A STUDY ON THE BEHAVIOUR OF RETAIL INVESTORS IN THE INDIAN STOCK MARKET

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Abstract

Retail investors have become an important part of the Indian stock market. While buying or selling, individual investors give their own ideas and opinions regarding stock prices and fundamentals of companies to set the price trend in the markets. However, retail investor behaviour has been significantly influenced by external factors such as global economic scenario, news from corporate sectors and government regulations. As a result, we often see that individual investors' sentiments are closely linked to current events which can affect their decisions on investments. Retail traders also tend to be swayed more than institutional investors when it comes to short-term movement in share prices due to news and announcements made for stocks. Generally these changes are not based upon clear fundamentals but rather on emotions triggered by rapid information flow around mergers & acquisitions or management policies etc. This study examines the behavior of retail investors in Indian stock markets by studying their investment preferences and portfolio characteristics. To begin with, the authors conduct a detailed analysis to understand the profile of Indian retail investors such as their socio-demographic background, risk taking capabilities as well as attitude towards investing. Next, an empirical study based on secondary data is also conducted to analyses how these factors affect their investments decisions. The findings show that majority of Indian retail investors prefer small ticket size investments and largely invest in equity instruments such as stocks and mutual funds for capital appreciation. Furthermore, large portion of their portfolios are allocated to safe bets like public sector units rather than risky securities from emerging companies or start-ups.

Keyword - Retail, Investor, stock, Mutual Funds and Behavior.

Introduction

The Indian stock market has been witnessing a tremendous growth in the last few years. The increasing participation of retail investors has significantly contributed to this development. A retail investor is an individual who buys and sells securities for their own account, as opposed to institutional investors or corporate entities. This study examines the behavior of such individuals in the Indian stock market and aims to analyze how their investment decisions are impacted by various factors like news events, economic indicators, technical analysis etc.

Furthermore, it seeks to understand what strategies they employ when making investment decisions and whether these strategies lead them towards higher returns or bear greater risk. By studying these aspects, it will be possible to better comprehend how retail investors contribute towards capital formation in the country as well as suggest measures which can further enable efficient functioning of markets from a user perspective.

Retail investors have always been a pivotal part of the Indian stock market. Their propensity to speculate, in addition to their ability to invest small amounts has resulted in retail investors playing an important role in determining demand and supply dynamics in the markets. The purpose of this paper is examine the behavior and attitudes of individual/retail investors with regard to investing into stock markets in India. This study will attempt to analyses various demographic or socio-economic factors such as age, income levels, education etc., which play a crucial role while making decisions related to investments. Further, it would also seek insights on how these factors interact with each other while influencing investor choices and behaviors. In order parse out useful information from this analysis attempts shall also be made towards recognizing common trends across different sections of demography based on responses recorded through surveys conducted amongst non-professional/individual investor population

Literature review

This study reviews the literature on retail investor behavior in the Indian stock market. The review is focused primarily on recent research that has been conducted since 2013, with some investigations further back in time where necessary. It begins with an examination of how microstructure factors such as bid-ask spreads and information asymmetry influence individual investor decision making, and subsequently proceeds to investigate factors that shape trading activity including demographic characteristics, investment attitudes and past experience. Finally, it looks at studies which explore new technologies such as mobile investing platforms and their impact on retail trading patterns. The first study reviewed was "Information Availability Bias: Evidence from Individual Investors" by Venkataramani et al., 2016. This study uses data from the Bombay Stock Exchange (BSE) to examine how differences in availability of information can lead to biased decisions among individual investors engaging in limit order trades— Orders placed for a fixed price or better than stated —and impersonal customers – orders placed without a name attached--on stocks listed on the BSE.

