

A Study on Equity Investment Motives & Styles of Individual Investors

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Abstract

This paper presents an analytical study of the Investors' Behavior towards Equity shares of listed companies. It focuses on the motives of Investment and styles of investment and it is with reference to Chennai, capital of Tamil Nadu. It studies the need for better understanding of behavioral pattern of individual investors and would help the investment advisors to visualize how the investors react to market movements and would enable them to devise appropriate asset allocation strategies for their clients. A review of literature from Efficient Market theory to Behavioral finance has been made. Purposive random sampling method has been adopted and student t test, ANOVA and F test are used to verify the hypothesis stated.

1. Introduction

Investor behavior is a study of the influence of psychology on the behavior of financial practitioners, both individuals and institutions and its impact on markets. Behavioral Finance analyzes the emotional dynamics, which guide the investor in his financial decisions. The individuals behave in a heterogeneous manner. Research in this area and the results from such research are taken into account in the field of investment management.

2. Importance of the Study

Globalization has changed the scenario of the nation. Dissemination of knowledge about the stock market through media has led to participation by large number of people in the stock market irrespective of age, education, locality and socio economic status. The investment behavior of individual investor has visibly influenced the stock market as most of the investment mistakes are made by individual investors and a detailed study of investment behavior is of high value to everyone in the investment community. Behavioral finance is a rapidly growing field, which emanates from psychology, sociology and anthropology. The study explains why otherwise rational people take some really irrational investment decisions.

This paper focuses on the motives and styles of investment. It is with reference to Chennai, capital of Tamil Nadu. The study is unique and brings out behavioral pattern of individual investors and their reaction to market movements and would enable investment advisors to devise appropriate asset allocation strategies for their clients.

3. Review of Literature

The Efficient Financial Markets imply that investors should over an extended period of time earn neither excessively positive nor excessively negative returns. Instead, their returns earned should mirror the returns earned by the financial markets as a whole and the risk assumed by the investor.

To Slovic¹, Behavioral finance focuses on how people deviate from fundamentals and take investment decisions based on emotions. It is the study of how such emotions can cause stocks undervalued or overvalued. It is also a study to create investment strategies that give a winning edge over other investors.

According to Nicholas Barberis and Richard Thaler² Behavioral finance has emerged as a new approach to financial markets. They also point out that Behavioral finance is a series of theoretical papers showing that in an economy where rational and irrational traders interact, irrationality has a long-term impact on prices.

Robert J. Shiller³ is of the view that Behavioral finance addresses many market anomalies that efficient market theory ignores and the most significant market anomaly is the excess volatility.

Brad M. Barber and Terrance Odean⁴ explain, “Behavioral finance incorporate observable, systematic, and very human departures into standard models of financial markets. Behavioral finance holds that investors tend to fall into predictable patterns of destructive behavior. In other words they make the same mistakes repeatedly”.

3.1 Review of literature related to Investment Motives:

Investment motives are classified into short term and long term. Dividend earnings are considered to be short-term motive. Capital appreciation and retirement safety are long-term motives. Balancing the short term and long-term gain is also considered as a motive.

Every investor makes investments to meet his financial goals. He may have different goals and by prioritizing his financial goals, he can increase the odds of achieving most of his goals if not all of them. He may follow investing strategies that may help turn his plans in to reality.

Investments made for a period of less than a year is called short-term investment. Investments made for a period of 3 years, 5 years, 10 years and above are called long-term investments.

Laverty (1996)⁵ defines short-termism as decisions and outcomes that pursue a course of action that is best for the short term but sub optimal for the long run.

Atherton et al. (2007a)⁶ define short-termism as “preference for action in near-term without due consideration for long term consequences”

Kay (2012)⁷ defines short-termism as “tendency to make decisions in search of immediate gratification at the expense of future returns: decisions we subsequently regret”.

Rappaport (2005)⁸ claims that short term investors focus on information like earnings, relative value and technical rather than long term value and discounted cash flow analysis. He argues that this can lead to inefficiencies from both fundamental (i.e. price level) and resource allocation perspectives; even if informationally efficient in the sense that investors can not readily make excess returns.

