CHAPTER - III

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INTRODUCTION

Behavioural Finance has remained one of the most fascinating fields of research in finance. It has enticed many researchers to engage in research and as a result, the various dimensions of behavioural finance have been investigated. Behavioural finance studies the motives, attitudes, preferences and expectations of investors. Studies so far conducted have broadly covered these aspects. Research studies conducted abroad outnumber the ones alone in India. In the following paragraphs the results of the earlier studies are summarised. Discussion of foreign studies precedes Indian studies.

RESEARCH IN ABROAD

Henry Allen Latane (1960)\textsuperscript{1} carried out a study with an aim to measure individual risk preference. The study was based on the choices between hypothetical risky portfolios and safe portfolios carried out by three college investment classes. The findings of the study indicated that there was no clear linear relationship between the proportion of students choosing a specified risky portfolio and the expected value and standard deviation of the probability distribution of returns of that portfolio. The most noteworthy result of the study is that the majority preferred to hold the safe portfolio

rather than the risk portfolio. Students liked returns as measured by geometric mean and disliked risk as measured by standard deviation. Results also tended to contradict the hypotheses that people must be paid a premium to induce them to undertake moderate risks instead of subjecting themselves to either small or large risks.

Randolph Western Feed (1969)\(^2\) in his study entitled "A Behaviour Approach to the Investment Management Decision and to the Securitas Market", examined the individual financial investment decision. This study used the Makowitz / Sharpe linear portfolio model to describe and evaluate the salient aspects of individual investment decision. It explored the relationship that existed between amateur investors and non-investors and examined individual risk performance and its importance in determining and explaining investment management and performance. The results of the study showed that there was a significance difference between an amateur investor and a non-investor with respect to risk performance. Certain personality and cognitive judgement factors were associated with choice rationality, perceived risk and risk preference.

Potter Roger Ewing (1970)\(^3\) carried out a study entitled, "motivating factors guiding the common stock investor", with an aim to identify those factors which motivate or guide the investment decisions of the common stock investors. A scientifically structured questionnaire consisting of 25 demographic questions and 50 behaviour related questions was used to


collect data from, 680 individual investors. The object of the study was tested with the help of multiple factor analysis, step wise regression analysis and chi-square analysis. The results of the study isolated six motivating factors within the group of non-professional investors and five motivating factors within the group of professional investors. The study revealed that the factors like desire for (i) income from dividends, (ii) rapid growth, (iii) purposeful investment as a protective outlet for savings and (iv) professional investment management were common to the groups of investors. The expectations are the desire for professional management, desire for growth and desire for professional management.

Keller Franks (1973) in his study on 'The Behaviour of Individuals in Security Investment Decisions', focused his attention on the common stock investment decision process to develop data that would facilitate the formulation of hypotheses concerning the determinants of security values, stock holder satisfaction and the nature of successful investment practice. His study was carried out with four individual investors comprising two sophisticated investors and two unsuccessful investors. The data for the study were collected through personal interview. He found that even though each decision process was highly individualised it was possible to synthesise a multi-step general model. The expectation of desirable future, 'reported earnings' to be generated from 'adequate company resource' by a good management was found a requisite to any investment. Dividends had value if any for their possible information content.

Keller Franks (1973), 'The behaviour of individuals on security investment decisions', The Journal of finance vol. XXV, No.4, pp: 942-943
Crooch, Gary Michael (1977)\(^5\) in their study on ‘An investigation of investors’ ‘Financial statement knowledge’ made attempt to measure the knowledge of financial statement terms and concepts currently held by the average non-professional investors. This study tried to know the respondents knowledge of the definition and concepts used by accounts when preparing financial statements. The data represented in the research was the result of respondents from 554 members. Factors like demographic attitude and behavioural variables were examined statistically for their relationship with the score on the scale of financial statement knowledge. The study revealed that the average non-professional investor did not have sufficient knowledge of finance statements. On the other hand, professional investors had sufficient knowledge of financial statements. The other important result of the study was that the financial terms and concepts best understood by the average non-professional and professional investors were those, which were most clearly defined by the label, placed on them.

