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UNDERSTANDING INDIAN INVESTORS BEHAVIOUR BIASES

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ABSTRACT

Traditional finance consider humans to be homoeconomicus i.e., beings that are rational with focus on maximising their returns but this assumption is flawed as we are here ignoring the biases, emotions , perceptions and other behavioural processes that affect the decisions of investors. Behaviour finance is still a new field of study in India whereas many studies are going on and have been done abroad. This article makes an attempt to compile the results of some Indian behavioural finance studies and throw light on the behaviour biases present in investors.

KEYWORDS: *Risk aversion, Anchoring, Homo economics, Mental accounting, Behavioural biases*

SUMMARY

Behaviour finance is a recent area of financial research as far as India is concerned. In the recent years many behaviour finance researches have been conducted in India which have thrown light on the biases and behavioural aspect affecting decision making of Indian investors. Most of the researches conducted have accepted that behaviour biases are present in investors and they are not all rational. Anchoring, overconfidence, regret aversion, herd behaviour are the behavioural factors present, affecting decisions of investors.

INTRODUCTION

According to traditional finance, financial decisions are not taken by emotional and error prone Homo sapiens but by rational homo economics. A homo economics wants to maximize his / her return from investment by application of traditional financial theories. The traditional finance researcher sees financial settings populated not by the error-prone and emotional Homo sapiens, but by the awesome Homo economics. The latter makes perfectly rational decisions, applies unlimited processing power to any available information, and holds preferences well-described by standard expected utility theory.

However in reality the assumption of homo economics is false. Behaviourists in finance seek to replace Homo economics with a more-realistic model. Richard Thaler, a founding father of behavioural finance said “The difference between us is that you assume people are as smart as you are, while I assume people are as dumb as I am.” Financial decisions are taken by people who are affected by emotions, biases and other psychological factors. behavioural finance can be define as the field of finance that makes use of social and psychological theories to explain the actions of individuals in trading and other financial decision making . It helps us in understanding why the behaviour of people differs from the traditional financial theories.

OBJECTIVES

1. To understand the origin and growth of behavioural finance
2. To study the behavioural biases present in Indian investors
3. To study the implication of these biases on investor decision making
4. To draw conclusion

RESEARCH METHODOLOGY

This article is based on secondary data collected from websites, research journals, books etc. Generally behaviour finance researches are experimental research conducted under controlled conditions an experimental research can be a lab experimental research or field experimental research. Like other behavioural researches our research is a field experimental research. Field experimental research has various advantages over lab experiments. The outcomes here are observed in a natural setting rather than in a highly controlled environment. Thus many times field experiment is considered to have higher validity over lab experiments.

TRADITIONAL FINANCE VS BEHAVIOUR FINANCE

TRADITIONAL FINANCE	BEHAVIORAL FINANCE
• Prices are correct; equal to intrinsic value • Consistent with efficient market hypothesis • Investors are homo economics	• What if investors don't behave rationally?

According to Adam smiths' theory of moral sentiments investors makes decisions on the basis of imprecise impressions and beliefs rather than rational analysis. Cognitive psychologist Daniel kahneman and Amon tversky are considered to be the fathers of behavioural finance whereas Richard thaler is responsible for its evolution. Critics of behavioural finance claim s that although there are some anomalies that cannot be explained but it doesn't mean that market efficiency theory should be totally abandoned in favor of behavioural finance. Many consider these anomalies short term chance events that are eventually corrected over time. However importance of behavioural finance cannot be ignored. Following points throw light on the importance of behavioural finance:

1. Reviewing the debatable issues in standard finance.
2. Protecting the interest of stakeholders in volatile investment scenario.
3. Analysing the influence of biases on investment process.
4. Discussing emerging issues in financial world.
5. Examining various social responsibilities of the subject.

