CHAPTER 2
REVIEW OF LITERATURE

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2.1. Introduction

Psychological factors have its impact on the decisions of investors. But many a times these factors are ignored in investment process. In India several studies have been done on the basis of demographic factors of the investors and very few has on the psychological factors. Foreign researchers have done abundant studies on psychological factors and types of investors which has been considered by researcher in further reviews.

2.2. Review of Literature

2.2.1. Research by Indian Scholars

Shalini Kalra Sahi, Nand Dhameja, Ashok Pratap Arora (2012) stated that predictive segmentation procedure to find out the variables that are the most important predictors of investor's preference for specific financial investment products. The results showed that psychographic variables emerged as the most important predictors in the case of investment products with greater degree of risk, and the demographic and socio-economic variables emerged as the most important for the investment instruments with lesser degree of risk. However, when the sample was divided based on occupation profile (government and non-government), for both the fixed returns based instruments and the non-or both the fixed returns based instruments and the non-fixed instruments, psychographic variables emerged as the most important predict.

Pavani and P.Anirudh (2010) had focused on gender difference study by considering the age group of male and female. They have also studied that mentality of male and female differs according to the age group while making investment decisions. The researcher opines that the portfolio managing companies should also consider the psychographic variables of investor while offering a portfolio to them.

D.Kiran and Prof.U.S.Rao (2008) had tried to identify the investor group segments using the demographic and psychographic characteristics of investors. They have focused on six parameters of psychographic variables (safety,liquidity,long term appreciation, High short term Returns and risk coverage) affecting risk bearing capacity.Even they have classified investors in four different types such as Professional investors, Ambitious investors, Cautious investor and Over-cautious investors. These segments each have different investment decisions. They found that the financial product designers equipped with this sort of information on various segments of investors and the factors that affect their risk-bearing capacity, can specifically target particular segments through their instruments for effective marketing.

Avanidhar Subrahmanyam (2007) states that the cognitive biases of investors do affect the price movements in the market due to which attention is diverted to the most active stocks in their portfolio thus raising the transaction costs and leading to less frequent price movements in less active stocks.

Researcher has reviewed four articles in Indian scenario which depicts that psychographic segmentation of investors is an important parameter for assessing risk bearing capacity of investor through which the financial institutions or intermediaries would target the particular segments through proper marketing strategy. Even they would also target the investors on the basis of gender differences.

2.2.2. Research by Scholars at International Front

Rohaizt Baharun and Abu Bakar Abdul Hamid (2011) had identified the values and lifestyles that best explain financial unit trust behaviors. Data were obtained from a questionnaire handed to a cluster sample of 1350 customers.A factor analysis was conducted on the information obtained and results of analysis revealed nine factors of segmentation of Malaysian customers for their new unit trust products.

Naveed Ahmed,Zulfqar Ahmed and Sarfaraz Khalil Khan (2011) had found that the decisions making process of the small investors seems to be influenced by the behavioral finance theory rather than conventional theories. They further state that prospect theory, regret aversion theory and heuristics also plays their role in decision making process of small investors in Lahore.

Yu-Je Lee (2010) had discussed how investment behavior and decision factors affect performance of Taiwan stock exchange. The research targets were randomly selected from Taiwan stock market investors. They have used correlation and one way ANOVA were explored in an examination of how these variables affect investment behavior and decision factors towards performance of Taiwan stock exchange.

Nick Chater,Steffen Huck and Roman Inderst (2010) state the decision-making processes of consumers in the market for Retail Investment Services. The objective of study was to study the both individual and behavioral traits influencing consumers decision-making in RIS and to explore the effectiveness of different policies helps consumers make better decisions of investment.

Bernues Hannes,Sandberg Carl and Wahlbeck David (2008) had examined that the professional investors behave irrationally due to psychological dilemma related to financial world. It has been found that the target group fall under same psychological dilemma it has been seen that Anchoring and Gambler fallacy has strong bias as compared to overconfidence.

