CHAPTER 2

REVIEW OF LITERATURE

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REVIEW OF LITERATURE

2.1 Introduction

Researcher has studied some previous literature related to this topic. An overall appraisal of literature reveals research studies covered the aspects at macro level, like motivational factors influencing individuals in their investment decisions and profile of individual investors; ownership patterns in capital market, occupation wise breakup, ownership pattern of shares/debentures. The age of investors has been studied along with family income, networth and assets composition of high income families. There are only few studies based on the issues of the relationship between the individual investors life cycle stage and investment pattern. The literature review includes the review of journals, internet access.

2.2 Review

R.A. Morin and A.F. Suarez (1969) find the risk taking ability of the individual investors decreases as their age increases. Study finds as age of individual increases risk taking ability decreases i.e. investors start reducing their investment in share and other such risky investment as their age increases. Also they find the households appear to become less risk averse as their wealth increases.

K.J. Arrow (1971) study focused to find the reasons of risk aversion increase with wealth. Since wealth of the investors increases with his/her age. Study finds that older individual investors invest smaller fraction of their wealth in risky assets. It also finds as the age of individual investors he/she invest smaller fraction of their money in risky assets such as shares/debentures.

Merton (1971) and Merton and Samuelson (1974) study found some results based on the golden assumptions that young investors invest a larger fraction of their financial wealth in risky assets then older investors. Study also finds some popular investment vehicles in many countries which are based on life cycle funds. So through the investment decision, individual investors decide how to invest the money in various financial assets on the basis on life

cycle funds so as to smooth consumption across various contingencies that may arise in the future.

Wilbur G. Lewellen (1977) study focused on identifying the systematic patterns of investment behaviour exhibited by individuals found age and expressed risk taking propensities to be inversely related with major shifts taking place at age 55 and beyond. Study finds systematic investment pattern of individual investor behaviour. Investment behaviour of investor changes as per there was change in the age of the investors. Study also expresses the risk taking tendency of the individual investors changes as the investors were shifting towards the age of retirement and beyond.

Robert D. Milne (1983) study focused on individual's risk and return preferences in terms of the stages of their life cycle. Study categories the individual investors based on their life cycle stages or the career where they are currently located. Study finds exactly where individual investor fixes his/her risk return trade off at various life cycle stages depends on the circumstances and individuals risk taking attitudes/tendency. It finds that effect an individual's risk tolerance is unique and subject to changes influenced by investors wealth position, health, family situation, age and temperament.

Bodie, Merton, and Samuelson (1988) study found that the younger investors have greater flexibility in their subsequent investment decisions and they should consequently be more risk tolerant. Study suggests that the younger investors may rationally choose to hold a higher fraction of their portfolio in share than older investors. It finds that the younger individual investors having tendency of high risk i.e. they invest their major funds in shares as compared to older investors i.e. investors at retirement stage invest their small part in share.

Paul A. Samuelson (1989) research concluded that older individuals rationally reduce their risk exposure because they need to ensure that their savings provide sufficient means to satisfy levels of minimum consumption. It was found from the study that older individual investors reduce their investment in risky assets because they need to preserve the

purchasing power for their bright future, because inflation reduces their purchasing power. But while investing their money, they select less risky investment options. The main objective of their investment is to satisfy levels of minimum consumption.

Jing J. Xiao, (1989) conducted extensive research under the title of Effects of Family Income and Life Cycle Stages on Financial Asset Ownership. The study investigated the effects of income and life cycle variables on the ownership of the financial assets. The research had indicated that life cycle variables, such as investors age, his/her marital status, his/her employment status and his/her child's presence, influenced the investment in 11 financial avenues. The results of research can used to reframe the various family life cycle scenarios to improve educational and business programs in financial planning and counseling.

