956	.342	IV
Familiarity	3.2125	1.00245	1.896	.062	II
Emotional attachment	3.2125	1.05662	-2.963	.004	II

Own intelligence	2.9000	.94935	-.942	.349	IV
Reliability of Information	3.4875	1.11371	3.915	.000	I

From the above table it is clear that reliability of information is the factor which affects most while making investment decision making whose mean value is 3.4875 which is significantly greater than the central score of scale of measurement 3 (P value .000). Among the factors familiarity and emotional attachment, the mean values of both are greater than 3, but there exists significant difference only in case of emotional attachment since it has p value less than 0.05.

Hypothesis testing table

Ho: There exists no significant difference between the various factors affecting investment decision making.

Summated Mean	Standard Deviation	t	P
2.9425	0.281	-0.577	0.582

From the above table it is clear that the summated mean (2.9425) is less than the central score of scale of measurement 3, and the P value is greater than 0.05 which means the difference is not significant and thereby concluding that there exists no significant difference between the various factors affecting investment decision making.

3. Analysis of the impact of various Behavioural Biases

Table 3.1
Overconfidence Bias

Overconfidence Bias	Mean	Standard Deviation	t	P
Trading in riskier stocks	2.9750	.98051	-.228	.820
Experienced trader	2.6875	1.00119	-2.792	.007
Market forecast	3.1250	.90533	1.235	.221
Summated Mean = 2.9292				

Results of t test reveals that the mean score of the factor market forecast (3.1250) is greater than the central score of scale of measurement 3, and the p value is greater than 0.05 thereby indicates that the difference in mean score is not significant. The summated score is also less than the central score of scale of measurement 3 which indicates that the overconfidence bias doesn't make much impact on investment decision making.

Table 3.2
Loss Aversion Bias

Loss Aversion Bias	Mean	Standard Deviation	t	P
Sensitive in loss making	3.0125	1.16373	.096	.924
Nervousness of loosing value	2.9750	1.16895	-.191	.849
Investment change	3.0625	1.15116	.486	.629

Preference of low return investment over high riskier	2.7500	1.10808	-2.018	.047
Preference of low price volatile investments	2.9000	.93592	-.956	.342
Summated Mean = 2.94				

Results of the study reveals that the mean score of investment change and the factor sensitive in loss making are greater than the central score of scale of measurement 3 and the p value is greater than 0.05 in both the cases thereby indicates that the difference is not significant. The summated score is 2.94 which is almost near to the central score of scale of measurement 3 which indicates that the loss aversion bias has a neutral impact on investment decision making.

Table 3.3
Familiarity Bias

Familiarity Bias	Mean	Standard Deviation	t	P
Restriction to familiar stocks	3.2125	1.00245	1.896	.062
Low risk expectation in known company	3.2375	1.02183	2.079	.041
Summated Mean= 3.2250				

Results of t test reveals that the mean score of both the factors of familiarity bias are greater than the central score of scale of measurement 3 but the p value of the factor low risk expectation in known company has greater importance since it has p value less than 0.05. The summated score(3.2250) which is greater than the central score of scale of measurement ,implies that familiarity bias has greater impact on investment decision making.

Table 3.4
Endowment Bias

Endowment Bias	Mean	Standard Deviation	t	P
Increasing share of present investments than new ones	2.9500	1.05423	-.424	.673
Sticking on due to emotional attachment	2.6500	1.05662	-2.963	.004
Summated Mean= 2.800				

Results of the study shows that both the factors of endowment bias has a mean score less than 3 and the summated mean score also implies that the endowment bias doesn't have greater impact on investment decision making.

Table 3.5
Recency Bias

Recency Bias	Mean	Standard Deviation	t	P
Choosing to invest due to its recent performance	3.3625	.98397	3.295	.001
Investment made expecting the same good performance	3.2625	1.04025	2.257	.027
Investment made in current outperforming stock	3.1875	.99484	1.686	.096
Summated Mean=3.2708				

The mean score of individual factors and the summated mean is also greater than the central score of scale of measurement 3 and the p value is less than 0.05 in cases of the factors, choosing to invest due to its recent performance and investment made expecting the same good performance implies that the difference is significant. Recency bias has a greater impact on investment decision making.

Findings

1. Of the various factors affecting the investment decision making, reliability of information is the factor which affects the most.
2. Overconfidence, Loss aversion and Endowment biases has neutral impact on investment decision making.
3. Familiarity and Recency biases has a greater impact on investment decision making.

Conclusion

Behavioural biases are common obstacles to investment success. Even the most rational individuals are vulnerable to making poor investment decisions based on erroneous conclusion or emotional reaction to new information. Behavioural biases contribute to the often-documented tendency of investors to achieve inferior returns relative to market benchmarks. A large part of investing involves individual behaviour. Ignoring or failing to grasp this concept can have a detrimental influence on portfolio performance. Investors who have a strategy for avoiding behavioural biases are more likely to earn investment success. By overcoming the behavioural biases inherent in them by the investors can ensure favourable outcomes to a certain extent.

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