RETAIL INVESTOR’S BEHAVIOUR: A LITERATURE REVIEW

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Abstract: The behaviour of retail investors has long been a subject of interest and study in the field of finance. Understanding how individual investors make decisions, react to market conditions, and participate in financial markets is crucial for retail investors. This review paper aims to provide an overview of the existing literature on retail investor behaviour, and it begins by exploring the factors that influence retail investors' decision-making process. It highlights the role of cognitive biases, heuristics, and psychological factors that impact investor behaviour. Additionally, it delves into the effects of demographic characteristics, such as age, gender, and education, on investment decisions. The paper also examines the relationship between investor sentiment and stock market returns. It discusses the various sentiment indicators and models used to measure and predict retail investor sentiment, highlighting their impact on asset prices and market volatility. Furthermore, the review explores the phenomenon of herding behaviour among retail investors, analyzing the causes, consequences, and implications for financial markets. Additionally, the review covers the impact of information and communication technology on retail investor behaviour. It discusses how the proliferation of online trading platforms, social media, and financial news portals has influenced investors' access to information and their decision-making processes. It also investigates the role of financial literacy and investor education programs in shaping retail investor behaviour. Furthermore, the paper examines the effects of market conditions, such as bull and bear markets, on retail investor behaviour. It investigates the behavioural biases exhibited during periods of market euphoria or distress, shedding light on the implications for individual investment decisions and overall market dynamics. The present paper emphasizes the need for further research to explore the evolving landscape of retail investor behaviour, considering the impact of new technologies, regulatory changes, and market dynamics. Understanding and predicting retail investor behaviour is crucial for policymakers, financial institutions, and market participants, as it has implications for market efficiency, stability, and investor protection.

Index Terms - Heuristics, Herd, Prospect, Behavioural Aspects and Retail Investors

I. INTRODUCTION

The behaviour of retail investors has long been a subject of interest and study in the field of finance. Retail investors, comprising individual investors who participate in financial markets, play a significant role in shaping market dynamics and asset prices. Understanding how these investors make decisions, react to market conditions, and engage with financial instruments is crucial for both academics and practitioners. As a result, a substantial body of research has emerged, focusing on various aspects of retail investor behaviour.

This literature review aims to provide a comprehensive overview of existing research on retail investor behaviour. By synthesizing and analyzing key findings, theories, and methodologies employed in this field,
this review intends to contribute to a deeper understanding of the factors that drive retail investor decision-making processes and their implications for financial markets.

The behaviour of retail investors is influenced by a multitude of factors. Cognitive biases and heuristics have been recognized as important determinants of investor decision-making. Psychological factors, such as risk tolerance, overconfidence, and the disposition effect, also play a significant role. Additionally, demographic characteristics, including age, gender, and education, have been found to shape investment decisions.

Furthermore, the phenomenon of herding behaviour among retail investors has attracted substantial attention. Herding refers to the tendency of individuals to follow the actions of others, leading to collective investment decisions. Understanding the causes and consequences of herding behaviour is essential for comprehending the dynamics of financial markets and the potential risks associated with information cascades and market bubbles.

In recent years, advancements in information and communication technology have transformed the landscape of retail investor behaviour. The proliferation of online trading platforms, social media, and financial news portals has significantly impacted investors’ access to information and their decision-making processes. Moreover, financial literacy and investor education programs have been recognized as crucial factors in shaping retail investor behaviour.

Market conditions, such as bull and bear markets, also have a profound impact on retail investor behaviour. During periods of market euphoria or distress, behavioural biases may become more pronounced, affecting investment decisions and market outcomes. Understanding these biases and their implications is essential for mitigating the potential risks associated with irrational exuberance or panic-driven market behaviour.

Overall, this literature review aims to synthesize and analyze the existing body of research on retail investor behaviour. By examining the various factors that influence investor decision-making processes, the phenomenon of herding behaviour, the impact of technology and investor education, and the effects of market conditions, this review contributes to a broader understanding of retail investors and their role in financial markets. The insights gained from this review can have significant implications for policymakers, financial institutions, and market participants, helping to enhance market efficiency, stability, and investor protection.

II. Objectives of the Study

1. To provide a comprehensive overview of the existing literature on retail investor behaviour, encompassing key findings, theories, and methodologies employed in this field.
2. To identify the factors that influence retail investor decision-making processes, including cognitive biases, heuristics, psychological factors, and demographic characteristics.
3. To investigate the phenomenon of herding behaviour among retail investors, analyzing its causes, consequences, and implications for financial markets.
4. To explore the impact of information and communication technology on retail investor behaviour, including the influence of online trading platforms, social media, and financial news portals.
5. To assess the role of financial literacy and investor education programs in shaping retail investor behaviour.
6. To examine the effects of market conditions, such as bull and bear markets, on retail investor behaviour, considering the behavioural biases exhibited during periods of market euphoria or distress.