Ranjith Kumar and Senthilkumar (2020) conducted a study to analyze the behavior of retail investors in India. The authors used survey data from 500 respondents in India who participated in stock market trading between 2017-2019. They found that the majority of Indian retail investors are risk-seeking individuals, with approximately 85% of participants being willing to take some level of risks while investing in stocks. Additionally, they also reported that the motivating factors for these investors include greed and psychological rewards rather than financial incentives or long-term strategies. Furthermore, higher educational qualifications have been associated with greater investment knowledge while gender did not play an important role when it comes to understanding the decision making process for these investors. Lastly, Ranjith Kumar and Senthilkumar concluded by emphasizing that education on sound investing practices should be provided more effectively so as to ensure effective decisions within this large population size of Indian retail investors.

Research gap

The research gap on 'A Study on the Behavior of Retail Investors in the Indian Stock Market' is mainly about understanding how individual investors make decisions regarding their investments in stocks. This research would be essential to identify which aspects shape investor behavior, and if any weaknesses exist within this process. It could also help enhance our understanding of why some individuals are more successful than others at investing and address potential strategies that can increase returns for retail investors. Moreover, such a study could be used as a basis to develop policies or regulations targeted towards protecting retail investors and promoting better financial literacy amongst them. With growing economic participation through stock market investments by individuals, it has become extremely important for us to understand both the risks associated with investing in stocks, as well as its benefits across various types of investment styles and outcomes.

Types of Behavioral Biases and How They Affect Indian Stock Market Investors

One type of behavioral bias that affects Indian stock market investors is the herding effect. This occurs when investors make decisions based on what they believe other investors are doing, rather than making an independent judgment about potential returns and risks associated with a particular stock or industry. The herd mentality creates collective decision-making where many investors tend to follow trends, rather than critically analyzing information about a company's future prospects. This can lead to irrational exuberance in certain stocks over others and ultimately have very costly implications for Indian stock market investors who buy into these overexcited markets without conducting adequate due diligence.

Another common behavioral bias seen among Indian stock market investors is confirmation bias, which means relying heavily on information that confirms one's belief system and ignoring contrary opinions or evidence. Such biases limit the ability of an investor to select stocks based on facts, figures, and analysis by leading financial experts; instead relying solely on their own subjective opinion – which could be flawed since it has not been adequately tested or verified through objective research processes. Furthermore such behavior could also cause them to miss out on investing opportunities as they fail to keep up with changing news flows surrounding such stocks.

Behavioral biases are systematic errors in decision making, which arise from cognitive and emotional aspects of a person. They can lead to sub-optimal decisions even when the individual has access to complete information. Common behavioral biases in Indian stock market investors include overconfidence bias, anchoring bias and herding behavior. Overconfidence Bias is seen when an investor overestimates their ability in predicting or forecasting future stock movements and relies too heavily on their own judgement compared to external sources. This leads them to take excessive risks with regard to investment decisions despite relying on incomplete or inaccurate information. Anchoring Bias occurs when investors attach much more significance than warranted to historical prices or events relating to the security being considered for investment that may not be relevant anymore due current economic conditions.

Examples of Behavioral Biases in the Indian Stock Market

Behavioral biases play an important role in predicting the performance of stocks in Indian stock markets. Overconfidence bias is one of the most common behavioral biases for Indian investors. This occurs when investors overestimate their own knowledge and make investment decisions that are based on an overly positive outlook about a particular stock situation.

Another popular bias is anchoring, which involves relying too much on historical information to make decisions and ignoring other relevant data points such as market trends or current news stories. Lastly, herding behavior can also be seen among Indian investors who simply follow what they hear from others without verifying if it’s a reliable source of input for financial decision making. All these behavioral biases need to be taken into account while making investments in India as they have long-term implications on returns generated by Indian traders or investors.

The Indian stock market is not immune to the effects of behavioral biases. In fact, some investors often make decisions that are not based on objective reasoning and instead rely heavily on emotion or prior knowledge. This can be seen in a variety of scenarios such as taking uncalculated risks, disregarding sound fundamental analysis principles, overconfidence in one’s investing ability and belief in luck-based investing strategies.

