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3.1 Introduction

It is said that investment activity directly depends upon saving. Saving can be defined as the access of income over expenditure. People may save funds but they may not be investors. For example, an individual who sets aside some money in locker for education of spouse or for marriage purpose is a saver. He cannot be considered an investor whereas an individual who opens a saving Account in bank and deposits some money regularly or as and when he has some spare amount of money for some specific purpose would be called an investor.

The distinction between a saver and an investor cannot be made on the basis of the motive of savings. The distinction can be made on the basis of their expectations. The saver who puts his money in a locker or somewhere in his house does not expect excess returns from the savings where as an individual who opens a saving bank account expects a growth of its funds through additional return from the bank. Thus we may conclude that the expectation of return is an essential characteristic of investment. An investor expects to earn additional return on its present money from the mode of investment that could be in the form of physical financial assets. An investment in shares, Debentures, Mutual funds, ULIPS, or Fixed deposits in bank etc., is a financial products whereas the purchase of house, gold, land, etc., is an investment in physical asset.

Saving and Investment habit of individual household in any economy plays a vital role in the development of economic activities, The growth of any economy can not be studied without studying the public and private investment activities in the economy, For studying investment activity the behavior of individual investor is an important factor to be studied. An important feature of the financial market is the depth and breadth of public participation in the market. Millions of households and individual investors make investment decision-making on the basis of firms promotional campaign. Thus, the number of households and individual investors are the two most important players in financial market which needs to be studied through this study.
The past few decades have experienced the radical changes in the Indian financial environment, from saving oriented economy to investment oriented economy. Due to the changes made in policies, leading to liberalization and globalization, the financial markets have experienced the product innovation, increased international integration more transparency and coordination. Due to these economic developments the Indian financial markets have found greater participation of individual investor in capital market as well as, in other investment avenues such as mutual funds, pension funds and the other traditional avenues, such as deposits and government securities. A developed securities market enables all individuals, no matter how limited their means, to share the increased wealth provided by competitive private enterprise. This has opened a new vision of studies on the basis of information, research and analysis based individual investor’s preferences and choices.

The Indian financial system has undergone a considerable change in the recent past. It has left the backwaters & entered in the open sea. It has to be competitive as what a free financial system ought to be in the era of globalization. It has to be competitive, market-oriented, cost-effective, modern, & should try to remain a float and struggling to push ahead. The transformation implies that the promotion components of the Indian financial system, that is, the institutions provide to investors needs to be check whether it is effective to create the awareness and purchase decision making. The system has become modern, having features such as derivatives & commodity market; with all new innovative financial instruments such as deep discount bonds, securitized paper, paperless trading, floating rate bonds etc.

**Reforms in Indian economy**

The Indian economy has already gone through the reform process, and a considerable shift of individual saving from defined return on investments to variable return on investment has been registered. The study on the promotional tool’s effectiveness on financial products will help the policy maker and the financial institution to explore and experiment with the structure of present promotion strategy in order to serve the requirements of the household sector in a more meaningful manner.
This Chapter consists of three Parts

1. Concept of Investment and Financial Product in India
2. Various Theory of Consumer Decision Making in Financial Product
3. Promotion Tools for financial product

3.2 Concept of Investment and Financial Product in India

3.2.1 Individual investors
An important feature of the financial products is the depth and breadth of public participation (i.e. individual investors) in the market. Millions of households and individual investors provide a pool of capital and a diversity of decision making that creates liquidity in markets and makes it dynamic. Thus the number of household and individual stock holders, fix-deposit holders in bank and post-office, Bond holders or investors in different mutual-funds, insurance linked investment plans is most commonly cited summary statistics denoting the breadth of investors in the population. These statistics are useful tools for understanding the changes that take place in the financial products and for policy formulation for promotional programmes of financial services sectors. It needs to mention that government, business, and individuals are three key participants in the investment process, and each may act as a supplier or investor of funds. Depending upon personal investment goals and objectives, individuals may place their savings in saving accounts, buy shares of a listed company, buy debt instruments, buy insurance or purchase various type of property.

3.2.2 Investment behavior of investor
To gauge the impact of the promotional strategy and growth of the investments market on individual investor during post liberalization and to analyze the quality of its effectiveness, the study of investment product’s purchase decision pattern & investor’s behaviour is required. Saving and investment is a disposable income which does not include consumption. In an economy where financial markets are developed, the savings of household sector are reflected through the investment in various financial instruments issued by different intermediaries like banks, financial institutions and the government. Investment in large extents influenced firstly through investment opportunities and then promotions campaigns which in turn depends upon articulation of various promotional tactics and the potential return available on those tactics, secondly it depends upon the
avenues available in the economy for mobilize financial products, in the form of well
developed financial products with a variety of features and markets for different financial
instruments and thirdly on the general thirst and habit of the people. It is therefore important
to estimate these statistics to assess impact of promotional campaign and programme on
purchase of various financial products. A large number of house-holds have also indirectly
owned equity shares and debentures through their participation in mutual funds. During the
recent past securities market are highly volatile and due to these reasons some individual
investors are more inclined towards traditional Investments like bank & Post office
deposits, insurance policies, ELSS & S.I.P. offered by banks and mutual funds.

**Consumer can take part from the purchasing process in five different roles:**

1. **Initiator** – person who first suggest purchasing a product.
2. **Influencer** – person who influences the final decision directly or indirectly.
3. **Decider** – person who makes the whole decision or parts of it; determines who buys
what, when, from where and how the payment is made.
4. **Purchaser** – person who makes the purchase.
5. **User** – person who uses or consumes the purchased product.

**The Bailard, Biehl & Kaiser divide investors into five categories (Investor Home:
Psychology & Behavioral Finance):**

1. **Adventurers** – risk takers and particularly difficult to advise.
2. **Celebrities** – like to be where the action is and make easy prey for fast-talking brokers.
3. **Individualists** – tend to avoid extreme risk, do their own research, and act rationally.
4. **Guardians** – typically older, more careful, and more risk averse.
5. **Straight Arrows** – fall in between the other four personalities and are typically very
balanced.

People often see other people's decisions as the result of disposition but they see their own
choices as rational. On one side of each speculative trade is a participant who believes he or
she has superior information and on the other side is another participant who believes
his/her information is superior. Yet they can't both be right. (Investor Home: Psychology &
Behavioral Finance)

There are two types of consumers who are the most difficult to influence: (1) consumers
with the highest and (2) consumers with the lowest self-esteem. Consumers with high self-
esteem are able to protect them better from external influences and do not allow to lead themselves. Consumers that have low self-esteem are more motivated to protect themselves from external influences. (Veerg, Tarbiya hoiakute muutmine)

3.2.3 Meaning of Investment Product

Investopedia explains ‘Investment Product’
Investment products are available for individual and institutional investors, and are purchased in an attempt to generate a profit. Some investment products, such as certain types of bonds, provide a fixed interest payment in addition to a return of the initial investment at the time of maturity. Other types of investment products, such as stocks, entail greater risk and while earnings (and profits) are anticipated, they are not guaranteed. An investor who diversifies will have a variety of investment products in his or her portfolio to manage risk.

3.2.4 Investment Options in India
1. Fixed Deposits
2. Government Bonds
3. Money-back insurance
4. Endowment Insurance
5. Stock Market
6. Real Estate
7. Mutual Fund

Definition of investment behavior
Investment behaviors are defined as how the investors judge, predict, analyze and review the procedures for decision making, which includes investment psychology, information gathering, defining and understanding, research and analysis. The whole process is “Investment Behavior” (Slovic, 1972; Alfredo and Vicente, 2010).

Investment
Investment refers to the investing of money or capital in order to gain profitable returns, as interest, income, or appreciation in value.

Investment Plan
An investment plan is a detailed description of all the major areas of your investments strategy. It will help you understand yourself and sets the framework for every investment activity you will participate in.

**Investment Strategy**
Investment strategy is the understanding of how you will invest your assets. It clarifies how to select, manage, prioritize, fund, and evaluate your investments.

**Finance**
Finance refers to the management of revenues; the conduct or transaction of money matters generally, esp. those affecting the public, as in the fields of banking and investment.

**Portfolio**
Portfolio refers to a group of investments held by an investor. The investment can be bond, stock or other.

**Stock**
The ownership of a company or corporation is indicated by shares. These shares represent ownership in the corporation's assets and earnings.

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### Types of investors

- 1. Risk Averse
- 2. Risk Seekers
- 3. Risk Free

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**Investment alternatives in India**

**Non marketable financial assets:**

These are such financial assets which gives moderately high return but can not be traded in market.

- Bank Deposits
- Post Office Schemes
- Company FDs
- PPF
**Equity shares**: These are shares of company and can be traded in secondary market. Investors get benefit by change in price of share and dividend given by companies. Equity shares represent ownership capital. As an equity shareholder, a person has an ownership stake in the company. This essentially means that the person has a residual interest in income and wealth of the company. These can be classified into following broad categories as per stock market:

- **Blue chip shares**- Shares of large, well established, financially strong companies with an impressive record of earnings and dividends.
- **Growth shares**- Shares of companies that have fairly entrenched positions in a growing market and which enjoy an above average rate of growth as well as profitability.
- **Income shares**- Share of companies that have fairly stable operations, relative limited growth opportunities, and high dividend payout ratios.
- **Cyclic shares** – Share of companies that have a pronounced cyclicality in their operations.
- **Defensive shares**- Shares of companies that are relatively unaffected by the ups and downs in general business conditions.
- **Speculative shares**- Shares of companies that tend to fluctuate widely because there is a lot of speculative trading in them.

**Bonds**: Bonds are the instruments that are considered as a relatively safer investment avenues.

- G sec bonds
- GOI relief funds
- Govt. agency funds
- PSU Bonds
- RBI BOND
- Debenture of private sector co.
Money market instrument: By convention, the term "money market" refers to the market for short-term requirement and deployment of funds. Money market instruments are those instruments, which have a maturity period of less than one year.

- T-Bills
- Certificate of Deposit
- Commercial Paper

Mutual Funds: A mutual fund is a trust that pools together the savings of a number of investors who share a common financial goal. The fund manager invests this pool of money in securities, ranging from shares, debentures to money market instruments or in a mixture of equity and debt, depending upon the objective of the scheme. The different types of schemes are

- Balanced Funds
- Index Funds
- Sector Fund
- Equity Oriented Funds

Life insurance: Now-a-days life insurance is also being considered as an investment avenue. Insurance premiums represent the sacrifice and the assured sum the benefit. Under it different schemes are:

- Endowment assurance policy
- Money back policy
- Whole life policy
- Term assurance policy
Financial Derivatives: These are such instruments which derive their value from some other underlying assets. It may be viewed as a side bet on the asset. The most important financial derivatives from the point of view of investors are:

- Options
- Futures

Mutual Funds: A brief introduction

A Mutual Fund is a trust that pools the savings of a number of investors who share a common financial goal. The money thus collected is invested by the fund manager in different types of securities depending upon the objective of the scheme. These could range from shares to debentures to money market instruments. The income earned through these investments and the capital appreciations realized by the schemes are shared by its unit holders in proportion to the number of units owned by them. Thus a Mutual Fund is the most suitable investment for the common man as it offers an opportunity to invest in a diversified, professionally managed portfolio at a relatively low cost. The small savings of all the investors are put together to increase the buying power and hire a professional manager to invest and monitor the money. Anybody with an investible surplus of as little as a few thousand rupees can invest in Mutual Funds. Each Mutual Fund scheme has a defined investment objective and strategy.

Types of mutual funds:

Open ended schemes:-An open-end fund is one that is available for subscription all through the year. This type of Mutual funds does not have a predefined maturity period. The key feature is liquidity. Direct dealing is another noticeable feature. One can easily buy and sell units at Net Asset Value related prices.

Close ended schemes:-Here maturity period is predefined usually ranging from 2 to 15 years. Investment can be done directly in the scheme at the time of the initial issue and units can be brought and sold whenever units are listed in the stock exchanges.
Types of Schemes

1. **Equity/growth oriented Funds**: Equity schemes are those that invest predominantly in equity shares of companies. An equity scheme seeks to provide returns by way of capital appreciation. As a class of assets, equities are subject to greater fluctuations. Hence, the NAVs of these schemes will also fluctuate frequently. Equity schemes are more volatile, but offer better returns.

2. **Balanced Funds**: The aim of balanced funds is to provide both growth and regular income. Such schemes periodically distribute a part of their earning and invest both in equities and fixed income securities in the proportion indicated in their offer documents.

3. **Index Funds**: An Index Fund is a mutual fund that tries to mirror a market index, like Nifty or BSE Sensex, as closely as possible by investing in all the stocks that comprise that index in proportions equal to the weight age of those stocks in the index.

4. **Income/debt oriented Funds**: These schemes invest mainly in income-bearing instruments like bonds, debentures, government securities, commercial paper, etc. These instruments are much less volatile than equity schemes. Their volatility depends essentially on the health of the economy e.g., rupee depreciation, fiscal deficit, inflationary pressure. Performance of such schemes also depends on bond ratings.

**ADVANTAGES OF A MUTUAL FUND**

1. **Professional Management**

Qualified professionals manage money, but they are not alone. They have a research team that continuously analyses the performance and prospects of companies. They also select suitable investments to achieve the objectives of the scheme, so you see that it is a continuous process that takes time and expertise that will add value to
investment. These fund managers are in a better position to manage investments and get higher returns.

2. Diversification

The cliché, "don't put all eggs in one basket" really applies to the concept of intelligent investing. Diversification lowers risk of loss by spreading money across various industries. It is a rare occasion when all stocks decline at the same time and in the same proportion. Sector funds will spread investment across only one industry and it would not be wise for portfolio to be skewed towards these types of funds for obvious reasons.

3. Choice of Schemes

Mutual funds offer a variety of schemes that will suit investors needs over a lifetime. When they enter a new stage in life, all needed to do is sit down with investment advisor who will help to rearrange portfolio to suit altered lifestyle.

4. Affordability

A small investor may find that it is not possible to buy shares of larger corporations. Mutual funds generally buy and sell securities in large volumes that allow investors to benefit from lower trading costs. The smallest investor can get started on mutual funds because of the minimal investment requirements. One can invest with a minimum of Rs. 500 in a Systematic Investment Plan on a regular basis.

5. Tax Benefits

Investments held by investors for a period of 12 months or more qualify for Capital gains and will be taxed accordingly (10% of the amount by which the investment appreciated, or 20% after factoring in the benefit of cost indexation, whichever is lower). These investments also get the benefit of indexation.
6. Liquidity

With open-end funds, you can redeem all or part of investment any time you wish and receive the current value of the shares or the NAV related price. Funds are more liquid than most investments in shares, deposits and bonds and the process is standardized, making it quick and efficient so that you can get cash in hand as soon as possible.

7. Rupee Cost Averaging

Through using this concept of investing the same amount regularly, mutual funds give investor the advantage of getting the average unit price over the long-term. This reduces risk and also allows you to discipline self by actually investing every month or quarterly and not making sporadic investments.

8. The Transparency of Mutual Funds

The performance of a mutual fund is reviewed by various publications and rating agencies, making it easy for investors to compare one to the other. Once you are part of a mutual fund scheme, you are provided with regular updates, for example daily NAVs, as well as information on the specific investments made and the fund manager's strategy and outlook of the scheme.

9. Easy To Administer

Mutual funds units in modern times are not issued in the form of certificates, with a minimum denomination rather they are issued as account statement switch a facility to hold units in fraction upto 4 decimal points.

10. Highly Regulated

The governing of mutual funds by SEBI ensures that the fund activities are carried out in the best interest of the investors.
3.2.5 Profiling of Investors, Savers and other in Urban India

Households plan for the future and the present by making savings and investments decisions. Some differences associated with savings and investment choices include risk and liquidity. In general, we expect households that exhibit a relatively high level of liquidity preference as well as low level of tolerance towards risk to engage in a greater degree of savings activity. Before we present the savings profile of households, it is worth investigating whether a rupee of surplus income will be entirely saved or entirely invested or the combination of these two.

Since the macroeconomic conditions consistently suggest that inflationary tendencies will persist which, in turn, will raise the prices of gold and precious metals as well as land, households are progressively treating financial markets as, at best, a tertiary source of returns. We shall now provide the savings profiles of households given this environment and finding. The terms 'savings' and 'investments' are often used interchangeably. However, savings are flow variables as they occur over time and they are a source of deferred consumption. Investment, on other hand, refers to a commitment to purchase capital or productive assets, such as financial instruments. Bank deposits, therefore, are not household investments; however, purchase of stocks and bonds constitute investment. Hence, one should observe wide variations in the pattern of savings and investments by households across the economic space. Both the magnitudes and the reasons for savings and investments are likely to be affected by life cycle factors, information asymmetry, need for a safety net, quality of regulation and, to some extent, location. In this part we shall provide a disaggregated profile of household savings behavior.

