CHAPTER - IV

PREFERENCE AND PERCEPTION OF RETAIL INVESTORS
4.1 PREFERENCE - DEFINED

Investors tend to develop preferences at a very early stage of their investing life. Investor’s preferences are part of what makes them who they are. The investment products such as mutual funds, insurance schemes, bank deposit schemes or stock etc seek by investors reflects their preferences. Also within one category of investment products such as mutual funds there are various types of schemes such as, equity growth and balance schemes, debt schemes, tax savings schemes, etc. All these schemes are preferred by investors according to their expectation of returns and risk taking capabilities. In every investment option, investors have many choices and higher expectations. The success of the strategy of a financial services organization (such as, mutual fund companies, insurance companies, banking companies etc) depends on the understanding of market and preference of various categories of investor. Preference for an investment option can be simply defined as choosing one investment option over the others for benefit accruing to the investors.

The Preferences can be explained in following four different categories:

a) Extraversion and Introversion
b) Sensing and Intuition
c) Thinking and Feeling
d) Judging and Perceiving

4.1.1 Extraversion and Introversion

Introversion is a personality trait which can be identified in many theories of personality. People those who are introvert and tend to focus more on internal thoughts, feelings and moods rather than seeking them in the form of external stimulation. Introversion is generally viewed as existing as part of a continuum along with extraversion. Introversion indicates one end of the scale, while extraversion represents the other end. Introverts tend to think about things before talking and want to have a complete understanding of a concept before they voice an opinion or try to offer an explanation. While extroverts typically learn through trial and error, introverts learn through observation.

With regard to investment decisions, individuals, those who are introvert feel comfortable reading research reports of a company to understand and they evaluate an investment proposal.
People who are high in extraversion tend to seek out social stimulation and opportunities to engage with others. These individuals are often described as being full of life, energy and positivity. An extravert investor would always talk to other people (friends, family members, relatives, investment advisors, stock brokers etc) about an investment option; listening from other investors about an investment instruments, to design a portfolio of investments of their choice. According to previous literature conclusions, investor’s preference is influenced by extraversion and introversion.

4.1.2 Sensing and Intuition

The preference refers to how an investor gather information to formulate their decisions. The "Sensing" preference absorbs data in a literal, concrete fashion for example, choosing an investment option, following a step to formulate a investment plan, etc. The "Intuitive" preference generates abstract possibilities—from information that is gathered such as, new methods of doing investments such as systematic investment plan, investment in a portfolio which replicates a benchmark index, investing in a portfolio where there is a prospect of capital appreciation in future etc. Investors use both “Sensing” and “Intuition” to different degrees of effectiveness and with different levels of comfort.

4.1.3 Thinking and Feeling

Jung (1971) studied human behavior and noticed that people have the capability to make decisions based on two very different sets of criteria: “Thinking” and “Feeling”. When an investor makes an investment decision based on logic and reason, they are operating in thinking mode, such as researching an investment product via research reports, and buying the best stock or fund to meet their needs. When someone makes a decision that is based on their value system, or what they believe to be right, they are said to be operating in “Feeling” mode. This can be explained as, taking an investment decision to invest in funds or stocks as per the liking of the investor. Some investors refrain from sharing information on investments with others since it may upset them.

4.1.4 Judging and perceiving preferences

Researchers from the field of psychological sciences identified this personality type. Judging and perceiving, influences the individual’s preferences on a day-to-day basis. People with the judging preference want things to be precise, orderly and established
such as preparing a line of action in advance. On the contrary, people having perceiving preference does things in a flexible and spontaneous manner. Judgers want issues to be settled and perceivers want things to be done with open-ended i.e., postponing decisions to see what other options are available. An investor who acts spontaneously to make investment plans and decides where and how much to invest instantly, are related to perceiving preference. These investors do things at the last minute as they are well aware of the consequence of the investment on a particular product and have sufficient experience and knowledge, as their perception is strong on their acts. While, if an investor's preference is drawn with proper planning, after the consideration of family's financial goals, it can said that the investor is influenced with judging preference.

4.2 RETAIL INVESTORS - DEFINED

According to Security Exchange Board of India (SEBI), “Retail investor” means an investor who applies or bids for securities (stocks, bonds, debentures etc) for a value of not more than Rupees two lakhs at the time of initial public offering of stocks made by a company. Retail investors buy and sell securities for their personal account, and not for another company or organization. Unlike corporate investors, retail investors buy in much smaller quantities than larger institutional investors.