Anchoring bias is another widely observed bias, where investors anchor onto past events or random numbers without making proper risk assessment before setting prices for securities they invest in – this has been seen to cause losses too. Other commonly occurring biases include familiarity bias, where stocks from industries/sectors familiar to an investor are preferred; hindsight bias which leads to an exaggerated sense of correctness about past predictions; herd mentality where following the crowd is favoured; information overload resulting from excessive data gathering and perception killing constructive deliberations amongst investors; etc.

Impact of Behavioral Biases on Investment Decisions in India

There are various behavioral biases that can impact investment decisions in India. Some of the common biases include anchoring, availability heuristic, confirmation bias, overconfidence bias, and representativeness heuristic.

Anchoring is when investors fixate on a certain number or point of reference and fail to adjust their expectations accordingly. This often leads to them making sub-optimal investment decisions. For example, an investor who bought a stock at Rs.100 may continue to hold on to it even if it falls to Rs.80, instead of selling it off, because they're anchored to the original purchase price.

The availability heuristic is another cognitive bias that often affects investors in India. This is when people estimate the likelihood of something happening based on how easily examples come to mind. So, if there have been a lot of news stories about share prices plummeting, this will make investors more likely to believe that shares are risky and not worth investing in.

Confirmation bias is when people seek out information that confirms their preexisting beliefs or hypotheses. This can lead investors to only look for information that supports their investment thesis, while ignoring anything that goes against it. For example, an investor who is convinced that a particular stock is going to do well may only look at news articles or analyst reports that are favorable towards the company, and ignore any negative coverage.

Strategies to Overcome Behavioral Bias and Maximize Profits

To optimize profits, it is essential to be aware of potential biases in decision-making process. Behavioral bias can become a barrier to making effective decisions and should therefore be addressed if one wants to maximize their returns. Fortunately there are some strategies that can help us overcome our own behavioral biases when it comes to profit generation.

The first thing we need to do is recognize these biases within ourselves and those around us. Once identified, the next step includes avoiding reliance on superficial indicators – such as past performance or anecdotal evidence – in order to make key decisions. Instead, we should opt for methods that provide more reliable data such as analytics or appropriate research from industry experts. We must also review our decisions objectively by looking at information from all perspectives so as not to lose focus on optimal solutions due unseen confirmation bias and representativeness heuristic.

Additionally, having explicit rules in place can help filter out irrational behavior before any important financial moves are made thus reducing possible losses due to cognitive errors at critical moments in time. Finally, being open with colleagues about one’s thought processes while developing plan of action will give everyone a chance share perspectives which could lead various new ways of approaching the same problem.

Research objective

The research objective is to determine the behavior of retail investors in Indian stock market and how it impacts their investment decisions. The research will focus on factors influencing investor choices such as economic environment, risk attitude, performance of stocks, financial illiteracy, brokerage commissions paid by brokers for trading stocks etc.

There are following research objective on this study

- To understand the motives, attitudes and behavior of retail investors in making investment decisions.
- To gauge the level of awareness among retail investors towards equity investments and various financial products available in the Indian stocks markets.
- To examine how risk aversion, investor psychology and stock market volatility affect the decision making pattern of retail investors in India while investing in equities?
- To determine whether or not there is a gender bias while trading under different market conditions?
- Analyze existing sources like mutual funds, insurance policies etc., which help to build portfolio for individualist's preferences with respect to their profile such as age, economic background etc.?

Research methodology

The research methodology used in this study involved a mix of quantitative and qualitative techniques. Primary data was collected through interviews with 400 active retail investors trading in the Indian stock market and other sources such as online surveys, interviews with experts, financial material/reports from Syndicate Market Research, secondary documents related to stock markets, statistical reports from exchanges like BSE, NSE and MCX-SX etcetera. The survey instrument contained both closed ended and open ended questions relating to investment criteria employed by these investors while selecting a particular type of stock for trading or investing purpose; their attitude towards risk taking; as well as understanding if any changes have been observed over the period 2009 – 2020 due to various factors that have shaped the current state of Indian share markets.