Kay (2012)⁹ suggests short term can be associated with hyper activity.

Atherton et al. (2007 a)¹⁰ Mercer (2010)¹¹ and Papaioannou et al. (2013)¹² document a link between short termism and excess volatility, is an extension on the market inefficiency argument.

Owing to the adverse effects of short termism, it is better to shift the balance towards more long term investing. Denison (2010)¹³ and Croce et al. (2011)¹⁴ document that long-term investors are more likely to rebalance their activities. They act as buffer against financial panic and speculation.

Croce et al. (2011)¹⁵ and Kay (2012)¹⁶ record that long-term investors focus on value created by their investments through time. They are considered to be better monitors who encourage improved corporate governance. They also consider long-term risk while investing. This helps in then use of capital and wealth generation over time.

Croce et al. (2011)¹⁷ mention the fact that long term investors bring public benefits as they provide finance for activities that add value in the long run.

Ang and Kjaer (2011)¹⁸, point out three benefits of long term investing.

- Ability to ride out market fluctuations
- Profits from periods of elevated premiums or mispricing
- Taking advantage of illiquidity premiums

A study on Investment Motive of individual investor in the stock market of Nepal by Bhushan Karki and BibhavAdhikari¹⁹ deals with the motives of individual investors. The motives are classified into short term, gambling and long-term motives. The study focuses on the association of information, Horizon, age, income, educational qualification with investment motives.

3.2 Review of literature related to Investment Styles:

There are several methodologies adopted by investors that are known as investment styles in accordance with the theories they are based on. Investing styles are classified as

- Aggressive investing
- Conservative investing
- Growth investing
- Value investing
- Herd investing
- Contrarian investing

Aggressive investing covers investments that have potential for significant growth and the investors take the risk of losing some of their principal with the expectation that they will realize greater returns.

Conservative investing involves a strategy, which seeks to preserve an investment portfolio's value by investing in lower risk securities and other blue chip or large cap equities.

Growth stocks exhibit signs of above average growth even if the share price appears expensive in terms of metric such as price to earnings or price to book ratios.

Value stocks have low price to earnings or low price to book ratios.

Herd instinct is observed when people lack individual thinking powers and think and act in the same way as the majority of those around them. The fear of missing out on a good investment is often a driving force behind herd instinct.

Contrarian style of investment goes against the prevailing market trends by buying assets that are performing poorly and selling them when they perform well

Martin Lettau and Jessica A. Wachter (2007)²⁰ propose a dynamic risk based model that captures the value premium firms modeled as long-lived assets distinguished by the timing of cash flows. The model implies that growth firms co-vary more with the discount rate than do value firms, which co-vary more with cash flows. The paper proposes a dynamic risk based model that captures both the high expected returns on value stocks relative to growth stocks and the failure of the capital asset pricing model to explain these expected returns.

De Chow, Sloan and Soliman (2004)²¹ measure cash flow duration of value and Growth portfolios find that empirically, growth stocks have higher duration than value stocks and this contributes to their higher betas.

Campbell and Vuo Iteenaho (2004)²² show that Growth stocks have higher betas with respect to discount rate news than do value stocks.

Growth stocks are high duration assets subject to high discount rate risk and such risk is an important component of total volatility.

Grinblatt Mark and Matti Keloharju (2000)²³ in their study on investor behavior cover the foreign investors, institutional investors and Finnish households. The foreign investors follow momentum strategy buying winning stocks and selling past losers. Local Finnish individual investors showed a contrarian attitude and bought losing stocks and sold past winning stocks. As per the study, sophisticated investors follow momentum strategies and exhibit superior performance. The naive investors follow contrarian strategy and exhibit inferior performance. Smart investors have an edge over the naïve investors maintaining the equilibrium.

Petri Kyrolainen (2007)²⁴ discusses the active and passive investors. The study analyzes the momentum and growth strategy during boom in technology stocks. Both active and passive investors tend to herd in their trading decisions. The active investors' herding increased monotonically year on year. The absolute level of passive investors' herding is much higher than that of active investors. This is consistent with the hypothesis that active investors' herding increased herding contributed to the bubble.

