CHAPTER VII
SUMMARY AND CONCLUSION

Investors' confidence is an essential pre-requisite for the growth of capital markets. Confidence gets generated only when both the primary and secondary markets are efficient and transparent in their functioning and the interest of the investors is fairly protected by a rule based regime through well developed in-built control mechanisms or regulations by appropriate bodies.

An investor, while investing in the shares of a company, does so with certain expectations about the performance of the company, the prospects of income from the investment and/or the capital growth of the securities that he holds and the corporate benefits that accrue to him. While making this important investment decision, he must have taken note of and duly evaluated the corresponding risks that go with such expectations.

One such risk is that the expectations of the investor on income and/or growth of the securities may not materialise. He may face the risk of losing the initial investment also. The investor, in order to take these risks boldly and to make an intelligent choice of investment, needs adequate information on certain aspects which may include the past performance of the company, his prediction about the future as well as justification of the risk factors as perceived by him.

Companies, while inviting capital have a moral duty to disclose all material facts so that investors would have a better idea of factors that might affect the value of their investments. The moral duty has been partly translated into a legal duty by various regulations due to which companies
have to disclose substantial information. This means that the potential investor is provided with all the information that is necessary to make an informed investment decision - taking into consideration the risks and the benefits of the proposed investment.

Investor protection is the most fundamental requisite for the healthy growth of the capital market. Protection is not to be conceived of as a system which guarantees to an investor that his investment will not diminish in value or that the return on his investment will remain assured for all time. Investor protection, however, demands that the markets operate with clear cut rules and regulations and there is provision for responding to grievances or complaints or simplify the deficiency of service rendered by the company.

In investments, as in the other realms of risk taking, the risk is largely in the eyes of the risk taker. Proper definition and measurement of risk are the basic problems in understanding investment risk. This necessitates an understanding of the perception of the investor about the risk associated with an investment, his expectations from the investment and his general demographic characteristics to get a sharper picture. There is an ongoing evolution in the thinking among the investment professional on how best to serve the individual investor.

**IMPORTANCE OF THE STUDY**

A wider base of investments and the spread of the investment (in company shares) habit are necessary for the growth of the capital market. The small investor, however he be defined, is therefore to be attracted. He is also
the person who is vulnerable to the risks involved and perceptual errors in the information provided by the capital raising companies. As such the need for his presence as well as protection are felt. There are also strong views that the small investor may find the investment game very risky and may be even withdrawing. The complexities in understanding the company provided information are so much that he may not be in a position to comprehend and take calculated risks while making investments. All that the regulatory bodies could do to save the situation is to ensure that the corporates provide meaningful information and the prospective investors take informed decisions.

There is not much literature in India on the issues referred to above. It is in this context that the present study has been undertaken and becomes important.

OBJECTIVES OF THE STUDY

The broad purpose of the study is to probe into the risk related information in an investment decision.

The specific objectives of the study are:

1. To examine the regulations and guidelines relating to share issues in general and those pertaining to transparency in providing information in particular;

2. To explain the information which may be considered to be relevant or irrelevant in the assessment of risk.
3. To find out the types of information that are associated with high/low risk; and

4. To explain the perceptual selectivity in the information-risk association in the investment decision process.

METHODOLOGY

The guidelines relating to issue of shares are provided by the Securities and Exchange Board of India (SEBI) and considerable data are available from the prospectus issued by various companies to study the transparency aspects of information.

For the rest of the problem, the primary data are to be collected from investors and since people perceive the same information differently, a variety of interpretation is possible.

A structured questionnaire with three sections - section A through C was used for this study. Section A consists of 25 statements which are some typical types of information given by companies in their advertisements inviting investment in shares. These are also the items of information required to be given by SEBI guidelines relating to issue of company shares.

Section B contains ten general statements about risk which are not basically technical but a sort of common sense questions.
Section C was designed to obtain certain personal information like occupation, amount of investment in shares in the last three years source of obtaining information and whether he invests through secondary market also.

The sample for the study consists of mostly 'small investors' - including those who invest occasionally, rely mostly on the information provided by the company and who do not have the expertise or resources beyond a certain level. Investors whose investment in the past three years does not exceed Rs.40,000 alone have been considered for this study.

The questionnaires were issued to 500 investors, from the city of Madras (now Chennai). Out of this 340 filled in questionnaires were collected back. On scrutiny, 13 questionnaires had to be discarded as unusable and finally 327 valid questionnaires formed the sample for this research study.