The given below table show various biases:

Bias	Explanation	Implication
Hindsight Bias	Tendency to view events as being more predictable after it is known	Regret a loss even though due care was taken while buying a stock
Loss Aversion	Being very uncomfortable with a loss or a potential loss	May lead to continue keeping loss-making stocks even if the stocks have a poor future but not adhering to stop loss discipline
Endowment Effect .	Attaching more value to what one possesses	May lead to lopsided portfolio or holding on to an overvalued stock in the portfolio However, not accurately gauge the actual or Market value of stocks in the portfolio. Mental
Mental Accounting	Account for different assets in the mind	May lead to not knowing the total return (income / dividend) Also may lead to poorly diversified portfolio
Disposition Effect	Being very uncomfortable with a loss or a potential loss and take wrong decision	May lead to selling all winner stocks and retaining losing ones
Anchoring	Being hooked to a specific price/return and not change one's opinion	May lead to not discount the changes in the Markets and remain status quo.

Source: Compiled by the author from ICICIdirect Money Manager - March 2013

In "The psychology of sunk cost" Arkes and Blumer (1985) study sunk cost effect. It is a tendency of people to continue an Endeavour once they have invested in time money or efforts. So their prior investment makes them to continue an Endeavour even when actually it shouldn't influence it. The deposition to sell winners too early and ride losers too long: theory and evidence by Shefrin and Statman (1985) makes use of investor behaviour in stock and mutual funds to put into light the tendency to treat sunk cost as relevant cost. It concluded that people have a tendency to sell winners far too quickly and hold onto losers far too long .so people's portfolio decision are affected by their emotional wellbeing. Status quo bias in decision making by Samuelson and Zeckhauser (1988)Samuelson and Richard used a series of decision making experiments to show status quo bias. Their research further discusses applications ranging from marketing techniques to industrial organization. In Aspects of investor psychology by Daniel Kahneman and Mark W. Riepe (1998) concerned with biases of judgment and decision making which are also called cognitive illusions. In this article they show the use of purchase price as reference point by large number of people. loss aversion and seller behaviour: evidence from housing market by Generous and Mayer (2000) studies the data from a boom –bust cycle in downtown Boston from 1990 to 1997 shows seller behaviour in residential real estate market and how they differ from perfect assets market. Real estate market is far from perfect assets market as here the transaction prices are determined by seller characteristics and in real estate market volume falls when prices falls cannot be explained by perfect asset model. Irrational financial market behaviour: evidence from the early exercise of exchange trades stock options by Allen M. Poteshmen and Vitaly Serbin (2003) Customers of discount brokers and full service brokers both were found to be engaged in a significant number of irrationalities exercises to select a stock's 52 week high as appropriate reference point. Housing and behavioural finance by Mayer and Todd Sinai (2007) this paper presents the relative role of fundamentals and psychology in explaining U.S. house price dynamics. The results of the study suggest that both rational and seemingly behavioural factors play an important role in explaining changes in the price rent ratio across U.S. metro areas. Mental accounting and false reference points in real estate investment decision making by Michael J. Seiler (2010)This study found that although 3/4th of the sample showed expected S shaped disposition curve the remainder not. Instead of S shaped curve there was an inverted altogether or is a U shaped curve opening in either direction. Mental accounting was found whether real estate asset was held in isolation or as a part of mixed asset portfolio. It also found out that people do experience a greater willingness to sell when price cross the breakeven threshold this breakeven price not only include purchase price but also transactional cost. The role of overreaction and deposition effect in explaining momentum in Latin America emerging markets by Abinzano, Muga and Santamaria (2010) this study tries to find out whether overreaction or disposition effect is responsible for momentum effect. Medium term continuation of stock return is called momentum effect. It happens due to biases, overreaction and disposition effect. This study note differences among different market. The result obtained show that momentum effect require concurrent of investor over reaction and disposition effect. Familiarity bias and perceived future price movement by Michael J Seiler, Vicky Z Seiler , Harrison and Mark lane (2012)This study confirmed the SQDA hypothesis. People believe that their house's price will fare better than their neighbours.