4.3 PERCEPTION - DEFINED

Perceived risk or risk perception is the subjective decision making process that an individual does, after duly considering the assessment of risk and the degree of uncertainty. The term is most frequently used with regards to risky personal activities and potential dangers such as environmental issues, health concerns or new technologies. The study of perceived risk developed from the discovery that novices and experts repeatedly fail to agree on the meaning of risk and the degree of risk for different types of technologies and hazards. Perception is the process by which an individual is in search of preeminent clarification of sensory information so that he or she can make a final judgment based on their level of expertise and past experience.

In the 1970s and 1980s, Paul Slovic, Baruch Fischhoff, and Sarah Lichtenstein at Decision Research\textsuperscript{10}, developed a survey-oriented research approach for investigating perceived risk that is still prominent today. The risk perception literature

\textsuperscript{10} \url{www.decisionresearch.org}
from psychology possesses a strong academic and theoretical foundation for conducting future research endeavours for behavioural finance experts. Within the social sciences, the risk perception literature has demonstrated that a considerable number of cognitive and emotional factors influence a person's risk perception for non-financial decisions. The behavioural finance literature reveals many of these cognitive (mental) and emotional characteristics which can be applied to the judgment process. Behavioural finance studies how an investor perceives risk for various types of financial services and investment instruments such as heuristics, overconfidence, prospect theory, loss aversion, representativeness, framing, anchoring, familiarity bias, perceived control, expert knowledge, affect (feelings), and worry.

4.4 RISK PERCEPTION - DEFINED

Since 1960s, the topic of perceived risk has been employed to explain investors' behaviour. Within the framework of investor behaviour, perceived risk is the risk which an investor perceives while purchasing goods or services from a particular merchant, whether or not a risk actually exists. The concept of perceived risk has a strong foundation in the area of investor behaviour that is rather analogous to the discipline of behavioural finance. It means, there are similarities regarding the decision making process of a consumer and an investor. Bauer (1960), a noted consumer behavioralist, introduced the notion of perceived risk when he provided this perspective: Consumer behaviour involves risk in the sense that any action of a consumer will produce consequences which he cannot anticipate with certainty, and some of which are likely to be unpleasant.

In case of buying investment products such as stocks, mutual funds, bank deposits insurance etc., investors have vast array of alternate uses of that money. This creates a problem of choice for investors those who are willing to invest money for a family cause or for a specific investment goal. Unfortunate investor decisions have cost many investors frustration and blisters, their self-esteem and the esteem of their family members, their jobs, and even their lives. It is inconceivable that the investor can consider more than a few of the possible consequences of his actions, and it is seldom that he can anticipate even these few consequences with a high degree of certainty. When it comes to the purchase of big ticket items the perception of risk can become traumatic. Within the social sciences, the risk perception literature has established that a
significant number of cognitive and affective (emotional) characteristics influence an individual's risk perception for non-financial judgments. The behavioural finance, economics, and accounting literature have revealed an assortment of these cognitive and affective issues exist during the financial decision making process in terms of how an investor perceives risk for a wide range of investment instruments (e.g., common stock, mutual fund) and financial services (e.g., tax planning, selecting a financial advisor).

Pertinent to risk perception, financial risk tolerance is defined as the maximum amount of uncertainty that someone is willing to accept when making a financial decision. The importance of assessing financial risk tolerance is well documented in various literature and previous research findings. In practice, to assess the perception of investor about risk on certain financial assets is very difficult due to the subjective nature of risk, investor's unwillingness to reveal their risk perception and homogeneity among investment funds leads to the inability to effectively determine investor risk tolerance, (Jacobs and Levy, 1996). Risk tolerance represents one person's attitude towards taking risk. Risk tolerance has implications for financial service providers and investors. For the latter, risk tolerance is one factor which may determine the appropriate composition of many assets in a portfolio. Optimal and satisfied investor's preference in terms of risk and return depends on the needs of the individual investors (Droms, 1987 and Hallahan et al., 2004).
REFERENCES


Perceived Risk", New York: Plenum Press, pp. 181–14, Source: