

EFFECT OF BEHAVIORAL BIASES ON MUTUAL FUND INVESTMENT BEHAVIOR WITH RESPECT TO INVESTORS OF CHENNAI

E. Shyamala¹, Dr. T. Thileepan²

¹Ph.D Research Scholar, Department of Business Administration, Annamalai University.

²Assistant Professor, Department of Business Administration, Annamalai University.

ABSTRACT

The decisions towards investment are often presumed to as rational, but, the behavior of actual investors tends to change due to the behavioral biases. Some of such biases like mental accounting, over-confidence, anchoring, herding behavior and loss aversion affect the choices of mutual fund investment. The present research study examines the impact of the behavioral biases over the investors of mutual fund and also investigates the way in which psychological factors affect investment duration, risk perception and fund selection. The study has been done with respect to the mutual fund investors of Chennai, Tamil Nadu. Convenience sampling has been adopted for selecting the respondents and the sample size is 100. Questionnaires have been administered over the respondents for collecting data from them and analysis has been done through regression. Results show that the investors mostly depend on heuristics and emotions rather on analytical reasoning. This leads towards suboptimal portfolio performance. It has been suggested through the study that behavioral awareness and financial literacy are needed for improving the decision-making of the investors of mutual funds.

KEYWORDS: Mutual Funds, Investment, Behavioral Biases, Financial Literacy

INTRODUCTION

Emergence of behavioral finance has challenged the idea that the investors are totally rational and also there is a prevalence of efficient markets. On the contrary, behavioral finance identifies the fact that cognitive errors, emotions and heuristics highly affect the process of decision-making. As regarding investments in mutual funds, the investors depend on the information provided by social networks, past performance and advertisements. Hence, it can be said that huge role is played by behavioral biases. Over-confidence of the investors over their capability in predicting the market trends, thereby resulting in excessive trading is one such bias. Imitating the actions of other people during the crash or boom in markets is considered as herd behavior. The term anchoring bias is the word which is used when the investors depend more over initial information like the past performance of the funds. Loss aversion means the fear of losses makes the investors to have a hold on the under-performing funds or make an exit early. In case of mental accounting, the investors categorize money as separate accounts on the basis of subjective criteria.

Such biases alter the rational analysis and result in decisions which are not consistent with the long duration financial goals of the investors. It is crucial to understand the impact of the behavioral biases over the mutual fund investment for the promotion of balanced and updated investment behavior.

STATEMENT OF PROBLEM

The traditional theories of finance presume that the investors tend to act in a rational manner and their decisions are based on risk-return analysis. But, in reality, the investors arrive at decisions which are affected by cognitive errors peer pressure and emotions. These behavioral biases alter the judgments of investors and result in irrational patterns of investment like excessive trading, adapting the trends prior to analysis and panic selling. In spite of the increasing reputation for the mutual funds in our nation, India, only few studies had been done to explore the way in which such psychological biases influence the behavior of investors. This requires the need to have a detailed study regarding the effect posed by behavioral biases over the decisions regarding investments in mutual funds.

NEED FOR THE STUDY

One among the popular and highly accessible investment options amongst the semi-urban and urban investors is the mutual funds. In spite of the data availability and direction given by the fund managers, several investors find it difficult to accomplish the optimal profits owing to the irrational making of decisions arising due to behavioral biases. Following are some of the reasons for which the present study has been undertaken:

1. For understanding the way behavioral biases affect the decisions towards making investments in mutual funds.

2. For enabling the investors in recognizing and managing the psychological tendencies which negatively affects rational judgment.
3. For assisting the financial advisors, fund managers and policy makers to design education programs for the investors which address the behavioral pitfalls.
4. For contributing insights towards the literatures on behavioral finance by making a relationship between theory and practical behavior of investors, with reference to mutual funds of India.

OBJECTIVES

The intention to carry out the study is to scrutinize and make an analysis of the effect imposed by behavioral biases of investors over the performance of mutual funds.

