SHIV SHAKTI
International Journal in Multidisciplinary and Academic Research (SSIJMAR)
Vol. 1, No. 4, November-December (ISSN 2278 – 5973)

ROLE OF BEHAVIOURAL FINANCE IN INVESTMENT DECISION MAKING
- A STUDY ON SELECT DISTRICTS OF ANDHRA PRADESH, INDIA.

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ABSTRACT

Behavioural finance is a new academic discipline which seeks to apply the insights of the psychologists to understand the behaviour of both investors and financial markets. It focuses upon how investor interprets and acts on information to take investment decisions it explains that individuals do not always act rationally in their financial decisions and that their behaviours cause them to make different choices about their financial decisions. The two building blocks of behavioral finance are cognitive psychology (how people think) and the limits to arbitrage (when markets will be inefficient).

Investors do not act wisely in taking decisions relating to investment. They have certain weaknesses like cognitive and emotional which take a predominating role in taking investment decision of individuals. They have behavioral biases in the event of taking investment decision. Investment decisions also depends on the types of investors, risk tolerance capacity, education, occupation, age, sex, income, marital status, family back ground, living area and environment and attachment with the financial advisor etc. Despite all the resources and infrastructure, investors adopt some avenues after analyzing different factors which are influenced by internal and external environments. Using the principles of behavioral finance the present study explores the psychological concept of individual attachment style, especially individual investors to different available investment avenues and their investment preference process. This study indicates that there is a significant role of income and occupation in investment avenue selection by the male and female investors. For this an organized analysis has been made by taking primary data collected through structured questionnaire and secondary data for consideration.

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INTRODUCTION

The most crucial challenge faced by the investors is perhaps in the area of taking investment decisions. Every investor differs from the others in all aspects due to various factors like demographic factors, socio-economic background, marital status, educational attainment level, age, gender etc. An educated person's decision making towards investment differs from an uneducated one.. A young bachelor, for instance, prefers to invest in risky avenues; where as an matured person with a family dependability prefers less risky and stable income generating avenues. Similarly, rural /urban background of individuals, availability of information, accessibility of avenues, and investment companies/colleagues also influence individuals in developing their perceptions. Investment behavior is the study of the decision making.

Behavioural finance attempts to explain and increase understanding of the reasoning patterns of investors, including the emotional processes involved and the degree to which they influence the decision making process. Essentially, behavioural finance attempts to explain the what, why, and how of finance and investing, form a human perspective. For instance, behavioural finance studies financial markets as well as providing explanations to many stock market anomalies. It endeavors to bridge the gap between neoclassical finance and cognitive psychology. It looks at the individual investor's decision making formula as well as at their behaviour, which, in turn, sheds light on the observed departures from the traditional finance theory. Thus, behavioural finance is the application of scientific research on the psychological, social, and emotional contributions to market participants and market price trends. It also studies the psychological and sociological factors that influence the financial decision-making process of individuals, groups. Human decisions are subject to several cognitive illusions. These can be grouped into two –

1. HEURISTICS: it refers to rules of thumb which investor's exercise to make decisions in complex, uncertain environments. The certainty, the investor's decision making processes are not strictly rational one. Thought the investors have collected the relevant information and objectively evaluated, in which the mental and emotional factors are involved. It is very difficult to split. Sometimes it may be good, but many times it may result in inferior decision outcomes. It includes: Representative ness, Over Confidence, Anchoring, Gamblers Fallacy etc...

2. PROSPECT THEORY

This theory has been developed by Kahneman and Tversky. The key concepts they discussed are Loss Aversion, Regret Aversion, Mental Accounting, and Self Control etc...

Cognitive Psychology is the study of all knowledge related (mental) behaviors. The Attention, Perception, Memory/Comprehension, and Decision Making links are the various aspects of cognitive psychology that play an important role in investment behavior of investors. The second psychological discipline has theories to explain the personality, attitudes, motivations, and behaviors of the individual influence and influences by social groups. Research studies have been carried out to examine the investment preferences and practices of the individual investors, their investment related characteristics and investment avenues. Behavioral Finance is a new emerging science that studies the irrational behavior of the investors. Behavioral finance attempts to identify the behavioral biases commonly exhibited by investors and also provides strategies to overcome them.

