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Significance of Investing in Stock Market with a reference of Behavioral Finance

Jitender Singh

Assistant Professor (Commerce), Govt College Dujana (India)

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ABSTRACT

Behavioral finance is a branch of finance that tries to understand the psychological aspects of investor in the process of decision making while selling, buying or investing in the market. Investment in the market is considered as good option for gaining profit. But, some kind of market risks is also associated in market investment.

Behavioral finance studies the factors that influence the decision of an individual while investing. It covers all the decisions of investors whether good or bad. This branch of finance also investigates the inefficiency of market. In daily life, people take several decisions leading to good or bad consequences. An individual may think to buy stock or a fund manager may think to sell a stock so as to make a balance the portfolio. The current article describes about various issues related to behavioral finance.

1. Introduction

Before investing in market, an individual studies all the options available and compares the market value of stocks and finally, makes the decision of buying interested stock. It is noticed that the decision of buying stock after a deep decision process goes right and gains the profit.

In some cases, the investor could not get the expected profit and may suffer a loss due to flexibility in the nature of market. Investor studies what went wrong and why the decision does not go in favor. It is also suggested by the experts that one should invest in market for long duration to get the effective profit as the flexible in the market is so much that short term investments may cause some loss. No one also can't deny the luck factor of the investor in order to make profit from stock market.

Behavioral finance also studies the cognitive factors such as emotional and mental status of the individual in the process of decision making for investing. In most of the cases, it is observed that a confident person takes better decision as compared to confused one.

The educational qualification also plays an important role in the process of decision making. It is noticed that less qualified person shows inconsistency in good decisions whereas average or higher educators take their decisions wisely and a sense of consistency is found in their decisions. These little things are very crucial for individual's ability of decision making.

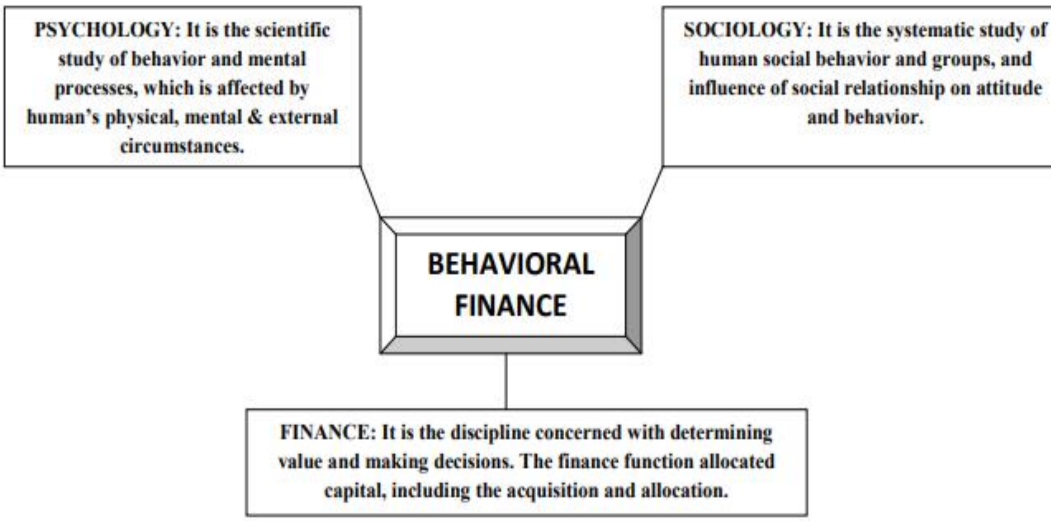

Fig. 1 Concept of Behavioral Finance

The branch of behavioral finance tends to understand the psychology of the investor and tries to understand the irrationality of the investors. Investors take the relevant information from the market experts and use their mind to take effective decisions.

Sometimes, investors are not able to realize the associated risk factors and pay the price for it. The use of business principles is also done by behavioral finance so as to understand the decision making process of investor. These days, the role of brain functioning of investor in financial decision is investigated.

It is also observed that the past experience of an individual in investing also influences the financial decisions. If a person invests in a particular stock and gets expected profit then psychologically, it increases the chances that the same investor will invest in the same stock next time and also suggest others in investing in that stock.

Behavioral finance studies the psychological, sociological and financial factors which can really influence the decision-making process of an individual.

2. Review of Related Literature

Schindler et al. (2010) described that decision making is a complex process involving choosing a particular alternative among a number of possible courses of action after careful evaluation of each option.

Shleifer et al. (2010) specified that most crucial challenges to investors is to make investment decision having a difference in their profile like socio and economic factors, demographic factors, educational levels, age, gender etc.

Lintner, G. et al. (2012) pointed out that behavioral finance helps investors as well as market participants to understand biases and other psychological constraint they display in market. And critical issue is that market participant cannot behave rationally always, as they deviate from rationality and expected utility assumption while making investment decisions.

Barber et al. (2013) described that behavioral Finance equips Finance professionals with a magnified lens which allows them to scrutiny, understand and overcome many proven psychological traps that exist involving behavioral biases i.e. emotional biases and cognitive biases.