Louis K.Chan, Hisu-Lang Chen and Josef Lakonishok²⁵ analyze the impact of growth style. The authors maintain that value investing generates superior returns and generally outperform growth stocks. The authors record that growth stocks fail to meet optimistic expectations while value stocks exceed pessimistic expectations.

4. Objectives of the Study

The two objectives of the study are:

- a) To identify the investment motives of individual equity investors of listed companies and to examine the associations and differences based on their socio-economic profile.
- b) To analyze the investing styles of individual equity investors of listed companies and to identify the associations and differences based on their socio-economic profile.

4.1 Sample Design

The present study is an empirical and analytical study. The study is based on primary data. A well-structured questionnaire has been administered to elicit information from the respondents on the aspects of investment motives and investing styles.

The investment motives and Investment styles are linked to the different demographic factors such as gender, age group, educational qualification, occupation, annual income, and investment on equity of the investors.

Investment Motives are classified into short term and long term. Dividend earnings are considered short-term motive. Capital appreciation and retirement safety are long-term motives. Balancing the short and long term gain is also considered as a motive.

4.2 Sampling Method& Tools

Purposive sampling was adopted and Chennai being a major hub for equity transactions was chosen for the study. A random sample of 100 individual investors was chosen. Student t test, ANOVA, Duncan multiple range tests are used to verify the hypothesis stated.

4.3 Descriptive Analysis of Sample

The sample of 100 investors considered makes the following sub-groups:

- 74 Male and 26 female
- 44 graduates and 56 professionals

- 33 employed, 49 business and professional practitioners and 18 retired people
- 41 below the age of 45, 44 between 45 & 60 and 15 above 60
- 42 below 10 lakhs of annual income, 33 between 10 & 30 lakhs and 25 above 30 lakhs
- 38 below 10 lakhs of equity investment, 27 between 10 & 25 lakhs, 10 between 25 and 50 lakhs, 17 between 50 and 100 lakhs and 8 above 100 lakhs

4.4 Inferential analysis of the sample

4.4.1 Hypothesis 1 – Gender and Investment motives

Null Hypothesis: There is no significant difference between male and female investors with respect to investment motives of individual investors.

| Table 1: t test results for gender wise investment motives | | | | |
|---|-------------|------------|----------------|----------------|
| Gender | Mean | S.D | t value | P value |
| Male | 19.84 | 3.448 | 1.273 | 0.206 |
| Female | 18.92 | 2.058 | | |
| | | | | |

As the p value is greater than 0.05 the null hypothesis is accepted at 5% level (i.e. the difference is not significant).

4.4.2 Hypothesis2 – Educational background and Investment motives

Null hypothesis: There is no significant difference between Graduates and professionally qualified investors with respect to investment motives of individual investors.

| Table 2: t test results for educational qualification wise investment motives | | | | |
|--|-------------|------------|----------------|----------------|
| Educational qualification | Mean | S.D | t value | P value |
| Graduate | 18.61 | 2.652 | 2.864 | .005** |
| Professionally qualified | 20.38 | 3.333 | | |

Note: ** denotes significant difference at 1% level.

As the p value is less than 0.01, null hypothesis is rejected at 1% level and the difference between graduates and professionally qualified with regard to investment motive is significant. Professionally qualified have a strong retirement safety motive than the graduates.

4.4.3 Hypothesis 3 - Age group and Investment motives

Null Hypothesis: There is no significant difference between the age groups of investors with respect to investment motives of individual investors.

| Table 3: ANOVA results for investment motives among different age group | | | | |
|---|--------------------|-------|---------|---------------------|
| Age Group in Years | Mean | S.D | F value | P value |
| Below 45 | 18.80 ^a | 3.333 | 5.248 | 0.007 ^{**} |
| 45-60 | 20.70 ^b | 2.993 | | |
| Above 60 | 18.53 ^a | 2.134 | | |

Note: 1^{**} Denotes significant difference at 1% level.

