Asymmetric Information and its Behavioural Impact on Investors: A Review

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Abstract

Behavioural finance is the branch in the field of finance which studies the influence of disciplines like psychology, economics, sociology and Finance and their impact on investor's decisions. Subsequently, it also to the higher extent affects the stock market also. The crux behind the study of behavioural aspects in finance is based on the fact that it focuses on the fact that investors are not always rational. They have their own perception, information precision and experience when it comes to investing in funds. They have limitations and can exercise self-control which is the resultant of biases leading to haphazard decisions. The present study focuses on predominantly the information asymmetric factor which has an impact in investors investing decisions. This is done with the help of thorough review of literature form various research contributions and tries to understand the reasons and consequences. Information efficiency is termed as all the efficient information which reflects the stock prices in market. It is very evident from the economic theory that the asymmetric information has been the convincing explanation for market failures. There has been an imbalance of information between the stock market participants can lead to market failure. Asymmetry in information leads to investment decisions taken in ignorance with due interests in the wake of stock market events. It could also add to increased cost of capital to the investors. Investors make decisions based on certain assumptions and hypothetical views about various sources from where the information flows alongside referring to the other peer group of who have subtle knowledge about the events in stock markets. Here, the study aims at understanding the intensity of impact that an investor faces while knowing the amount of information and its precision which could affect his decisions.

Keywords: Behavioural finance, Information Asymmetry Information Efficiency, Stock Prices, investment decision

INTRODUCTION

Field of Behavioural Finance

Behavioural finance is the branch in the field of finance which studies the influence of disciplines like psychology, cognitive, economics, sociology and Finance and their impact on investor's decisions. Subsequently, it also to the higher extent affects the stock market also. The crux behind the study of behavioural aspects in finance is based on the fact that it focuses on the fact that investors are not always rational. They have their own perception, information precision and experience when it comes to investing in funds. They have limitations and can exercise self-control. Investors for several instances fall trap while adopting their own strategies in the urge of receiving returns.

Efficient Market Hypothesis is one such theory which explains the move of stock prices. It was developed from economist Eugene Fama's PhD dissertation in the year 1960s.It is a hypothesis which states that the stock prices are reflected by all available information. It is referred as an implication of" beat the market, which says that market prices should only be reacting to new information as and when it is reflected by other factors. There has always been a point to prove that not always all the time the investors have with them the right and quality information which could not form the part of wise investment decision. However, there were criticisms with respect to what is assumed that all investors perceive all available information in precisely the same manner. This assumption turns to be untrue and baseless because the investors have different ways in modelling the information flow that they receive.