John Telesephore Bart (1980)\(^6\) in his study, “The Expectations of Stock Market Participants for Selected Stocks”, investigated the nature of investor’s expectations of financial return from common stocks. Empirical data for the study were obtained from 800 individual investors, from 4 types of stocks market participants (buyers, sellers, owners and security analysis) for three selected common stocks (a utility, a petroleum based stock and mineral resource stock) inter and intra-stock comparisons of the parameters of measured expectations led to the conclusions that investors expected a

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return from risk stocks, sellers of stock expected a lower return than either buyers or owners of the stock, and that all publicly available information was not fully reflected in the price of the three stocks at the time of the study.

Lewellen, Wilbur G., Ronald C. Lease and Gary, G. Schlarbaum (1982)\(^7\) carried out a study to examine the patterns of investments strategy and behaviour among individual investors. The main purpose of their study was to ascertain the portfolio decision processes of individual equity investors. For this purpose they collected data from 972 individual investors residing in the U.S. The results of their study indicated that age had a strong influence of the portfolio goals of the investors. Aged investors had interest in long-term capital gains while the young investors had a desire for short term capital gains. Age and risk raking properties were found to be inversely related. Women investors were found to be broker-reliant unlike men.

Groth John, C., Wilbur G. Lewellen, G. Schlarhaum and Ronald C. Lease, (1984)\(^8\) made an attempt to probe into the capabilities of those entities that purvey investment recommendations to individuals who opt to participate directly in the market by managing their own portfolio. They have pointed out that brokerage house recommendations to its individual customers during 1960s suggested that they were genuinely valuable. Abnormal returns were associated primarily with buy, rather than sell recommendations.


Lakonishok, Josef and Edwin Maberly, (1995)\(^9\) in their article “The weekend effect; Trading patterns of individual and institutional investors” tried to point out the weekend effect of transactions. The study was based on the unique data namely NYSE odd lot sales and purchases of cash account customers of Merill Lynch and NYSE block transactions. The propensity of individuals to transact on Monday was highest related to other days of the week and that of institutions was the lowest. The propensity of individuals to sell on Monday was higher than their propensity to buy. In addition, the increase in activity by individuals on Mondays was not symmetric for buy and sell transactions. There was a tendency for individuals to increase the number of sell relative to buy transactions.

Gniewosz (1994)\(^10\) examined the use of accounting and other information in the share investment decision process of an institutional investor. It was an exploratory case study conducted within the context of an organisation’s everyday working environment. The interaction between information from different sources over a full investment period and the extent to which information in the annual report were used in share investment process was considered to be the specific orientation of the paper.

Brennan M.J (1998)\(^11\) in his article entitled, “The individual investor”, focused his attention on several phenomena that arose from the limited information possessed by individual investors. He also studied the


source through which investors received information about securities. He also tried to find out the extent of information disseminated by brokers. An individual investor who did not possess expert knowledge of finance markets has to venture unaided into the treacherous waters of the market primarily for securities guided perhaps by the sometimes unreliable advice of friends or stock brokers.

Zvi Bodie and Dwight Crane (2000)\textsuperscript{12} in their article, entitled; "Personal investing: Advice, theory and Evidence" made an attempt to know whether the advice available to individuals from newspapers, magazines and then providers of financial products were in agreement with economic theory and to examine the actual behaviour of a group of survey respondents to see whether they behaved in accordance with the advice. The results of the study revealed that the survey respondents were better informed and more experienced about investing than their counterparts at other places of employment who might not have had similar exposure. The percentage of equity in total financial assets declined with age and rose with wealth controlling for the effects of age and wealth, there were still substantial differences among individuals in the fraction of their total assets invested in equity.

Terrance Odean (2004)\textsuperscript{13} examined the behaviour of individual investors. He made use of data from trading records of 10000 accounts at a large discount brokerage house. He found that the investors exhibited disposition effect i.e., they realised their profitable stock investment at a


much higher rate than their unprofitable ones except in December. According to him, the disposition effect represented the tendency of investors to hold losing investments too long and sell winning investments too soon. These investors demonstrated a strong preference for 'realizing winners', rather than for 'losers'. Their behaviour did not appear to be motivated by a desire to rebalance portfolios or to avoid the higher trading costs of low priced stocks not was it justified by subsequent profitable performance.