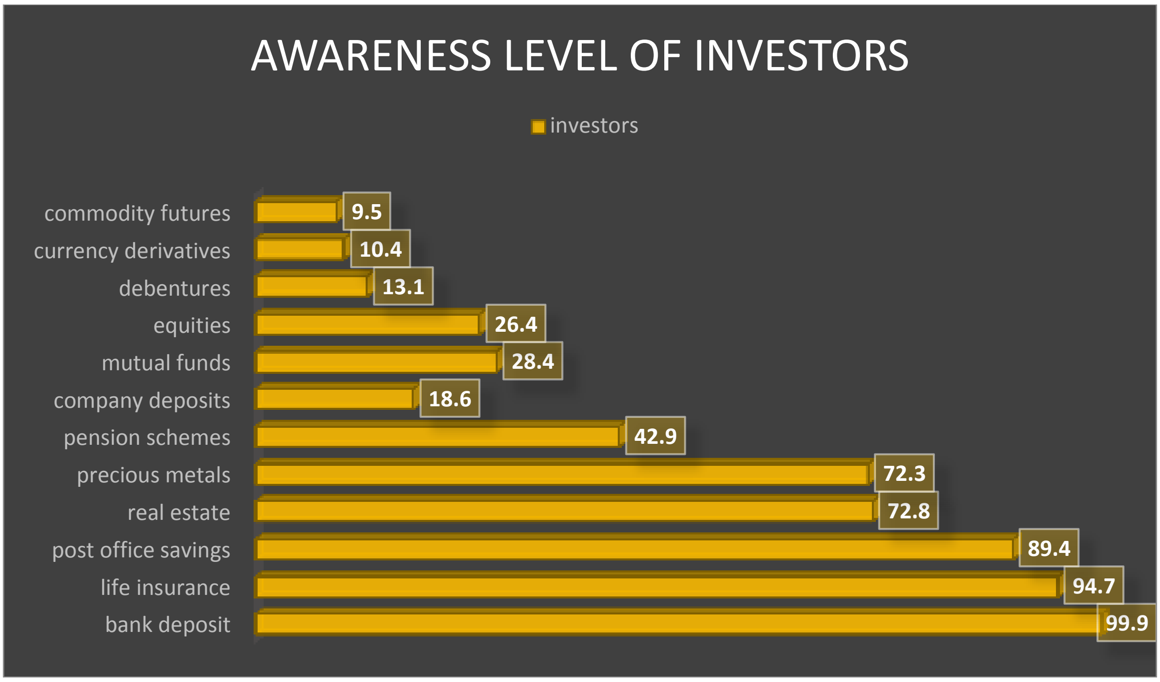
INDIAN INVESTORS

In the order to understand the biases present in Indian investors first and foremost we need to understand their characteristics, investment preferences and pattern.