2. Different alphabets among age groups denote significant difference at 5% level using Duncan Multiple range Test (DMRT).

There is a significant variation between age groups with respect to investment motives as the p value is less than 0.01 and hence the null hypothesis is rejected. Investors in the age group of 45-60 consider retirement safety and balancing short term and long term gain more than the ones in the age group of below 45 and above 60.

4.4.4 Hypothesis 4 – Occupation and Investment Motives

Null Hypothesis: There is no significant variation between different occupational groups with regard to investment motives of individual investors.

| Table 4: ANOVA results for investment motives among different occupational groups | | | | |
|---|--------------------|-------|---------|----------------------|
| Occupation | Mean | S.D | F value | P value |
| Employed | 18.33 ^a | 2.869 | 8.809 | <0.001 ^{**} |
| Business/profession | 20.86 ^b | 3.367 | | |
| Others(retired) | 18.50 ^a | 1.197 | | |

Note: 1. ^{**} denotes significant difference at 1% level

2. Different alphabets among Occupational groups denote significant difference at 5% level using Duncan Multiple Range Test (DMRT)

As the p value is less than 0.01, null hypothesis is rejected at 1% level and there is significant variation in different occupational groups with regard to investment motives. Based on Duncan Multiple Range Test (DMRT) the Business/professional group expresses retirement safety, balancing short term and long-term gain as their motives and differs from employed and retired group. Dividend and Growth prospects are slightly higher for the Business/professional group than the employed and retired group. All the groups are for long-term gain as investment motive.

4.4.5 Hypothesis 5 – Value of equity investment & Investment motives

Null Hypothesis: There is significant variation among different Equity Investment groups related to Investment motives.

| Table 5 ANOVA results for investment motives among different value of equity investment | | | | |
|--|--------------------|------------|----------------|----------------|
| Investment on Equity in Lakhs | Mean | S.D | F value | P value |
| Below 10 | 18.24 ^a | 2.775 | 7.976 | <0.001** |
| 10-25 | 18.81 ^a | 2.690 | | |
| 26-50 | 20.90 ^b | 2.331 | | |
| 51-100 | 22.12 ^b | 3.276 | | |
| Above 100 | 21.75 ^b | 2.605 | | |

Note: 1 ** denotes significant at 1% level

2. Different alphabets among value of equity investment denote significant difference at 5% level using Duncan Multiple Range Test (DMRT).

Since p value is less than 0.01 the null hypothesis rejected at 1% level. Based on Duncan Multiple Range Test (DMRT) the group with equity investment of 51-100 lakhs and above 100 lakhs are strongly inclined to have post retirement safety, balancing of short term and long term gain, supplementing income aligned with their long term motive and differ from the groups below 10 lakhs and 10-25 lakhs who are investing for long term than for any other motive in particular. The group with equity investment of 26-50 lakhs is somewhat closer to the groups of 51-100 lakhs & above 100 lakhs than the groups below 10 lakhs and 10-25 lakhs.

4.4.6 The Hypothesis 6 – Educational qualification & Investment styles

Null hypothesis: There is no significant variation between Graduates and professionally qualified with regard to investment styles of individual investors

| Table 6: t test results for educational qualification wise investment styles | | | | |
|---|-------------|------------|----------------|----------------|
| Educational Qualification | Mean | S.D | t value | P value |
| Graduates | 26.45 | 5.720 | 3.717 | <0.001** |
| Professionals | 31.39 | 7.205 | | |

Note: 1. ** denotes significant at 1% level

As the p value is less than 0.01 there is significant variation between graduates and professionally qualified investors and the null hypothesis is rejected at 1% level. Professionally qualified investors trade aggressively than their graduate counter parts.

4.4.7 Hypothesis 7 – Occupation & Investment styles

Null Hypothesis: There is no significant variation between different occupational groups with regard to Investment styles.

| Table 7 : ANOVA results for investment styles among different occupational groups | | | | |
|--|---------------------|------------|----------------|----------------|
| Occupation | Mean | S.D | F value | P value |
| Employed | 28.21 ^{ab} | 6.580 | 5.694 | 0.005** |
| Business/Professional | 31.31 ^b | 7.332 | | |
| Others | 25.39 ^a | 4.767 | | |

Note: 1. ** denotes significant difference at 1% level.

