SHARE INVESTORS' BIASES AND INVESTMENT DECISION; A STUDY WITH SPECIAL REFERENCE TO NILAMBUR IN KERALA

***Jaseela KB**

**Research scholar, Kerala University Library and Research Centre. Palayam, Thiruvananthappuram*

ABSTRACT

Behavioural Finance is a new area which attempts to explain the anomalous behaviour of security prices by the psychological biases of investors. It is an approach that studies how psychological factors influence decision making under uncertainty. Behavioural finance stalwarts Amos Tversky and Daniel Kahneman developed new psychological theory of behavioural finance called prospects theory, in which they discussed several states of mind which may influence investor decision making process. This paper is descriptive in nature to analyse the role of share investors' biases in investment decision with special reference to Nilambur in Kerala, where the primary data were collected from 78 investors by using non random judgement sampling method. Percentages and tables are used to present and analyse the data. The results of the study reveal that investors' biases such as over confidence, regret aversion etc. have a great impact in investment decision making. Majority of them are considering past performance, trading volume of stock etc. for investing and most of them prefer high risky investments. Behavioural Factors play a vital role in decision making process.

Key words: - *Behavioural Finance, Prospects Theory, Behavioural Biases*

Introduction

Behavioural Finance is a new area of finance that explores the psychological factors affecting investment decisions. It attempts to explain market anomalies and other market activity that is not explained by the Efficient Market Hypothesis. It is an approach that tries to explain anomalous behaviour of security prices by the psychological biases of market participants. It studies how psychological factors affect decision making under uncertainty. According to Sewell, "Behavioural Finance is the study of the influence of psychology on the behaviour of financial practitioners and the subsequent effect on markets. Belski and Gilovich prefer to call behavioural finance as behavioural economics and say that "Behavioural 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."

In 1973, Tversky and Kahneman introduced the availability heuristic a judgement heuristic in which a person evaluates the frequency of classes or the probability of events by availability, ie by ease with which relevant instances come to mind. They presented a critique of expected utility theory. Bernouli 1738, Von Newman and Morgenstern 1944, Bernouli 1954 as a descriptive model of decision making under risk and develop an alternative model which they call prospect theory.

Prospects theory

The prospects theory was originally conceived by Kahneman and Tversky (1979) and later resulted in Danial Kahneman being awarded the Nobel Prize for economics. Tversky and Kahneman applied psychological principles to investigate judgement and decision making. Prospects theory is based on psychological models. Prospects theory states that people underweight outcomes that are merely probable in comparison with outcomes that are obtained with certainty they discard components that are shared by all prospects under consideration. Daniel Bernouli was the first to introduce the concept of systematic bias in decision making based on psychological model.

Behavioural biases

Following are important behavioural biases of investors.

Representativeness

Gilovich et al (1983) define Representativeness as "an assessment of the degree of correspondence between a sample and a population, an instance and a category, an act and an actor or, more generally, between an outcome and a model". Representativeness is concerned with determining conditional probabilities. Using the heuristic the probability that an object or event A belongs to a class or process B is determined. Representativeness is said to be usually employed, while making judgments under uncertainty, when people are asked to judge the probability that A belongs to B (Tversky and Kahneman, 1983). In case A and B are described in the same terms, Representativeness can be reduced to 'similarity' (Tversky and Kahneman, 1981: in O'Hagan et al, 2006).

Over confidence

"In this most basic form, Overconfidence can be summarized as unwarranted faith in one's intuitive reasoning, judgments, and cognitive abilities" (Pompian, 2006). Psychologists have determined that Overconfidence causes people to overestimate their knowledge, underestimate risks, and exaggerate their ability to control events.

Herding

Herding in financial markets can be defined as mutual imitation leading to a convergence of action (Hirshleifer and Teoh, 2003). This is the most common mistake where investors tend to follow the investment decisions taken by the majority. That is why, in financial markets, when the best time to buy or sell is at hand, even the person who thinks he should take action experiences a strong psychological pressure refraining him to do so. The main reason for this is pressure from or influence by peers.

Anchoring

Anchoring is a psychological heuristic which can be said to occur when investors give unnecessary importance to statistically random and psychologically determined 'anchors' which leads them to investment decisions that are not essentially 'rational'. When required to estimate a good buy price for a share and investor is likely to start by using an initial value – called the "anchor"

Regret aversion

Regret Aversion is a psychological error that arises out of excessive focus on feelings of regret at having made a decision, which turned out to be poor, mainly because the outcomes of the alternative are visibly better for the investor to see. The root cause of this type of error is the tendency that individuals hate to admit their mistakes. Because of suffering from this bias, investors may avoid taking decisive actions for the fear that whatever decisions they make take will be sub-optimal in Hindsight.

Cognitive dissonance bias

According to Pompian (2006), there are two identified aspects of Cognitive Dissonance that is related to decision making. (i) Selective perception: where investors only register information, which affirms their beliefs thus creating an incomplete view of the real picture. (ii) Selective decision-making: Investors are likely to reinforce commitments previously made even though it might be visible that it is the wrong thing to do. This occurs because of commitment to the original decision forcing the investor to rationalize actions, which would allow him to stick to it, even though these actions are sub-optimal.