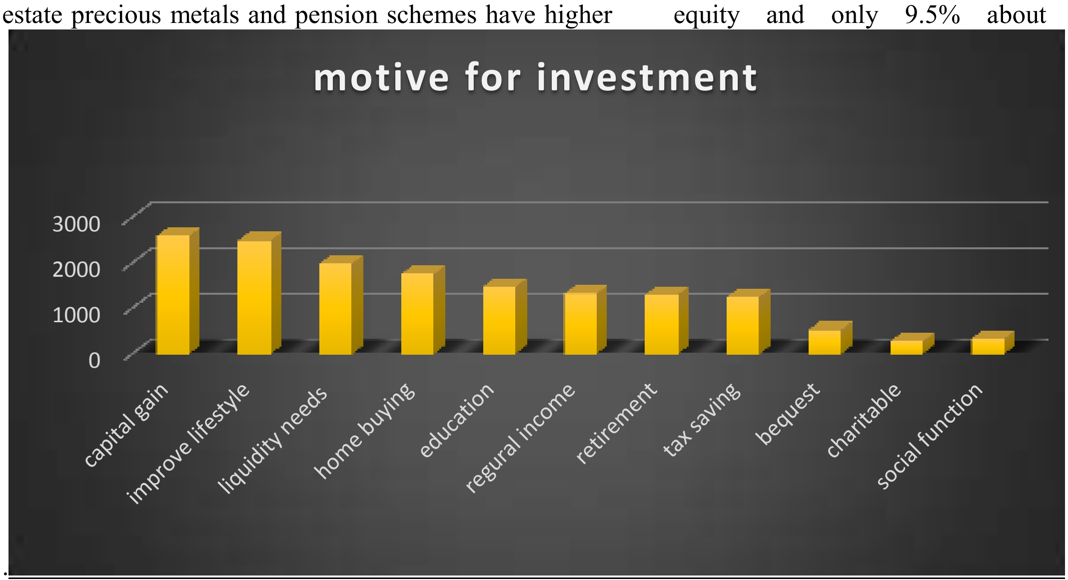
Urban investors

As per the survey conducted by SEBI it was found that the urban households have a higher awareness of saving schemes in comparisons to their rural counterparts. It is middle income group that saves a larger portion of their annual income in comparison to higher income groups

The primary motive was found to be capital gain. This goal was closely followed by improvement in lifestyle. It was found that more were investing in mutual funds rather than equity with percentage 66% and 55% respectively. A positive correlation was found between education and portfolio diversification. Education and occupation were found to have higher impact on investment pattern rather age, marital status, household size etc.



Bank deposit, life insurance, post office savings real estate precious metals and pension schemes have higher level of awareness. 26.3% respondents were aware about equity and only 9.5% about commodity future



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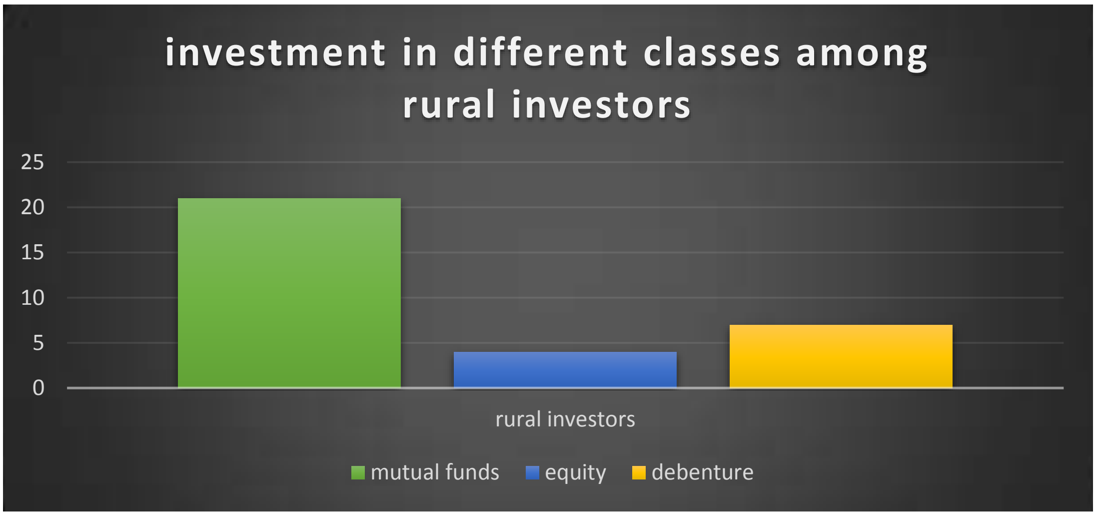
with respect to motives capital gain , improvement in lifestyle , liquidity needs and home buying are among top four whereas tax saving , bequest, charitable and social function among last four.

