



## EMPIRICAL ANALYSIS OF STOCK SELECTION BEHAVIOR OF RETAIL INDIVIDUAL INVESTORS

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### Abstract

After globalization greater risk is exposed for the retail investors as due to increase in volatility and fluctuations. Retail Equity investor's behavior towards stock investment and their expectations of returns in terms of capital appreciation and regular income i.e. dividend is also changing. Investors expect return out of their investment to meet expectations of their investment which is influenced by their behavioral approach towards the stock. Now a day's organizations are also paying good amount of dividend to retain existing shareholders and attract new investors. To maximize the wealth of investors dividend payout by the organizations are improving from the past as according to an study and analysis conducted by S&P Dow Jones Indices (SPDJI), since August 1996 till April 2014, the sensx has increased 537% on market price return basis — the returns which only take consideration of market price movements of the index. On the other hand, when total return for sensx is considered as the price movements and also dividends paid by every constituent stock are reinvestment into the index constituents itself than the total gains goes to 759%. This reflects that 222%, or near to third of the returns from investing in the sensx, results from the dividends earned since 1996. Investor's behavioral viewpoint is changing due to shifting behavior and psychology towards financial decision making. This research paper is an attempt to study and understand the behavior influence of retail investors in stock investment and how expectations are getting changes in the era of uncertainty. For the research study primary data will be collected from the retail individual investors by designing structured questionnaire and secondary data will also be collected from journals, websites, published research papers and news articles. Research can assist in throwing light on retail individual investor's expectations which can result to promote more domestic retail investment in stocks as well as to devise organizations dividend policy.

**Keywords- Competition, Retail Individual Investor, Dividend, Dividend Decision, Organizations, Stock.**

### Introduction

Behavior is said to be one of the determining factors for stock selection and investment decision making of individual as it is individual behavioral outlook which provides justification for individual behavior as why people make rational and irrational financial decisions. **Behavioral** and cognitive psychology of investors is influenced by lot of external and internal factors as well as by their unique circumstances. Investor's expectations of return and appetite for taking risk are influenced by their behavioral approach. Now a day's due to increasing fluctuations and uncertainty investors expectations are also getting change as they need to compensate with future risk so It is crucial to understand their expectations from stock investments as it influences the retail individual investment in stocks. According to data available retail individual investment is hardly 5 % in stocks. Retail individual investment can be improved if expectations and causes for avoiding stock investment is understand .This research work attempts to spotlight and investigate the behavior influence of retail investors in stock selection and investment decisions as well as their expectations from stock investment.

### Objectives of the study are

1. To study and understand the Stock selection behavior of retail Investors
2. To understand behavioral factors influencing stock selection and Investment decisions.
3. To analyze the behavioral persuade of retail investors in stock selection and investment decisions.
4. To investigate for the factors considered in stock investment decisions by the investors'.

### Hypothesis for the Research work

1. H0: Dividend payout does not influence the Stock selection behavior of Individual Investors.  
H1: Dividend payout influences the Stock selection behavior of Individual Investors.
2. H0: Stock selection behavior of retail Investors are not influenced by existing dividend models.  
H3: Stock selection behavior of retail Investors are not influenced by existing dividend models.
3. H0: For retail investors the rational Investment decisions does not depend upon opportunity cost involved in comparable investment  
H2: For retail investors the rational Investment decisions much depends upon opportunity cost involved in comparable investment.

### Theoretical Background

Research work attempt to focus on the behavioral influence of investors in making stock selection and investment decisions



so it is crucial to know and the identify the behavioral factors and parameters which are significant for the investor's decision making for stocks.

### **Behavioral Finance**

Behavioral Finance is defined as

“Field of finance which gives the notion for behavioral, cognitive psychological factors and theory with accustomed economics to make available explanations and basis for investor's behavior as justification and clarification for the causes why individual makes irrational financial decisions.”

Behavioral Finance can also be stated as

“The Study of behavior sustained and supported by psychology, effort to comprehend how sentiments and cognitive error influence decision making in finance.”

### **Behavioral Approaches**

#### **Heuristics Theory**

Heuristics is defined as the concept in which decision making is easier, particularly in multifaceted and indecisive situations by deteriorating the difficulties of assessing likelihood and forecasting values for easier decisions. The important heuristic driven biases and errors that impair judgement are -representativeness, anchoring, aversion of ambiguity, availability bias, Innumeracy and overconfidence.

**Prospect Theory:** Prospect theory provides explanation for decision-making of individual investors influenced by the investors' value system. According to the Prospect theory individual look at choices in terms of potential gains or losses I relation to a specific reference point. It explains the biases influencing an individual's decision-making processes and states of mind including: loss aversion, mental accounting and regret aversion.