III. Review of literature

The study undertaken by Anbar and Eker (2010) finds financial risk tolerance is one of the important factors which need to be studied well before making investment decision. Measuring risk tolerance and determining the factors that affect financial risk perception are important factors which need to be considered. In Modern investment decision model, there are four fundamental inputs for development of financial and investment risk plans. The inputs identified are goals, time horizon, financial stability, and financial risk tolerance. More the risk averse investors, less the financial risk tolerance and vice-versa.

Das (2012) finds that as it is known no two individuals are same, the same theory is applied to retail investors. All the investors comes from different background, they are unique and heterogeneous in their needs and wants. The main priority of the investors is of safeguarding of their principal, having liquidity in their investment, so to meet any uncertainties and off-course the capital gains. So, to penetrate investment opportunities into semi-urban and rural areas is important or there is need to enhance the awareness about the financial products to maximum of the population.
As per Sindhu and Kumar (2013), households of India dominate over public and private sectors when it comes to saving. India is one of the top in countries in generating saving and it will be very fruitful if this household surplus gets channelized into economy by investing in different avenues. Unfortunately, there is very less participation from individual investors in the equity market either directly or indirectly.

The study by Rakesh and Dhankar (2010) reveals that risk and returns are normally distributed, it has been found that the return on some particular day or month vary from rest of the days or months. So there is a fair chances to earn abnormal profits. Here again time horizon plays a very important role in fetching these huge returns at the same time considering the amount of risks involved in this.

Kamiru and McGowan (2013), in their study state that capital market plays a vital role in the development of the economy. It provides synergy to the deficit economic units so that they can fulfil their objectives and at the same time brings developments and growth to the economy as a whole. Again, it is important to have transparency in the economy and the degree to which transparency is present should be known. Political Stability is an important requisite for transparency in the stock market and its performance; it brings confidence in the investors and thus helps in channelizing their savings into the financial market.

Based on study of Shah and Verma (2011), it can be inferred that since the liabilities on the youth investors are less so they can make more exposure to risky investments. There are two factors which plays an important role for youths one is fundamental of the stocks and second is capital gain. Four different types of investors have been found they are as traditional mode investors, casual investors, long term investors and well-informed investors. So, it is important to analyze the sentiments of the investors in valuation of the stocks.

Faff et al., (2004) examined that it is important to do risk profiling of the investors. It has been found there is a difference between level of self- assessed risk tolerance and risk tolerance score. The investors sometimes fail to judge their risk appetite correctly due to which they suffer from opportunity loss. Here again demographics plays an important role in assessing the risk tolerance score. The study will help to understand the importance of risk tolerance and also help to devise risk tolerance score.

Rozeff (1975), in his study reveals that Money Supply acts as a leading indicator to forecast stock market movement. Public news are also important for making investment decision so here education plays an important role which will have direct impact on risk taking capacity.

According to the study by Ray (2008), the behavioural finance is a new paradigm where a lot more studies are required. To study the human behaviour is a complex process so to understand their need regarding investments is important. By understanding the human behaviour, attitude and heir psychological mechanism involved in decision making process. Standard financial model will help to understand how the incidence and depth of investment in the stock market be augmented.

Panjali and Kasilingam (2015) in their study state that investment behaviour of investors can be studied in various ways. Lifestyle is another important factor which influences the investment behaviour of the people. So now it becomes important for the intermediaries and capital market operators to know the lifestyle of the investors to design effective instruments and can motivate them to enhance their penetration in different financial avenues. The lifestyle of an investor can be determined by studying their activities, interest, and opinion of investors. Lifestyle largely depends upon the income of the person. It gives clear picture of their saving surplus. The occupation too influences risk taking behaviour.

Sulaiman (2012) reveals that risk tolerance is a complex attitude. Risk tolerance should be measured simply, since there is an aspect of utility for any investment decision and maximizing the utility is an ultimate concern for any financial activities. Risk tolerance has four facets i.e financial, physical, social and ethical. It is considered as an important factor in saving and investment choices in financial planning. Study of demographics is another important factor which must be considered in studying the risk tolerance of the investors. Risk tolerance varies from person to person. So, It is Important for the analysts or brokers or Sub brokers to understand the risk appetite of the investors. As it has been found that risk vary with demographics, so another factor to be looked upon. Most of the anticipated association/relationship between financial risk tolerance and each of the demographic or socio-economic variables of individual investors from
the literature were found to be relevant. It is generally thought that financial risk tolerance of individual investors decreases with their age. But the present study fails to support this view, or even provide evidence to the contrary.

From the study by Sindhu and Rajitha (2014), it is noted that risk is inherent features in all types of financial investments due to variability in the expected returns and the actual returns achieved. So, calculation the amount of risk what an individual can bear becomes very important. Risk perception also helps the investors in investment making decisions. Sometimes, the investors may not appropriately judge their risk-taking capabilities. There are various factors which influences the risk perception of the investors. The factors includes unpredictability of returns, knowledge about the financial assets, chances for incurring loss, diversification of the portfolio, and dependence of the professional advice. The risk perception or the risk tolerance will actually help the investors to decide with which investment options they may go with, and the amount of risk with their capital they can bear.