3.2.6 Household Demographic Profile by Level of Savings

There are a number of factors that potentially affect household savings behavior. These include household-level characteristics such as age (life cycle), education, family size, asset ownership, and the presence of safety nets. Savings can also be influenced by macroeconomic factors, such as interest rates and expectations regarding inflation or recession. The relationship between current income and level of savings is consistent with the predictions of economic theory. That is, the marginal propensity to save will increase (sometimes at a decreasing rate) with income. However, the relationship between the level of education, asset holdings and savings is mediated by income.
3.2.7 Sources of information
The findings of the survey, suggest that the source of retardation in the rate of participation by Indian households in the financial market is due to both information asymmetry as well as the poor quality of information. For example, a single important source of information for investors across all income/education categories while applying for an IPO is newspapers. This ought to be of serious significant concern since both current and potential market participants are basing their judgment on inadequate source of information. There is a need to fine-tune the investor camps so that households avoid their unreliable sources of information. Given the existing scenario related to the provision of information, not surprisingly most market participants find information from intermediaries such as brokers more useful. The sources of information for investors while participating in mutual funds as well as in the secondary market remain sub-optimal. A significant majority still depends on the advice given by intermediaries and friends. The market activities based on such information will render this market volatile and thin. The reason for thinness is not difficult to see since participant's base their choices in stocks on unreliable and often speculative sources of information. Information gleaning from a proper analysis of various publications continues to remain a peripheral source of dissemination. Research reports and information from stock market websites continue to be perceived as inadequate and unreliable. The findings of the survey suggest that this lacuna should be overcome as uninformed decision-making cannot constitute the core of activities in the market. The reasons for not participating in markets are found to be (in descending order) inadequate information, lack of skills and uncertainty about safety of returns. Households have also identified inadequate financial resources as constraint on participation. It is evident that SEBI could take additional steps to impart skills, reduce the information asymmetry at the time of participation and put in place measures to guarantee the safety of returns.
The constraints faced by participating in the secondary market seem to vary depending on the source of information. Interestingly, the source of information is based on the print media, a stock market website or advice from brokers, but a significant constraint seems to be inadequate information about choices available in the market. This implies that a participant who is likely to base his/her investment decision on informal sources of information is likely to make sub-optimal choices in the market place.
Table 3.1 Distribution of Investors across Investment Portfolio (Million)

<table>
<thead>
<tr>
<th></th>
<th>Bond</th>
<th>Debentures</th>
<th>IPO</th>
<th>Secondary Market</th>
<th>Mutual Fund</th>
<th>Derivative</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>All India</td>
<td>3.64</td>
<td>1.70</td>
<td>2.46</td>
<td>5.28</td>
<td>10.50</td>
<td>0.89</td>
<td>24.48</td>
</tr>
<tr>
<td>Urban</td>
<td>2.29</td>
<td>1.30</td>
<td>1.29</td>
<td>3.24</td>
<td>6.21</td>
<td>0.89</td>
<td>15.23</td>
</tr>
<tr>
<td>Rural</td>
<td>1.35</td>
<td>0.39</td>
<td>1.17</td>
<td>2.04</td>
<td>4.29</td>
<td>0.00</td>
<td>9.25</td>
</tr>
</tbody>
</table>

3.2.8 Distribution of Savers, Investors and Others

The majority of Indian households do not participate in the markets. Though the growth in the investor population has been nearly 6 per cent over the past 10 years, the overall number of investors is still insignificant. The reason for non-participation will be documented later in the report. Regional distribution of household categories in urban areas is summarized in table 3.2 and 3.3.

Chart 3.1 Distribution of Savers, Investors and Others in India

Table 3.2 Household of Investors, Savers and Other by Region (Million)

<table>
<thead>
<tr>
<th>Region</th>
<th>Investor Households</th>
<th>Savers Households</th>
<th>Other Households</th>
<th>Total Households</th>
</tr>
</thead>
<tbody>
<tr>
<td>Central Region</td>
<td>0.14</td>
<td>2.70</td>
<td>1.14</td>
<td>3.98</td>
</tr>
<tr>
<td>Eastern Region</td>
<td>2.62</td>
<td>5.28</td>
<td>1.63</td>
<td>9.53</td>
</tr>
<tr>
<td>Northern Region</td>
<td>1.42</td>
<td>10.20</td>
<td>5.80</td>
<td>17.42</td>
</tr>
<tr>
<td>North-Eastern Region</td>
<td>0.32</td>
<td>0.66</td>
<td>0.16</td>
<td>1.15</td>
</tr>
<tr>
<td>Southern Region</td>
<td>4.84</td>
<td>5.75</td>
<td>11.20</td>
<td>21.79</td>
</tr>
</tbody>
</table>
Online trading was introduced in 1990s to increase the spread of investors and to ensure transparency. Prior to this India had regional stock exchanges. Neither the regional stock exchanges nor the popularity of the NSE has done much to bring about a more uniform spread of investors. 55 per cent (Table 4.19) of all investors are still found in the western region. The western region has been historically more exposed to financial sector than the other regions, the majority of investors are found here. The majority of investors are urban in central and eastern India. This reflects the fact that the degree of urbanization is weaker in these regions.

3.2.9 Distribution of Investors, Savers and Others by Type of Instrument

Financial markets are in direct competition with other investment destinations. Since land markets have been increasingly deregulated, real estate is now a significant destination for investment (especially in towns and cities that are rapidly urbanizing). Of all the regions, the south is the most conservative when it comes to participation in financial markets.

<table>
<thead>
<tr>
<th>Region</th>
<th>Investor Households</th>
<th>Savers Households</th>
<th>Other Households</th>
<th>Total Households</th>
</tr>
</thead>
<tbody>
<tr>
<td>Central Region</td>
<td>3.58</td>
<td>67.89</td>
<td>28.53</td>
<td>100</td>
</tr>
<tr>
<td>Eastern Region</td>
<td>27.54</td>
<td>55.41</td>
<td>17.05</td>
<td>100</td>
</tr>
<tr>
<td>Northern Region</td>
<td>8.19</td>
<td>58.44</td>
<td>33.37</td>
<td>100</td>
</tr>
<tr>
<td>North-Eastern Region</td>
<td>28.16</td>
<td>57.61</td>
<td>14.24</td>
<td>100</td>
</tr>
<tr>
<td>Southern Region</td>
<td>22.25</td>
<td>26.41</td>
<td>51.34</td>
<td>100</td>
</tr>
<tr>
<td>Western Region</td>
<td>30.13</td>
<td>45.74</td>
<td>24.13</td>
<td>100</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>20.78</strong></td>
<td><strong>45.66</strong></td>
<td><strong>33.56</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

Table 3.3 Household Percentage of Investors, Savers and Others By Region
Table 3.4 Households by Type of Investment and Town Class (Million)

<table>
<thead>
<tr>
<th>Town Class/Financial Product</th>
<th>Mutual Fund</th>
<th>Bond</th>
<th>Debenture</th>
<th>IPO</th>
<th>Secondary Market</th>
<th>Derivative</th>
</tr>
</thead>
<tbody>
<tr>
<td>Town Class 1</td>
<td>1.70</td>
<td>0.45</td>
<td>0.33</td>
<td>0.24</td>
<td>0.83</td>
<td>0.21</td>
</tr>
<tr>
<td>Town Class 2</td>
<td>0.31</td>
<td>0.22</td>
<td>0.13</td>
<td>0.13</td>
<td>0.20</td>
<td>0.06</td>
</tr>
<tr>
<td>Town Class 3</td>
<td>0.81</td>
<td>0.30</td>
<td>0.13</td>
<td>0.25</td>
<td>0.34</td>
<td>0.02</td>
</tr>
<tr>
<td>Town Class 4</td>
<td>0.22</td>
<td>0.05</td>
<td>0.02</td>
<td>0.02</td>
<td>0.05</td>
<td>0.01</td>
</tr>
<tr>
<td>Total</td>
<td>3.03</td>
<td>1.02</td>
<td>0.60</td>
<td>0.63</td>
<td>1.42</td>
<td>0.30</td>
</tr>
</tbody>
</table>

Table 3.5 Household Savers by Town Class (Million)

<table>
<thead>
<tr>
<th>Town Class/Financial Product</th>
<th>Post Office Savings</th>
<th>LIC</th>
<th>Pension Scheme</th>
<th>Commercial Bank</th>
<th>Regional Bank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Town Class 1</td>
<td>3.91</td>
<td>8.86</td>
<td>1.25</td>
<td>11.01</td>
<td>1.97</td>
</tr>
<tr>
<td>Town Class 2</td>
<td>0.76</td>
<td>2.87</td>
<td>0.41</td>
<td>3.21</td>
<td>0.06</td>
</tr>
<tr>
<td>Town Class 3</td>
<td>2.52</td>
<td>5.99</td>
<td>0.57</td>
<td>7.29</td>
<td>0.68</td>
</tr>
<tr>
<td>Town Class 4</td>
<td>0.49</td>
<td>1.4</td>
<td>0.11</td>
<td>1.69</td>
<td>0.07</td>
</tr>
<tr>
<td>Total</td>
<td>7.68</td>
<td>19.12</td>
<td>2.34</td>
<td>23.2</td>
<td>2.78</td>
</tr>
</tbody>
</table>

Table 3.6 Investment of other households by Town class (Million)

<table>
<thead>
<tr>
<th>Town Class/Financial Product</th>
<th>Commodity Market</th>
<th>Real Estate</th>
<th>Business</th>
<th>Private Funds</th>
<th>Art &amp; Jewellery</th>
</tr>
</thead>
<tbody>
<tr>
<td>Town Class 1</td>
<td>0.21</td>
<td>1.34</td>
<td>2.62</td>
<td>0.55</td>
<td>1.95</td>
</tr>
<tr>
<td>Town Class 2</td>
<td>0.07</td>
<td>5.10</td>
<td>3.12</td>
<td>0.24</td>
<td>11.11</td>
</tr>
<tr>
<td>Town Class 3</td>
<td>0.04</td>
<td>2.05</td>
<td>6.77</td>
<td>0.29</td>
<td>2.94</td>
</tr>
<tr>
<td>Town Class 4</td>
<td>0.01</td>
<td>0.44</td>
<td>1.35</td>
<td>0.09</td>
<td>0.19</td>
</tr>
<tr>
<td>Total</td>
<td>0.32</td>
<td>8.94</td>
<td>13.87</td>
<td>1.17</td>
<td>16.19</td>
</tr>
</tbody>
</table>
Table 3.7 Percentage Share of investors by city within region

<table>
<thead>
<tr>
<th>City</th>
<th>% Share of Investors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ahmedabad</td>
<td>8.1</td>
</tr>
<tr>
<td>Mumbai</td>
<td>65.48</td>
</tr>
<tr>
<td>Nagpur</td>
<td>5.46</td>
</tr>
<tr>
<td>Ponda</td>
<td>0.07</td>
</tr>
<tr>
<td>Pune</td>
<td>11.17</td>
</tr>
<tr>
<td>Surat</td>
<td>9.72</td>
</tr>
<tr>
<td>Western Region</td>
<td>55.36</td>
</tr>
</tbody>
</table>

Table 3.8 Proportion of Investors, Savers and Others by Surat City (per cent)

<table>
<thead>
<tr>
<th></th>
<th>% Share of Investors</th>
<th>% Share of Savers</th>
<th>% Share of Others</th>
</tr>
</thead>
<tbody>
<tr>
<td>Surat</td>
<td>5.38</td>
<td>3.56</td>
<td>2.97</td>
</tr>
</tbody>
</table>
3.3 Various Theory of Consumer Decision Making in Financial Product

3.3.1 Human Behavioral Theories

In order to explain the various irrational investor behaviors in financial markets, behavioral economists draw on the knowledge of human cognitive behavioral theories from psychology, sociology and anthropology. Two major theories are discussed: Prospect Theory and Heuristics

**Prospect Theory**

The Prospect theory was originally conceived by Kahneman and Tversky (1979) and later resulted in Daniel Kahneman being awarded the Nobel Prize for Economics. The theory distinguishes two phases in the choice process: the early phase of framing (or editing) and the subsequent phase of evaluation. Tversky and Kahneman, by developing the Prospect Theory, showed how people manage risk and uncertainty. In essence, the theory explains the apparent irregularity in human behavior when assessing risk under uncertainty. It says that human beings are not consistently risk-averse; rather they are risk-averse in gains but risk-takers in losses. People place much more weight on the outcomes that are perceived more certain than that are considered mere probable, a feature known as the “certainty effect”. (Kahneman and Tversky, 1979).

People’s choices are also affected by the ‘Framing effect’. Framing refers to the way in which the same problem is worded in different ways and presented to decision makers and the effect deals with how framing can influence the decisions in a way that the classical axioms of rational choice do not hold. It was also demonstrated systematic reversals of preference when the same problem was presented in different ways (Tversky and Kahneman, 1981).

The value maximization function in the Prospect Theory is different from that in Modern Portfolio Theory. In the modern portfolio theory, the wealth maximization is based on the final wealth position whereas the prospect theory takes gains and losses into account. This is on the ground that people may make different choices in situations with identical final wealth levels. An important aspect of the framing process is that people tend to perceive outcomes as gains and losses, rather than as final states of wealth. Gains and losses are defined relative to some neutral reference point and changes are measured against it in relative terms, rather than in absolute terms (Kahneman and Tversky, 1979).
When it comes to investments in stocks, the natural reference point is the purchase price of stock. Indeed, most of the empirical studies motivated by the prospect theory find that the purchase price of stock appears to be one of the reference points used by an investor. However, it is possible that some additional reference points affect an investor. For example, the maximum stock prices in the recent return history are found to affect investors’ trading decisions. In principle, framing can be broad or narrow. An investor applying a broad framing could analyze gains and losses in total wealth level. Intermediate and narrow framing, instead, refer to the process whereby an investor defines gains and losses with regard to isolated components of wealth. Intermediate framing may take place on the level of a stock portfolio, whereas the narrow framing is usually defined at level of individual securities. The vast majority of empirical studies implicitly assume narrow framing.

The most central element of the prospect theory is the S-shaped value function depicted in Figure below:

**Prospect Theory Value Function, Source: Kahneman and Tversky (1979)**

The value function is defined in terms of changes in wealth rather than final states. The shape of the function is concave in the region of gains and convex in the loss region, reflecting risk aversion in the domain of gains and risk seeking in the domain of losses. An interesting property of the value function is that it is steepest at the reference point. This implies that a given change in gains or losses has a smaller effect on the value experienced by an investor when the distance to the reference point is large. Prospect theory argues that
when choosing between gambles, people compute the gains and losses for each one and select the one with the highest prospective utility. In a financial context, this suggests that people may choose a portfolio allocation by computing, for each allocation, the potential gains and losses in the value of their holdings, and then taking the allocation with the highest prospective utility.

Another element of the prospect theory is the weighting function: The value of each outcome is multiplied by a decision weight. Decision weights measure the impact of events on the desirability of an investment. They are not probabilities and typically do not add up to unity. Kahneman and Tversky (1979) call this property sub-certainty. Decision weights are generally regressive with respect to true probabilities, implying that preferences are less sensitive to variations in probability than the rational benchmark would suggest. Prospect theory describes several states of mind that can be expected to influence an individual’s decision-making processes.

3.3.2 Behavioral Finance and Decision Making

Decision-making can be defined as the process of choosing a particular alternative from many available alternatives. It is a complicated multi-step process involving analysis of various personal, technical and situational factors. There are no exceptions in the case of making decisions in the stock markets either. Taking investment decisions is the most crucial challenge faced by investors. Some personal factors are age, education, income etc. On the technical side, investment decisions can be derived from various models of finance, for e.g. the capital asset pricing model (CAPM). Decisions should not be reached without considering situational factors that take into account the environment, the market psychology in other words.

Effective decision making in the Financial market requires an understanding of human nature in a global perspective on top of financial skills. Thus cognitive psychology should be given importance in the process of decision-making (Chandra, 2008). As a result of the bull market from 2004 to 2007 and the subsequent financial crisis, there has been a lot of fresh focus on the irrational investor. Studying irrational investor behavior has become important.

“Behavioral Finance is becoming an integral part of decision-making process because it heavily influences the investors’ performance”. (Banerjee, 2011)
“An understanding of how our emotions result in irrational behaviour is indispensable for any investor”. (Parikh, 2011)
Investors can educate themselves about the various biases they are likely to exhibit and then take steps towards avoiding it thus improving their effectiveness. Some common mistakes made by investors are selling too soon while booking profits, holding too long while facing losses, buying overpriced stocks based on market sentiments and positive evaluation by all and sundry. The key, according to Parikh, for an investor so succeed is to get in touch with the emotional indiscipline he has exhibited, and deal with it so that it is not repeated. In the words of Warren Buffet,
“It is only when you combine sound intellect with emotional discipline that you get rational behavior” (Parikh, 2011).