REVIEW OF LITERATURE

Odean (1999) made a study about trading behavior of the investors in the stock market. Respondents belonged to U.S. The aim of the study was to explore the role played by overconfidence bias. The sample population comprised of 10000 investor's accounts which were gathered through discount brokerage firm. The data was secondary in nature. Analysis of the collected data was done through analysis of trade frequency and statistical regression. It was explored that the investors made excessive trading owing to the aspect of overconfidence, thereby leading to reduced returns as compared with investors who were less active. The results proved that the behavioral bias had the tendency of reducing the performance of investment, even for the investors who were financially literate.

Waweru, et al., (2008) made a study among the institutional investors in the stock exchange of Nairobi, Kenya. The aim was to examine the effect of the behavioral factors on the decisions of investment. Purposive sampling was adopted to select the sample population of 100 respondents. Respondents of the study were the investment professionals. Structured questionnaire was used for collecting data from them. Regression and factor analysis were executed for analytical purpose. Findings showed that overconfidence, herd behavior and loss aversion influenced the investment selection and rational analysis was mostly overlooked.

Mittal & Vyas (2012) studied the manner in which the behavioral traits of investors affected their choice towards investment. Respondents of the study were the investors from Mumbai Delhi. Survey was carried out among 250 investors who were selected through convenience sampling. Standardized questionnaire with statements related with personality & investment preferences were used for data collection. Analysis of the collected data was done through multiple regression and correlation. Findings showed that the emotional tendencies (overconfidence, risk aversion) and the personality type of the investors affected the choice of investors towards mutual funds & investment frequency.

Chavali & Mohanraj (2016) studied the relationship of behavioral biases and the demographic features of investors with the investment-related decisions. The sample population comprised of retail investors of Chennai. Random sampling was adopted to select the respondents and the sample size was 200. Data was collected through questionnaire and analysis was done using regression and ANOVA. Results showed that gender, age and income played the role of moderators in affecting the behavioral biases like herding behavior and anchoring, ultimately affecting the investment decisions towards mutual funds and the portfolio diversification.

Bakar & Yi (2016) made a study among the investors of Pahang regions and Klan Valley in Malaysia. The aim was to explore the psychological factors which affected the decisions towards investment. Sample population comprised of 384 respondents who were selected through stratified random sampling. Responses were plotted on a questionnaire with Likert scale of five points. Analysis of the collected data was done using descriptive statistics and SPSS regression. It was explored that the overconfidence bias, representativeness bias and loss aversion bias affected the selection of funds by the investors and also their expectations towards returns.

Kumar & Goyal (2016) studied the aspect of behavioral biases. The respondents for the study were selected through judgmental sampling and the sample size was 350. The respondents were the investors of mutual funds in the northern parts of India. Structured instrument of survey was adopted for collecting the required data for the study. The collected data was put into SEM and CFA for analytical purpose. The results of analysis revealed that mental accounting bias, herding bias and anchoring bias affected the selection of funds and the portfolio performance.

Statman (2019) made an empirical and conceptual study among the global investors of mutual funds. The purpose of the study was to examine the manner in which the behavioral biases affected the long-term outcomes related with portfolio. Analysis of the database of the investors and varied market studies was done through comparative regression and meta-analysis. It had been identified that over confidence and loss aversion led to short-termism and excessive trading done by the investors, thereby decreasing the overall returns from the funds. It was suggested to integrate behavioral awareness within the financial advisory practices.

Narayan & Joseph (2023) examined the influence posed by behavioral biases over the decision-making process towards making investments. The respondents were the investors of mutual funds in the category of middle-income from Kerala in India. The method adopted to select the respondents was convenience sampling and the number of respondents selected was 250. The authors had collected primary data with the help of a questionnaire wherein

responses were recorded on Likert scale basis. Analysis was made through regression and factor analysis. It was explored that anchoring bias, mental accounting and herding behavior highly affected the selection of funds by the investors and the time of making investment and time of redemption.