Cliff Mayfield,Grady Perdue,Kevin Wooten (2008) had focused on big five personality taxonomy. Even they have evaluated the traits using structural equation modeling. Further they have stated that investment pattern of individuals through personality traits. It also emphasis on that identifying specific group of people for deriving their investment needs.

Martin Sewell (2007) had focused on three heuristics approach that affects the investment decisions those are affect which is associated with goodness and badness of an investment. Availibility approach relies on the knowledge which is readily available. Similiarity approach refers to judgement between current situation and other situation.

Hussein A.Hassan Al Tamimi (2006) had focused on the factors influencing the investment decisions of investors in UAE markets.The most influencing factors were expected corporate earnings, stock marketability and past performance of the firm etc.

Pompian and John Longo (2004) had focused on new paradigm of creating investment programs based on personality type and gender by using Myers-Briggs type indicator. This model is based on broad eight types of personalities such as Extrovert or Introvert (E vs I), Sensing or Intutive (S vs I),Thinking or Feeling(T vs F),Judging or Perceiving (J vs P).they have also summarized that women are more risk averse than men. Even men often look after portfolio and are likely to cut their losses while women try to buy more and hold the stocks.

Jay Ritter (2003) provides a brief introduction to behavioral finance.focussing on \two building blocks of behavioral finance ie, cognitive psychology (how people think) and the limits to arbitrage (when markets will be inefficient)

CH.Van Schalkwyk (2003) had stated that individual do not act in rational manner while making investment decisions. He also stated that the behavioral factors that do affect the decisions such as prospect theory, regret and cognitive bias, overconfidence, greed and fear etc. He also stated that the behavioral factors need to be incorporated as a risk factor when constructing and rebalancing investment portfolio of individual investors.

H. Kent Baker and John R. Nofsinger (2002) had discussed the psychological influences in investor decision-making and also focused on the social factors that affect financial decisions.Even they have suggested five steps that investors can take to help to overcome common investor mistakes.

James E.Hunton,Ruth Ann McEwen and Sudip Bhattacharjee (2001) had proposed that an important psychological factor associated with optimistic earnings forecasts in the propensity of analysts o engage in risky choice behavior as described by prospect theory. Furthermore, the motivational incentives faced by analysis may aggravate risky choice behavior thereby magnifying overestimates of earning.

Daniel and Subrahmanyam(1998) indicated that investors are overconfident and believe too strongly in their private information. Even investors attach too much significance to signals that confirm their prior beliefs. This stream of research suggests that cognitive factors often influence the valuation of assets by individuals.

Barberies,Shleifer, and Vishny(1997) They suggest that investors ignore the laws of probality and behave as if events recently observed are typical of earnings generating process. Investors are slow to update their prior beliefs in response o new information. These two behavioural tendencies combined cause underreaction in some situations and overreaction in others.

Kahneman and Tversky (1979) they have propounded the Prospect Theory which states that people value gains and losses differently. It is believed that the net effect of the gains and losses involved with each choice are combined to present an overall evaluation of whether a choice is desirable.

Researcher has reviewed twenty one articles in International scenario which focuses on the psychological biases which affect the investment decisions. These factors are inherent in every individual and do contradicts at the time of investment which would lead to some common investment mistakes. To overcome these mistakes foreign researchers have suggested some remedial measures. Also they have focused on the psychographic segmentation on the basis of personalities for which they have used Myers-Briggs and Big Five Personality models through which investors are segmented on the basis of the personalities.

2.3. Conclusion-

From above review of literature it has been observed that behavioral finance plays a vital role in world of finance. Many researchers have contributed towards it. In domestic review 4 articles have been reviewed and 21 articles have been reviewed in International Scenario. Majority study has been done on psychographic segmentation and gender differences. Even various psychographic variables have been determined through the study. From the above review it also clear that psychographic variables do affect the decisions of an investor. Also the personalities of investors can be derived by using the personality tests models on the basis of psychographic variables. Major eight factors affecting the behavior of an investor those are Representative Bias, Familiarity Bias, Mood And Optimism, Mental Accounting, Disposition Effect, Overconfidence, Social Factors and Attachment Bias can be derived from the review of researchers undertaken earlier in the field of Behavioral Finance.