3.3.3 Behavioral decision research
From the point of view of modern – i.e. “new” – behavioral economics, the most important development was the emergence in the 1970s of a new branch of psychology called “behavioral decision making” (BDM) or “behavioral decision research” (BDR). BDR is often described as a direct consequence of the cognitive revolution. Thus, Reid Hastie and Robyn Dawes (2001) identify two insights that emerged in the cognitive revolution, and which proved critical for the development of BDR. The first insight “is that many aspects of human thinking, including judgment and decision making, can be captured with computational models,” according to which we “compare, combine, and record ... mental representations” (Hastie and Dawes 2001, 9). The second insight is that properties of our cognitive apparatus “play major roles in our explanations for judgment and decision-making phenomena” (Hastie and Dawes 2001, 10). Thus, among other things, “the limited capacity of working memory is used to explain many departures from optimal, rational performance” (Hastie and Dawes 2001, 10). Drawing on these insights, behavioral decision researchers, then, apply insights gleaned from the cognitive revolution to the topic of human judgment and decision making.
As Hastie and Dawes summarize the take-home message of their 2001 textbook, and therefore by extension the whole field: The most important finding is that diverse people in very different situations often think about their decisions in the same way. We have a common set of cognitive skills that are reflected in similar decision habits. But we also
bring with us a common set of limitations on our thinking skills that can make our choices far from optimal (Hastie and Dawes 2001, 2).

A central focus of behavioral decision researchers, then, is to identify the common set of cognitive skills, their benefits and limitations, and to explore how they help produce observable behavior. What truly distinguishes BDR from other approaches to human judgment and decision making, however, is that it studies judgment and decision making by taking as its starting point theories of rational decision. In the words of Dawes:

Basically, behavioral decision making is the field that studies how people make decisions. Because all types of people are making all sorts of decisions all the time, the field is potentially very broad. What has characterized the field both historically and theoretically is the comparison of actual decision making with certain principles of rationality in decision making (Dawes 1998, 497).

3.3.4 Cognitive Processes: The Individual Level

Almost everyone would agree that decisions made by humans differ from the predictions of rational models. Opinions differ, however, as to whether these differences can be treated as noise that will cancel out in a higher level of description, or whether the difference is so fundamental that standard economic theory cannot be treated as an adequate model of human economic behavior. The difference exists on both the individual and the social level. The line of research in cognitive psychology that resulted in prospect theory, which we will explain shortly, clearly pointed out how individual decision-makers differed from the rational model.

Individual decisions and judgments differ from the prescriptive models in many ways. These differences involve cognitive processes, motivation, emotion, self structure, and personality factors. The decisions of individuals also strongly depend on how the alternatives are framed, rather than just being based on objective probabilities and outcomes. Individuals use heuristics to estimate probabilities rather than deriving them from the frequencies of occurrences of events. Availability heuristics, for example, describes a process where the decision-maker estimates the probability of events on the basis of how easy it is to recall those events from memory.

Other challenges to the view that humans are rational decision-makers come from cognitive psychology. The results of many experiments show that humans do not use the rules of
mathematics and logic as suggested by decision theory, but instead base their judgments on schemas. This leads to a dependence of information processing on context. Child street vendors in Brazil, for example, are perfectly capable of performing arithmetic operations using money in the context of selling, but are unable to repeat the same operations on abstract numbers in a laboratory situation.

Wason’s card selection task provides another example of this. Imagine that you are working in a company producing games. Your task is to check whether the cards follow the rules of the game. For a certain game that the company produces all the cards must follow the rule: If a card has a vowel on one side, then it must have an even number on the other side. You know that all the cards have a number marked on one side and a letter on the other. In front of you there are four cards. Marked on their upper sides are the following:

\[ \begin{array}{ccc}
E & K & 5 & 4 \\
\end{array} \]

Which cards do you have to turn over to make sure that none of them violates the rule? The correct answer is ‘E’ and ‘5’. This is because, if there were an odd number, say 3, on the other side of E (which is a vowel), this card would violate the rule. But the rule would also be violated if there were a vowel, say A, on the other side of 5, since the rule dictates that a vowel on one side implies an even number on the other. Nothing on the other side of K would violate the rule, since the rule does not state what should be on the other side of consonants.

Using the same reasoning the card with 4 could not possibly violate the rule. This puzzle is quite difficult, and even people trained in mathematics often have problems finding the correct answer. In the original study less than 10% of individuals correctly solved the puzzle. The vast majority of people make mistakes in this puzzle. This is because people do not usually use the rules of formal logic in their reasoning, combined with the fact that this example does not look similar to any problems they have encountered so far.

Now consider the following puzzle. Imagine you work in a bar. The rule is that, if a customer drinks alcohol, that customer must be over 18 years old. The bar is dark and you see someone’s hand holding a glass of whiskey and another’s holding a Coca Cola, but you do not clearly see the faces associated with the hands. You also see two other individuals, one with the face of someone who looks about 16 years old and another with a face that looks over 40 years old. Which of the four individuals do you need to check in order to
know how old they are or what they are drinking? The answer is straightforward and usually people have no problems with an answer: one should check the age of the person drinking whiskey and determine what the 16 year old is drinking. Logically, the card game and the bar example are equivalent. The reason why the bar example is so much easier is that it follows a permission schema, a schema that is often used in reasoning in everyday life. The conclusion we can draw is that, even in problems that have clear formal solutions, people usually use schemas. So to solve problems and make decisions, people are often likely to search for the most relevant schema and use that to arrive at the answer. It follows that, if more than one schema is available, the choice of schema is likely to influence decisions. This effect is often called framing. Therefore, the context in which the decision is made can influence the choice of schema, and the chosen schema will be used as the tool for decision-making. Another set of challenges to the view of humans as rational decision-makers comes from personality psychology and social psychology. Human decision-making is shaped by various motives. It also depends on emotions.

### 3.3.5 Belief, Attitude, Intention and Behavior

From the perspective of marketers, it is of interest to understand what makes consumers buy certain products and services. Research suggests that beliefs, attitudes and intentions predict behavior. Thus, understanding consumer beliefs, attitudes and intentions open possibilities both to understand and influence consumer behavior. (East 1997, 109)

Kotler (2006) defines the term belief as .a descriptive thought that a person holds about something,. A belief may be an outcome of an experience or it might just be an opinion about something and it does not necessarily reflect the reality. Attitude is defined as a persons consistently favorable or unfavorable evaluations, feelings, and tendencies toward an object or idea. (Kotler 2006, 152) Consumers have many different attribute beliefs toward a product or a service and these bundles of beliefs then form one’s attitude toward that product or service. Thus, attitude is a complex cognitive concept posing difficulties for marketers in quest for changing them. Attitudes predict behavior and also explain it by providing one reason for the action, whereas intention is an outcome of many attitudes and only predicts behavior. (East 1997, 131-132) According to Ajzen & Fishbein (1980) intention is the closest proxy for behavior.
Research on the causal relationship between attitude and behavior shows that change in attitude results in a change in behavior. When consumers have alternatives and the choice is free, they form preferences that lead to favorable and unfavorable attitudes and ultimately to the selection of alternatives. Behavior of such is rational within the limits intruded by such as knowledge, habit, available information and effort. The rational behavior fails when the choice is not free, the situation is so new that no information exists or consumer lacks the capacity to handle the available information. Rationality is reinforced when behavior is repetitive in nature. In that case, the initial choice might have been rational but based on fallible beliefs. Beliefs are also adjusted by the acquired experience. (East 1997, 118)

Some research also shows weak correlation between attitude and behavior (Wicker 1969 in East 1997, 123). There are two common reasons suggested for that. The first explanation is the other variables which refer to the possibility that other variables than attitude predict behavior. Such variables as involuntary behavior and normative control are suggested for being responsible of diminishing the causality of attitude and behavior. The second explanation is the possible mismatch between the measured attitude and behavior variables. For example, only a positive attitude toward a brand might not be sufficient and do not correlate with the behavior. Instead, a positive attitude toward using a brand might correlate with the actual behavior. Thus, the use of compatible measures of attitude and behavior is emphasized in behavior predicting research. (East 1997, 123-127)

3.3.6 Motives

In economics it is assumed that humans maximize their outcomes. These outcomes are usually defined in terms of the expected value that would result from the choice. When making a decision, however, individuals often try to maximize more than one outcome. For example, when making money, individuals may also be trying to win approval or make new friends. Choices that seem irrational from the perspective of one goal may turn out to be rational if we take all the goals into consideration. It is also the case that decisions that satisfy all the goals of an individual will be preferred and made faster than decisions that satisfy only some goals but frustrate other goals.

Economic theory assumes self-interest. Psychological research has revealed that people’s choices may be governed by different motives and value orientations. Although prevalence of self-interest is quite common, individuals are often oriented toward cooperation, trying to
maximize both their own outcomes and those of a partner. Another frequent motive is competition, where individuals, rather than trying to maximize their own gain, attempt to maximize the difference between their own outcome and the outcome of a partner. In opposition to this is an equalitarian orientation, where individuals try to keep their own outcomes and the outcomes of the partner even. Value orientation depends on personality and other individual characteristics of the decision-maker and the relation between the decision-maker and the partner, but also the situation, cultural considerations, and the nature of the decision.

3.3.7 Emotions

Human decisions and judgments are also strongly shaped by emotions. Common sense analysis of market dynamics is often made in terms of the dominance of fear or greed. Many lines of research in psychology have proven that emotions influence memory, information processing, judgments, and decisions. Positive emotions, for example, facilitate action and risky decision-making, while negative emotions prompt individuals to refrain from acting and encourage safety-seeking.

The emotional congruency effect describes the tendency to recall positive memories when individuals experience positive emotions, and to recall negative memories when in a negative mood. There is also evidence both from psychology and neurophysiology that decisions are often made on the basis of emotions, while cognitive processes serve to justify the decisions.

3.3.8 Self-Structure

Self-structure is the largest and most powerful of psychological structures. It encodes all self-relevant information and performs regulatory functions with respect to other psychological structures. It is also a strong source of motivation. Two motives dominate the regulatory functions of self-structure. The self-enhancement motive drives the tendency for positive self-evaluation. Conforming to social norms, seeking approval, and striving to win against the competition or trying to look attractive all stem from the self-enhancement motive.

People also have a tendency to confirm their view of themselves. This tendency is described as self-verification. If someone believes that he or she cares about the environment, he or she would likely donate to environmental causes. If someone believes he or she has no
talent at math, this person is likely to do poorly in this subject. In other words, people are likely to engage in actions congruent with beliefs they have about themselves. Beliefs concerning the self may originate in feedback from others. This process is called labeling. If others perceive an individual as a risky player, for example, the individual will be more likely to take risks. What is interesting is that people have the tendency to construct beliefs of themselves on the basis of observing their own actions. In effect, if individuals for some reason engage in a behavior, e.g., trading, this may lead to the development of a self-view as a trader, and this, in turn, may encourage them to engage in further trading.

The two modes of functioning of self-structure are called promotion and prevention. In the promotion mode, individuals are oriented toward achievement. They are seeking situations where they can succeed, be noticed, win a competition, etc. Their emotions oscillate between the happiness of success and the sadness or anger associated with failure. In the prevention mode, individuals aim to minimize the losses. Everything that is happening around them is perceived as a potential threat. Individuals have the tendency to refrain from action since an action could potentially result in negative consequences. Their behavior is aimed at self-protection. Their emotions vary between anxiety and relaxation.

Whether an individual is in the promotion or prevention mode depends to some extent on the individual’s own general characteristics, but also on the situation and their current mood. Factors that are highly valued in promotion mode may have a negative effect in prevention mode. Economic theory assumes that rational individuals take into account all the relevant information. Research in psychology shows that the decision-making process consists of different stages. Up until a certain moment, individuals are open to all incoming information. When they arrive at a decision, however, their information processing changes qualitatively. They selectively seek information that supports their decision, and avoid information that contradicts their decision. They are no longer open to arguments. This phenomenon is called cognitive closure.

Individuals differ in the strength of their tendency for cognitive closure. Individuals characterized by a high tendency for cognitive closure form opinions relatively soon, after hearing a small amount of information. From this moment they concentrate on defending the opinion they have already formed. Individuals with a low tendency for cognitive closure
do not form fixed opinions for a relatively long time. They are open to new incoming information and arguments, and are ready to adjust their opinions.

The tendency for cognitive closure also depends on the situation. Situations in which it is difficult to concentrate, for example, with a lot of noise, encourage early cognitive closure. Cognitive overload, i.e., trying to perform multiple mental operations at the same time also tends to accelerate cognitive closure. Time pressure has similar effects. In summary, although information may be available, some individuals under some circumstances are likely to ignore information that is contrary to an opinion they have already formed.

Deviations from rationality on the individual level are not necessarily incompatible with the existing theories in economy. Although each individual’s decisions are to some extent irrational, it may be that these deviations from rationality can be treated as errors or noise, and while this may be quite pronounced on the individual level, the error of many individuals taken together on the group level could cancel out, provided that the individual errors are not correlated, i.e., provided that they are independent of each other. If the errors of different individuals are correlated, as for example in the case of false information influencing a large proportion of traders, individual errors could add up, rather than cancel. In this case the predictions of the rational model may still be corrected by adjusting the outcome in a way that reflects the influence of the external factor. Social processes occurring among individuals can make the outcome of a group process very different from the sum of the outcomes of individual processes. Processes occurring at the group level cannot be reduced to processes occurring at the individual level.

3.3.9 Investors communicate with other investors and with financial advisors

Advisors also frequently communicate with other advisors to gain better understanding of what is currently happening in financial markets. They also communicate with other people in their social networks such as their families and friends. Some of the communications are face-to-face discussions in dyads or groups, and such interactions are also often mediated by telephone or Internet.

An important medium for the creation of shared reality is Internet discussion groups. Here both advisors and investors can interact with strangers, and this extends the creation of a shared reality. Media, in particular specialized papers and juveniles, also play important roles in the creation of shared reality.
3.3.10 Traditional Finance

The proposition that has dominated finance for over 30 years is efficient market hypothesis (EMH). There are three basic theoretical arguments that form the basis of the EMH. The first and most significant is that investors are rational and by implication securities are valued rationally. Second is based on the idea that everyone takes careful account of all available information before making investment decisions. It is related to internal consistency. Each decision has to be made in a systematic way such that it is in agreement with one another whatever the subject is.

The third principle is that the decision maker always pursues self-interest. Most widely applied in finance is the expected utility model of choice under risk, proposed by Von Neumann and Morgenstern (1947) in DeBondt (1998). Its rationality is based on axioms underlying expected utility maximization as the optimal rule. The accumulation and processing of information and the formation of expectations occur efficiently, yielding possible outcomes (of total wealth) and corresponding possibilities.

3.3.11 Behavioral finance

A brief outline

Over the past few decades, behavioral finance has become a household name in the finance industry. Many financial institutions now offer financial services which trade on strategies that are partly (solely) based on behavioral finance findings. For instance, pension plans in which people have to decide on how to invest their retirement money (i.e. defined contribution plans), use findings from behavioral finance to help participants improve their investment strategies. And, many hedge funds act based on strategies originating in behavioral finance.

As the name suggest, behavioral finance aims at improving the understanding of financial markets and its participants, by applying insights from behavioral sciences (e.g. psychology and sociology). This in sharp contrast to the traditional finance paradigm, which seeks to understand financial decisions by assuming that markets and many of its participating people and institutions (called economic agents) are rational; that is, they act in an unbiased fashion and make decisions by maximizing their self-interests. In essence, the economic concept of rationality means that economic agents make the best choices possible for themselves. Although appealing, this concept entails strong and unrealistic assumptions
about human behavior and the functioning of financial markets. For example, economic agents are assumed to process new information correctly and make decisions that are normatively acceptable (Barberis and Thaler, 2003). Agents must be capable of integrating and considering many different pieces of information relating to assets and must fully understand the future consequences of all their actions. Moreover, financial markets must be frictionless, such that security prices reflect their fundamental value (i.e. prices are right) and the influence of irrational market participants is corrected by rational traders (i.e. markets succumb to efficiency).

By contrast, human beings and financial markets do not possess all of these capabilities or characteristics. For example, people fail to update beliefs correctly (Tversky and Kahneman, 1974) and have preferences that differ from rational agents (Kahneman and Tversky, 1979). People have limitations on their capacity to process information, and have bounds on capabilities to solve complex problems (Simon, 1957). Moreover, people have limitations in their attention capabilities (Kahneman, 1973), and only care about social considerations (e.g. by deciding not to invest in tobacco companies). In addition, rational traders are bounded in their possibilities, or may even be absent such that markets will not always correct this ‘non-rational’ behavior (Barberis and Thaler, 2003).

Hence, classic finance theories may give a bad description of behavior. In fact, a lot of studies confirm this suggestion in the aggregate behavior of financial markets, the individual trading behavior of individual investors and the behavior of managers (see Campbell 2000, Hirshleifer, 2001, Barberis and Thaler, 2003, Baker, Ruback and Wurgler, 2006 and Campbell, 2006 for excellent reviews in the main finance field of Asset Pricing, Corporate Finance and Household Finance). For example, numerous evidence shows that the most important traditional asset pricing theory, the Capital Asset Pricing Model (CAPM), is inconsistent with many empirical regularities found in cross-sectional asset pricing data, showing that one group of stocks earn higher (risk-adjusted) returns than another. Moreover, stock and bond returns are predictable based on various macro economic variables, as well as investor’s sentiment measures (Fama and French, 1988, 1989, Whitelaw, 1994, Cremers, 2002, Avramov, 2004, Baker and Wurgler, 2007).