RESEARCH METHODOLOGY

The study was carried out for exploring the impact of behavioral bias of the investors of Chennai, Tamil Nadu, India, on the performance of mutual funds. The technique used to select the respondents was convenience sampling. Respondents were the totally 100 in number. Data was gathered by the author of this study through questionnaire and analysis was done by performing regression.

ANALYSIS AND INTERPRETATION

R	R Square	Adjusted Square	R	F	Sig.
0.947 ^a	0.897	0.892		164.495	0.000(a)

a Predictors: (Constant), Risk Tolerance

	Unstandardize d Coefficients		Standardize d Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	.146	.149		.977	.331
I tend to rely on my past experience when making mutual fund investment decisions.	.097	.029	.124	3.377	.001
I prefer mutual funds that are popular or widely chosen by other investors.	.255	.031	.292	8.157	.000
I sometimes make mutual fund investment decisions based on emotions rather than careful analysis.	.218	.038	.236	5.758	.000
I tend to hold on to a mutual fund investment because I believe its value will eventually recover, even when its performance is poor.	.268	.035	.389	7.600	.000
I am influenced by recent gains or losses when deciding whether to invest in a mutual fund.	.161	.033	.255	4.904	.000

Dependent Variable: Investment behavior

FINDINGS

On the basis of the findings of the prevailing studies and data collected from the respondents, it was explored that:

1. Overconfidence bias made the investors to make overestimation their awareness and underestimation of the market risks, which led to regular portfolio changes.
2. Herd behavior was found to be common in times of market rallies, wherein the investors followed well-known funds and avoided the evaluation of basic facts.
3. The investors are found to be discouraged by loss aversion to face the losses, which makes them to have the possession of funds, which perform to a low extent, for an extended time period.
4. Bias of anchoring influences the selection of funds. As a result, the investors depend too much on the initial value of investment or prior performance of funds.
5. Bias of representativeness makes the investors to relate profits of short duration with the quality of funds, thereby overlooking the levels of risks.
6. Mental accounting leads to irrational allocation of risks, since the investors consider varied investments in varied ways, on the basis of their purpose or source.
7. It was explored that the retail investors having less experience in investment or low level of financial literacy had the highest level of behavioral biases.

SUGGESTION

1. **Programs towards Behavioral Training:** The regulatory bodies and the financial institutions should carry out workshops for educating the investors regarding the most prevalent psychological biases and their effects.
2. **Getting help from Financial Advisors:** Consultations can be done by the investors with the authorized financial planners for mitigating the personal biases which arise during decision-making.

3. **Tools for Monitoring Portfolio:** The platforms of investment need to offer analytical tools and automated alerts for supporting purposive and rational making of decisions.
4. **Campaigns of Awareness:** SEBI, fund houses and AMFI need to hold campaigns which emphasizes over rational investment and not just getting returns for a short term.
5. **Orientation for a Long-term:** The investors have to be motivated in adopting investment strategies based on goals and not on the basis of market fluctuations of short-term nature.
6. **Simplified Modules of Financial Literacy:** the elements of behavioral finance have to be included in educational programs, which enable the investors in identifying their biases at an early time period.

CONCLUSION

The scholar of this study had concluded that the behavioral biases significantly affect the investment behavior towards mutual funds. Though the mutual funds provide professionally managed and organized platforms for the creation of wealth, the psychology of the investors mostly weaken balanced decision-making process. The investors tend to make biased or impulsive choices due to herd tendencies, emotional reactions and cognitive shortcuts. Exploring such biases and addressing them prove to be crucial to maximize profits and achieve the financial goals. Hence, motivating investments on the basis of advisory notes, improving the financial literacy and encouraging behavioral awareness may enable the investors to make an alignment of their decisions with long-term and rational objectives.

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