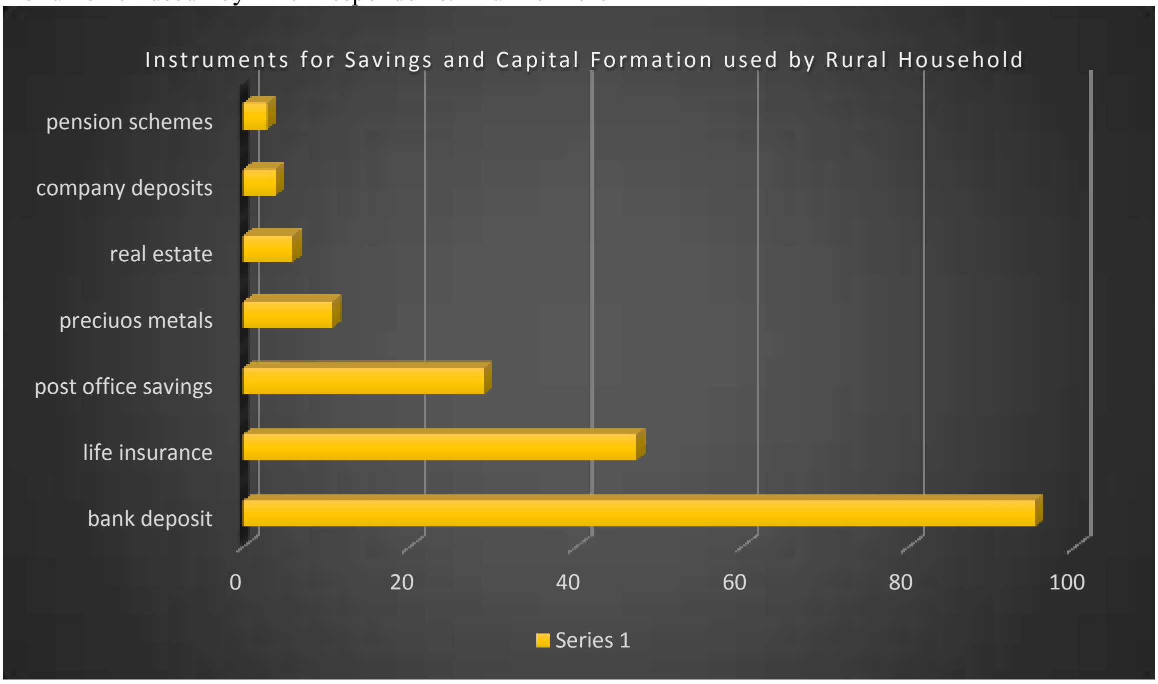
RURAL INVESTORS

As per investor survey 2015, 95% of rural respondents were found to have bank accounts. However the awareness level about equity and mutual funds was 0 .5% and 1.4% respectively.

The data was unable to find a clear relationship between demographic factors like education, income, occupation and investment with investment.it was found that mutual funds emerged as major investment instrument whereas equity and debentures were not even 10%

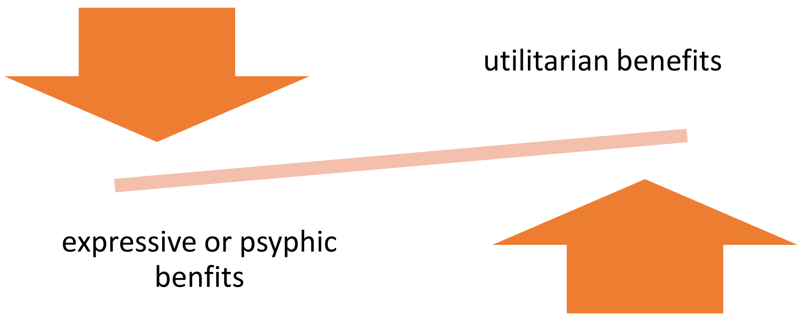


As shown in the figure bank deposits, life insurance , post office saving were the prominent investment instruments used by the respondents. Furthermore awareness with regards to equity was at 1.4% whereas with respect to commodity future 0.3%.



INDIAN INVESTOR AND HIS BEHAVIOURAL BIASES

According to behavioural finance theory an individual look for both utilitarian and expressive benefits from his investment. Thus he or she not only want to maximise return and minimise risk but also want psychic benefits from it. Indian investor is no exception. He too is affected by his psychological processes.