The study uses for data analysis quantitative analytical techniques, supplemented with qualitative comments. The techniques used include simple mean score, weighted average score, tests of significance and factor analysis.

**LIMITATIONS**

The present study is subject to the following limitations:

1. The data for study was collected during 1997-98 when the capital market was sluggish.
2. The study is confined to the investors in the city of Madras (now Chennai) which is one of the four metropolitan cities in India. The findings must, therefore, be generalised with necessary caution.

3. The inferences on relevance of information and the related questions are based wholly on the perceptions of the investors. The opinions of the other two related groups, namely the companies making the issue and regulatory authorities are not sought.

4. The definition of the small investor is also hypothetical in nature. No official definition exists for this purpose. More than the size their "occasional investment in small sums" characterise this population.

THEORETICAL ISSUES CONCERNING RISK AND RISK BASED INVESTMENT

A major concern for the investor is decision-making under conditions of risk. The investor is expected to choose among possible risk-return combinations which best suits his own individual circumstances and interest. The theoretical aspects regarding risk and information, both are in a way too involved, technical and academic. Description and articulation of the 'risk' involved or the direct relationship between risk and return and how even an approximate quantification is possible is so technical for the small / occasional investor.

It is also worth noting that the theoretical descriptions are based mostly on investors in the secondary market - where the shares are already listed and have a market price. In India, a large number of companies entered the
primary market for the first time during the early 1990s which made the subject important, but in the later part share market itself, leave alone the portfolio investors, shrunk. This development (decline) cannot be ignored while attempting to understand the small investor.

REGULATIONS RELATING TO DISCLOSURE OF INFORMATION

For promoting sustained growth in the securities markets over a long period, it becomes necessary to evolve a comprehensive securities law with a unified set of objectives, a development approach, a single administrative authority, and an integrated framework to deal with all aspects of the securities markets. A body like the Securities and Exchange Commission of U.S.A. was recommended to be set up in India. The need for a more comprehensive law and a better, single enforcement agency led to the creation of a Board called Securities and Exchange Board of India.

As provided in Section 11 of the SEBI Act, the primary objective of the Board is to protect the interest of the investors in securities and to promote the development of and to regulate the securities market by taking appropriate measures.

These objectives are proposed to be accomplished by being responsive to the needs of the three groups which basically constitute the market, viz, the issuers of securities, the investors and the market intermediaries. To the issuers it should afford a market place in which they can confidently look forward to raising finances they need in an easy and efficient manner; to the investors, it should provide reliable and authentic information and disclosure
of information on a continuous basis; to the intermediaries, it should offer a competitive, professionalised and expanding market with adequate and efficient infrastructure so that they are able to render better services to the investors and the issuers.

Statistics show that small investors formed nearly 85 to 90 percent of the applicants in an average public issue during 1995-97. It is generally believed that, the smaller the investor less protected he feels. With regard to issue of securities the approach, it is stated, would be for the protection of rights and interests of the investor especially for true and fair information.

SEBI has noted certain general deficiencies with regard to disclosure of various categories of information and several reforms were made to overcome those deficiencies. After SEBI activated the Investor Grievance cell, representatives of many companies have started collecting investor complaints against their names personally from SEBI, for quicker redressal. Some companies have informed SEBI that they have created a special investors' cell to look into their grievances.

The grievance redressal rate of SEBI has also been increasing from 20.80% in 1992-93 to 75-87% in 1996-97. The grievances received during 1997-98 were substantially lower than those received in the earlier years.

Though SEBI is handicapped by the fact that it is still an evolving organisation and there is no sufficient clarity on the extent of its powers and responsibilities, its regulations are, ineffect, intended to enable the investors to make well informed decisions, not necessarily the best decisions.
RELEVANT INFORMATION FOR EVALUATING RISK

In order to find out the types of information which are considered to be relevant in making an investment decision, 25 statements, which cover the most common pieces of information provided by companies have been presented in the Questionnaire.

It is found that almost 70% of the investors consider all the information to be relevant. When these pieces of information were regrouped into eight factors depending on the issue they are closely associated with, it is found that market oriented factors are of high relevance followed by stages in industry cycle, performance related factors, technological factors, management oriented factors, financial factors, employee related factors and finally the nature of industry.

Incidentally, it proves that the information contents prescribed by the SEBI are considered relevant in evaluating risk for their investment decision.