**Market Theory:** Investors behaviour influence can be seen on the financial market also as change in market reflects change in expectations and perception towards market. It can be said that over or under reaction can be seen in the market share price due to changes or new information; extrapolation of past trends into the future; lack of thought to fundamentals underlying stocks as may be focus on well known or stable stocks and cyclical movements.

**Herding Theory:** Herding effect is defined as approach in which investor behaviour inclination is more as what other investors follow as can be said to a behavioural approach which states inclination of investors' behaviors to pursue the others investors' decisions and performance. Herding may be basis of various emotional biases, taking congruity conformity and cognitive conflict. Investors can have a choice for herding if they think that herding can support them to take out important and reliable information.

### **Identified Behavioral Factors influencing Investor's decision-**

Stock selection and investment decisions are always backed by cognitive and behavioral psychology which decide influence and also risk appetite for investor.

For the research work identified behavioral factors and parameters are listed below-

- a) Anchoring /Overconfidence & Availability bias(Heuristic approach)
- b) Knowledge base(Market Information - Price changes, market information, past trends, fundamental of underlying Investment, over reaction to price changes or corporate actions )
- c) Financial Literacy (availability ,awareness and analysis )
- d) Expectations
- e) Attitude (Prospect approach- Loss Aversion, Regret Aversion)
- f) Influence of decision of other investors(buying and selling choice and Volume- Herding effect approach)
- g) Experience learning(past gain or loss )

Above mentioned behavioral factors are vital for individual's financial and investment decision making and stock selection. These factors affect the stock selection and investment decisions of individual investors directly or indirectly.

### **Research Methodology**

Research is of descriptive nature as research target to study and examine the psychology and behavioral aspect of investors for stock selection and investment decisions as preferences towards regular income ( dividend) and capital



appreciation (price changes). Population for research purpose will be all those individuals who invest in stocks for their own purpose in Mumbai region. As there is no appropriate data base which can depicts the accurate population data hence infinite population is taken into consideration. All those Individuals who invest in equity for their own purpose in Pune region of the age group of the 18 to 65 is considered as Sampling Frame. 300 retail individual data is collected for the research work. For retail individual investor's **non probability sampling** will be used as population is infinite or undefined. In non probability sampling, **Purposive sampling** will be used for the collection of primary data of retail individual investors.

### Sources of data Collection

**Primary data**-Primary data will be collected from the following Sources:

- i) The structured Questionnaire for Retail Individual Investors
- ii) Unstructured interviews and discussions with retail individual investors.

### Sources of Secondary data

For the proposed research work Secondary data will be collected from the following Sources:

- i) Websites of organizations, web links relevant to proposed research work and National Stock Exchange website
- ii) Books and research journals relevant to research work
- iii) New articles
- iv) Available literature

### Data Analysis

Primary Data is gathered by filling Questionnaire from the retail individual investors. Data analysis is done using SPSS 20.0. Chi Square test is done for hypothesis testing and analysis. 300 respondents Analysis and the interpretation in percentage terms is also done below-

### Calculated value of Chi square

Chi Square test is applied for testing hypothesis, Outcome of which is shown below in tables. –

**Table No-1**

Particulars	Q-7.1	Q-7.2	Q-7.3	Q-7.4	Q-7.5	Q-7.6	Q-7.7	Q-7.8	Q-7.9
Chi-Square	204.980	129.547	13.740	67.213	171.627	7.280	87.627	95.707	91.227
df	2	3	2	1	3	2	3	3	3
Asymp. Sig.	.000	.000	.000	.000	.101	.264	.000	.000	.000

**Table No-2**

Particulars	Q-7.10	Q-7.11	Q-7.12	Q-7.13	Q-7.14	Q-7.15	Q-7.16	Q-7.17	Q-7.18
Chi-Square	155.280	46.22	145.433	137.233	216.987	80.827	140.780	164.420	183.233
df	3	2	4	4	3	3	2	2	4
Asymp. Sig.	.000	.000	.000	.000	.000	.000	.000	.000	.000

**Table No-3**

Particulars	Q-7.19	Q-7.20	Q-7.21	Q-7.22	Q-7.23	Q-7.24	Q-7.25	Q-7.26	Q-7.27
Chi-Square	83.760	72.560	190.320	238.020	194.82	233.280	185.820	83.760	72.560
df	2	2	2	2	3	3	2	2	2
Asymp. Sig.	.000	.000	.000	.000	.000	.000	.000	.000	.000

### Interpretation

- For First alternative hypothesis -From the data mentioned in above table it can be stated that p value is less than 0.05 as calculated value of chi square is more than of table value of Chi Square at 5 % level of significance for Question no7.1 to Question no-7.4 .So it can be concluded null hypothesis should be rejected and alternative hypothesis (H1) should be selected.
- For Second alternative hypothesis- P value is more than 0.05 as calculated value of chi square is less than of table value of Chi Square at 5 % level of significance for Question no7.5 & 7.18 .So In this case it can be stated that null hypothesis should be selected and alternative hypothesis (H2) should be rejected. Respondents responded that they want more dividend income but does not take reference of any dividend policy model.