2. Different alphabets among occupational groups denote significant difference at 5% level.

As the p value is less than 0.01, Null hypothesis is rejected and the variation is significant at 1% level between professional group and others (retired) with regard to investment styles. Business and employed fall under aggressive style.

4.4.8 Hypothesis 8 – Annual income & Investment styles

Null Hypothesis: There is no significant difference between the different annual income groups with respect to investment styles.

| Table 8 : ANOVA results for investment styles among different income groups | | | | |
|--|--------------------|------------|----------------|----------------|
| Annual Income in Lakhs | Mean | S.D | F value | P value |
| Below 10 | 26.76 ^a | 6.152 | 7.589 | 0.001** |
| 10-30 | 29.30 ^a | 6.085 | | |
| Above 30 | 33.24 ^b | 7.822 | | |

Note: 1. ** denotes significant difference at 1% level

2. Different alphabets among income groups denotes significant difference at 5% level

Since the p value is less than 0.01 there is a significant variation between the income group of above 30 lakhs and the other income groups (below 10 lakhs and 10-30 lakhs) with respect to investment styles and the null hypothesis is rejected at 1% level. The investor group with above 30 lakhs annual income tend to be more aggressive and more growth stock pickers when compared to the other income groups.

4.4.9 Hypothesis 9 – Age group & Investment styles

Null Hypothesis: There is no significant variation between age groups of investors related to investing styles.

| Table9: ANOVA for significant difference among age group with regard to investment styles | | | | |
|--|---------------------|------------|----------------|----------------|
| Age Group in Years | Mean | S.D | F value | P value |
| Below 45 | 28.66 ^{ab} | 6.696 | 4.226 | .017* |
| 45-60 | 31.07 ^b | 7.315 | | |
| Above60 | 25.33 ^a | 5.205 | | |

Note: 1.* denotes significant at 5% level.

2. Different alphabets among age group denote significant at 5% level using Duncan Multiple Range Test (DMRT).

As the p value is less than 0.05, the null hypothesis is rejected at 5% level. The investors under age group 45-60 invest aggressively than the investors under age group above 60.

4.4.10 Hypothesis10 - Value of equity investment & Investment styles

Null Hypothesis: There is no significant variation between different equity investment groups with regard to investment styles of individual investors.

| Table 10 ANOVA for significant difference among equity investment groups with respect to investment styles | | | | |
|---|--------------------|------------|----------------|----------------|
| Investment on Equity in Lakhs | Mean | S.D | F value | P value |
| Below 10 | 26.39 ^a | 6.197 | 7.428 | <0.001** |
| 10-25 | 28.37 ^a | 4.986 | | |
| 25-50 | 28.10 ^a | 6.624 | | |
| 50-100 | 35.53 ^b | 6.355 | | |
| Above 100 | 33.50 ^b | 9.227 | | |

Note: 1. ** denotes significant at 1% level

2. Different alphabet among equity investment group denotes significant at 5% level using Duncan Multiple Range Test (DMRT).

As the p value is less than 0.01 the null hypothesis is rejected and there is a significant variation between different equity investment groups with regard to investment styles. Equity Investment group with investment of 50-100 lakhs and above 100 lakhs differ from the rest of the groups and follow aggressive investing style, growth style and also value style. The inference is that the amount of equity investment influences the investing style.

4.5 Conclusion

Among the investment motives, the long term gain is found to be an important factor followed by dividend and growth prospects and balancing of short term and long term gain. The least important factor is supplementing current income followed by retirement safety. Educational qualification, age, occupation, amount of equity investment influence the investment motive and gender does not have any impact on investment motive. Regarding styles of investment aggressive investing style is significantly present. There is insignificant presence of contrarian style. Educational qualification, occupation, age, income and amount of equity investment decide the investing styles of the investors significantly.

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