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A STUDY ABOUT THE PSYCHOLOGICAL FACTORS INFLUENCING INVESTMENT IN STOCK MARKET

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ABSTRACT

Traditional finance considers investors as rational beings. This means that every investor before investing in stock market calculates the risk, the return and finally how to trade off risk-return to maximize utility. However behavioral finance studies revealed that human beings are not always rational, they are emotional as well. So at times their investment is affected by their psychological feelings also. The objective of this study was to establish the various psychological factors influencing investment in stock market as well as to find out whether there exists any relationship between these factors. The study was conducted on 50 individual investors. To collect data the researcher used structured questionnaire constituting 10 questions.

INTRODUCTION

Modern finance is based on rational and logical theories such as CAPM model and EMH model. According to these theories investors are rational wealth maximizers. These theories believe that investors are always rational while making economic choices. But in the real world this is not true. People are emotional beings rather than rational beings. They tend to be influenced by emotions even when they make economic decisions. This is where behavioral finance becomes relevant.

The researchers of behavioral finance point out that there are five factors which affect the behaviors of investors. They are as follows:

- Overconfidence,
- Excessive Optimism,
- Herd behavior,
- Psychology of risk
- Pessimism.

Overconfidence happens when people overestimate their skills, knowledge and accuracy of their information. They are over optimistic about the future and the ability to control the situations. There is fine line between confidence and overconfidence. Confidence involves realistically trusting in one's abilities, while overconfidence usually implies an overly optimistic assessment of one's knowledge or control over a situation. Overconfident investors tend to believe they are better than others at choosing the best stocks and best times to buy or sell shares.

Excessive optimism origins from overconfidence. People who are excessively optimistic believe that future events will be better than the actual. Optimism can help people have positive emotions, but excessive optimism or unrealistic optimism can cost.

Herd Behavior or herd mentality is the behavior of an investor to imitate the action of other investors or follow the movement of the market instead of relying on their own logic. Herd behavior, gives a tendency for individuals to mimic the actions (rational or irrational) of a larger group. Individually, however, most people would not necessarily make the same choice.

Psychology of risk is the attitude or mindset of investors to take risk. Some investors are risk lovers. They are ready to take high risks for high profits. Whereas there are some others who are risk averters. They are ready to take moderate risk and expect only moderate profits.

REVIEW OF LITERATURE

1. Overconfidence happens as people overestimate the reliability of their skills, knowledge and accuracy of their information, or over optimistic about the future and the ability of control the situations (Camerer & Lovallo, 1999; Hirshleifer, 2001; Glaser & Weber, 2007).
2. A typical theoretical research done by Gervais et al. (2002) found that excessive optimism often causes positive impacts because it encourages managers to invest in. This effect is positive because awareness of risks usually affects firm value negatively. However, excessive optimism can cause negative impacts as it can lead companies or investors to accept to invest in projects which have negative NPV or assets which have high risks.
3. Herd Behavior or herd mentality is the behavior of an investor who imitates the action of other investors or follows the movement of the market instead of relying on their own strategic information (Biekhchandani and Sharma, 2001).

4. Hussein A. H, (2007) found that expected corporate earnings, get rich quickly, stock marketability, past performance of the firm's stock, government holdings, and the creation of the organized financial markets are the investors considerations.
5. Dimitrios I. M, (2007) conducted a study on Investors behavior in the (ASE) and found that individual investors rely more on newspapers/media and noise in the market when making their investment decisions, while professional investors rely more on fundamental and technical analysis and less on portfolio analysis. Market participants are exposed to a constant flow of information, ranging from quantitative financial data to financial news in the media, and socially exchanged opinions and recommendations. Processing all this information is a difficult task. Variables that are loaded heavily on this factor include coverage in the financial and general press, recent stock index returns, information obtained from internet, current economic indicators and recommendations by investment advisory services (Francis and Soffer, 1997).Each of these variables represents an outside source of information that is perceived to be unbiased.

OBJECTIVES OF THE STUDY

- To understand about the various psychological factors which influence the investing in stock market.
- To understand the relationship between profile of respondents and their investment behavior.

METHODOLOGY

In this paper the subjects studied are individual investors who invest in stock market. 50 individual investors were selected using simple random sampling method from a stock brokerage firm.