LITERATURE REVIEW

Behavioral Finance is a new emerging discipline that studies the irrational behavior of the investors. Perhaps the literatures consisting of behavioural finance can be best explained by the works of Tversky and Kahneman who were recognized as the fathers of behavioural finance. Their literary works include:

- In 1973 they introduced availability heuristics. “A judgmental heuristic in which a person evaluates the frequency of classes or the probability of events by availability i.e., by the ease with which relevant instances comes to mind.” The reliance on the availability heuristic leads to systematic biases. In 1974they introduced three heuristics that are employed while making judgments under uncertainty, representativeness, availability, anchoring and adjustment. In 1979 they presented a critique of Expected utility theory in their paper that appeared in Econometrical. In another important paper, Tversky and Kahneman 1981 introduced the concept of Framing. They showed that the psychological principles that govern the perception of decision problems and the evaluation of probabilities and outcomes produced predictable shifts of preference when the same problem is framed in different ways.
- Behavioral economist Martin Weber (1999) makes the following observation, “Behavioral finance closely combines individual behavior and market phenomena and uses the knowledge taken from both the psychological field and financial

theory” (Fromlet, 2001). Behavioral finance attempts to identify the behavioral biases commonly exhibited by investors and also provides strategies to overcome them. Behavioral finance has two building blocks: cognitive psychology and the limits to arbitrage. Cognitive refers to how people think. Though the literature is very large, a brief review has been presented. A few studies have been carried out to examine the investment preferences and practices of the individual investors.

- Lewellen (1977) found that age, sex, income and education affect investors' preferences. Study by Rajarajan (2000) revealed an association between lifestyle clusters and investment related characteristics.
- Bandgar (1998) in his study found that investors are educated in investment decision making.
- Soch and Sandhu (2000) have studied perceptions of bank depositors on quality circles, customer complaint cell, quality, priority banking, telebanking, and customer meets in private banks.
- Study by Rafael La Porta et al., (2000) reveals that a strong investor protection is a manifestation of the security of property.
- The investment decision making process of individuals has been explored through experiments by Barua and Srinivasan (1986, 1987, and 1991). They conclude that the risk perceptions of individuals are significantly influenced by the skewness of the return distribution. This implies that while taking investment decisions, investors are concerned about the possibility of maximum losses in addition to the variability of returns. Thus the mean variance framework does not fully explain the investment decision making process of individuals.

- Gupta (1991) argues that designing a portfolio for a client is much more than merely picking up securities for investment. The portfolio manager needs to understand the psyche of his client while designing his portfolio. According to Gupta, investors in India regard equity debentures and company deposits as being in more or less the same risk category, and consider mutual funds, including all equity funds, almost as safe as bank deposits.
- Investors may range from confident to anxious. Method of action is reflected in how methodical investors are, as well as how analytical and intuitive they are. This can range from careful to impulsive. Within these ranges, the model defines four personalities:
  1. Individualist: Careful, confident and often takes a do-it-yourself approach
  2. Adventurer: Volatile, entrepreneurial and strong-willed
  3. Celebrity: Follower of the latest investment fad
  4. Guardian: High risk averse and wealth preserver

NEED FOR THE STUDY

It is observed that investors are more reliable and attached with a particular type of investment avenues. So it becomes significant to study the motivational factors that compel them for selecting the investment avenues. A study on the investors perceptions and preferences, assumes a greater significance in the formulation of policies for the development and regulation of security markets in general and protection and promotion of small and house-hold investors in particular, which ultimately leads to the economic development of a nation.

OBJECTIVES

The objectives of the study are:

- To study investment decision-making process and to study the factors that influence investment behavior of Individual Investors
- To study the attitude of respondents towards different financial instruments and to evaluate the awareness about various investment opportunities.
- To study the factors which influence the investors to make an investment.
- To analyze investors' savings and risk attitude towards different investment avenues.
- To offer suitable suggestions to the investors to make their investment in better way.

METHODOLOGY

This study was based on primary data obtained through a structured questionnaire containing 35 questions. The first part of the questionnaire relating to socio-economic background of employees consisted of 12 questions relating to age, educational qualification, income etc. The second part of the questionnaire consisted of 23 statements relating to various factors of avenue selection for the study. The sample size was 270 and the respondents were randomly selected from urban investors of two districts of Andhra Pradesh which are Warangal and Karimnagar. The Primary data obtained from the questionnaire was analyzed by using the simple descriptive tools like average and percentage. The analysis was performed using Microsoft Excel application package. Further, the secondary data had been obtained from various internet websites, journals, magazines and other published sources.