Shefrin et al. (2010) mentioned that behavioral trap exists across the board because of psychological influences of Heuristics & Biases. A financial market is a market in which people trade financial securities, commodities, and other fungible items of value at low transaction costs and at prices that reflect supply and demand.

Frankfurter et al. (2010) described that securities include stocks and bonds, and commodities include precious metals or agricultural goods. In Economics, typically, the term market means the aggregate of possible buyers and sellers of a certain good or service and the transactions between them.

Shefrin H et al. (2011) specified that the advocators of behavioral finance firmly believe that psychological factors influence investor's investment decisions. They defend that in today's economic scenario and investment decisions demand a better understanding of investor psychology or rather individual investor's behavioral biases.

3. Aim of Study

In this study, the aim is to establish the existence of fundamental issues, driven by various psychological influences, in the investment decision making process.

4. Research Methodology

There were 50 respondents in the current study.

Descriptive research is used in this study in order to identify the issues in behavioral finance. The method used was questionnaire and interview of the experienced loan officers.

Primary Data

a. Observation Method b. Interview Method c. Structured Questionnaire

Secondary Data

a. Books
b. Articles and Research Papers
c. Internet

SAMPLING SIZE: 50 Respondents

5. Results And Analysis

There were 50 respondents in the current study.

Classification of respondents according to their return expectation

The frequency wise classification of respondents on the basis of their expected return on investment is shown in the below table.

Table 1 : Expected return on investment by Respondents

Expected Return on Investment	No. of Respondents	Total (%)
1% - 10%	64	21.0
10% - 15%	75	24.6
15% - 20%	100	32.8
More than 20%	66	21.6
Total	305	100

It is clear from Table 1, out of 50 respondents 32.8 percentages expect 15- 20% return per annum, 24.6 percentages of respondents expect 10-15% of return on investment, 21.6 percentages of respondents expect more than 20% return per annum and 21 percentage expect return in the range of 1-10% per annum.

Classification of Respondents with their Primary Investment purpose:

The frequency wise classification of respondents on the basis of their purpose of investing in stock market is given in the following table.

Table 2: Primary Investment Frequencies

Primary Investment	No. of Responses	Total (%)
Savings	2	0.5
Tax Benefit	44	10.0
Investment Returns	171	39.0
Contingency requirement & liquidity	27	6.2
Wealth Creation	154	35.2
Speculation	40	9.1
Total	438	100

Table 2 clearly shows that 39.0% have opted for Investment returns, 35.2% for Wealth Creation, 10% for availing Tax Benefits, 9.1% speculate in stock market, 6.2% for their liquidity requirements & negligible of 0.5% have opted to save their income by investing in stock market.

Chi-Square Analysis: Hypothesis Testing – Gender & Type of Risk

Table 3: Chi-square test between the gender and type of risk

Gender	Type of risk			*Total*	Statistical Inference
	High	Moderate	Low		
Male	91	109	68	268	$X^2 = 3.699^+$ df=2
	29.8%	35.7%	22.3%	87.9%	
Female	7	20	10	37	
	2.3%	6.6%	3.3%	12.1%	
Total	98	129	78	305	
	32.1%	42.3%	25.6%	100.0%	

+ Not Significant

It is observed from the table 3 that gender only majority of male respondents (35.7%) are taking moderate risk, 29.8 % of them are taking high risk and only 22.3% of them are taking low risk in investing in equity and other funds.

Chi-Square Analysis: Age of Type of Risk

Table 4: Chi-square test between the Age and type of risk

Age	Type of risk			Total	Statistical Inference
	High	Moderate	Low		
18 – 30	23	32	18	**73**	$X^2 = 8.040^+$ df=6
	7.5%	10.5%	5.9%	**23.9%**	
31 – 45	43	74	40	**157**	
	14.1%	24.3%	13.1%	**51.5%**	
46 – 60	28	21	19	**68**	
	9.2%	6.9%	6.2%	**22.3%**	
Above 60	4	2	1	**7**	
	1.3%	0.7%	0.3%	**2.3%**	
Total	**98**	**129**	**78**	**305**	
	32.1%	**42.3%**	**25.6%**	**100%**	

+ Not Significant

It is observed from Table 4 that majority of risk taker are in age group 31-45 with 24.3% take moderate risk, 14.1% in High risk category and 13.1% participate taking low risk in stock market.

6. Conclusion

From the findings of this study, it is very clear that psychological biases exist among the retail investors influencing their investment decision and its outcome. To a greater extent Mental Accounting and Anchoring can help investor yield a satisfiable outcome. It is advisable for individual investors to take professional advice from Financial Planners and implement financial planning for their financial goals.

The psychological biases are not necessarily meant to make investors irrational but to know how investor processes the information and how they act on such information. An investor to be successful should understand his own investment psychology and it starts with recognizing and avoiding psychological biases from their own experiences and by setting of realistic and achievable objectives through a diversifiable portfolio and also consider all the mechanisms of financial market.

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