Primary data was collected using questionnaires. The questionnaire consists of 10 questions. The independent variables selected were Overconfidence, Excessive Optimism, Herd Behaviour and Psychology of Risk. Section 1of questionnaire sought to capture the general data (Bio-Data) about the investor. Section II consisted questions about psychological factors that affect individual investment decisions. Three questions each were asked under each variable. Respondents were asked to indicate their degree of how they are influenced by each of the items on five point Likert scale. The questionnaires were administered to the individual investors personally.

The questions are designed in the study as follows.

1. Overconfidence is expressed through the results from following questions:
- You feel confident to evaluate price of shares by yourself.
- You are confident to select securities by yourself into investment portfolio
- You feel confident in understanding the behavior of stock market every time.
2. Excessive Optimism is expressed through the results from following questions:
- Although index is losing its value, you continue to increase your investment in stock market.
- At time the stock price is relatively low, but you believe that the stock price will increase next time
3. Herd Behavior is expressed through the results from following questions:
- When you need to make decision to buy/sell stocks in the stock market, you follow other investors.
- Information from relatives, friends and colleagues are has high reliability
4. Psychology of Risk is expressed through the results from following questions:
- You are risk-lover investor.
- You prefer to buy shares of prestigious company.
- You prefer companies which pay stable dividend.

DATA ANALYSIS AND FINDINGS

Demographic Profile of Respondents

Demographics	Variables	No. of Respondents	%
Gender	Male	42	84
	Female	8	16
Age	Below 25	2	4
	26-40	34	68
	41-60	12	24
	Above 60	2	4
Income	Less than 50,000	6	12
	50,000-100000	42	84
	More than 100000	2	4
Qualification	Under Graduate	0	0
	Graduate	41	82
	Post Graduate	8	16
	Phd	1	2
	Other	0	0

The above table shows the demographic profile of the respondents. 84% of the respondents are male and 16% are female. This shows that males are investing more in share market than female.68% of respondents below to the age group of 26 to 40 years signifying the presence of youth. The profile further shows that 84% have an income between Rs 50,000 to Rs 100000. 82% of investors are graduates.

Sl No.	Statement	SA		A		N		D		SD	
		F	%	F	%	F	%	F	%	F	%
1	I feel confident to evaluate price of shares by myself.	15	30	10	20	2	4	5	10	18	36
2	I am confident to select securities by myself into my investment portfolio	16	32	13	26	4	8	7	14	10	20
3	I feel confident in understanding the behavior of stock market every time.	13	26	12	24	1	2	4	8	20	40
4	Although index is losing its value, I continue to increase my investment in stock market.	19	38	13	26	0	0	7	14	11	22
5	Even when stock price is relatively low, I believe that the price will increase again next time.	16	32	18	36	1	2	5	10	10	20
6	When I need to make decision to buy/sell stocks in a short time, I follow other investors.	19	38	13	26	6	12	6	12	6	12
7	Information from relatives, friends and colleagues has high reliability.	20	40	18	36	0	0	1	2	11	22
8	I am a risk-lover investor.	10	20	8	16	1	2	18	36	13	26
9	I prefer to buy shares of prestigious companies.	19	38	18	36	1	2	10	20	2	4
10	I prefer company which pay stable dividend.	15	30	9	18	2	4	14	28	10	20

36% of investors strongly disagree that they are confident to evaluate the price of shares by themselves. 32% strongly agree that they are confident to choose shares by themselves for investment. 40% strongly disagree that they feel confident in understanding the behavior of stock market every time. 38% strongly agree that they will continue to invest continually even when market index is low thinking that the index will increase next time. 36% agree that they believe that share price will go up the very next time and so they will continue investing in shares. 38% strongly agree that they follow their friends or family when they have to buy or sell shares within a short time. 36% disagree that they are risk loving investors. 38% strongly agree that they prefer to buy shares of prestigious companies. 30% strongly agree that they prefer to buy shares of companies which will pay them stable dividend.

CONCLUSION

Even though investing is considered as a rational process, this paper tries to explain that it is not always so. Most often many psychological elements are involved in it. This explains the unexpected raises and falls of stock market. An understanding of these factors will help a investor to be aware of it and thereby reduce the effect of these emotional elements while making an investment.

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