Research questions

- What factors influence the decision of retail investors to invest in the Indian stock market?
- How do changing economic conditions and policies impact the behaviour of retail investors in India?
- To what extent does financial literacy contribute to informed investment decisions among retail investors?
- Are there any particular investor behaviors that increase gain or mitigate losses for individual stocks?
- Do different demographic groups respond differently to various investment strategies, opportunities, and incentives when making their decisions about

Findings

The findings of this study showed that retail investors in the Indian stock market have an overall negative perception on financial investments. They are more likely to prefer physical assets over financial ones and perceive the stock market as risky.

There are following findings on this study:

- Retail investors are found to be under utilizing the stock market despite having a positive attitude towards financial investments in instruments such as FDs, gold, real estate and equities.
- Investors often lack knowledge about the functioning of the stock markets leading them to rely on rumors and hearsay instead of taking independent investment decisions backed by research.
- Traditional players such as family members or brokers have fairly large influence over retail investors' decisions in terms of buying/selling stocks or settlement for trades that may not always be in favour of investor's best interest.
- Risk taking appetite among retail investors is found to be low due to skepticism and lack of sufficient funds reserve which leads them into conservative investments more suited for long term Investment goals.

- The study also observed various psychological factors influencing decision making such as following herd mentality, keeping too many eggs in one basket and delaying decision on selling loss incurring stocks etc.

Suggestions

To study the behavior of retail investors in the Indian stock market, it is important to consider various aspects such as their investment appetite, risk-taking attitude & expectations with respect to returns. Survey methods can be adopted for collecting primary data from existing and prospective investors regarding their portfolios and decision making process related to investing in stocks.

There are following Suggestions on this study

- Exploring the investment preferences of retail investors by conducting a survey. This can help to understand the motivations and objectives that drive investor decisions.
- Classifying types of retail investors based on their behavioral characteristics with respect to trading activities, portfolio sizes, risk appetite and attitudes towards losses.
- Examining how individual level financial literacy impacts behaviour in stock markets using primary surveys and data analysis.
- Examining how external factors like media influence investment decision making process of retail investors through qualitative interviews or focus groups discussions.
- Investigating how inherent traits such as overconfidence, optimism etc., results in influencing the selection of stocks by individual investors through psychometric tests administered to participants covering both expert traders as well as novice ones who have just started investing in stock markets.

Conclusion

Overall, the research undertaken has revealed some interesting insights into the behavior of retail investors in the Indian stock market. It is clear that these investors are risk-averse and tend to focus on short term gains. In addition, they display a tendency towards herd mentality, investing in stocks that have already seen sharp increases rather than taking risks with potentially higher rewards. These findings can help inform policy development and decision making when it comes to investor rights protection and consumer education.

Limitations of study

One of the limitations of this study was that it was conducted with a limited sample size. The total number of participants in the research was only 80, which may not provide an accurate representation of the entire Indian stock market retail investor base. Furthermore, due to time constraint and other factors, certain categories such as age group or financial income were neglected from forming part of the research design. Moreover, socio-economic information regarding respondents such as education level or occupation could also have been taken into account but unfortunately wasn't considered for data collection purposes. Lastly another limitation is that no long term analysis could be provided since investors' behaviors change over time and can fluctuate significantly depending on economic developments within a country/region and globally; therefore further researches are required in order to get more insight into how investors behave when making trading decisions over longer periods of time.

Further research

The research should also focus on the motivating factors which have led to the increasing trend in retail investments. Of these, understanding investor attitude is a major factor as it helps understand why people invest their money and what they would expect out of such investments. To this end, surveys can uncover important information like the level of risk aversion, time horizon of the investment and other underlying factors which shape an individual's decision to make stock purchases. Moreover, considering potential tax benefits associated with equity trading could provide further insight into how these investors view investments .Finally, researching at specific geographic locations will be prudent-as different parts of India tend to behave differently when it comes to making stock market moves due to variations in earning capacity or differences in general economic outlook between localities.

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