

CHAPTER -7

INVESTOR BEHAVIOUR

Dr. Divya Verma Gakhar

Contents

2

- ▣ Introduction
- ▣ Investor Behaviour
- ▣ Types of Investors
- ▣ Objectives of Investment
- ▣ Factors influencing Investor Decision Making
- ▣ Factors influencing Investor Personality
- ▣ Characteristics of Successful Investors
- ▣ Behavioural Biases
- ▣ Managerial Implications for Investors and Investment Managers

Meaning

3

- Investor behaviour attempts to define the psychology of investors while making investment decisions. Investors use their mind and logic while investing in any security or portfolio. Investor behaviour elaborates the reasons and the biases due to which there can be mistakes in the judgment and evaluation of a security.
- Investor behaviour can be defined as the reaction, attitude and action of investors in a particular or a combination of situations which are available in the market or implied by the knowledge and experience of an individual.

TYPES OF INVESTORS

4

Classification Based on Investment

- **Overconfident investors** are those investors who are sure of their decision of chosen security or portfolio irrespective of the unfavorable market conditions. They may earn huge return from that but there is an equal chance of losing all the money. Such type of investors overestimates their quality of information and their ability to predict the future conditions resulting in severe consequences.
- **Status Quo investors** are opposite of overconfident investors. They stick to their investments despite potential gains on selling them. They display a lack of attention while managing their portfolios. They often underestimate their decision making skills and are reluctant of taking any risk. The studies have shown that women are less overconfident and stick to their investment for longer as compared to men.

Classification on Basis of Nature and Trading Style

5

- **Active investors** are those investors who take interest in trading of the market on the regular basis and change their portfolio from time to time. They may not trade on daily basis but keep an eye on the securities daily and record the fluctuations. They pay a lot of attention while making decision and do not hold the security for long time unnecessarily.
- **Passive investors** are the lazy investors in the financial markets. They do not go for the decisions which involve high stress and require investing a lot of time. These types of investors either invest in mutual funds or go to the traders to manage their funds. Passive investors are not experienced and often hesitate in taking crucial decisions.

Classification based on Objectives of Investment

6

- **Regular Investors**
- **Only Savers**
- **Seasonal Traders**
- **Angel Investors**
- **Business Investors**
- **Risk-taking Investors**

Objectives of an Investment

7

- Safety
- Growth
- Income
- Tax Exemption
- Liquidity
- Fight Inflation
- Finance Long term Expenses.

Factors Influencing Investor Decision Making

8

Internal factors are those which affect the decision of the individual due to his/her own judgment of choosing the type of security. In other words, it is in the hands of the investors to control these factors:

- **Emotional Attachment**
- **Attitude**
- **Personality**
- **Income Level**
- **Objective of Investment**

External factors are those factors which are not in the control of the investors. These are the factors due to which the investor is forced to change his/her decision about their investment:

- ❑ **Peers Pressure**
- ❑ **Market Movement**
- ❑ **Company's Financial Position**
- ❑ **Economic Situation**
- ❑ **Family Pressure**
- ❑ **Expert Opinion**

Factors Influencing Investor Personality

10

A. Biological Factors - Nature designs the biological characteristics of an individual and it comes as a combination of various factors. These are discussed hereunder:

- **Heredity**
- **Physique**
- **Endocrine Glands**
 - ***Thyroid gland*** – Any disturbance in this gland causes tension, diseases, mood swings and overall health.
 - ***Parathyroid gland***- disturbance in this hormone causes emotional instability, various deficiencies and irritation.
 - ***Pituitary gland*** –It causes growth, if this hormone is released more it leads to more growth and slow hormone causes less growth and short structures.
 - ***Adrenal gland*** - Adrenin is released in times of great emotional stress.
- **Nervous System**
- **Gender**

B. Environmental Factors - The external and internal environment also has a significant role in defining personality of an individual. Personality of an individual is affected by all stimulus and response he receives and gives during various stages of life which is known as environment.

- **Home**
- **School**
- **Early Experience**
- **Success and Failures**
- **Self-Image**
- **Cultural Factors**
- **Social Factors**
- **Social Norms**

C. Situational Factors

Characteristics of Successful Investor

12

Warren Buffet has suggested 15 characteristics for successful investors

- ❑ **Investors are proactive learners**
- ❑ **Invest with a planned exit strategy**
- ❑ **Investors are patient**
- ❑ **Have strong emotional control**
- ❑ **Well defined investment strategy**
- ❑ **Investors should thrive on risk**
- ❑ **Investors are disciplined**

- **Know how to use leverage to their advantage**
- **Learn quickly from their mistakes**
- **Investors are focused**
- **Use trend for their advantage**
- **Investors are persistent**
- **Team of professional advisors**
- **Strong financial background**
- **Passionate about the game of investing**

Behavioural Biases

14

- **Cognitive Biases:** Cognitive biases refers to those judgments which are made from the inferences drawn from what an individual thinks in his/her mind.
- **Emotional Biases:** Emotional biases occur when people listen to their inner instinct and make their judgments according to that, instead of applying the facts and logic.

Managerial Implications for Investment Managers

15

- Understand the Investment objective of your client.
- How much is the risk taking capacity of the client? The investor is conservative, aggressive or balanced in terms of taking risk.
- One must look at the total horizon of investment. Is it short period, medium period or long period?
- Understand the personality traits of the investor which will help you understand his attitude and general investment choices.
- Look at the demographics factors of your client like age, gender, family background, marital status, income as these are important while designing portfolios.
- Understand the return expectation of the investor from financial market.
- Evaluate various behavioural biases which are affecting the investor and design strategies to manage biases.
- Keep frequent and open communication with your client. It helps build trust and confidence.

Thank You

16

- Chapter – 8
RISK ATTITUDE

Continued...