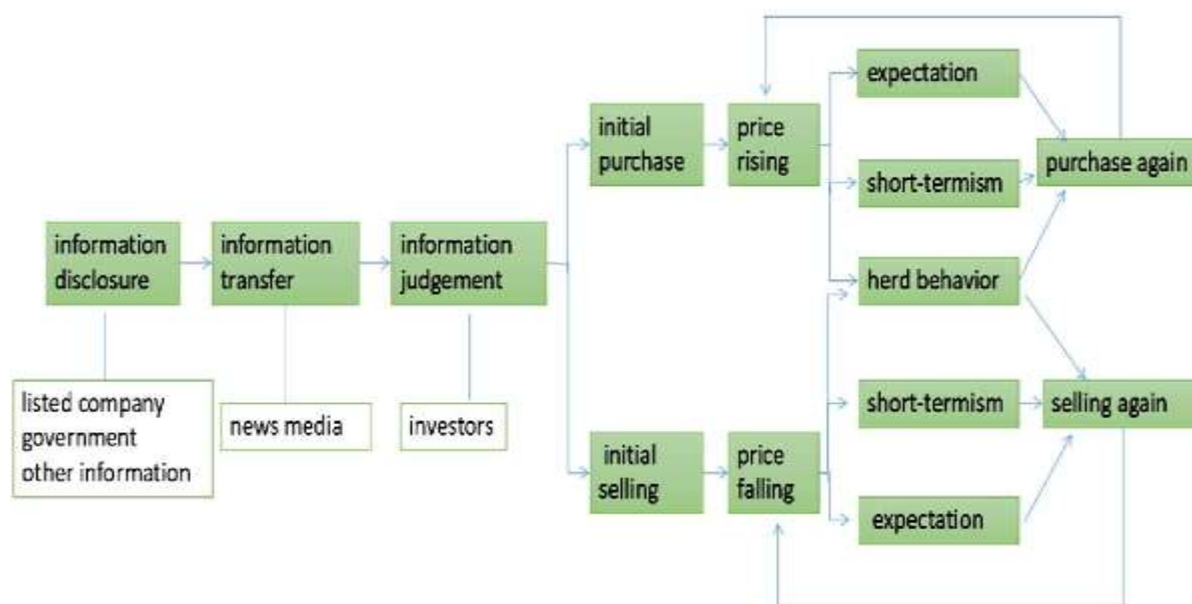

Figure 1. The mechanism of creating bubbles in stock market
(Source: DOI: 10.4236/jss.2018.68016)
Bikhchand, Hishleifer, and Welch Model

The above figure explains the role of information and the way in which it moves creates a sensation in the stock prices. There are several sources of information regarding the stocks and the implications of decisions made by the companies. And accordingly, there is a swift change in those company's stock prices. Information regarding bonus declaration, the percent of bonus declaration, announcement related to dividend declaration and finance related information does have an impact created in the investor's psychology. Sources like media have a higher impact in this new age technology, since everything is very transparent. Based on the information knowledge what investors are aware within their peer group largely impacts their decisions also. This information, once is known by majority of people, be it a positive or a negative could react in the form of stocks soaring higher creating a bullish trend and on a contrary stock falling creating a bearish market. Further this leads to a tendency in financial markets in such a way that the information what investors as a whole in equilibrium receive forms a herd behaviour. The herd behaviour is a tendency in a behaviour among investors where they follow each other while processing of information received from the financial markets and make investment decisions which are similar to each other rather than making decisions individually. But, the point of discussion is the authenticity of the information drive. Had the information being accurate, investors are in a better position, the other way around could leave them with higher losses and failure.

To describe the gist of the above figure 1 , it explains how the asymmetric information creates bubbles in stock market affecting the stock prices. The model is also known as Bikhchand, Hishleifer, and Welch Model. This model explains that the asymmetric information creates bubbles and herd behaviour. The information asymmetry can lead to herd behaviour. This can create bubbles only when shocks come into the market. This model makes an assumption that in a situation when the stock values are uncertain, except all the public information, investors also are aware about the private information which is insufficient for decision making. Each investor has the tendency of observing and acting upon the information that other investors are also aware of. This model has certain underlying assumptions like; all the opportunities in the market are equal across all the investors, investors have two options, either they will invest or they will not invest, all the investors have certain news, wherein all the investors can observe the decisions of others,, but they cannot get news with each other, investors are independent, have same initial wealth, such assumptions

What is a Hub of Information?

Information concerned to stock prices and the causes of increase or decrease basically is received from various sources can impact the investor's decision making and the resultant of which can be positive or negative. Financial markets provide information which has no symmetry in any transactions that takes place

wherein one of the two parties involved has more information than the other and thus has the ability to make a more informed decision. On a contrary, economists say that asymmetric information leads to market failure.
Investors need to be conscious as well as cautious in receiving the accurate information. Not all the information flowing into the markets, media and other sources create a value and therefore would help the investors in making rational decisions.
Companies publish their financial results in media which can be used by investors to understand the fundamental part of the performance of those stocks. Favourable stocks produce good returns, since their fundamental value, i.e., the intrinsic value of that stock is favourable in market. Other fundamental factors would be the earnings ratio, sales turnover, profit margin, operating profit and likewise could assist the investors to judge upon their own making it a successful fundamental analysis. Comparisons could be made to understand the performances of stock for relevant past periods to predict the performance of future.
Whereas, on the other hand, technical analysis is a very rigorous, yet a logical analysis which provides an investor with an accurate and deeper understanding of the stock behaviour. Market trends, moving averages, relative strength index are one of its kinds which help the investors to understand the trend line of the stocks. It does not compare just a day before data on stocks but also presents past two plus year data helping the investors make a right decision.
Many wise investors adopt this strategy in order to avoid suggestions from their peer groups. They rather believe than an intense technical analyst can prove himself with abundant knowledge on stock behaviour and accordingly make enormous profit. Short-term gains are the basic objectives of technical analysts. Since the stock trends do not follow the symmetry trend lines as they seem to be very volatile. The timing and the right approach, both can help investors gain abnormal returns.