LIMITATIONS OF THE STUDY

The limitations of the study are:

a) The area covered under the study considered the sample respondents only from two districts – Warangal and Karimnagar districts of Andhra Pradesh.
b) The study has taken a few limited but representative investment avenues like Mutual Funds, Insurance, Bank Deposits and Post Office saving schemes, Share market and Bullion.
c) As the nature of research being related to financial domain, there has been lesser disclosure from the part of the investor. But every effort was sincerely made to convince the respondent that the information given by them may be used for academic purpose.

HYPOTHESIS

The two major null hypotheses tested and analyzed in this study are:

H1: There is no significant difference in income and investment avenue selection.

H2: There is no significant difference in occupation and investment avenue selection

DATA ANALYSIS AND INTERPRETATION

Table1: Demographic Details of the Respondents

	Preference in Investment Avenues

Demographic factor	Variable	Number of respondents	Bullion	Post Office RD	Insurance	Bank RD	Mutual Funds (MF)	Equity Shares
Gender	Male	190	25	18	49	56	20	22
	Female	80	18	13	17	20	7	5
Age (in yrs)	18-30	49	12	10	7	9	5	6
	31-40	92	10	8	20	17	22	15
	41-50	75	13	10	20	15	9	8
	Above 50	54	8	12	10	18	2	4
Annual Income (In lakhs)	Up to 1.2	38	5	8	12	6	3	4
	1.2-3.0	42	6	6	14	11	3	2
	3.0-5.0	60	8	10	10	9	12	11
	5-10.0	54	8	6	8	9	10	13
	Above 10.0	76	9	6	11	10	18	22
Education	Under matriculation	33	8	7	10	7	1	nil
	Intermediate	54	12	8	13	15	4	2
	Graduate	88	18	15	24	20	6	5
	Post graduate	95	16	10	20	17	18	14
Occupation	Govt. Employee	62	12	8	16	14	7	5
	Private Employee	82	11	11	20	9	16	15
	Self employed/Business	90	16	8	18	13	19	16
	Retired	36	6	5	9	10	4	2

It is observed from table 1 that the respondents vary in age, occupation, gender, income, risk bearing capacity etc. A total of six investment avenues namely Bullion, Post office savings schemes, Insurance, Bank Deposits, Mutual funds and Shares were taken for study. It can be observed that the investors take different investment avenues for meeting their Psychological, Social and Financial need. Table-1 as provided above presents the demographic details of different investors varying in age, occupation, education, gender and their preferences to different investment avenues.

In the above table out of six avenues, investment in shares is regarded as risky avenue as compared to other available avenues as it is directly associated with the capital or stock market. It shows that investors who are in the age group of 41-50 and above 50 years prefer to invest in safer investment avenues like Bank deposits, Insurance, Post office saving schemes and Bullion. 'Income' factor also affects in fund selection behavior of investors. The analysis of the null hypothesis is presented below

H1: There is no significant difference in income and investment avenue Selection.

The investors having high income prefer to invest in share market even though it involves more risk as compared to other available investment avenues. Among the investors with income above 10 lakh, 8.14% of them prefer investing in shares, 6.66% in mutual funds 4.07%, in insurance 3.70% in bank Deposits, 3.33% in Bullion and only 2.22% in post office savings schemes.

Out of the investors whose income is between 5 to 10 lakh p.a., it was found that 4.81% invest in equity share, 3.70% in mutual funds, 3.33% in Bank deposits, 2.96% in insurance and Bullion and just 2.22 % invests in post office saving schemes.. Similarly analyzing the investor preference in the income group of Rs. 3 to 5 lakh per annum, revealed that 4.07% of investors invest in shares, 4.44% in mutual funds, 3.70% in Insurance and Post office, 3.33% in Bank deposits, and 2.96 % in Bullion. Thus, it was observed that investor group with income level less than Rs.3 lakh per annum invest in investment avenues (Shares and Mutual funds) in a lesser rate or percentage (varying from 0.37% -1.11%) than the investors having high income level. So there is great impact or influence of income level of investors on investment avenue selection.

H2: There is no significant difference in Occupation and Investment

It was found that out of investors who were in the business class/Self employed, 7.03% invest in mutual funds,6.66% in insurance, 5.92% in Bullion and shares, 4.81% in bank deposits and 2.96% in post office saving schemes. Among those investors who were government employees 5.92% of them invest in insurance, 5.18% invest in Bank deposits, 4.44% invest in Bullion, 2.96% invest in post office saving schemes, and 2.59% invest in mutual funds and 1.85% in shares. Further, it was found that 7.40% of investors who are private employee invest in insurance, 6.29% in shares, 5.92% in mutual fund, 4.07% in Bullion and post office saving schemes, and 3.3% in bank deposits. Analysis revealed that lesser percentage of investors who were retired people invested in share (0.74%), while 1.48% invests in mutual fund, 3.70% in Bank deposits, 3.33% in Insurance, 2.22% in Bullion and 1.85% in post office saving schemes. On the whole, it may be concluded that investment in mutual funds is highest among each of the investor class segregated on the basis of income, while there are wide variations among investment preferences for other investment avenues for the different occupation class of investors. Thus, occupation affects the preference of investors in their investment avenue selection.