Hence, not all information is correctly included in market prices. In addition, another traditional finance anomaly is the equity premium puzzle, which says that stocks
outperform bonds over long horizons by a difference that is too large to be explained by any rational asset pricing theory (Mehra and Prescott, 1985). Furthermore, individual investors generally hold investment portfolios that are insufficiently diversified or non-preferred (Benartzi, 2001 and Benartzi and Thaler, 2002) and that under-perform benchmarks due to excessive trading (see for example Barber and Odean, 2000).

By contrast, the main thought behind behavioral finance is that investment behavior exists, that differs from what the traditional finance paradigm assumes, and that this behavior influences financial markets. Indeed, a number of recent studies show that behavioral finance theories can explain some of the findings the traditional finance theories leave unexplained. For example, Benartzi and Thaler (1995) and Barberis, Huang and Santos (2001) show how a disproportionately large aversion to losses, in combination with an annual investment horizon, can explain the puzzling high returns of equities over bonds (i.e. the equity premium puzzle). Similarly, Barberis, Shleifer and Vishny (1998), Daniel, Hirshleifer and Subrahmanyam (1998), Hong and Stein (1999) and Barberis and Shleifer (2003) explain the high (low) returns after good (bad) earnings announcements, high (low) returns for recent winners (losers), and the reversal of these recent winner or loser returns over longer horizons, by modeling various behavioral biases and limitations investors are subject to.

Moreover, Shefrin and Statman (1984) show how behavioral finance can explain why firms pay dividends, while dividends actually have a tax disadvantage. In fact, findings from behavioral finance have proven to be excellent tools for improving the decisions of individual investors, especially in investment decisions for retirement (see Benartzi and Thaler, 2004).

However, a lot of work remains to be done. This thesis presents a collection of articles that provide new insights into the field of behavioral finance. Next, I will discuss the main building blocks of the traditional finance paradigm. Subsequently, I will turn to the psychological evidence that challenges part of these assumptions, followed by a summary of the various research methodologies available to the field of behavioral finance.

**What is behavioral finance?**

Behavioral finance studies the psychology of financial decision-making. Most people know that emotions affect investment decisions. People in the industry commonly talk about the
role greed and fear play in driving stock markets. Behavioral finance extends this analysis to the role of biases in decision making, such as the use of simple rules of thumb for making complex investment decisions. In other words, behavioral finance takes the insights of psychological research and applies them to financial decision-making.

3.3.12 Traditional vs. behavioral finance

Over the past fifty years established finance theory has assumed that investors have little difficulty making financial decisions and are well-informed, careful and consistent. The traditional theory holds that investors are not confused by how information is presented to them and not swayed by their emotions. But clearly reality does not match these assumptions. Behavioral finance has been growing over the last twenty years specifically because of the observation that investors rarely behave according to the assumptions made in traditional finance theory. Behavioural researchers have taken the view that finance theory should take account of observed human behavior. They use research from psychology to develop an understanding of financial decision-making and create the discipline of behavioral finance. This guide summarizes the findings of these groundbreaking financial theorists and researchers.

Behavioral finance is a branch of finance that studies how the behavior of agents in the financial market and influenced by psychological factors and the resulting influence on decisions made while buying or selling the market, thus affecting the prices. The science aims to explain the reasons why it’s reasonable to believe that markets are inefficient. Some of the key definitions of behavioral finance are discussed below.

According to Sewell (2007), “Behavioral finance is the study of the influence of psychology on the behaviour of financial practitioners and the subsequent effect on markets.” The science deals with theories and experiments focused on what happens when investors make decisions based on hunches or emotions.

Shefrin (2000) defines Behavioral finance as “a rapidly growing area that deals with the influence of psychology on the behavior of financial practitioners”.

Belsky and Gilovich(1999) prefer to call behavioral finance as ‘behavioral economics’ and says that “Behavioral economics combines the twin disciplines of psychology and economics to explain why and how people make seemingly irrational or illogical decisions when they spend, invest, save, and borrow money.”
“Behavioral finance relaxes the traditional assumptions of financial economics by incorporating these observable, systematic, and very human departures from rationality into standard models of financial markets. The tendency for human beings to be overconfident causes the first bias in investors, and the human desire to avoid regret prompts the second” (Barber and Odean,1999).

Thus, Behavioral finance can be defined as a field of finance that proposes explanation of stock market anomalies using identified psychological biases, rather than dismissing them as chance results consistent with the market efficiency hypothesis.(Fama, 1998). It is assumed that individual investors and market outcomes are influenced by information structure, and various characteristics of market participants (Banerjee, 2011).

**Background and Evolution**

The Modern Portfolio Theory (MPT), Capital Asset Pricing Model (CAPM) and Arbitrage Pricing Theory (APT) are the quantitative models that underpin the rational expectations based theories. Unfortunately, there is a large amount of research, which could not confirm this theory in the available investment data. For example, Fama and French, (1993, 1996) and others have shown that the basic facts about the aggregate stock market, the cross-section average returns and individual trading behavior are not easily understood in this framework. The behavioral finance paradigm has emerged in the response to the difficulties faced by the traditional paradigm. In essence, it argues that investment choices are not always made on the basis of full rationality, and it attempts to understand the investment market phenomena by relaxing the two doctrines of the traditional paradigm, that is, (i) agents fail to update their beliefs correctly and (ii) there is a systematic deviation from the normative process in making investment choices. (Kishore, 2004)

**3.3.13 How behavioral biases affect investment behavior**

Research in psychology has documented a range of decision-making behaviors called biases. These biases can affect all types of decision-making, but have particular implications in relation to money and investing. The biases relate to how we process information to reach decisions and the preferences we have. The biases tend to sit deep within our psyche and may serve us well in certain circumstances. However, in investment they may lead us to unhelpful or even hurtful decisions. As a fundamental part of human nature, these biases affect all types of investors, both
Professional and private. However, if we understand them and their effects, we may be able to reduce their influence and learn to work around them. A variety of documented biases arise in particular circumstances, some of which contradict others. The following sections discuss the key biases and their implications for investors and advisers.

- **Overconfidence**

  Psychology has found that humans tend to have unwarranted confidence in their decision making. In essence, this means having an inflated view of one’s own abilities. In practical terms, human beings tend to view the world in positive terms. While this behavior can be valuable – it can help you recover from life’s disappointments more quickly – it can also cause an ongoing source of bias in money-related decisions.

- **Overconfidence and investing**

  Overconfidence has direct applications in investment, which can be complex and involve forecasts of the future. Overconfident investors may overestimate their ability to identify winning investments. Traditional financial theory suggests holding diversified portfolios so that risk is not concentrated in any particular area. ‘Misguided conviction’ can weigh against this advice, with investors or their advisers ‘sure’ of the good prospects of a given investment, causing them to believe that diversification is therefore unnecessary. Overconfidence is linked to the issue of control, with overconfident investors for example believing they exercise more control over their investments than they do. In one study, affluent investors reported that their own stock-picking skills were critical to portfolio performance. In reality, they were unduly optimistic about the performance of the shares they chose, and underestimated the effect of the overall market on their portfolio’s performance. In this simple way, investors overestimate their own abilities and overlook broader factors influencing their investments.

- **Too much trading**

  Investors with too much confidence in their trading skill often trade too much, with a negative effect on their returns. Professors Brad Barber and Terry Odean studied US investors with retail brokerage accounts and found that more active traders earned the lowest returns.
**Skill and luck**

Overconfidence may be fuelled by another characteristic known as ‘self-attribution biases. In essence, this means that individuals faced with a positive outcome following a decision, will view that outcome as a reflection of their ability and skill. However, when faced with a negative outcome, this is attributed to bad luck or misfortune. This bias gets in the way of the feedback process by allowing decision makers to block out negative feedback and the resulting opportunity to improve future decisions.

**Loss aversion - Attitudes to risk and reward**

Established financial theory focuses on the trade-off between risk and return. Risk from this perspective means variability of outcomes and riskier investments should, broadly speaking, offer higher rates of return as compensation for higher risk. The theory assumes that investors seek the highest return for the level of risk they are willing and able to bear. Financial advisers often ask clients to complete a risk attitude questionnaire to establish their attitude to risk, and consider issues such as investment time horizon and wealth levels to establish risk tolerance. Risk tolerance drives the types of investments they recommend for the investor.

**Fear of loss**

Behavioral finance suggests investors are more sensitive to loss than to risk and return. Some estimates suggest people weigh losses more than twice as heavily as potential gains. The idea of loss aversion also includes the finding that people try to avoid locking in a loss. More generally, investors with losing positions show a strong desire to get back to break even. This means the investor shows highly risk-averse behavior when facing a profit (selling and locking in the sure gain) and more risk tolerant or risk seeking behavior when facing a loss (continuing to hold the investment and hoping its price rises again)

**Advisers and loss aversion**

Advisers have a key role in helping clients deal with loss aversion and contain their desire to sell winners and hold losing investments. The adviser can help the client evaluate whether the investment still has good future prospects and whether it is still suitable for the client’s circumstances.
The disposition effect
Professors Shefrin and Statman developed the idea of loss aversion into a theory called the ‘disposition effect’, which indicates that individuals tend to sell winners and hold losers. In later research, Professors Barber and Odean tested this idea using data from a US retail brokerage. They found that investors were roughly 50% more likely to sell a winning position than a losing position, despite the fact that US tax regulations make it beneficial to defer locking in gains for as long as possible, while crystallizing tax losses as early as possible. They also found that the tendency to sell winners and hold losers harmed investment returns.

The problem of inertia
Regret avoidance
Inertia means that people fail to get around to taking action, often even on things they want or have agreed to do. A related issue is a tendency for emotions to sway you from an agreed course of action – ‘having second thoughts’. The human desire to avoid regret drives these behaviors. Inertia can act as a barrier to effective financial planning, stopping people from saving and making necessary changes to their portfolios.

A fundamental uncertainty or confusion about how to proceed lies at the heart of inertia. For example, if an investor is considering making a change to their portfolio, but lacks certainty about the merits of taking action, the investor may decide to choose the most convenient path – wait and see. In this pattern of behavior, so common in many aspects of our daily lives, the tendency to procrastinate dominates financial decisions.

Overcoming inertia with an autopilot
In recent years behavioural researchers have designed ‘autopilot’ systems to counteract inertia. For example, in the realm of retirement planning it has been observed that many individuals fail to join their company pension plan, possibly as a result of inertia. Changing the pension scheme so that employees are automatically enrolled in the scheme, while retaining a right to opt out, tends to boost take up rates considerably. In effect, the automatic enrolment approach puts inertia to a positive use. Automatic enrolment is planned for use in the UK’s new pension regulations, due to be implemented in 2012. Individuals in pension plans are also often found to be saving at low rates that are unlikely to generate the levels of retirement income the individuals would hope for. One study found that asking members to
pre commit to future increases in their pension contributions was an effective way of raising contributions.

_workflow: Autopilot approaches to investing

Autopilot approaches can also have relevance in investing, such as taking a disciplined approach to portfolio rebalancing, or a commitment to regular monthly savings. Such disciplined approaches – often called ‘commitment devices’ by behavioural economists – can help investors avoid biases like overconfidence and promote rational investor behaviour.

In terms of rebalancing, using a regular schedule for guiding decisions can help investors to avoid being swayed by current market conditions, recent performance of a ‘hot’ investment or other fads. It results in a regular strategy that sells out of markets or investments that have recently outperformed and adds to markets or investments that have lagged. Regular investing, the process of ‘pound cost averaging, also helps as the investor tends to accumulate more units or shares of an investment when markets are low than when they are high.

_workflow: Advisers and inertia

Savings schemes, pound cost averaging and automatic portfolio rebalancing are autopilot approaches that can be used to help clients overcome inertia and meet their financial goals.

_workflow: Constructing portfolios-Framing

Finance theory recommends we treat all of our investments as a single pool, or portfolio, and consider how the risks of each investment offset the risks of others within the portfolio. We’re supposed to think comprehensively about our wealth. Rather than focusing on individual securities or simply our financial assets, traditional financial theory believes that we consider our wealth comprehensively, including our house, company pensions, government benefits and our ability to produce income. However, human beings tend to focus overwhelmingly on the behaviour of individual investments or securities. As a result, in reviewing portfolios investors tend to fret over the poor performance of a specific asset class or security or mutual fund. These ‘narrow’ frames tend to increase investor sensitivity to loss. By contrast, by evaluating investments and performance at the aggregate level, with a ‘wide’ frame, investors tend to exhibit a greater tendency to accept short-term losses and their effects.
 Anchoring
Social representation of financial markets is created through different types of communication between heterogeneous agents. The dynamics of financial markets depends to a large extent on the decisions of the largest players, mainly governments, who decide in which currencies to buy and in which to sell. To minimize the impact of these high-volume transactions on financial markets, they are spread over longer time spans. Other high volume players are banks. When the experts working for banks think they know which currency will go up and which will go down, these banks engage in trading. The volume of trading by individual investors is usually much smaller. The decisions of an individual investor usually have a negligible effect on the market. If, however, a larger number of investors synchronize in their decisions, they can influence the market in a significant way. Social representation of the market, also called shared reality, provides one of the main ways in which a large number of investors are likely to synchronize.

 Advisers, framing and mental accounting
Behavioural finance suggests that advisers could derive an advantage from developing an awareness and understanding of framing and mental accounting. The adviser could focus on the particular mental accounts the client has and the objectives and risk tolerance of each one. It may not be possible to establish a single overall tolerance for risk. Rather, the client may have a different risk tolerance for their pension, ISA and so on. Advisers should counsel clients to evaluate their financial assets with the widest ‘frame’ possible and avoid focusing on individual securities or instruments.

 Mental accounting
Our psychological self thinks about money and risk through ‘mental accounts’ – separating our wealth into various buckets or pools. We often base these pools on goals or time horizon (such as ‘retirement’ or ‘school fees’). Accounts can also vary in risk tolerance, investing some in risky assets for gain while treating others more conservatively. Investors pay less attention to the relationship between the investments held in the different mental accounts than traditional theory suggests. This natural tendency to create mental buckets also causes us to focus on the individual buckets rather than thinking broadly, in terms of our entire wealth position.
Managing diversification

Advisers understand the critical importance of portfolio diversification. However, behavioral finance research suggests investors sometimes struggle to apply the concept in practice. Advisers have an important role to play in helping clients achieve effective diversification and avoiding a concentration of risks in particular investments, no matter how familiar they are. They should caution clients that familiarity is not a substitute for a good spread of investments.

Naïve diversification

Evidence suggests that investors use ‘naïve’ rules of thumb for portfolio construction in the absence of better information. One such rule has been dubbed the ‘1/n’ approach, where investors allocate equally to the range of available asset classes or funds (‘n’ stands for the number of options available). This approach ignores the specific risk-return characteristics of the Investments and the relationships between them. Investors might understand the importance of diversification, but not knowing exactly how to achieve it, go for a simple approach. The twist here is that despite the apparent behavioral bias, recent research has shown investors using naïve ‘1/n’ techniques can sometimes do better than the investors who construct portfolios using sophisticated computer models. One of the more common aspects of naïve diversification is the tendency for some households to hold extreme portfolio allocations. On the one hand are aggressive investors who only hold all-equity portfolios. On the other hand are ultra conservative Investors who are reluctant to hold anything other than bonds. Many such investors need the help of an adviser to ensure a balance of risk and return in portfolios.

Investing in the familiar

Investors have been documented to prefer investing in familiar assets. Investors associate familiarity with low risk. This manifests itself in home bias – high portfolio weights in assets from an investor’s own country. Institutional and individual investors around the globe tend to bias portfolios towards familiar local markets and away from international markets. In these cases, the danger is one of inadequate diversification. In the UK in recent years, the familiarity of property may have caused many investors to underestimate the risks involved, although recent market falls may have changed this perspective.
Using – or misusing – information Researchers have documented a number of biases in the way in which we filter and use information when making decisions. In some cases, we use basic mental shortcuts to simplify decision-making in complex situations. Sometimes these shortcuts are helpful, in other cases they can mislead.

❖ **Availability bias**
Some evidence suggests that recently observed or experienced events strongly influence decisions. Psychologists refer to this as the ‘availability bias’. Researchers found that individuals were likely to overestimate the chances of being in a car crash if they had seen a car crash on a recent journey. The recent memory made the prospect more vivid – available – and therefore more likely. To give a financial example, investors are more likely to be fearful of a stock market crash when one has occurred in the recent past.

❖ **Representativeness bias**
The notion of ‘representativeness bias’ reflects the case where decisions are made based on a situation’s superficial characteristics (what it looks like) rather than a detailed evaluation of the reality. Another way of putting this would be saying that decisions are made based on stereotypes. A common financial example is for investors to assume that shares in a high-profile, well-managed company will automatically be a good investment. This idea sounds reasonable, but ignores the possibility that the share price already reflects the quality of the company and thus future return prospects may be moderate. Another example would be assuming that the past performance of an investment is an indication of its future performance.