Therefore, a choice of well-organized approach of information system is a core to success. In order to follow a fundamental approach, an investor has to look into these key points such as; growth, profitability, earnings, dividend

Whereas the technical the analyst has to measure the stock behaviour using parameters like moving averages, relative strength index, market trends, beta(risk) and the return on stock investment in portfolio management.

Literature Review

The authors from the paper " present their study with an analysis done for Korean Stock exchange. The sentiment index for Korea with respect to information source in internet search about the stocks and its impact on decision making patterns predict a positive future return after the three-week period showing a temporary increase in volatility.

In the study conducted by ….. is based on a simple model of information transmission and price dynamics. Investigations whether information can contribute to the momentum (normal market movement) or reversal (due to shocks in stock market) while impacting investment decision. The findings from the study discusses on the availability of private information which promotes the price momentum in investors behavior and will move in reversal with an impact of word-of-mouth information In this study, it was evident that initially with the private information prices showed an increase but eventually decreased in certain unknown conditions.

The paper …. discusses on analysis made to find out the impact of investors knowledge about the market information on stock price dynamics. The results show that whenever there is a shock accompanied by any new information, the reversal was observed in the stock price dynamics.This new information is in symmetry across all the investors peer group.But, on a contrary , something interesting was also observed; if there is an asymmetric effect on the reversal the price dynamics could be more stronger with having no effect on shocks and volatilitu , but where there isn't an asymmetry information it resukted into higher volatility

Studies conducted by ….tried to analyze the mechanism of stock market bubble created due to asymmetry information through various post studies as their reviews. The authors proposed a hypothesis that " The asymmetric information would lead to herd behaviour leading create a bubble in the market.The results from the paper report that if there was any shock wave in the stock market, it could create herd behaviour and that in turn causing bubbles.These bubbles then get advanced to the herd behaviour causing further bubbles. The

authors have made an attempt to gather studies from the previous works in the field and presented their results with reliability with the assistance of studies which were supported with hypotheses.

The authors in a paper titled"…. Have made an attempt to explore the relation of investments with the information i.e.,the impact of asymmetry information on the investment sensitivity to stock prices and the impact of asymmetric information on the price sensitivity to a. The results from this study reveals that asymmetric information has the significant negative impact on the investment sensitivity to stock prices but has a positive significant impact on the stock price sensitivity to investments.

The study in the paper…. Explores herding behaviour during market asymmetries and its impact on trading volume and volatility on herd pattern. The results show significant positive impact of herd behaviours with market asymmteries.

From the journal of IJARAFMS, authors proposed to analyze the four important issues related to financial information that investors consider; Growth prospects of company, Significant factors of financial markets, investment parameters and investment strategies. Here, the study was conducted using a mathematical model VaR model in order to understand the extent of impact of asymmetric information on trading volumes.

In the study ….. authors….. discussed the relation between information differences across investments and cost of capital. They believe through prior studies, that there is a long-standing concern to regulations and that the information differences across investors is huge. Further, the study discusses the precision of information which can cause a greater impact in investors decision as well can increase the cost of capital in firms.

CONCULSIONS

The prior studies refereed for the purpose of reviewing literature has covered only fewer areas in understanding the concept of asymmetry in information. Further the studies concerned to asymmetry information n and its impact on herd behaviour have been reviewed in many research works. Information regarding stocks and company's performance and other sources flows among the groups of investors more so in an uneven pattern. Information known by one group of investors could differ from that of other. Hence information symmetry could always affect the momentum in stock prices.

SCOPE FOR FUTURE RESEARCH

Studies concerned to asymmetry information and its impact on investment decisions have been undertaken in a fewer context. Many researchers who have undergone reviews in prior studies. The literature review done for this paper is limited to only the research areas pertinent to information asymmetry and its impact on investment decisions. Further researchers can focus on work related to other biases in behavioural finance affected investors decisions.

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