Gamblers fallacy

Kahneman and Tversky (1971) describe the heart of gambler's fallacy as a misconception of the fairness of the laws of chance. Gamblers' Fallacy arises when investors inappropriately predict that trend will reverse

and are drawn into contrarian thinking. Gamblers' Fallacy is said to occur when an investor operates under the perception that errors in random events are self-correcting.

Objective

To analyse the role of investors' biases in Investment Decision with special reference to Nilambur in Kerala.

Research Methodology

The present study is descriptive in nature, based on primary data collected from 78 investors by using non random judgment sampling method. Questionnaire method is used for collecting primary data. Percentages and tables are used to present and analyse the data.

Analysis and Interpretation

The factors are analysed under the two sections

Section I : Demographic Factors

The factors considered are age, Occupation, income and year of experience of the investors.

Table1 Age Classification of investors

Sl.No	Age Category	Frequency	Percentage
1	20-30	35	44.9%
2	30-40	24	30.8%
3	40-50	8	10.3%
4	50-60	4	5.1%
5	60-70	4	5.1%
6	70-80	3	3.8%
	Total	78	100

Source: Primary Data

The table 1 shows out of 78, 44.9% of the investors are under the age of 20-30.

Tble 2 Occupation level

Sl.No	Occupation	Frequency	Percentage
1	Business	40	51.3%
2	Profession	25	32%
3	Other	13	16.7%
	Total	78	100

Source: Primary Data

Table 2 indicates 51.3% of the investors are business people, 32% are professionals and the remaining is engaging in other occupational activities such as agriculture and the like.

Tble 3 Monthly Income of Investors

Sl.No	Income in Rs.	Frequency	Percentage
1	Below 25000	48	61.5%
2	25000-50000	0	0%
3	50000-750000	22	28.2%
4	75000-100000	8	10.3%
	Total	78	100

Source; Primary Data

Most of the investors (61.5%) have a monthly income below RS. 25000.

Table 4 Classification according to Investment experience

Sl.no	Category on Investment Experience	Frequency	Percentage
1	Young Investors	48	61.5%
2	Experienced Investors	30	38.5%
	Total	78	100

Source; Primary Data

Out of 78 most of the investors (61.5%) are young and the remaining (38.5%) is experienced investors.

Section II: Behavioural Aspects

The role of selected investors' biases on investment decisions was estimated by different statements and questions, based on which the following conclusions are made

- 41% of the investors' decision is based on the judgment analysis made by themselves. And 26% of the investors are making decision with the help of opinions of experts. The 22 % is by brokers' services and the remaining 11 % by the influence of media.
- 78% of the investors sometimes consider the past performance of stock before investing in it. Only 22% of them are always considering this factor.
- Out of 78, 49% of them stated that sometimes the trading volume of stock do affect their decision. 19% of them are always giving preference to the trading volume
- 47%of the investors undertake high risky investments. 27% take moderate risk and 26% of them undertake low risky investments
- 46% of the investors think that their investment decisions of about 50%-80% are right. The 28% investors' confidence level is above 80%. Only 26% are in the confidence level below 50%.
- Majority of the investors (62%) are regret avers.
- Majority of the investors (60%) are confident that they may predict future share prices better than others. 23% of the investors are more confident about this capability.
- Majority of the investors (54%) believe that when their judgment went wrong, the next time it will get right.
- 20% of the investors rate that they are very good at decision making. 62% rate their capacity as average and the remaining 18% think that they are poor in decision making.

Conclusion

Behavioural finance is a new area of finance which explains the influence of human psychology in financial market and investment decisions. Many behavioural finance stalwarts such as Amos Tvesky, Daniel Kahnman, Bernoulli, etc have proven the role psychology in financial decision making. This study reveals that investors do not make scientific analysis before they are going to invest. They depend on their own judgements. Majority of them are considering past performance, trading volume of stock for investing and most of them prefer high risky investments. The study also reveals that many investors are experienced by the biases of over confidence and regret aversion. The study indicates behavioural biases have a great role in investment decision making.

References

1) Gnani Dharmaja .V, Ganesh .J, Dr. Santhi .V(2012). "A Study on the Individual InvestorBehavior with Special Referance to Geojit BNP Paribas". International Journal of Research in Management & Technology
2) Nicholas Barberis, Richard Thaler, (2003) University of Chicago "A survey of Behavioural Finance"

3) Heena Kothari, "Investors Behaviour towards Investment Avenues: A Study With Reference To Indore City". Altius Shodh Journal Of Management And Commerce Volume : 1 Issue : 2

4) Martin Sewell, University of Cambridge (2010) "Behavioural Finance"

5) Amos Tvesky and Daniel KAHNEMAN (1979)."Prospects Theory: An Analysis of Decision Making Under Risk", Econometrica.

6) M. Kannadhasan, Faculty, BIM, Trichy "Role of Behavioural Finance in investment Decisions"

7) Daniel Kahneman (1992). Advances in Prospects Theory: Cumulative representation of uncertainty. Journal of Risk and Uncertainty.

8) Rahul Subhash, (2012). "Role of Behavioural Finance decisions in Portfolio Investment decision: Evidence from India"

9) Andrei Shleifer, "Inefficient Markets, an Introduction to Behavioural Finance"