Both behavioural and economic benefits have an impact on investment decisions

Prior researches show that investors here are less risk taking as compared to other Asian investors (The Economic Times, 2011; Baxi, 2011). Dhawan, Roseman, Naidu, Thapa and Resttek (1995) found that Indians are more collective, in the sense that they depend on each other while making decisions, as compared to Americans. Behavioural finance: testing applicability on Indian investors by Dr. Deepak Sahni the findings show that Indian Investors are Loss Averse investors perceive market trend to be influenced by the past performance of a stock market on three consecutive days, which shows that the anchoring theory is relevant in case of Indian Investors. Investors were also found to show the tendency of holding onto loosing stock. Awan M. Hayat, Khuram Shahzad Bukhari and Bushra Ghufran (2010) found that dimension of overconfidence plays an important role in the determination of overall behaviour. The research paper titled "An Empirical Analysis on Behavioural Pattern of Indian Retail Equity Investors" by E.Vijaya revealed that there is a positive relationship between the factors of Overconfidence, Loss Aversion, Herding with investment performance but a negative relationship between market factors and investment performance. Here the technique used is Confirmatory factor analysis (CFA). The Biases Influencing an Investor's Behaviour in India by shoumita dey make use of Chi square analysis (goodness of fit) using SPSS software with the aims to investigate the impact of behavioural biases on the investor's financial decision making with special focus on confirmation bias, loss aversion and endowment bias. The study shows that these biases have a direct impact on the decisions taken by the investors. Whereas in another study by Jaya Mamta Prashod herd behaviour was not seen except in bull phase. Over confidence and deposition effect were also found in Indian equity market. This study id relates to Delhi ncr region. Stakeholders have been mostly depending on the efficient market and rational investment behaviour to make investment decisions. But the irrational behaviour of the investors has always been exhibited with different behavioural biases since inception. Antti Seppala (2009) found that investors are exposed to behavioural biases but the degree and impact are affected by experience and other characteristics. Investment advisers are less exposed to hindsight bias than others.it was found that professionals outperform other people with lower level of confidence and are most exposed to self-attribution bias. Results also indicated more intuitive investors are exposed to more behavioural biases. A Study on Behavioural Bias of Individual Investors by Imthiyas, Sudha ramar and Shyamasundar on the individual investors of age varying from 23 to 57 years belonging to Software/IT/ITES profession in Chennai city IT/ITES/Software organization were found to exhibit Frame Dependence: Self Control and Heuristics :Representativeness with cumulative mean as 4.25 and 3.97. Few investors from IT/ITES/ Software organization exhibited Inefficient Markets: Frame Dependence and Heuristics: Aversion to Ambiguity with cumulative mean as 2.28 and 2.15. The Factor Model for Determining the Individual Investment behaviour in India by Dr.S.Jayaraj makes use of principal component analysis technique for multivariate analysis. The results of the principal component analysis revealed underlying psychological factors influencing the individual investor behaviour. These factors are conservativism, diligent and discreet, remorse abhorrence, cognition, prudence and precaution, under confidence. The results revealed that conservativism, diligent and discreet, remorse abhorrence fall in line with the earlier research to some extent. But prudence and under confidence seemed to be influencing individual investors" trading behaviour in Indian Stock Market.

CONCLUSION

Behavioural finance throws light on the irrationalities of investors. Investors are not calculative utility maximizing machines they are people who are affected by emotions, biases and other psychological processes. Behavioural finance has helped us in realizing that the concept of the homo economics is false. Investors are people who may lack self-control, be overconfident about their abilities, miscalculate information, overreact or follow the crowd without thinking. The term regret is used to describe the sense of sorrow or disappointment over something done or not done. The various researches done in the field of behavioural finance in India have found the presence of these biases in Indian investors. So Indian investor is no exception he too is also affected by his emotions and other psychological processes. Still most of the researches concerning behaviour finance in India are limited to mutual funds, stocks etc. there have been seldom attempts to analyse these biases with respect to traditional assets. Moreover a study at all India level has not been conducted due to time and money limitations. If conducted it will give a better view of the biases affecting Indian investors. Never the less the researchers conducted generally accepted that the behavioural factors do play an important role in forming decisions of investors.

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