Investors also suffer from representativeness bias when they evaluate fund managers. Investors are often drawn to a manager with a short track record of beating market averages over a few years. Meanwhile they show less interest in a manager with a much longer track record that has exceeded averages by only a small margin. Statistically, the manager with the long-term track record has the stronger case to make about skill. But we tend to look at the manager with the short-term track record, and believe that the record of superior performance will continue.

Various biases act on our decision-making. Advisers can use checklists to identify potential investment pitfalls, such as:
• Am I, or my client, being anchored by an irrelevant factor, or being affected by the way the issue is framed?
• Am I, or my client, responding to an available memory, or judging based on superficial similarity?
• Am I, or my client, being too conservative in updating views based on recent changes in information?

   ❖ **Conservatism bias**

   ‘Conservatism bias’ describes the idea the decision maker clings to an initial judgment despite new contradictory information. Or they only partially adjust their view in light of the new information. Taking the example above, investors who buy shares in a high profile company may be slow to adjust their view of the company’s prospects even after the company’s profitability deteriorates.

   ❖ **Group behavior**

   The biases discussed so far relate to individual decision making. An important question is how these and other biases affect decisions made by groups. A group situation may counteract a particular bias or it may strengthen it. Equally, the group situation could create new biases.

   ❖ **Two heads are better than one?**

   We typically use groups to make decisions in order to benefit from the range of knowledge and experience in a group. However, a desire for social acceptance may encourage individuals with conflicting views to fall into line. Or, those with opposing views may start to doubt their own convictions.

   ❖ **Crowds vs. groups**

   Evidence suggests that crowds – groups of unrelated individuals – are often able to identify correct answers to problems. This is typified in the ‘asks the audience’ feature of the Who Wants To Be a Millionaire quiz show. The benefit of the audience is that the range of knowledge and experience is diverse and that individuals give their opinion independently of the opinions of others. The research suggests the majority opinion of the audience is correct over 90% of the Time This provides some guidance for effective decision making in committees. Firstly, we need to make sure the committee is appropriately diverse – two heads aren’t better than one if both the heads think the same way. Secondly, individuals on
the committee must be encouraged to give their own opinions rather than fall into line with the views expressed by one or a few dominant individuals such as their boss.

Decision-making in groups

Effective decision-making in groups requires making sure that the group comprises people with diverse experience and perspectives. The group should be run in a manner that allows individuals to express their views freely and not feel pressure to fall into line with other views expressed.

Behavioral finance models often rely on a concept of individual investors who are prone to judgment and decision-making errors. This article provides a brief introduction of behavioral finance, which encompasses research that drops the traditional assumptions of expected utility maximization with rational investors in efficient markets. The article also reviews prior research and extensive evidence about how psychological biases affect investor behavior and prices. The paper found that the most common behavior that most investors do when making investment decision are

1. Investors often do not participate in all asset and security categories,
2. Individual investors exhibit loss-averse behavior,
3. Investors use past performance as an indicator of future performance in stock purchase decisions,
4. Investors trade too aggressively,
5. Investors behave on status quo,
6. Investors do not always form efficient portfolios,
7. Investors behave parallel to each other, and
8. Investors are influenced by historical high or low trading stocks.

However, there are relatively low cost measures to help investors make better choices and make the market more efficient. These involve regulations, investment education, and perhaps some efforts to standardize mutual fund advertising. Moreover, a case can be made for regulations to protect foolish investors by restricting their freedom of action of those that may prey upon them.

How people handle decisions?

Most financial decisions are made in situations characterized by a high degree of complexity and uncertainty, since many aspects play a role (e.g. other decisions situations
and alternatives). For example, in a choice between many alternatives, each with many consequences, the ‘homoeconomicus’ acts if it performs exhaustive searches over all possible alternatives, evaluates all consequences by integrating other decisions, and then picks the best.

However, psychological work shows that people are limited in their abilities and capabilities to solve such problems (Simon, 1955, 1957, 1959, 1979, Arthur, 1994, and Conlisk, 1996); that is, people are limited in their capacity for processing information, such as a limited working memory and limited computational capabilities. Moreover, people are limited in their attention capacity and hence ability to perform multiple tasks simultaneously (Kahneman, 1973). Therefore, complex decision problems generally exceed people’s cognitive capabilities, and people are unable to deal with them in the way economic theory prescribes.

To overcome these problems and manage the problem of interest, people generally rely on a limited number of simplifying rules-of-thumb, or heuristics, which often fail to accommodate the full logic of decisions (Simon, 1955, 1979, Newell and Simon, 1972, Tversky and Kahneman, 1974).

For example, when people have to choose among many alternatives they do not weight of all the advantages and disadvantages of all options, but choose among alternatives by sequentially eliminating alternatives that do not possess certain aspects (Tversky, 1972, Payne, 1976). In a financial context, people tend to divide their money equally between the funds they select in their retirement accounts (Benartzi and Thaler, 2001). In fact, Gabaix and Laibson (2000) show that in even simple economic decisions people are bounded by their cognitive capabilities and rely on heuristics instead. Moreover, people formulate and integrate decisions for themselves in ways that differ from that of the ‘homo-economicus’.

In this process, called “mental accounting” (Thaler, 1980, 1999), people tend to integrate decisions in a narrow fashion; that is they consider decision problems one at a time instead of adopting a broader frame (Kahneman and Lovallo, 1993). For example, the work of Tversky and Kahneman (1981) shows that people do not integrate even simple choice situations and tend to consider each choice in isolation. Similarly, Read, Loewenstein and Rabin (1999) show that the extent to which decisions are mentally or physically bracketed, or grouped together, substantially influences decisions.
In a financial context investors may care about fluctuations in the individual stocks they hold instead of fluctuations in their total portfolios. In fact, as shown by Barberis and Huang (2001), this form of “narrow bracketing” (or “narrow framing”), in combination with some behavioral biases in preferences, can explain the high returns on stocks with favorable multiples of fundamental over market value. In fact, the way in which people bracket (or frame), depends heavily on how decision problems are presented. People tend to display cognitive inertia, meaning that people deal with problems they way they are presented to them. If choices come one at a time, they will bracket them narrowly, and if choices come many at a time, they will bracket more broadly (Redelmeier and Tversky, 1992, Read, Loewenstein and Rabin, 1999, Kahneman, 2003). Furthermore, people tend to use only information that is explicitly displayed and will use it the way it is displayed (Slovic, 1972a), and tend to give thoughts to as little information as possible in order to minimize demands on their cognitive capabilities (Payne, Bettman and Schkade, 1999).

Moreover, narrow bracketing implies that the frequency with which people tend to evaluate decisions has large influence. In general, people tend to be myopic, meaning that they evaluate decisions relatively frequently, and by that, make choices that they would not make if they evaluated over appropriately longer horizons (Thaler, 1999). An important financial consequence of this behavior is given by Thaler, Tversky, Kahneman and Schwartz (1997) and Benartzi and Thaler (1999), who show that people invest more in stocks if a longer evaluation horizon is enforced, something called myopic loss aversion. In fact, this behavioral pattern is especially strong among options and futures traders (Haigh and List, 2005).

This myopia is absent in the ‘homo-economicus’, since it considers the consequences of its decisions over its entire lifetime. In a similar spirit, Langer and Weber (2001) show the opposite effect for loan like securities that consist of a small probability of a large loss, in which people are less willing to invest if they evaluate more frequently. In fact, the puzzling high returns on equities over bonds can at least partly be explained by assuming that investors have a relatively short, but plausible investment horizon of one year (Benartzi and Thaler, 1995).

In addition, people set up separate mental accounts, or mental budgets for different decisions and outcomes (Thaler, 1985). For instance, some money is kept as ‘household
money’, some money as ‘leisure money’, some money as ‘vacation money’, and some money as ‘investment money’. Between the various mental budgets money is generally non-fungible. This mental processing stands in sharp contrast with the rational view in economics that people should maintain a comprehensive view of outcomes and money is fungible, and may help to overcome the self-control problems that people frequently encounter (Thaler 1999, Thaler and Shefrin, 1981).

To summarize, since time and cognitive resources are limited people cannot optimally analyze all information needed for decisions. Hence, unlike the ‘homo-economicus’ people are unable to solve complex problems and rely on heuristics instead. Moreover, people consider decision problems one at a time, evaluate decisions too frequently, and use different mental accounts for different decisions. These practices may yield biases in financial markets, as compared to the traditional finance paradigm; for example, stocks with higher measures of fundamental over market value earn higher returns, and different amounts are invested in equities or loans depending on the enforced evaluation horizon.

- Psychological foundations for beliefs and judgments

An important aspect in the behavior of financial markets are the expectations agents have and how they form them (Barberis and Thaler, 2003). Traditionally, the field of finance assumes that the ‘homoeconomicus’ forms its expectations according to the laws of probability and it updates its beliefs correctly if new information arises. However, for many situations a wealth of evidence from cognitive and affective psychology indicates otherwise (for an extensive overview, see Rabin, 1998, and Kahneman, 2003). Most notably, often people reduce the complex task of assessing probabilities to simpler judgmental operations (Tversky and Kahneman, 1974). These judgmental heuristics are often very useful, but sometimes result in systematic errors (called “biases” or “cognitive illusions”).

For example, when people evaluate the probability of an uncertain event belonging to a particular population, they often make probability judgments using similarity, or what Kahneman and Tversky (1972, 1973) call the “representativeness heuristic”. According to this judgmental heuristic, people evaluate the probability of an uncertain event by the degree to which it is similar in essential characteristics to its parent population and reflects the salient features of the process by which it is generated (Kahneman and Tversky, 1972). When an event (e.g. a good reputation of a specific company) is highly representative of a
class of events (e.g. the performance of that company's stock), the judged probability that the event originates from that particular class is higher. Representativeness induces people, among other things, to give too much weight to recent evidence and too little weight to base rates or prior probabilities (the so-called “base-rate neglect”, Kahneman and Tversky, 1972), to make forecasts that are too extreme (Kahneman and Tversky, 1973), to underestimate the impact of new evidence that is not representative of the process (called “conservatism”), to judge a joint probability more likely as one of its components (called the “conjunction fallacy”, Tversky and Kahneman, 1983) and to display misconceptions of chance. The latter means that people expect a sequence of events of a process that is completely random to represent the essential characteristics of that process, even when the sequence is short. As a result people believe in the “gambler’s fallacy”, in which chance is viewed as a self correcting process. For example, people believe that after four fair coin tosses in a row yielding heads, tails is now due. By contrast, in cases in which people do not know the underlying data generating process, people often try to infer it from just a few data points.

For example, people may believe that a stock market analyst is good after four successful predictions in a row, since this is not representative of a bad analyst (Rabin, 1998, Barberis and Thaler, 2003). Moreover, people try to spot trends in random processes (e.g. in stock prices) and expect past price changes to continue, (called the “extrapolation bias”, see De Bondt, 1993 and 1998). In addition, people believe small samples to be highly representative of the population from which they are drawn (called the “law of small numbers”), and tend to systematically overvalue this small sample evidence. For instance, people may think that even a two-year record is plenty of evidence for the investment skill of a fund manager. In fact, Barberis, Shleifer and Vishny (1998) show how the representativeness biases can create high (low) returns after good (bad) earnings announcements, high (low) returns for recent winners (losers), and the reversal of these recent winner or loser returns over longer horizons, as observed in financial markets.

Besides judging probabilities using similarity, people judge the probability of an event with the ease with which instances come to mind. This heuristic, called “availability”, is generally employed when people have to judge the plausibility of a particular development (Tversky and Kahneman, 1974). Violations of the laws of probability arise, because not all
events are equally retrievable. Availability is higher for recent events, events that are better imaginable, events that are easier to remember, events that are more vivid, events that are more familiar, and events that are more salient (Kahneman, 2003). For example, in a financial context people tend to give too much weight to recent information, and may assign a higher probability to a bad stock market performance if they recently experienced a large stock market decline. By contrast, when people have to make numerical predictions, they often employ the so-called “anchoring and adjustment heuristic” (Tversky and Kahneman, 1974). People make judgments by starting form an initial value (the anchor) that is subsequently adjusted to yield the final judgment. However, in many cases this adjustment is insufficient, causing biases in the judgment. For example, when there recently has been a correction in the stock market to an overreaction to bad news, investors may anchor on this past price trend and expect it to continue (albeit in a weaker form).

Besides these heuristics, there are other factors that bias people’s expectations. First, people are overconfident (see Lichtenstein, Fischhoff and Phillips, 1982). This manifests itself as, among others, people thinking they can predict the future better than they actually can, people overestimating the reliability of their knowledge, people believing they have better abilities than others, people being excessively optimistic about the future, and people believing they can control random events (called the “illusion of control”, Langer, 1975). In addition, most people have unrealistic views of their abilities and engage in wishful thinking (Weinstein, 1980). For example, De Bondt (1998) shows that a group of individual investors who invest between $25,000 and $1,025,000 in stocks are overconfident and optimistic about the future performance of the stocks they own, while simultaneously underestimating their risks. In fact, as argued by Barberis and Thaler (2003), overconfidence is often strengthened by the tendency of people;

(i) to ascribe success to their own skills while blaming failure on bad luck (called the “self-attribution bias”), and

(ii) to believe they predicted an event beforehand, but after it actually happened (called the “hindsight bias”).

The importance of overconfidence in a financial context is illustrated by Odean (1999) and Barber and Odean (2000, 2002), who show how overconfidence by individual investors
results in excessive trading. In addition, Daniel, Hirshleifer and Subrahmanyam (1998) show how overconfidence about the precision of private information (strengthened by a self-attribution bias), yield similar patterns in asset prices as predicted by Barberis, Shleifer and Vishny (1998).

Moreover, people are perseverant in their beliefs; that is they toughly and slowly change their opinions once they have formed them (Lord, Ross and Lepper, 1979). For example, once people become convinced that a particular stock is going to perform well, they may not give enough weight to evidence that suggests that the stock is actually a bad investment. In addition, judgments tend to be biased towards an equal chance on every possible partition, since they reflect a compromise between the decision makers’ initial beliefs and an equal distribution among the salient categories in which the options are partitioned (Fox and Clemen, 2005).

Hence, expectations depend on the partition of the state space, as is for example observed in the economic derivatives markets of Goldman Sachs and Deutsche Bank (see Sonnemann, Camerer, Langer, and Fox, 2008). Besides these cognitive factors, emotions may have a large influence on beliefs as well (Loewenstein, Weber, Hsee and Welch, 2001). For example, happier people tend to assign higher probabilities to positive events (Wright and Bower, 1992), and people who experience stronger fear (anger) make more pessimistic (optimistic) risk estimates (Lerner, Gonzalez, Small and Fischhoff, 2003). In fact, emotions influence financial markets as well. For example, Hirshleifer and Shumway (2003) find that positive moods caused by a lot of morning sunshine, lead to higher stock returns. Similarly, Edmans, Garcia and Norli (2008) find that bad moods, caused by international soccer losses in important games, predict poor returns in the loosing country the next day, especially among small stocks.

To summarize, people use a variety of practices that yield beliefs that deviate from the beliefs of the ‘homo-economicus’. People form beliefs by the degree to which an event reflects the essential characteristics of a process, by the ease with which instances come to mind, and by anchoring on initial values and adjusting this estimated insufficiently. Moreover, people are overconfident and optimistic and allow emotions to influence judgments as well. These mental shortcuts and mistakes sometimes bias investor’s expectations, which may affect financial markets and its participants in a number of ways.
Securities may not represent their correct value, and investors who are prone to these biases will take excessive risks of which they are not aware, will experience unanticipated outcomes, and will engage in unjustified trading (see also Kahneman and Riepe, 1998)

Behavioral finance is a study of the markets that draws on psychology, throwing more light on why people buy or sell the stocks and even why they do not buy stocks at all. This research on investor behavior helps to explain the various ‘market anomalies’ that challenge standard theory. This is because this anomaly is persistent. Therefore this behavior exists. Behavioral finance encompasses research that drops the traditional assumptions of expected utility maximization with rational investors in efficient market. The two building blocks of behavioral finance are cognitive psychology and the limits to arbitrage (Ritter, 2003).

Cognitive refers to how people think and the limit to arbitrage when market is inefficient. There is a huge psychology literature documenting that people make systematic errors in the way they think: they always make decision easier (heuristics), overconfidence, put too much weight on recent experience (representativeness), separate decisions that should be combined (mental accounting), wrong presenting the individual matters (framing), tend to be slow to pick up the changes (conservatism), and their preferences may also create distortion when they avoid realizing paper losses and seek to realize paper gains (disposition effect). Behavioral finance uses models in which some agents are not fully rational, either because of preferences or because of mistaken beliefs. An example of an assumption about preferences is that people is loss averse. Mistaken beliefs arise because people are bad Bayesians.