Z. Bodie (1992) conducted a research on the individual investor investment decision based on age factor. Researcher had found that married individuals invest smaller proportion of their portfolios in risky assets than do single individuals other things being equal. Study found that younger individual investors will act in manner with lower risk tendency because they have more flexibility in their career decisions. This flexibility allows young individuals to increase their input to compensate for any losses from holding risky assets.

Rajarajan V. (1994) conducted study based on the demographics of the individual investors. Study found that the size of the investment in the financial assets provides significant information on the preferences of individual investors from particular class and their investment approaches. The holding of the individual investors shows the percentage of risky assets to total financial investment declined as the investor moves up through various stages in life cycle and it was also found that life cycle characteristic as segmentation variable provides an opportunity for segmentation of investors and blurs some differences between individual investors and their financial service need.

Peter S. Yoo (1994) research was conducted to find the relationship between individual investor life cycle stages and investment preferences of the investors. It was found from the

study that there were no uniformity in the investment preferences passes through various life cycle stages i.e. the diminishing of risky assets over an individual's life time to be not uniform and individuals appeared to increase their investment in risky assets throughout their working life time and decrease their risk exposure once they retire.

Rajarajan V. (1999) conducted study to find out the existence of relationship between life cycle stage of the individual investors and their investment preferences and their investment in risky assets. Study was based on 405 individual investors. Study finds the systematic relationship between life cycle stage and investment preferences as well as risk taking capacity of individual investor declines as he/she move up through his/her various stages in life cycle.

Gollier (2001) and Gollier and Zeckhauser (2002) conducted study to know there will be decline in equity holding in the portfolio of the investors as their age increases. Study finds that as the age of investors increases they reduce the equity holding i.e. as age increases they are less averse or as age increase investors are looking for rebalance their portfolio. They reduce their equity holdings from portfolio because to protect their future.

Cocco, Gomes, and Maenhout (2005) researchers found that a lifecycle investment strategy that reduces the household's equity exposure as it ages. Study found that investors used the strategy for asset allocation based on their life cycle stages. Many other studies have examined the risk of different investment strategies in the context of lifetime saving programs that resemble defined contribution plans. The researchers conduct recent research on the correspondence between theoretical models of lifecycle asset allocation and empirical evidence on actual investment patterns.

Teulings and de Vries (2006) study was conducted to outline a stylized model to explore optimal financial planning over the life cycle of individual investors. Researchers had outline in detail the arguments underlying their recommendations for individual saving and investment decisions. Researchers explore alternative models based on the labor income, financial risks and their investment preferences. In addition to analyzing optimal saving and

investment decisions over the life cycle, researchers have studied the role of financial intermediaries. It is observed from the study that individuals delegate financial decision making to financial intermediaries for a certain reasons. Firstly, individuals were lacking in the technical knowledge to implement a financial plan for their lives. Secondly, financial intermediaries reduce the costs of long-term financial planning by benefiting from the scale economies associated with specialization in acquiring financial expertise (e.g. asset management) and accessing financial markets.

Ralph S. J. Koijen, Theo Nijman , Bas J. M. Werker, (2009) researchers conduct the study on the basis of economic importance changes as per time changes on the basis of life cycle stages consumption and problems faced by investors regarding portfolio choice. An investor who conditions only on age and wealth, researchers found that the processing fee is willing to pay on the basis of either current risk or for both current and future risk. .

Ameriks and Zeldes (2004) and Poterba and Samwick (2001) researchers found the empirical evidence on age-specific patterns in household asset allocation suggests at best weak reductions in equity exposure as households age. Present empirical study found evidence on how portfolio shares for stocks, bonds, and other assets vary over the lifecycle. Researcher had concluded that investment of the individual investors in equity shares decline very little at older ages.

Ameriks and Zeldes (2004) researchers find some evidence that some households reduce their equity holdings when they reach at retirement or annuitize their accumulated holdings in defined contribution accounts. To provide the perceived desire of investors to reduce their equity exposure as they age, and to help investors overcome the problems of inertia in retirement asset allocation that are documented by Samuelson and Zeckhauser (1988) several financial institutions have created lifecycle funds for the betterment of the individual investment as per their life cycle stages.