Apart from these factors or pieces of information, there may be something else also that investors might consider as the decisive factor. This factor which finally clicks the investment decision may also differ from one investor to another. This probably explains the 30% of ‘irrelevance’ of given information.

After examining the relevance of information it is related to the degree of risk as perceived by the investor. For this purpose, the weighted average
mean was computed, with a weight of 5 for 'very high risk' and for 'very low risk'.

It is found that for the sample investors, there is nothing like 'very high risk' or 'very low risk'. Though the maximum weighted average mean could be 5 and the minimum being 1, for almost all the pieces of information it varied between 3.6 and 2.2. Thus most investors perceive risk to be of moderate nature.

Investors, while making an investment decision, do not consider one particular information or factor alone. It is a combination of a few pieces of information or factors that result in the investment decision. In order to identify the pieces of information that go together, an advanced statistical tool viz., factor analysis was done.

The results of the factor analysis show that nine factors explain more than 60 percent of the variance and the following are the nine indicating the risk related sets of information:

**Types of Information used in the assessment of risk**

<table>
<thead>
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<th>Factor</th>
<th>Information</th>
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<tr>
<td>1</td>
<td>Entry Barrier and Substitute Products.</td>
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<tr>
<td>2</td>
<td>Supplier Dependence and Indigenous Technology.</td>
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<tr>
<td>3</td>
<td>Growth stage in life cycle, Stability and Consumer power.</td>
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<tr>
<td>4</td>
<td>Recession stage, Capital cost and Foreign investment.</td>
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<tr>
<td>5</td>
<td>Cut-throat Competition</td>
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<tr>
<td>6</td>
<td>Market Leadership, Profitability and Value of Shares</td>
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<tr>
<td>7</td>
<td>Financial stability and Indigenous Technology.</td>
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</tbody>
</table>
9. Professional management, Trade union strength and Production constraints.

Thus, for a large majority the sets of information which dominate the perception of risk are what are given above. The heterogeneous nature confirms only one thing that perceptions being what / how one understands, have more than one dimension. These may be somewhat strange combinations, nevertheless the particular information is a necessary input for the perception.

After a detailed analysis of the 25 relevant variables in terms of their information value to evaluate risk, an attempt is made to examine "overall impressions" relating to risk vis-a-vis investment decision based on such risk.

To understand how a small investor perceives risk and how it is related to the investment decision, ten statements which are non-technical but based on common sense was presented to the investors. These were again regrouped into six to draw a meaningful inference. It mainly concerns about the vastness and variety of information provided, the main source of information concerning risk, affordability of the investor to take risk, the influencing factor is investment decision - whether it is the profitability of the investment on the possibility of loss of income or capital and finally whether the information explains the price of the investments.
In other words, when risk is perceived in a certain way it is intended to lead to a decision to invest or not to invest. The non professional small investor may pursue a not fully rational step-by-step process but may be influenced by a few items of information - this is the general hypothesis which is put to test in the analysis of overall impressions referred to above.

The overall inference is that if an overall inference is to be drawn it would be that a substantial size i.e. around 40 percent would agree and about 45 percent would disagree about such overall observations.

An attempt was also made to analyse whether this overall impression varies for different investor groups based on their occupation, amount of investment, source of obtaining information and the market in which they trade. It is found by Chi-square tests that there is no significant difference in the perception of investors in terms of their demographic characteristics and hence the sample group can be taken as a whole.

CONCLUSION

Information to be provided, though relevant and insisted by SEBI, helps the investors to take informed decisions, the small investors however are handicapped in terms of their understanding information for the purpose of assessing risk and more than that their ability to predict the future events. Their vulnerability to risk and affordability add to their hesitation. As the information becomes technical and complex the small investor may find share investment not worth the risk he can undertake. The new transaction costs (consulting fees, demating charges) may hasten his exit from the equity capital
market and the performance of mutual funds in India in recent times indicates that the small investor may not find even this institutional arrangement as satisfactory. Even if the market revives, the fundamentals as far as the smaller groups are concerned are not going to be different.

SUGGESTIONS FOR FURTHER STUDY

Based on the limited experience in this study a few suggestions may be made for future researches as follows:

1. Whether the sources of the information and risk related factors differ among small, medium and large investors.

2. What are the expectations which must be fulfilled by the intermediaries, regulatory institutions and issuing companies to motivate the small investors.

3. A model which could explain the investment decision process with the most common conditions could be developed.