Much of the basic theories of behavioral finance concern with a series of new concept under the general heading of ‘bounded rationality,’ a term associated with Herbert Simon (1947, 1983). It relates to cognitive limitations on decision-making. As a result, human behavior is made on the basis of simplified procedures or heuristics (Tversky and Kahneman, 1974). This is consistent with the study done by Slovic (1972) on investment risk-taking behavior. He found that, man has limitations as a processor of information and shows some judgmental biases which lead people to overweight information. People also tend to be over react to information (De Bondt and Thaler, 1985, 1987).
Shiller (1999) surveys some of the key ideas in behavioral finance, including Prospect theory, Regret theory, Anchoring, and Overand under-reaction. Prospect theory introduced by Khaneman and Tvernsky (1979, 1981, 1986) suggests that people respond differently to equivalent situations depending on whether it is presented in the context of a loss or a gain. Investors typically become distressed at the prospect of losses and are pleased by possible gains:

even faced with sure gain, most investors are risk-averse but faced with sure loss, they become risk-takers. Thus, according to Khaneman, investors are “loss aversion”. This “loss aversion” means that people are willing to take more risks to avoid losses than to realize gains. Loss aversion describes the basic concept that, although the average investors carry an optimism bias toward their forecasts (―this stock is sure to go up‖), they are less willing to lose money than they are to gain.

“Regret theory” (Larrick, Boles, 1995) is another theory that deals with people’s emotional reaction to having made an error of judgment. For example, investors may avoid selling stocks that have decreased in value to avoid the regret of having made a bad investment or embarrassment of reporting a loss. The embarrassment may also contribute to the tendency not to sell losing investments.

Some researchers theorize that investors follow the crowd and conventional wisdom to avoid the possibility of feeling regret in the event that their decisions prove to be incorrect. Many investors find it easier to buy a popular stock and rationalize it going down since everyone else owned it and thought so highly of it. Buying a stock with a bad image is harder to rationalize if it goes down.

Anchoring (Yates, 1990) is a phenomenon in which in the absence of better information, investors assume current prices are about right. In a bull market, for example, each new high is ‘anchored’ by its closeness to the last record, and more distant history increasingly becomes an irrelevance. People tend to give too much weight to recent experience, extrapolating recent trends that are often at odds with long-run averages and probabilities.

Market over-or under-reaction (DeBondt and Thaler, 1985) is the consequence of investors putting too much weight on recent news at the expense of other data. People show overconfidence. They tend to become more optimistic when the market goes up and more pessimistic when the market goes down. Hence, prices fall too much on bad environment.
Most investors think they can beat the market although evidence is overwhelming that they
cannot. Based on the study done by Kahneman and Odeon (1999) on the behavior of buying
and selling stock, they found that when an investor sells a stock and immediately buys
another, the stock that is sold does better in the following year, by 3.4% on average. They
also pointed out that people are prone to “cognitive illusions”, like becoming rich and
famous or being able to get out of the market before a bubble breaks. People exaggerate the
element of skill and deny the role of chance in their decision making process. People are
often unaware of the risk they take. Add loss aversion to the mix and it is no wonder the
average investor panics in a market downturn, a time perhaps to buy rather than sell.

Table 3.9 Classification of investment Products

<table>
<thead>
<tr>
<th>Mode of investments</th>
<th>Classification</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment in Cash, Savings Bank Account, Bank/Postal</td>
<td>Clearly safe financial assets</td>
</tr>
<tr>
<td>Deposits &lt; 1 year</td>
<td></td>
</tr>
<tr>
<td>Investment in Bank Deposits more than one year</td>
<td>Clearly safe financial assets</td>
</tr>
<tr>
<td>Investment in Postal Saving Schemes(POMIS, TDs, RDs)</td>
<td>Clearly safe financial assets</td>
</tr>
<tr>
<td>Investment in NSS, NSC, IVP, KVP</td>
<td>Clearly safe financial assets</td>
</tr>
<tr>
<td>Investment in PPF</td>
<td>Clearly safe financial assets</td>
</tr>
<tr>
<td>Investment in Money Market Mutual Funds</td>
<td>Fairly safe financial assets</td>
</tr>
<tr>
<td>Investment in Infrastructure/ RBI Bond</td>
<td>Clearly safe financial assets</td>
</tr>
<tr>
<td>Investment in PF/ EPF Contribution</td>
<td>Clearly safe financial assets</td>
</tr>
<tr>
<td>Investment in life Insurance</td>
<td>Fairly safe financial assets</td>
</tr>
<tr>
<td>Investment in Capital Market mutual Funds</td>
<td>Risky financial assets</td>
</tr>
<tr>
<td>Investment in Shares</td>
<td>Risky financial assets</td>
</tr>
<tr>
<td>Investment in Corporate Bonds</td>
<td>Risky financial assets</td>
</tr>
<tr>
<td>Investment in Gold and Silver</td>
<td>Fairly safe financial assets</td>
</tr>
<tr>
<td>Investment in Residential House</td>
<td>Fairly safe financial assets</td>
</tr>
<tr>
<td>Investment in Land, Secondary House</td>
<td>Fairly safe financial assets</td>
</tr>
</tbody>
</table>
3.3.14 Different views of consumer decision making

❖ Economic Man
The theoretical economics portrays a world of perfect competition and marks the consumer as ‘economic man’, one who takes rational decisions. This view is criticized by consumer researchers for various reasons. The major criticism of this view is that the consumer to act rationally requires a complete knowledge of market including all available product alternatives, knowledge to rank each alternative in terms of benefits and costs and rank the best alternative. However, in reality, consumers rarely have enough information, or sufficiently accurate information, or even an adequate degree of involvement or motivation to make perfect decisions.

The major limitations of economic man can be listed as the following. The man has limitations in his skills, habits and reflexes, he is limited by existing values and goals, and he is limited by the extent of his knowledge. Consumers operate in an imperfect world, one in which they do not maximize their decisions in terms of such economic considerations as price-quantity relationships, marginal utility, or indifference curves.

❖ Passive Man
The passive man is basically submissive to the self-serving interests and promotional efforts of marketers. The image of man implied in advertising is one of a passive person who is vulnerable to external and internal stimuli leading to spending. The unconscious become the vehicle for directing economic behavior. A prototype of a passive man is the dissatisfied, restless housewife who visits the supermarket, lets herself titillated by the exhibited goods, and spontaneously, without clear-cut wants and purpose, succumbs to the lure of salesmanship and buys something she does not really need and will later regret having bought them. This view is rejected as unrealistic as the consumer is not so passive but plays a dominant role in the purchase decision.

❖ Cognitive Man
This view says that the man as a problem solver. Man always focuses on the information about selected brands and retail outlets as a choice involves risk. He uses the information about alternatives to avoid risks like functional risk, economic risk, physical risk, social risk, psychological risk, and time risk. The consumer also patronize the retailer and shows loyalty to a particular brand which gave him some satisfaction in an earlier purchase. Thus
the strategies adopted by the consumer makes him a problem solver or a cognitive man who learns from the past behaviours and applies strategies to avoid further risks associated with his purchase decisions. Thus the consumers become information processing systems which thereby create preferences and purchase intentions. This view is somewhere in between the positions of economic man and passive man. Though the consumer is seeking information to process, he may not be able to collect all the information or he may drop the effort to collect information as he is already loaded with plenty of information. A cognitive man represents the educated and involved consumer.

❖ Emotional Man

This view says that the consumers take their decisions driven by emotions rather than carefully searching, deliberating and evaluating alternatives before buying. The emphasis is not on information but the mood and feelings. This does not imply that an emotional decision is irrational. This particular face of man is utilised by the producers and marketers of products like liquor, tobacco, perfumes, and greeting cards. The advertisers are recognizing the renewed importance of emotional or feeling-oriented advertising. This view is a departure from all other views about the consumer decision making.

❖ Consumer and Needs

The very act of consumption is the result of the need for it. Every individual has needs which are very closely intertwined to their lives. Some of the needs are instinctive and some other are acquired needs. The instinctive needs are physiological or biogenic like the needs for food, for water, for air, for clothing, for shelter and for sex. It is very explicit that these needs are to sustain biological life hence called as primary needs or motives. The acquired needs are those needs we learn in response to our culture or environment. These needs include the needs for esteem, for prestige, for affection, for power, and for learning. These needs are psychogenic in general and they are considered as secondary needs or motives. They result from the consumer’s or individual’s subjective psychological state and from relationship with others. A dwelling place would be sufficient as a shelter for a person which meets his primary need. But when he decides to opt for a bigger house to live in where he can entertain large groups of people to fulfill his social needs, then he is addressing his psychogenic need rather than biogenic need. If this big house is in an
exclusive location to impress his friends and family then he is addressing his ego need which is also psychogenic.

The characteristic theory of demand also says that the consumer is not consuming the product but the features of it. Joan Robinson also mentioned the advertisement elasticity of the products.

A simple model\(^3\) of motivation process

All behavior is goal oriented and goals are sought-after results of a motivated behaviour. Consumers’ unfulfilled needs, wants and desires leads to tension. This tension will create positive and negative motivations so as to get a benefit or to avoid a cost. When tension is experienced they try to learn about the situation and how to solve it. This is a cognitive process which results in a behaviour which is expressed through a decision which will ultimately the fulfilment of the goal.

Goal Selection

Consumers are careful in the selection of goals to fulfill. The goals selected by the individuals depend on their personal experiences, physical capacity, prevailing cultural norms and values, and the goal’s accessibility in the physical and social environment. The individual’s own perception of himself also determines the specific goals. The product a person owns, would like to own, or would not like to own are often perceived in terms of how closely they reflect the person’s self-image. A product that is perceived as fitting an individual’s self-image has a greater probability of being selected than other. For e.g., a man
who perceives himself as young and smart may drive a Toyota Corolla or a woman who perceives herself as rich and conservative may drive a Mercedes Benz. The types of houses people live in, the cars they drive, the clothes they wear, the gadgets they use, the food and beverages they eat—these specific goal-objects are often chosen because symbolically they reflect the individual’s self-image while they satisfy specific needs.

The researcher assumes that the role of promotion tools, as detailed in the introduction chapter, is high in molding the behavior. The promotion triggers the cultural change. The culture and practices decides the level of needs. A person in a purely rural background may not think about the urban lavishness in the personal care and personal supportive gadgets. In addition, the food habits, the clothing, etc all are to the minimum or stands at the utility level than an exhibition of one’s social standing and the diversity may not be present. The tastes for the change are imbibed by the act of continuous influence by the media. As Penrose (Penrose, 2005) rightly noted in his Book, Shadows of the Mind, the consciousness is a flow like a river. It is only a pattern which can be changed if the intervention is proper.

❖ Interdependence of Needs and Goals

Needs and goals are interdependent. People may not be aware of their needs but aware of their goals. Needs gets built into the goals in the subconscious mind. Motivation is the driving force which gives direction to the consumer in the journey towards the fulfilment of the goals. The positive drives are called as needs, wants and desires and the negative drives or motivations are called fears and aversions (Schiffman and Kanuk, 1990). Goals are also positive and negative. The goal to which is behaviour is directed is a positive goal or approach object. The goal from which behaviour is directed away is a negative goal or avoidance object. However, both the goals are motivated behaviour for the fulfilment of needs, wants and desires. When allopathic medicines were not highly prevalent people resorted to traditional or indigenous medicines and practices. However, the information and knowledge about the allopathic or modern practice gives the awareness that there is something more to be explored. They started spending beyond their limits which gave a steep boom in the allopathic medical system and the corollary, the modern pharmaceutical industry.
What created this? The only possible answer is the spread of information through media. It is astonishing that people are blind in the belief and trust in allopathic medical practice, though they cannot even comprehend the science behind it.

**3.3.15 Role of Promotion Tools in Financial Decision Making**

Generally, promotion is communicating with the public in an attempt to create awareness and persuade them toward buying products and/or services. The word promotion is also used specifically to refer to a particular activity that is intended to promote the business, product or service. A store might advertise that it's having a big promotion on certain items, for instance, or a business person may refer to an ad as a promotion.

Promotion means a method is used for getting people to create awareness among people about products or services being offered by the company. Advertising, public relations, point-of-sale displays, and word-of-mouth promotion are all traditional ways for promotion. Promotion is the method for providing the link of information between the seller and prospects of the products or services. The choice of a promotional strategy will be dependent upon objectives, type of offers, budget, and availability of said promotional vehicle. The other concept used for promotion is called marketing communication. When any communication is given in the market with the help of any media is called marketing communication. The requirement of promotional activities in the market is increasing with increasing competition level. In past, the need for promotional efforts was not there at all. The demand for promotional efforts increased slowly and in present time without promotional efforts the business cannot be carried out effectively as per plans of the company. Especially care is to be taken. In some of the leading companies there are difference sections taking care of different tools for promotion separately. Further, the role of promotion relating activities would be increased. The importance of promotion would be very high in near future in the global scenario.

Promotion relating to products, services, branding and other activities undertaken by the company is needed. The different teams are involved. So there is need for coordination among different teams, sections, divisions, departments and locations of the company. The coordination is needed horizontally at same level, vertically from corporate plan to departmental plans, internal within the teams or departments, external with advertising and public relation agencies. The efforts for promotion purpose are to be integrated so that the
efforts would be in the right direction to achieve the objectively very efficiently and effectively. Integration of all marketing tools, approaches, and resources within a company that maximizes impact on consumer mind and which results into maximum profit at minimum cost. Generally marketing starts from "Marketing Mix".

Promotion is one element of marketing mix. Promotional activities include different promotional tools like advertising, personal selling, publicity, and sales promotion. It also includes the new tool those developed with the changing time like internet marketing, sponsorship marketing, direct marketing, database marketing and public relations. Relating to product life cycle of products or service or company an integration of all elements of marketing mix is needed get the competitive edge over other competitors is needed.

- Promotion is defined as marketing activities usually specific to a time period, place or customer group, which encourage a direct response from consumer or marketing intermediaries, through the offer of additional benefits. (Peattie & Peattie 1994a)
- Consumer Behavior refers to the cognitive process that consumers go through prior to a transaction decision. (American Marketing Association 2008)
- Consumer Decision Making refers to the process of selecting from several products or services. (American Marketing Association 2008)
- Financial Products refer to a wide array of financial instruments offered by banks, financial companies and insurance companies.

3.3.16 Promotion of Financial Services Products

Promotion is the direct way an organization tries to reach its publics. This is performed through the five elements of the promotion mix, i.e. advertising, sales promotion, personal selling, public relations, and direct marketing. (Czinkota & Ronkainen, 2004) With the growing importance of the financial sector, pressures are escalating for more effective marketing management of the financial services. Despite the recent recessions, the financial services sector is continuing to grow in terms of turnover and profits and thus, has a supreme impact on the other spheres of the economy. Consequently, there is currently growing interest in applying marketing techniques and tools in financial services. (Meidan, 1996)

In spite of major changes on the market of financial institutions, there are indications that banks have not yet successfully embraced the marketing philosophy or achieved levels of its
implementation consistent with satisfied customers. Financial institutions are realizing that their established promotion practices are inadequate for new market conditions as levels of customer defection in the sector grow.

Traditionally, banks have tried to reach out to everyone in the community, but recent research proposes that banks should aim to identify and serve micro-segments (Dawes & Brown, 2000). The role of promotion has been redefined into managing long-term relationships with carefully selected customers, including construction of a learning relationship where the marketer maintains a dialogue with an individual customer (Dawes & Brown, 2000). Due to this fact, the personnel are one of the most important resources of a bank. Their competence will determine the quality of the bank and how well it operates. (Marquardt, 1994)

3.3.17 Characteristics of Financial Services products

In the literature, services are distinguished from goods by their unique characteristics, which are intangibility, inseparability, perishability and heterogeneity (Harrison 2000, 50; Howcroft et al. 2003). McKechnie (1992) adds two characteristics that are common to financial services; fiduciary responsibility and two-way information flow. Beckett (2000) includes three additional characteristics that distinguish financial services. These are transparency of performance, uncertainty of outcome and poor comparability. It is widely accepted fact, in the literature, that goods are different from services. However, goods and services cannot be seen as polar extremes to one another and even within services there are variations. Only in the branch of financial services a great variety can be found in the differences of characteristics. Thus, while the characteristics are widely accepted, one must still bear in mind that exceptions to the general rules do exist. However, the service characteristics are an important beginning point for the analysis of services (Harrison 2000, 50).

Intangibility of services is possibly the single most crucial characteristic that set services apart from goods. Services cannot be possessed and are impalpable in nature. Thus, services are difficult to grasp mentally and therefore difficult for consumers to evaluate. (McKechnie 1992, 4) Due to the intangibility, services are low in search qualities, which are tangible attributes and high in experience qualities, which are attributes that can only be assessed after the consumption. Impalpability together with the high rank in experience qualities
make service evaluations, especially pre-purchase evaluations, more difficult than evaluations of goods. (Harrison 2000, 50; Howcroft et al. 2003)

The intangibility makes consumers look for other signals of service quality. They tend to concentrate and make evaluations based on available tangible elements such as the place, people, price and communication. Therefore, service providers should make their offering tangible in some way to give signals about quality. (Kotler 2006, 257) However, not all the services are solely intangible and all the goods tangible. Services can also include physical aspects such as credit cards, account statements and other physical cues that make judgment and evaluation of services easier. (Harrison 2000; Shostack 1977)

Inseparability means that services are produced and consumed simultaneously. Thus, they can be seen as processes or experiences that cannot be separated from the producer. The presence of both the producer and the customer makes services interactive in nature. (Kotler 2006, 259) McGoldrick & Greenland (1992) question the applicability of inseparability and state that it only applies to a few financial services. They argue that it is questionable at which point for example an insurance policy is consumed.