Donaldson, and Mehra (2002) researchers found that most of the studies are based on the suggestions derived based on the knowledge of the expert financial planners as well as the portfolio theory, which suggested that the proportion of shares in households' portfolio should decrease with age, young people hold very little stocks. On the contrary researchers had found that the holdings of equities in investors' portfolios display increasing.

Jagannathan and Kocherlakota (1996) researchers had found that there was declining present value of future labor income is the only economically sound justification for the widespread conventional wisdom that investors should reduce stock market exposure as they age. In the life-cycle context, there was another important effect of human capital on asset allocation. Since human wealth declines as agents age (simply because there are fewer years of labor income left), so does the implicit holding of the near-risk free asset. Thus the investors near retirement age, they can shift some of their investment from shares to government bonds/bills.

Poterba and Samwick (1995) and Ameriks and Zeldes (2001) researchers conducted study and they found that the observed stock holding profile appears to be hump-shaped: i.e. young households tend to stay out of the stock market or have minimal stock holdings, but as investors get older i.e. as their age increases their participation in the stock market also increases. The shares holdings pattern is peak at the middle age of the investors and then decrease with age as they approach retirement. They also find that stock holdings rise with education and income levels.

Nikolai Roussanov (2010) researcher had found that the stock holdings of the young investors are two-fold. It was found that wealthier young investors the presence of the option to invest in capital lower risky investment option holdings, which thus peak in the middle of the life-cycle, after the option has been exercised. On the contrary, for the poorer young investors the presence of such an option can increase their risky asset holdings. thus potentially deepening the puzzle of low stock holding among the young.

Vanjeco (2012) researcher had conducted all-India survey of Indian Investors' Investment characteristics. Study focuses on the individual investor's preference, future preferences, Equity investment strategy based on Demographic Factors. This report present some more interesting information regarding association between Age and Investment related characteristics of Individual investors in survey conducted in Udaipur city. Further it was found that investor with lower expected return, lower risk bearing capacity and with loss avoidance behavior prefer a portfolio more fixed asset. Whereas investor with high expected rate of return, higher risk bearing capacity and loss avoidance prefer a portfolio more in risky assets.

Andrew Beattie (2009) study was based on investor's life. Researcher found that the income from other sources other than investment, income will change as investor become older. It is found that as investor will have most income when he has the least amount of time to invest. It means investor get higher income at he moves towards retirement stage.

Sharma B.C., Sharma Dinesh, (2007) researchers has found that the investment activity by retail investors is very low in India. The research was based on retail investor's investment patterns behaviour and attitudes that they hold about stock investing. Study was conducted in Jammu state. Results of the study shows that, the profile of retail investor as young, well informed, and also regularly trades and they holds moderately low belief towards stock market institution's regulatory capabilities and towards safety of small investor.

Paul Anand, Christopher J. Cowton (1993) researchers find some interesting findings based on finance theory focuses on risk and return as the factors relevant to the construction of investment portfolios. But there is evidence of a growing number of investors who wish to incorporate moral or social concerns in their decision-making. Using principal components analysis, this paper attempts to infer possible 'non-financial' dimensions of utility functions by considering the preferences of 125 'ethical investors'.

2.3 Conclusion

Also many researchers had studied the investment preferences based on the demographic factors, investor's ownership pattern in capital market, ownership pattern of shares/debentures. However the relationship between the stage in life cycle and risk taking and the stage in life cycle and investment size of Indian investors has not been examined adequately.

Thus it is concluded that researcher has found the scope for the study of investment preferences based on the life cycle stages, because many researchers have attempted to theoretically explain the relationship between the stage in life cycle and risk taking by individuals and a few have also experimented on the same. Therefore researcher has studied the investment preferences of investors as well as the relationship between stage in life cycle and investment pattern of individual investors.