Table-2: Factors and Scores Influencing the Investment Decisions

Factor	score/Bullion	score/Post office deposits	score/Insurance	score/Bank deposits	score/Mutual funds	score/shares
Safety	168	145	210	195	18	16
	62.2%	53.7%	77.7%	72.2%	6.6%	5.9%
Periodic returns/dividends	48	75	43	55	20	59
	17.7%	27.7%	15.9%	20.3%	7.4%	21.8%
High returns	78	50	72	45	69	85
	28.8%	18.5%	26.6%	16.6%	25.5%	31.4%
Secured future	85	92	130	120	23	20
	31.4%	34.0%	48.1%	44.4%	8.5%	7.4%
Ease of purchase	80	68	90	75	16	19
	29.6%	25.1%	33.3%	27.7%	5.9%	7.0%
Liquidity	105	64	35	83	38	30
	38.8%	23.7%	12.9%	30.7%	14.0%	11.1%
Easy marketability	65	35	52	40	35	54
	24.0%	12.9%	19.2%	14.8%	12.9%	20.0%
Tax benefit	8	39	68	35	5	0
	2.9%	14.4%	25.1%	12.9%	1.8%	0
Mortgage need	72	38	20	57	12	25
	26.6%	14.0%	7.4%	21.1%	4.4%	9.2%
To meet future contingency	114	95	135	100	35	46
	42.2%	35.1%	50%	37.0%	12.9%	17.0%

It can be seen from table 2 that investors preferred those types of avenues which are safe, lead to secured future, liquidity and meet future contingency etc. It was also observed that 77.7% of investors preferred insurance and 72.2% preferred bank deposits for safety purpose, 48.1% preferred insurance and 44.4% towards bank deposits for secured future, 50% preferred insurance to meet future contingency and 25.1% for getting tax benefits. Similarly, 37.0% of investors preferred bank deposits, 42.2% preferred bullion and 35.1% towards post office deposits primarily to meet future contingency. This is probably because they assume that equity shares are more risky investment avenues than other four investment options namely mutual funds, insurance, bank deposits, and post office deposits. Column 3 of table 2 shows that 31.4% investors prefer investing in equity share in order to obtain high returns in the form of capital gains,11.1% for liquidity purpose, and 17.0% investors for meeting future contingency.

It can be found from table 2 (column 4) that 25.5% investors select mutual fund for getting more return as compared to other avenues with single exception of equity share since investing in mutual funds carry relatively less risk as it is invested in a well diversified portfolio by the well qualified professionals. But, in case of investing in insurance products it is observed that, in general, the investors (irrespective of any demographic class) select it for reasons of safety, secured future, tax benefit, meeting future contingency, getting periodic return, easy to purchase, capital appreciation, and liquidity etc. Among these77.7% investors select for safety needs, 48.1% for secured future, and 25.1% for tax benefits and 50% for meeting future contingency.

CONCLUSION

The study reveals that investors invest in different investment avenues for fulfilling financial, social and psychological need. While selecting any financial avenue they also expect other type of benefits like, safety and security, getting periodic return or dividends, high capital gain, secured future, liquidity, easy purchase, tax benefit, meeting future contingency etc. The study found that males are more interested to invest in risky avenues like shares (8.14%) in this study than females (1.85%) investors. Female investors are not more exposed with shares and mutual funds. Educated, male investors falling under the age group of 31-40, having more income (Employee or business men) are more interested with the risky avenues like share and mutual fund. They also make a good portfolio for them and think for their future with an objective of getting high capital gain from a particular avenue. It is seen that there is significant relationship between income and occupation on investment avenues in order to satisfy safety, periodic return, liquidity, better future and future contingency needs, etc. Risks bearing capacity and educational level of investors are also the two main factors which affect in investment avenues selection. Male urban investors are more participative in nature with regard to investment avenues selection as against their female counterparts, as they are more exposed with the environment and market knowledge. Hence it can be suggested that the financial investment avenues should be designed by seeing the geographical horizon of the investors, their age, income, occupation, gender and risk tolerance capacity etc, as investors or customers are the key of success for any business.

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