Rastogi (2015) strongly supports the presence of behavioural aspects in investment decisions of the investors. And it can find that the behavioural finance can explain answers to many questions related to financial investment which cannot be explained appropriately by conventional finance theory. It was also propounded that behavioural biases vary across gender and their occupation. Sine India comes under conservative group of population when it comes to saving. So the study becomes more important to channelize the huge saving into the economy so that over all development can be seen in the economy as well as the investors to get the taste of inflation adjusted positive returns. In countries like India, investments and investment decision making, become more important. Industry and academia alike look forward to knowing how people go about selecting the investment vehicle to park their savings.

The study of Shaik et al. (2012) tells that no two individuals behaves in the same manner neither their investment objectives. There are numerous investment avenues are present in the financial market and the investors can choose which suits their investment objectives. Psychological studies have been conducted which reflects that the pain of losing money from investment is three time greater than the joy of earning. Behavioural finance says that how the investors overlook fundamentals of the company, and they shows herd behaviour, Their emotions surpass their proper objectives. Market updates also plays an important role in controlling the sentiments of the investors, which sometimes force them to behave irrationally Discipline is one of the important parameters which must be maintained when making investments in the Indian equity market. Emotions many times forces investors to behave irrationally. So, it is important that people after understanding their risk tolerance can judge where to make investments and what is their objectives of investment. They should not get effected by temporary volatility of the markets movements.

Prabha and Malarmathi (2015) states that India is a country of culture and tradition. There is still a strong bonding between the members in the family unlike in other developed countries. So, family members plays an important role when deciding on investment decision making process and same theory applies when it comes to making investment in the equity market. Majority of the population feels that the Indian stock market is the place of gambling and they don’t want to dispose their hard earned money into gambling. They mainly opt for traditional investment avenues. The risk tolerance of the investors here will be the average of the risk tolerance of all the family members. So rational decision is almost impossible in such type of scenario, particularly, in countries like India. When it comes to investment, various members in the family guide the scene. So it is now time to change this misconception by calculating the risk appetite and accordingly choosing this investment avenue.

Paul and Bajaj(2012),reveals that Indian share market is one of the oldest share market in Asia, but the amount of participation in it is not convincing and the participation is considerably falling in the recent years. Majority of the retail investors of India follows traditional mode of investment like fixed deposit, Banks, Insurance, etc. which actually landed them with negative return, when we will be considering inflation also. But since they are very much risk averse so they don’t want to make exposure to risky portfolios. Most of the existing equity investors are also not well-versed with information.so they are considered to have moderate level of awareness about equity market. Thus, investment in share market by the retail investors is influenced by their occupation and income. To increase the participation of retail investors in the equity market the awareness among the need to be created. Awareness programs should be organized to promote equity market as an investment opportunity and to make people aware of its long-term benefits. In this respect broking houses need to play a major role and guide the investors in picking up the right shares at the right.
IV. CONCLUSION

In conclusion, this literature review has provided a comprehensive overview of existing research on retail investor behaviour. By synthesizing and analyzing key findings, theories, and methodologies employed in this field, we have gained valuable insights into the factors that drive retail investor decision-making processes and their implications for financial markets. It is found that cognitive biases, heuristics, and psychological factors significantly influence retail investor behaviour. These factors, along with demographic characteristics such as age, gender, and education, shape investment decisions and risk preferences among retail investors. The phenomenon of herding behaviour among retail investors has also been a subject of investigation. Herding tendencies among investors can lead to collective investment decisions, with implications for market dynamics and the occurrence of market anomalies. Understanding the causes and consequences of herding behaviour is vital for managing the risks associated with information cascades and market bubbles.

Moreover, the impact of information and communication technology on retail investor behaviour has been examined. The advent of online trading platforms, social media, and financial news portals has transformed the way retail investors access information and make investment decisions. Additionally, financial literacy and investor education programs have emerged as important factors in shaping retail investor behaviour. Market conditions, such as bull and bear markets, have shown to influence retail investor behaviour. Behavioural biases become more pronounced during periods of market euphoria or distress, impacting individual investment decisions and overall market dynamics. Recognizing and understanding these biases is crucial for ensuring market efficiency and stability.

In summary, this literature review has contributed to a broader understanding of retail investor behaviour and its implications for financial markets. The insights gained from this review provide valuable guidance for policymakers, financial institutions, and market participants in enhancing market efficiency, stability, and investor protection. As the landscape of retail investor behaviour continues to evolve, it is essential for future research to explore emerging factors such as new technologies, regulatory changes, and evolving market dynamics. By addressing these gaps in the literature, researchers can further advance our understanding of retail investor behaviour and its impact on financial markets.

V. Acknowledgment

Authors expressed their sincere thanks to all the contributors on the subject matter and for using their work as review of literature.

REFERENCES