- For Third alternative hypothesis- P value is more than 0.05 as calculated value of chi square is less than of table value of Chi Square at 5 % level of significance for Question no7.19 & 7.27 .So In this case it can be stated that null hypothesis should be selected and alternative hypothesis (H2) should be rejected. Respondents responded that they want more dividend income but does not take reference of any dividend policy model.

### **Data Analysis & Interpretation**

- Data belongs to diverse class like respondents are of private job (40 %), Business (20 %), retired (15%), students (18 %) and 12 % Govt. job.
- It can be said that most of the respondents belongs to annual income of 4 lakhs to 5.5 lakhs (34 %) and 5.5 lakhs and above (26 %).
- Most of the respondents belong to the age group of 25-35(40 %) and of 35-45 age groups (32 %).
- Respondents' preference is for long term stock investment as compared to short term.
- Most of the respondents agreed for the statement that organization should follow stable and continuous dividend policy as 47 % respondents said strongly agree and 22 % respondents said agree for the statement.
- 76 % respondents stated that less than 10 % of income they preferred to invest in stock and they are moderate risk taker as they do not wish to take high risk.
- 77 % Respondents were strongly disagree and stated that Dividend payout expectations are not at all influenced by any of dividend policy model as even they don't consider those models in making investment decision in equities.
- 84 % Respondents stated strongly disagree for the statement that Dividend policy models do not have realistic implications as in expectation towards dividend amount.
- Respondents stated that rational Investment decisions much depends upon opportunity cost and return involved in comparable investment than individuals market perceptions. Investors compare the return with the opportunity cost involved before investing in equity as 74 % respondents strongly agree for the statement.
- 72 % respondents stated that Investor's expectations of dividend varies as due to diverse economic conditions, as they responded that in boom capital appreciation gives the return in stocks but in other economic conditions due to instability expected returns are not obtained.
- 68 % respondents stated strongly agree for the statement that they can hold and wait for recovery in the particular share price if loss is compensated by more dividend payments.
- It can be stated that 86 % respondents believed that dividend amount depend upon the recent financial condition of the organization and imitate the strength and soundness of the organization.
- 48 % Respondents stated that on the basis of past financial performance, future potential movements of the stock prices can be anticipated and whether market conditions will be favorable or unfavorable can be known.

### **Major Findings & Observations**

- It can be said from data analysis that rational Investment decisions much depends upon opportunity cost and return involved in comparable investment than individuals market perceptions. Investors compare the return with the opportunity cost involved before investing in stock.
- Dividend payout is taken into consideration while making stock selection and investment decision. So it can be said that it is one of the important factor for stock price movement.
- Identified major behavioral factors are attitude, Expectations, Overconfidence, herding, prospect, Heuristic and market information.
- It can be said that available market information and interpretation of same reflects the unusual changes in stock prices as how they perceive new information.
- Attitude toward risk as to take risk or avoid also influence the decision of stock selection and investment.
- Investors are influenced by past experiences as well as by decisions of other investors while making stock investment decisions.
- It is found that Investor's expectations of dividend are different in diverse economic condition. Investors specifically expect more dividends in the period of slack or slowdown as to compensate with time value of money or holding period return as in boom sufficient capital appreciation is there in stocks price.
- Investors are ready to hold and wait for recovery in the particular stock if loss is compensated by more dividend payout.
- Investors stated that they expect regular and stable divided amount from organization as according to them it depicts the financial resources availability and soundness of the company.



- It can be said from data analysis investors expect good amount of dividend irrespective of organization's type and stage (growth, decline & indifferent firm).
- Respondents stated that on the basis of past financial performance, future potential movements of the stock prices can be predicted.

### **Conclusion**

Stock investment decisions are always said to be crucial as it depend on how individual behavior determine and analyze various factors and perceives the state of affairs. Researcher came cross various behavioral factors and parameters influencing stock selection and investment decisions in which vital factors can be concluded as attitude, Expectations, Overconfidence, herding, prospect, Heuristic and market information. In conclusion it can be said that if investors get something more in terms of return as compared to what he target from other investment alternatives, than he is interested for more stock investment. More stock investment can be there of retail individual investors if opportunity cost will be there as compared to other investments as risk factor will be reduced or risk is compensated with appropriate returns. Hence it can be concluded that investors now a day's expect more amount of dividend payout as in volatility if they hold certain holding period return should be there.

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