Renate Schubert, Martin Brown, Mattrias Gysler, and Hans Wolfgang Brachinget, (2005) in their article entitled, 'Financial Decision making: Are women Really more risk averse?' examined, the extent of difference between male female investors in risk-taking ability. The study was designed to examine gender specific risk propensity in decision relevant for investors and mangers. The study was carried out with the help of 141 under graduate students from different fields at the university of Zurich and the Swiss federal institute of technology. The study revealed that male and female subjects did not differ in their risk propensity towards contextual decisions. In abstract gambling decisions, however gender differences on risk propensity did arise, female were more risk averse than male investors. At the same time when identical decisions were presented as investment and insurance choices, no gender differences in risk attitudes were found. Committing on the risk perception of women, Renate Schubert et. al observe that preconceptions concerning the risk attitudes of female investors and managers may be more prejudiced.

Mark Grinblatt, Matti Keloharju (2007)\textsuperscript{15} in their study on ‘The Investment Behaviour and performance of various investor types: A study of Finlands unique data set’, analysed the extent to which past returns determine the propensity to buy and sell. According to them foreign investors tended to be momentum investors, buying past winning stocks and selling past losers. Domestic investors, particularly households tended to be contrarians. The distinctions in behaviour were consistent across a variety of past return intervals. The portfolios of foreign investors seemed to outperform the portfolios of households, even after controlling the behavioural differences.

Wood, Ryan; Zaichkowsky, Judith Lynne (2008)\textsuperscript{16} in their study on “Attitudes and Trading Behaviour of Stock Market Investors: A Segmentation Approach”, focused that this study identifies and characterises segments of individual investors based on their share investing attitudes and behaviour. A behavioural finance literature review reveals five main constructs that drive investor behaviour: investment horizon, confidence, control risk attitude, and personalisation of loss. Ninety individual investors were surveyed via questionnaire on these constructs. A cluster segmentation analysis identified four main segments of individual investors: 1) risk-intolerant traders: 2) confident traders: 3) loss-averse young traders: and 4) conservative long-term investors. Each segment purchased different types of stocks, used different information sources, and had different levels of trading behaviour.


RESEARCH IN INDIA

Santi Swarup, K and Amika Verma (1998)\textsuperscript{17} made an attempt to examine the important stock exchange reforms and their impact on capital market development from the angle of intermediaries. The theme of the study comprised 30 brokers from Delhi stock exchange. The perception of brokers such was obtained through a questionnaire. They were asked to state their perception about the major reforms that have taken place in the operation of stock exchange like changes on forward trading, introduction of depositories, reduction in settlement period, changes in capital adequacy norms and the segregation of transactions. This study came out with suggestion to brokers which consisted of (i) Investors need to be educated about scripless trading and (ii) brokers should be qualified enough to deal with the clients more effectively.

Gupta L.C., (1999)\textsuperscript{18} carried out a study to find out the problems associated with the Indian capital market. For this purpose, a sample of 300 middle and upper middle class households were interviewed. It was found that the majority of the respondents were not satisfied with the company management and about 64 percent were of the same opinion about the statutory auditors. A majority of the investors did not have much confidence even with the regulatory agencies. A large number of respondents had complaints against companies rather than stock brokers.


Shanmugam, R., and Muthusamy, P., (2001) in their study on 'Decision process of individual Investors', have thrown some light on areas like views of individual share investors about their objective, of investment, basic approach to investment decisions and the nature of their equity portfolio. This study was carried out on 201 investors and they were divided into three groups namely of tax savers, traditionalists and risk takers. All the respondents belonged to Coimbatore city of Tamil Nadu. The data were analysed with the help of chi-square test and analysis of variance the main findings of the studies were that a majority of shareholders were salaried people. They were young and mostly first generation investors. The time spent on investment analysis was inadequate and portfolio diversification was moderate. The Regional industry had its impact on industrial portfolio. Educational level of investors had its impact on the use of technical analysis. Occupational category had an impact on the use of fundamental approach.

Gupta, L.C., (2004) conducted a major survey of Indian owners in 1990. This survey generated a new set of data on Indian investors, their investment habits and preferences. The survey involved interviewing of about 600 households in 250 residential blocks spread over more than 250 cities of India. The major findings of the survey were as follows:

i. Share ownership has become a middle class phenomenon, the median income of Indian share owning households is about Rs.62.00 per annum.


ii. Influx of young people into the share market.

iii. Inadequate diversification in the share investment portfolios.

iv. Majority of Indian share owners are long term investors, with holding duration of over 3 years.

v. New issue markets found favour with the investors rather than buying from secondary market.

vi. The unit Trust of India / Mutual fund units were perceived as safe by a majority (over 90%) of investors.

vii. Investors were dissatisfied with mechanism for redressing of their grievance; and

viii. More than 50% of share owners has specific complaints against stock brokers and over 60% of investors had specific complaints against the companies.

