PERSUASION OF BEHAVIOURAL BIASES IN INVESTMENT MANAGEMENT OF INDIVIDUAL INVESTORS

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Abstract

Investment decisions of individuals is based on several factors among which behavioural biases plays a dominant role. Nowadays every information about an investment is available easily which could be relied by the investor. While making the investment decision, investors should identify their flaws and invest in those avenues which help to gain maximum profit without overemphasizing on emotions, feelings and fear of loss.The behavioural biases identified for the study were herding behaviour, overconfidence bias, availability bias, representativeness bias, anchoring bias, gamblers fallacy and mental accounting. Data were collected from 408 investors using judgement sampling through structured questionnaire. Investors having investments in share market were only considered for the study. It is identified that investors were affected more by representativeness bias followed by availability bias and affected least by herding behaviour while investing. The influence of behavioural biases should be identified and reduced while managing investments as emotions and feelings may drain the profit or income that they could receive from these investments.

Key words:- Behavioural Biases, Risk Perception, Investment Decision, Individual Investor, Herding Behaviour

Traditional financial theories depicts that investors are rational. But in reality human beings are influenced by many sociological and psychological factors. Behavioural finance analyses these factors and its influence on investment decisions of individuals. While assessing investment, the risk associated with the security is very important, and the selection of it will depend on the risk perception of the investor, which is

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linked to human emotions or psychology.

The biases along with the influence of socio demographic factors affects the decisions that they make. Understanding the behavioural biases, helps in reducing the loss that results from sudden decisions.Investors could be generally classified as aggressive or passive based on their investment strategy. Aggressive investors are those who are ready to take higher amount of risk for the return. These investors will only invest aftercareful analysis of the market and economy. Passive investors may prefer to invest in those avenues which represent the market index so thatminimal return is guaranteed.In balanced portfolio management, investment would be made both in active and passive manner. Investors who are prepared to take some risk may opt for a constant mix of fixed income-generating investments and varying income-generating investments in their portfolio for gaining maximum profit. While making all these decisions, the influence of behavioural biases is inevitable. The present study aims at understanding the influence of behavioural biases while making investment decision by individual investors.

Statement of the Problem

In traditional theories individuals were identified to be rational but in reality they were not as they may not consider every information available before making investment decision and may be influenced by several biases which could lead to suboptimal decisions. The biases may affect their decision making skills especially during critical situations and may lead to losses. It may influence how individuals invest their money and if it is not done properly it may lead to financial difficulties. Thus identifying and understanding these biases helps the investor to better their decisions, hence the study.

Significance of the Study

In the practices of managing investments, investor behaviour or influence of behavioural biases is inevitable. Understanding the psychological or emotional factors that predispose investors to behavioural biases can help financial advisors differentiate their services and give better advices to them. It also helps the investor to pre-conceptualize it and reduce their flaws. Thus the study was significant as it was undertaken to ascertain the influence of the behavioural biases while managing investments by individual investors.

Scope of the Study

The study is confined to individual investors in Kerala and those investing in share market were only considered for the purpose of the study.

Objective of the Study

The main objective of the study is

- To ascertain the influence of behavioural biases in managing investments by individual investors

Methodology

The study analysis the behavioural biases affecting investment decision of individual investors. It is conducted using primary and secondary data. Primary data were collected from 408 respondents using structured questionnaire. Sampling technique used is judgement sampling. The study is confined to individual investors and those investors having investments in share market were only considered for the study. Secondary data from national and international articles, journals, and online reports were referred.

Behavioural Biases Affecting Investment Decisions of Investors

Human beings are influenced by many sociological and psychological factors while making an investment decision. Behavioural finance analyses these factors and its influence on investment decisions of individuals. While assessing investment, the risk associated with the security is very important, and the selection of it will depend on the risk perception of the investor, which is linked to human emotions or psychology.(Phuoc Luong, Thi Thu Hal, Lad, & Tailor, 2018).

Overconfidence Bias. Being overconfidently biased occurs when the investors are overconfident about the investment decisions that they made and believes that any profit incurred from investments is entirely due to their skill and capacity. If there is any loss from investing, then the investor likes to believe that it is due to their bad luck. (Chen, Kim, Nofsinger, & Rui, 2007; Fischhoff, B., Slovic, P., & Lichtenstein, 1977)(Fischhoff, 1975)

Representativeness Bias. Investor relates performance of the investment to some representative thing, and the investor believes that it will continue in the future too. For eg. If an investment avenue generated better returns in the past, then the investor believes that it will create the same pattern of recurrence in the future also. Investors focusing on good attributes of a company like quality of product, managers etc while investing is also affected by this bias. This will keep them away from other better return generating options. (Chen et al., 2007)

Anchoring Bias. Investor's decisions and judgements will be based on the initial piece of information offered to them. For example: If an investor decides to buy an investment which generated 10 percent return, suddenly the return reduced to 9 percent due to some market fluctuations.Investor may not be willing to invest in it even though 9 per cent return is better as compared to returns of other investments because 10 per cent returnwill be having more dominance in their mind. (Tversky & Kahneman, 1974)(Sean D. Campbell and Steven A. Sharpe, 2007)

Herding Behaviour. The process of herding refers to following a group while making decisions. These types of investors will always follow what the crowd do during indifferent situations and may follow the decisions made by their friends or family members and may not be willing to make their own decisions with the fear of having loss. They believe that the decisions of the others are correct. Some investors will intentionally follow what others do while it can be same group of investors with similar decisions problem. (Bikhchandani & Sharma, 2000)

Availability Bias. Readily available or known information will influence the decisions of the investor. Investors who evaluate frequency of classes or probability of events by availability is

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affected more with this bias. It also based on ease with which events come to mind of individuals. (Tversky & Kahneman, 1973, 1974).