Perishability is the outcome of simultaneous production and consumption. It follows that service providers are unable to build and maintain stock. For a service marketer this highlights a problem of smoothing demand, where demand is adjusted according to its fluctuations. (Harrison 2000, 52) According to Grönroos (1990) the inseparability of production and consumption also make the tasks of production and marketing more interactive.

Heterogeneity of services means that there is variability in quality. It varies depending on who is the provider as well as when, where and how the service is produced (Kotler 2006, 259). Quality of service experience is also heavily dependent on personal interactions between the buyer and the seller (McKechnie 1992, 5) Fiduciary responsibility is a characteristic peculiar to financial services. It is the implicit responsibility that a financial service organization has over customers. Customers must also be able to rely on the financial advices given by the organization. (Harrison 2000, 52). In the exchange of financial services, customers are essentially buying a set of promises over their financial well being. Thus, confidence and trust are in a key role for customers. Both trust and confidence are established only after experience. Thus, consumers must first rely on
personal sources of information and to such factors as brand image, the size and familiarity of a given financial organization to make evaluations. Complex establishment of trust can also create inertia in a customer supplier relationship. Since a lot of effort and time is required from a customer to start trusting the company, it is usually the case that once satisfied, a customer is also likely to remain with the organization. Therefore, relationship building becomes a key to any financial service organization. (McKechnie 1992, 5)

Two-way information flow refers to the fact that financial services are rarely one-off purchases. Instead, they usually involve various two-way transactions over a long period of time, such as the use of a credit card and saving and borrowing. (Harrison 2000, 52) Two-way information flow opens tremendous opportunities for financial services organization to the collection of customer information that could be used to enhance organization's relationship building capabilities. (McKechnie 1992, 5)

Transparency of performance refers to the availability of information and to consumers' ability to make evaluations based on that information. Due to the varying degree of performance transparency, consumers might have difficulties in understanding and identifying the outcomes of financial services. Some of the services are more transparent than others. For example, information about credit cards and savings accounts is easily available and performance is fairly simple to interpret, whereas the available information and performance evaluations of investment funds might prove difficult. (Beckett 2000, 198)

Uncertainty of outcome refers to the role of services in giving consumers control over the uncertain external environment. Some financial services are designed to increase consumers' control and thus make life easier by giving certain promises for the future. Examples of these are money transmissions, bank accounts, credit cards and such. However, some financial services, such as investments, expose consumers to uncertainty and are problematic for consumers to evaluate. When buying these kinds of services consumers are in fact buying a set of promises regarding future. (Beckett 2000, 198)

Some financial services are characterized by poor comparability. Product and service comparisons are an important stage in consumers' decision process. Some financial services have more identifiable attributes and benefits, and thus are more comparable. Long-term maturity in addition to uncertainty make service comparisons of many financial services difficult. (Beckett 2000, 199)
Most of the services characteristics influence to the fact that services are more difficult for consumers to evaluate than goods are and evaluations of many financial services are even more difficult. Among financial services there is, however, variation in difficulty (Howcroft et al. 2003).

Howcroft et al. (2003) identify five consumer behavior and decision-making implications that are due service characteristics.

- First, during the information search consumers rely much more on personal sources, such as the Recommendations of friends and family.
- Second, in service evaluations, consumers rely on a limited number of quality cues, of which the majority is related to the price and the physical aspects of the service offering.
- Third, in a face of many alternatives, consumers might just pick out the first acceptable offering instead of maximizing satisfaction by evaluating all the different options.
- Fourth, due to the intangibility, consumers perceive greater risk while purchasing services and especially financial services.
- Finally, because of the greater risks, consumers tend to rely more on brand loyalty and achieve toward a relationship with the service organization.

Howcroft et al. (2003) also identify two implications that are especially true for financial services. First, because customers are buying a set of promises when acquiring financial services, they might experience difficulties in buying highly intangible services such as many financial services are. Second, because of the complexity of many financial services and the fact that financial services are low in search qualities, evaluation of them is even more complicated.

Given that services are difficult for consumers to evaluate and variation among services exists, some classification of financial services is required to better conceptualize and understand financial consumers Behavior. An example of such a classification is the one provided by Devlin (1998). In his research, he states that differences among financial services could be examined in terms of the value added between simple and complex financial services:
Simple services are those where, on average, customers will exhibit a reasonable understanding of product features and associated benefits and will be able to perform satisfactory pre-purchase evaluation of the service. Such services are likely to be of low risk in nature. (Devlin 1998, 1108)

Complex services are those which, on average, customers will find confusing and complicated with a resultant lack of understanding of features and benefits being apparent. Pre-purchase evaluation will also prove difficult. Such services are likely to be of a medium to high risk nature. (Devlin 1998, 1108)

According to Devlin (1998) price is more important in adding value to service offering in simple service category, whereas image and reputation proved to be more important in the category of complex services.

Beckett (2000) introduces another classification of financial services by dividing financial services broadly into general and investment instruments. General instruments have little outcome uncertainty and satisfy only low level psychological needs. Investment instruments, however, have a lot of outcome uncertainty and are used to satisfy high level psychological needs. General instruments, which have clear outcomes, can be evaluated more easily and information about these is also easily available. Therefore consumers can act on the available information and make the outcome more predictable. Investment instruments are more uncertain for consumers and thus, decision making is more difficult. There is also less information about investment instruments and the available information is difficult for consumer to evaluate. (Beckett 2000, 201)

3.3.18 Financial Products Decision Making

The consumer purchase decision theories can be broadly classified into three paradigms; the cognitive approach, the reinforcement approach and the habit/behavioral approach (East 1997, 7). The cognitive approach of consumer decision making emphasizes a rational consumer and views purchasing as a problem-solving activity. When faced with a purchase decision, a consumer moves through a series of stages in order to solve a problem. The foundations of the approach lie in the model by Simon (1957), in which consumers pass through the stages of problem identification, information gathering and choice selection. (Harrison et al. 2006, 7) Simon’s model (1957) is later developed by many researchers, such as (Howard & Sheth 1969; Engel et al. 1968).
One of the most frequently applied models is the one by Engel, Kollat & Blackwell, in where consumer decision-making is divided into the five interlinked phases of problem recognition, information search, evaluation of alternatives, purchase decision and post purchase evaluations. (Harrison 2003, 6) In the context of financial services, Gabbott & Hogg (1998) and Harrison (2000) use a variation of the Engel-Kollat-Blackwell model. In their analysis, the consumer decision-making is divided into pre-purchase information search, evaluation of alternatives and post-purchase evaluation (Harrison 2000). Cognitive approach was also developed by Ajzen & Fishbein (1980) in their attitude and behavior predicting research.

The cognitive approach has also been challenged by other research traditions. The reinforcement approach on the one hand gives critique to the aspects of rationality and the over weighted value of information in consumer decision-making. Instead, reinforcement approach argues that, in some cases, consumers might not engage into information processing at all. The favors of this tradition state that instead of information and rationality, experience and learning are the driving forces of consumer purchase decisions. The behavioral approach on the other hand highlights the habitual buying behavior, which remain relatively stable over time. Despite the critique, the cognitive approach still provides a good starting point and a framework to begin within the analysis of consumer behavior. (East 1997, 13; Harrison et al. 2006, 7-8)

Prior to any purchase decision, consumers engage to pre-purchase information search. Consumers main sources of information can broadly be categorized in internal and external sources. The search of internal sources is based on a scan of memory and it is based on the previous experience. Because internal sources are one’s own experiences they are regarded as very reliable. In a situation where internal sources are not available or are insufficient, consumers lean on to external sources of information. (Gabbott & Hogg 1994, 314-315)

External sources can either be personal or non-personal. Personal sources such as friend recommendations and word-of-mouth are regarded more reliable as the ones of non-personal like advertising or non-marketing material. Factors such as product category experience, product complexity and the degree of buyer uncertainty have an effect on the degree of the use of external sources. Thus, in the case of complex services, consumers tend
to rely, in addition to internal sources, more to external sources in order to decrease uncertainty. (Harrison 2000, 58)

The effectiveness of available external information is dependent on the nature of the service. Services also tend to have more experience qualities than search qualities, and thus are more difficult for customers to evaluate prior to purchase. (Gabbott & Hogg 1994, 315) Evaluation of alternatives follows information search. Based on the information consumers have gathered they develop an evoked set of alternatives. Because of the difficulties in obtaining relevant information about services, the evoked set in services is smaller than in products. (Harrison 2000, 59) If a consumer has positive prior experience about the service, the evoked set might be just that one service. If consumer does not have any prior experiences or have limited or negative experiences, then the size of the evoked set is dependent on the effectiveness of the external information. If information is easily available and reliable the evoked set is larger and vice versa.

(Gabbott & Hogg 1994, 316) In addition, due to intangibility, services cannot be compared side to side and also the lack of physical attributes makes quality assessments harder. Thus, consumers must rely on peripheral cues such as physical facilities and brand image, to make about the level of service quality. Research on financial services has discovered that in the case of very complex services consumers tend to remain loyal after they have discovered a service that meet their requirements. It is argued in the later research that in complex services, consumers remain loyal more likely because of inertia instead of true brand loyalty. (Harrison 2000, 60-61)

In the post-purchase evaluation stage, consumers build experience and knowledge about the service and make evaluation whether the service has fulfilled their expectations. Consumers have a predetermined standard against which to compare the outcome. (Gabbot & Hogg 1994, 317) For many financial services, evaluation process can be difficult because consumer might not have clear expectations or they just don’t have enough knowledge to evaluate what they have received. On contrary, post-purchase evaluations of simple services can be very straightforward. For example, payment by a credit card fulfills customer requirements if it is just accepted. Also, participation in the service production process has an effect on evaluation process. Participating consumers might feel partially responsible for the success or failure of the outcome. (Harrison 2000, 61-62)
Consumer decision-making process is adjusted according to the complexity of the purchased service. Decision making in more complex offerings include more information search and evaluation than decisions in simple offerings and thus process lasts longer. In an extreme situation, consumer can even feel that the service is too complicated and decides not to purchase at all. On contrary, decision making in simple services can be very straightforward. When a need is actualized, consumer might move straight to buying without searching information or evaluating alternatives. In these situations, consumer just buys the service that is familiar or reaches in for a competing service. (Kotler 2006, 157)

3.4.1 Promotion Tools for financial product
3.4.2 Meaning of Promotion

The concept of promotion has been defined by experts as follows:
(a) Promotion is defined as the coordination of all seller-initiated efforts to set up channels of information and persuasion to sell goods and services or promote an idea. Promotion is best viewed as the communication function of marketing. In short we can say that the strategy to get hike and to create awareness.
(b) It is not enough for a business to have good products sold at attractive prices. To generate sales and profits, the benefits of products have to be communicated to customers. In marketing, this is commonly known as "promotion".
(c) Promotional marketing is a business marketing strategy designed to stimulate a customer to take action towards a buying decision. Promotional marketing is a technique that includes various incentives to buy such as advertising, sales promotion, personal selling, publicity and packaging.
(d) Promotion, as a general term, includes all the ways available to make a product and/or service known to and purchased by customers and clients. The word promotion is also used
specifically to refer to a particular activity that is intended to promote the business, product or service.

 Promotion Mix

For selling the products or service the marketing department is using a number of methods. The objective is to create awareness, remind the customers to persuade and buy the products. The company is interested to increase the sales and profits of the company in the markets. The markets may be different for different products and service.

3.4.3 The Promotion for financial Services

Promotion is according to Brassington & Pettitt (2000) the direct way in which an organization communicates the product or service to its target audiences. Within the financial services industry, promotion is used in many different ways (Meidan, 1996).

Brassington & Pettitt (2000) has categorized the promotional tools into five main elements;

 Advertising
 Sales Promotion
 Public Relation
 Direct Marketing
 Personal Selling

(a) Advertising

Brassington & Pettitt (2000) define advertising as any paid form of non-personal communication directed towards target audiences and transmitted through various mass media in order to promote and present a product, service or idea. The key difference between advertising and the other promotional tools is that it is impersonal and communicates with large numbers of people through paid media channels. (ibid)

Meidan (1996) states, that a financial services organization can use its advertising for either its short-term or its long-term objectives. A bank attempting to generate a long-term build-up of its name would use institutional advertising, while a bank interested in promoting its brand name and its different services would use a brand advertising policy. (ibid)

Meidan (1996) further states that the institutional advertising consists of promotion of the firm’s image as a whole, and promotion of the products offered, with extra emphasis on the specific firm’s name organization. The organization seeks through its marketing
communications, to build awareness and to impress customers looking for the best range of financial services. Due to the former impression of banks as impersonal institutions with no interest in their customers as people, and of financial services as abstract and quite similar, the institutional advertising has become more and more important. Brand advertising follows closely in the footsteps of institutional advertising. Its purpose is to create awareness of the bank’s name and to advertise the different services it is offering. Since financial firms are serving a mass of people, the problems of brand advertising are to know who to advertise to, and how to advertise. While institutional advertising is directed towards the whole population, the brand advertising of particular products has to be much more selective, since it has to show that the consumer will benefit from the service. Furthermore, all the individual campaigns of brand advertising have to be compatible in tone and presentation, and match the image the bank has created through its institutional advertising. (ibid)

Mortimer (2001) states that an important part of advertising is to make the service tangible in the mind of the consumer in order to reduce perceived risk and provide a clear idea of what the service comprises. Furthermore, she considers it important to advertise consistently, with a clear brand image, in order to achieve differentiation and encourage word-of-mouth communication (ibid).

According to Meidan (1996), there are two types of advertising channels appropriate for financial advertising. That is — above-the-line” and — under-the-line” advertising. Above-the-line advertising contains different channels of communication, such as television, radio, posters, magazines and newspapers. Under-the-line advertising constitutes a huge part of a financial organization’s advertising activities. It is the invisible advertising of the bank’s services, including leaflets, pamphlets, explanatory guides and manuals that can be used to support selling of a specific service. It is hard to draw a definite distinction between under-the-line advertising and sales promotion. Under-the-line advertising is very easy and cheap to produce, but it must be used discreetly. Furthermore, this kind of advertising does not attract new customers, and it is depending on personal selling for its effectiveness. (ibid)

Advertising is a one method of presenting message to persuade an audience to purchase or take some action upon products, ideals, or services. Any paid form of non-personal presentation of ideas about products or services in the media by and identified sponsor. The advertisement is given by using the brand name of the products or services and their
benefits to users are highlighted. The media used for communication includes television radio, newspapers, magazines, billboard posters, periodicals, cinema etc. In one effort through advertisement the message reaches to a large number of customers or audience. Advertising is intended to persuade and to inform. In advertisement by the identified sponsor the message is designed and given to media for further communication. The sponsor may be company, dealers, or jointly given the company and dealers. For advertisement a huge amount is spent in a year. High cost is involved in advertising because the advertisements are given in different media and repeatedly. The message given in an advertisement is non personal. It is not related to any individual but it is related to the company, products or services. Advertising can be used for commercial and non commercial purposes depending upon the planning of the sponsors. The advertising was not used in the past much but it developed with mass production of products and increasing competition. To achieve the targets of the company nowadays it has been used mainly. No doubts it is also used for non commercial purposes also like political, social, religious etc. It can be placed by the company or advertising agency on behalf of the company.

(i) Objectives of advertising: Main objective of advertising are following:

- The advertisements are placed in the media targeting the audience mainly the prospects or customers with the objectives to communicate them. When a new advertisement is placed regarding the company has launched first time and customers do not know about this. The objective is to create awareness among them. It is through advertisement they would come to know.
- If the customers know then they can be reminded for the existing products or service so that they should not forget the products and services of the company.
- After repeated advertisement, the objective is to persuade them to take buying decision. The customers have to think when it is reminded repeatedly. One day they have to go for it whenever they are in need of such products of services.
- For existing customers, the further objective of advertisement is to retain them in future also. They should not think to change over to the new products of other companies. They are kept informed regarding the new features and benefits of the products time to time.
(ii) **Advantages:** The major advantages of advertising are following:

- Cost-effective with large audiences are covered in one effort on media. It reached to a large number of audiences through television, radio, newspaper etc. The amount spent in one advertisement is high but the cost calculated per head per advertisement is less.

- The coverage by the mass media is very wide. If we take example of one advertisement placed on national radio, in one attempt it covers the whole territory of India. It covers all direction, urban, sub urban and rural area. The coverage is very wide through advertisement.

- Effective method of presentation of ideas about the products or services through audio video feature. With both audio and video the message can be explained with very high degree of clarity. The objective of communication is served properly.

- It has the ability to create images and symbolic appeals to the target audience. It can be related to certain situations to explain the message effectively so image can be created in mind of audience.

- In advertisement the message is placed by the company or advertising agency on behalf of the company. Whenever they want to review the message it can be done easily. They have proper control over the message in advertising.

(iii) **Disadvantages:** There are many advantages of advertising but it does not mean that it does not have its limitations or disadvantages. The disadvantages of advertising are following:

- Costly, particularly television: When the cost per audience is calculated with radio, it is higher side. For repeated advertisements the budget for advertising is very high. Some of the medium companies may not like to go for this type of advertisements.

- Difficult to determine effectiveness: The advertisements are placed in different media for audience. On this a huge amount is spent but it has become difficult to measure the effectiveness that how much is the effect on sales, customers perception etc.

- Alone advertisement cannot sell the products to the customers without supply of products to the customers or dealers. It cannot work alone.
It is bit difficult to trust because many times false advertisements are given by the unidentified sponsors. The false claims are done through advertisement and that misguide the customers. The credibility of advertising is not very high in the markets. When the critical analysis of advertising is done on the basis of its advantages and disadvantage, then it can be said the advertising is very useful for promoting the products or services of the company in the markets. It can be concluded that despite of its limitations it is needed in the present time of competition.

(b) Sales Promotion

According to Brassington & Pettitt (2000) sales promotion is different tactical marketing techniques with mostly short-term incentives, which are designed to add value to the product or service, in order to achieve specific sales or marketing objectives. Furthermore, Meidan (1996) states that it has two distinctive qualities. Firstly, it provides a —bargain chance—, since many sales promotion tools have an attention-gaining quality that communicates an offer that will not be available again to purchase something special. The disadvantage, however, is that although they appeal to a wide range of buyers, many customers tend to be less brand loyal in the long run. Secondly, if sales promotions are used too frequently and carelessly, it could lead to insecure customers, wondering whether the service is reliable or reasonably priced. (ibid)

Meidan (1996) indicates that due to the conflicting ideas concerning the benefits of sales promotions, a financial service organization must base its decisions upon relevance and usefulness of sales promotion, as well as cost-effectiveness.

Peatti & Peatti (1994) claim that normally, coupons, special offers and other forms of price manipulation are the dominant forms of sales promotion. However, price-based promotions are difficult and probably dangerous to use for financial service markets. This due to the fact that the price setting of a financial service is already a difficult process, and that consumers often see lower prices as a result of lower quality. (ibid)

However, Meidan (1996) states that sales promotion within financial services appears to be most effectively used in combination with advertising. The primary objectives with sales promotion within financial services are to attract new customers; to increase the level of deposit accounts, thereby increasing the banks share of savings; to increase market share in
selected market segments; and to lower the cost of acquiring new customers by seeking to
avoid direct price competition with other financial institutions. (ibid)
Sales promotion is one of the promotional mixes other than advertising, publicity/public
relations and personal selling. The efforts are put to increase the sales by motivating
everyone whoever in involved in the sales of the products. The major parties involved in the
sales are salesmen, dealers and customers. The sales promotion efforts are targeting them to
stimulate them to buy through different incentives or benefits. The objective of promotional
efforts is short term. When the company is interested to increase the sales of the products or
services the different methods are being used. When efforts are there other then advertising
and personal selling is called sales promotion. Marketing efforts through which the targeted
parties are stimulated to buy the products for extra value or incentive. These efforts can be
targeted to salesmen, customers and dealers to increase sales in short term. The sales
promotion activities can be divided as customer oriented, trader oriented and sales force
oriented. Through sales promotion tool the extra benefits are provided to the targeted group
so that they can be stimulated to buy the products and increase the sales and profits of the
company.

The parties involved in sales promotion are customers, salesmen and traders of different
types. They play different roles in sales. The customers are the end users and efforts are put
to persuade them to buy and use the products for them or their family members. They are to
be motivated by providing extra benefits so that the relative worth of their money is
increased. The second party is sales force. They need to be motivated so that they put their
best efforts so they provide proper link between company and traders and customers and
company. Timely information, support and supply of products are maintained so that the
sales can be increased. When the products are sold through dealers they are needed to be
motivated. When they get motivation then only they would sell the products of the
company. All these parties are needed to give their best output. For their motivation purpose
sales promotion is used. The different promotional tools are used separately for all parties.
One method is not suitable for all the concerned parties. The promotional tools are separate
for customers, dealers and salesmen.

(i) Objectives of sales promotion: Following are the objectives:
- **To introduce new products:** When the company is interested to introduce the new product in the market the sales promotion method like samples is used. The free samples of the products are given to the parties for introduction of the product. If the sample is liked by the customer then the product can be bought in future.

- **To attract new customers and retain the existing ones:** Sales promotion measures are used with the objectives to attract new customers and retain the existing one by providing extra benefits. The customers are attracted towards the products that offers price off, discount, gift, premium prize, etc on buying. There are many methods of promotion being used in market so that the existing customers can be retained and new can be added to the list of customers.

- **To Increase sales of seasonal products:** There are some products like woolen clothes, rainwear, air conditioner, fan, refrigerator, cooler, room heater, sunscreen lotion, etc. , these are used by the customers in particular season only. The demand of these products is not there is their off season. So the increase the sales of such products the sales promotion works wonderful. The customers are provided more and additional benefits to motivate the customers for buying. Thus the sales of seasonal products increase.

- **To neutralize the competition effect:** Nowadays the market situation is very competitive. It is very difficult to increase the sale of the product because every competitor is trying hard to increase the sales. Through sales promotion the extra benefits motivate the customers to buy the products. So to neutralize the competition effect the company has to bring sales promotion scheme. If not the products of the other companies would be sold out more. The company may lose the opportunity for selling more would be lost.

- **To push the sales of slow moving products:** Some of the products are not in demand due to their old design, features or out of fashion. Such products are not moving and they are lying in the stores of the company. To increase the sales of such products the suitable measure for promotion are used. Due to these the sales of slow moving products increase. In this the benefits are given of higher value so that the customers are motivated to buy.
The company is using different types of sales promotional methods so that the objectives can be fulfilled. It is not necessary that at one time all type of methods would be used. For different parties for different objectives the promotional methods used may differ. It depends up to the strategy of the company.

(ii) **Advantages of sales promotion:** The main advantages of sales promotion are following:

- There is very useful for price sensitive customers. It can make good appeal to them. Such customers wait for sales promotion scheme to buy the products.
- Provides extra benefits to the customers through sales promotion schemes and create in customers to buy the products.
- Helps in increasing the sales of the current, seasonal, slow moving, out of use or fashion products.
- Neutralize the competition effects through sales promotion tools.
- The profits and sales of the company are increased with the sales promotion tools time to time.
- The effect of this method is direct and can be measured easily on sales after sales promotion scheme.
- It supports the push strategy of promotion. The products are pushed near to the customers to buy.

(iii) **Disadvantages:** In addition to advantages of sales promotion there are disadvantages also. These are following:

- It is focusing on short-run effect on sale. The sales are to be increased at a particular point of time of promotion efforts.
- The long term gains are sacrificed for short term gains and do not develop the brand image of the products and company in the market.
- It is suitable mainly for price sensitive customers and such customers become habitual to buy when sales incentives are given.
- Sales promotion competition adds costs to the selling budget of the company and profitability goes down.
(c) Personal Selling

Brassington & Pettitt (2000) define personal selling to be a two-way communication tool between a representative of an organization and an individual or group, with the intention to inform, persuade or remind them, or sometimes serve them to take appropriate actions. Furthermore, personal selling is a crucial element in ensuring customers' post-purchase satisfaction, and in building profitable long-term buyer-seller relationship built on trust and understanding (ibid).

Verhallen et al. (1997) state that the increased competition within the fast changing environment of financial services has lead banks to develop and maintain comprehensive relationships with their customers. Furthermore, Julian & Ramaseshan (1994) state that the long-term person-to-person relationship is an important factor for retail bank to achieve a competitive advantage. Meidan (1996) points out that once a customer has chosen its bank, he is unlikely to switch to another. Thus, personal selling is probably the most important element in the communication process within the financial services industry. (ibid) Lee (2002) state that personal selling can be performed either face-to-face or through technological aids such as the Internet.

According to Julian & Ramaseshan (1994) the relationship between the salesperson and the customer is perceived as being of great importance for the marketing of a bank. Hence, the sales force within the financial services industry needs not only to be trained in the art of selling, but also to be aware of all the services available and be able to clearly explain what each service offers. Since customers’ needs and motivation are likely to be complex, and their ability to assess alternate courses of action without professional assistance is likely to be limited, it is of great significance for the sales force to know their customers, as well as their products. (ibid) Verhallen et al. (1997) indicate that banks should see the selling as a problem-solving process in which the sales force engages and co-operates towards the customer, trying to find a solution to the customer's problem, rather than only persuading him to purchase the products or services. In addition, Meidan (1996) claims that it is up to the sales force to enhance the bank’s reputation by looking after its customers.

Personal selling is one of the promotional methods used for increasing the sales of the products or services. In personal selling the salesmen of the company personally meet the customers, dealers relating to sales.
They go directly to the concerned parties when the nature of the product is such that it cannot be distributed through wholesalers, retailers etc. The need for salesmen is felt depending upon the nature of the products, distribution network and policy of the company. In personal selling there is personal presentation by the firm’s sales force for the purpose of making sales and building customer relationships. Personal selling is paid personal communication that attempts to inform customers and persuade them to purchase products or services.

The salesmen approach the customers with all detail information regarding products, company management, features and benefits of the company, knowledge of customers profile, products of competitors and other related information. Before meeting the customers the salesmen prepare the list of prospects, details of prospects, job of salesmen, products features, management detail, company profile, competitor’s products etc. Home work is essential for the salesmen for effective selling. He explains all required information to the customers with the efforts to convince them to buy. If the customers agree then he takes the order from them. Later on follow up action is also done by the salesmen. During discussion when demonstration of the products is required then it is also arranged by the salesmen.

All doubts, fear, anxiety relating to products and company are clarified by the salesmen during his visits to the customers. The task given to the salesmen is very challenging. Most effective tool for creating and building buyers’ preferences, convictions, and actions; through personal interaction between customers and salesmen feedback is possible. This method of promotion is the most expensive of the promotional tools but most effective also.

(i) **Objectives of personal selling:** The major objectives of personal selling are following:

- To create long term customers relationship with the customers. Through feedback, problem handling and assurance the company is interested to long term relationship,
- To meet the requirement of personal presentation through personal selling. When demonstration and doubt clarification are required the best suitable method of sales promotion is personal selling.
- To meet the requirement of industrial or heavy price products sales. This type of products cannot be sold out through dealers, wholesalers or retailers.
(ii) **Advantages:** Sales promotion is one of the methods of promotion and main advantages of it are following:

- Two way communications under personal selling is very effective.
- Face to face communication makes the things very clear and fears, doubts confusions are avoided on the spot.
- Demonstration of products performance is possible in personal selling. This helps in convincing the customers easily to buy the products.
- It gives long term impact on the customers because the assurance is given by the sales men.
- Contributes in developing good relationship and image of the company in markets.

(iii) **Disadvantages:** The disadvantages of personal selling are following:

- The coverage of sales force is very limited because there is involved of individual salesmen. So he can cover a limited number of customers in a time.
- It is a very expensive method of promotion because the cost involved per customer is very high in comparison with other methods of promotion.
- It is only suitable for high price products only and not for low price or FMCG products.
- Heavy budget is needed for personal selling activities. It is not suitable for small and medium size of the companies.

(d) **Public Relation**

According to Brassington & Pettitt (2000) the essence of public relations (PR) is to look after the nature and quality of the relationship between the organization and its different publics, and to create a mutual understanding. PR covers a range of activities, for example the creation and maintenance of corporate identity and image; charitable involvement, such as sponsorship, and community initiatives; media relation for the spreading of good news, as well as for crisis management, such as damage limitation. Moreover, an organization can attend trade exhibitions to create stronger relationships with key suppliers and customers as well as enhancing the organization’s presence and reputation within the market. (ibid)

Meidan, (1996) states that another part of public relations is the publicity gained through magazines. Financial services obtain considerable publicity in so called quality press, such as
different financial journals. In popular newspaper the publicity is, in contrary to the quality press, often negative from the financial firm's point of view. (ibid) Meidan (1996) further claims that the importance of public relations is being increasingly attended, and financial services often have public affairs officers, working actively to generate publicity.

In Public relations the efforts are put to create and maintaining good public image for products or services, businesses of the company, non-profit organizations, celebrities, leaders etc. Public relations is defined as building good relationships with the concerned parties of company out of public so to create good image regarding products, services and business of the company. The public should make positive publicity of the company so that adverse situation can be handled in future.

Public relations convey messages to the target public with the help of the media on behalf of a client, with the objective to influence the opinions and create favorable image for products, services and business of the company. The major parties involved in the public are employees, customers, dealers, bankers, suppliers, consultants and government. The different messages are given focusing on different target segments. Public relations convey messages to the target public with the help of the media on behalf of a client, with the objective to influence the opinions and create favourable image for products, services and business of the company. The major parties involved in the public are employees, customers, dealers, bankers, suppliers, consultants and government. The different messages are given focusing on different target segments. It is very effective when it is supporting the goal of the organization. It is viewed as a strategic management function.

Publicity is one of the elements of promotional mix. The other components of promotions are advertising, sales promotion, and personal selling. Publicity is closely related to public relations. In public relations the communication between company and public are managed and the publicity is the management of product or brand related communications between the firm and the general public. It is primarily an informative activity and its ultimate goal is to promote the company’s products, services, or brands. Publicity can be called as a planned programme for obtaining favorable press coverage regarding company, products and services. The techniques used for creating publicity are press release, telephone press conferences, in studio media tours, multi-component video news releases, newswire stories, and internet releases. These should be used for the interest of the public. For example, when
opinion of a customer using car is taken and released in press. This press release in made in favour of the product of the company, the publicity is made by words of mouth gives very good impact on the mind of the other customers.

(i) The advantages of publicity are low cost, and credibility of publicity made is very high. It gives very good impact on the prospect customers. It spreads very fast.

(ii) The disadvantages of publicity are also there. It is very difficult to find out from where the publicity has originated. It lack of control over the message. If the adverse publicity is there then it is difficult to control it. It may damage the image of the company. In this case special care should be there so that the adverse publicity should be avoided.

**Direct Marketing**

According to Brassington & Pettitt (2000), direct marketing is an interactive system of marketing, using one or more advertising media to achieve measurable response anywhere, forming a basis for creating and further developing an on-going direct relationship between an Organization and its customers. To be able to create and sustain quality relationships with sometimes hundreds or even thousands of individual customers, an organization needs to have as much information as possible about each one, and needs to be able to access, manipulate and analyze that information. Thus, the database is crucial to the process of building the relationship. (ibid)

Lee (2002) states that the fast advances in technology over the past 30 years have reshaped how consumers today interact with their financial institutions. The financial sector has extended its —face-to-face—selling towards direct marketing of products and services in the form of phone, mail, or computer transactions. (ibid)

Mols (2000) claims that as computer literacy and the availability of computers increase and the costs decrease, Internet banking consumers are increasing consider ably. Through the Internet banks, the customer s can identify what interests them. Furthermore, the Internet technology also makes it possible to follow individual customer usage. With the information gathered in an integrated database it is possible to read the customer’s needs and satisfy them. This knowledge can be used for different kind’s of direct marketing. (ibid)

**3.4.4 Selection of Promotion**

There are four different methods of promotion methods and each method is having its own advantages and limitation. Considering strengths and weaknesses of each method and
objectives of promotion the resources are applied to make the efforts of promotion successful. Out of these for promotion purpose any one or more are to be selected. There is no hard and fast rule that a particular method is to be selected. The selection is done by considering the requirement of promotion campaign. The promotion efforts should be very effective. For this purpose the following factors are to be considered:

(a) Type of products to be sold
(b) Time of selling the products.
(c) Objectives of the company
(d) Promotion budget
(e) Target customers and their locations
(f) Availability of promotion methods.
(g) Methods used by the competitors.
(h) Personal interest of top management.
(i) Product life cycle of the products or services

There may be other reasons for selection of particular methods of promotion. Generally the leading companies are using two or more or in combination of these methods so that their sales targets, customers relationship and image of the company etc, are maintained properly. The company is in position to maintain its position in the market. The selection of promotion mix must be in position to give the competitive edge to the company over other competitors.

According to economic theorists, investors think and behave “rationally” when buying and selling stocks. Specifically investors are presumed to use all available information to form “rational expectations” about the future in determining the value of companies and the general health of the economy. Consequently, stock prices should accurately reflect fundamental values and will only move up and down when there is unexpected positive or negative news, respectively. Thus, economists have concluded that financial markets are stable and efficient, stock prices follow a “random walk” and the overall economy tends toward “general equilibrium”.

In reality however, according to Shiller (1999) investors do not think and behave rationally. In the contrary, driven by greed and fear, investors speculate stocks between unrealistic highs and lows. In other words, investors are misled by extremes of emotion, subjective
thinking and the whims of the crowd, consistently form irrational expectation for the future performance of companies and the overall economy such that stock prices swing above and below fundamental values and follow a somewhat predictable, wave-like path.

Investors behavior is part of academic discipline known as “behavioral finance” which explains how emotions and cognitive errors influence investors and the decision making process. Behavior of the individual investors has long been the interest of academics and portfolio managers but not the investors themselves since the herd mentality sometimes dominates over reasons. Human herding behavior results from impulsive mental activity in individuals responding to signals from the behavior of others (Prechter, 1999).