Madhumathi, R., (2005)²¹ carried out a study to examine the risk perception of individual investors and its impact on their investment decision. In order to carry out the study a sample of 450 individual investors was selected on a random basis from major metropolitan cities in India. The investors were divided into three groups as risk seekers, risk bearers and risk avoiders. The results of the study revealed that, a large number of investors (76%) were risk bearers. The risk bearers had the tendency to use company performance as a basic factor to take investment decisions and they used to depend on the advice of share brokers and investment consultants. The risk seekers on the other hand took their decision mainly on the basis of market condition, industrial position and social changes. Their source of information consisted of impersonal sources such as newspapers and reports. In fact they

were advice givers rather than advice takers. Risk avoiders did not have a specific trait in terms of information perception processing capacity or situational constraint. They were very objective and looked for facts and certainty in their investment decision situations. Their decisions were mainly based on the advice of their friends and relatives. Market performance of the share company’s operating level capital, performance and the expectation of the investors were found to influence the risk perception of the investors.

Rajarajan, V., (2006) conducted a study on “Investor’s Life styles and investment characteristics” with an object to find out life styles based on segmentation of individual investors and to analyse the investment size, pattern and future investment preference of individual investors on the basis of their life styles. This study was arrived at in a state capital, by getting data from 405 investors through questionnaire. The investors were divided into three groups, namely active investors, individualists, and passive investors. The association between the life style groups and the various investment related characteristics was studied by using cluster analysis, correspondence analysis and Kruskal Wallies test. The study revealed that the level of expenses, earnings and investment associated with size of households. Active investors group was dominated by officers, individual group by clerical and passive investors group by professionals. The expected rate of return from the investment varied based on the investment styles. As for risk bearing capacity, it was found that investors had more than 40% of their financial assets in risky category dominated the active investor group. Individualists were possessing upto 20% of their financial assets in the risky investment.

Bandgar, P.K., (2007) made an attempt to study the existing pattern of financial instruments in India and the performance of middle class investors. He also studied the behaviour of investors and the problems faced by middle class investors. Questionnaires were administered for obtaining the data. Average, skewness, chi-square test and fisher Irving test were used to analyse the data. The results of the study revealed that only 16% of the investors were facing difficulties in buying and selling instruments. Though the middle-class investors were highly educated, they lacked still and knowledge in investing. Female investors preferred to invest in risky securities as compared to male investors. The study also revealed that there was a moderate and continuing shift towards shares and deserters from bank deposits. There was a massive shift towards traditional important financial instruments namely, life insurance policy and Government securities.

Panda K. Tapan., and Tripathy, N.P., (2008) carried out a study entitled “Recent Trends in marketing of public issues; An Empirical study of investors perception” with an aim to identify the investors awareness and attitude towards public issues. Information from 125 investors covering the salaried and business class people who belonged to the city of Bhuvaneshwar was obtained through a questionnaire. The data collected were analysed through simple percentage and weighted average. It was found that a majority of the investors (83.90%) used newspaper as the sources of information. Financial journals and business magazines are ranked next to newspaper. A large number (63.30%) of investors were of the

opinion that they were not in a position to get the required information from the company in time. A sizable number of investors were found to face problems while selling securities with regard to the factors associated with investment activities, “safety” occupied the first rank and the factor ‘regular return’ stood second. Equity shares were preferred by the investing public only for its higher rate of return.

CONCLUSION

Studies both in India and abroad, have extensively examined the investors' behaviour in detail. The areas of research covered hardly include the investors' investment decision process and their behaviour. Research works that have concentrated on the knowledge of industry are relatively scant. To be an effective investor one should not only be aware of the principles of investment but also be well versed with the various aspects that come under the domain of capital market. Knowledge of the recent regulations relating to the functioning of capital market empowers an investor to shield himself from any onslaught he may encounter. Thus stock market literacy becomes a predominant pre-requisite for an investor: Studies reviewed indicate that this area dealing with the awareness of investors about company, stock exchange as well as capital market regulatory bodies has not been studied so extensively. In order to fill this vacuum the present study has been undertaken.