Gamblers Fallacy. The investors believe that if an investment performed well for a particular period, it will change suddenly and will start to generate loss and vice versa. Thusthe investment decision taken by the investor are based on past data whether it is dependantor not. But the investor instead of making random judgements must identify the underlyingcore component which drives the market favourably or unfavourably and should take decisions accordingly. (Farmer, Warren, & Hahn, 2017; Haugen, Christy, & Roden, 1974)

Mental Accounting Bias. This bias analyse how individuals behave when they receive unexpected money that is whether they invest it or use it for personal purpose.

Analysis and Findings

The behavioural biases analysed include herding behaviour, overconfidence bias, availability bias, representativeness bias, anchoring bias and gamblers fallacy and mental accounting.

Table 1.1

Behavioural biases affecting investment decision making of individual investors

Statements		Strongly disagree	Disagree	Neutral	Agree	Strongly agree	Mean	SD
I follow the investment decisions of my friends/family while investing (herding behaviour)	N	5	87	174	98	44	3.22	0.94
	%	1.23	21.32	42.65	24.02	10.78		
The higher returns that I receive is due to my skill and ability(Overconfidence bias)	N	4	14	109	247	34	3.72	0.71
	%	0.98	3.43	26.72	60.54	8.33		
My financial decisions are based upon the known information about the investment (Availability bias)	N	0	14	37	330	27	3.91	0.53
	%	0.00	3.43	9.07	80.88	6.62		
I estimate future earnings from my investment using earnings growth in the past (Representativeness bias)	N	0	10	41	319	38	3.94	0.54
	%	0.00	2.45	10.05	78.19	9.31		
If a security which generated nine per cent return suddenly reduced to eight per cent but it is better than returns of similar securities, so I will invest in it. (Anchoring bias)	N	5	38	44	306	15	3.71	0.74
	%	1.23	9.31	10.78	75.00	3.68		
If an investment generated profit in the past, it may suddenly start to generate losses (Gamblers fallacy)	N	1	25	78	278	26	3.74	0.68
	%	0.25	6.13	19.12	68.14	6.37		

Source: Primary data

Most of the respondentswere in the age group of 30-40 and are male. Investors with post-graduation educational qualification constitute the most. Regarding occupational status and income level most of them are salaried and have a monthly income of ¹ 40,000 to ¹ 60,000.

The influence of various behavioural biases on investment management is explained in table 1.1. From table 1.1 it can be inferred that among the respondents 42.65 per cent of the respondents are neutral about their opinion regarding herding behaviour and 24.02 per cent of the respondents agreed, 10.78 per cent strongly agreed, 1.23 per cent of the respondents strongly disagreed and 21.32 per cent disagreed towards herding behaviour. Investors are identified to be highly influenced by representativeness bias with mean value of 3.94 which depicts that they consider past return as representative of future return and make decisions based on it. It is followed by availability bias with mean value of 3.91and it depicts that they make decisions based on known or easily available information. Comparatively investors are shown lesser inclination towards herding behaviour with mean value of 3.22 and overconfidence bias with mean value of 3.72.

Individual investor's aversion towards mental accounting bias were observed and explained in table 1.2. It was inferred that respondents constituting 71.25 per cent opined that if they got unexpected money they may invest in risk free assets or risky assets, while the remaining opined that they use it for personal purposes. Thus the influence of mental accounting bias is identified to be comparatively low among investors as instead of using it for personal purpose they invest it.

Thus investors were found to take decisions based on past trends and information that are already known and easily available for them. The influence of herding behaviour while investing is found to be low and they are not identified to be overconfident regarding their decisions and not influenced by mental accounting bias.

Recommendations

The following recommendations were formulated

- An investor should have a goal based planning strategy to reduce the maximum possible loss and should control emotions especially during severe economic situation and should not jump into sudden decisions.
- During negative situations fear, stress and anxiety dominates the investor

Table 1.2

Mental Accounting Bias among Individual Investors

	N	%
Will invest in risky or risk free financial assets	310	75.98
Will use the amount for personal purpose	98	25.02

Source: Primary data

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so an investor should focus on what is right or wrong to them.

- Without focusing on previous winner stocks an investor should try to explore the upcoming opportunities to gain profit after seeking maximum possible information
- Only invest after considering ones risk profile
- Avoid over expectations about the investments.
- Investors must be patient and avoid continuously tracking the investment

Conclusion

Behavioural biases can create varying influence on investment decisions of individuals and it affects their investment management.It is identified that representativeness bias and availability bias are identified to influence investors more while herding behaviour influences the least. They are not identified to be influenced by loss aversion.The influence of behavioural biases should be identified and reduced while managing investments as emotions and feelings may drain the profit or income that they could receive from these investments.

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