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ROLE OF AN ATTITUDE AND FINANCIAL LITERACY IN STOCK MARKET PARTICIPATION

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Abstract

The Indian stock market is one of the oldest stock markets in the world. Individual investors do invest in Indian stock market and they have invested big part of their savings in the view of better returns. These investment decisions of an investor will be based on risk associated with investment and expected from that investment. Investors always expect higher possible returns on stock market investment because the risk associated with stock market participation.Nowday's studies have been focused on investor's financial decisions and the behavioral factors which cause to take such decisions. This is known as behavioral finance. The study of individual behavior finance is the biggest objective in research. But most of the research was related to either financial literacy or attitudinal behavior. Combination of these two attributes was never considered.Psychological factors are also important in behavioral finance as it improve investor's knowledge about financial products and help investors to become free from financial limitations. This is an attempt to explore how individual investor's behavior gets influenced by emotions and attitude irrespective of their financial literacy levels. This study tries to evaluate the importance of attitude and financial literacy in stock market participation by comparing them and to decide, which factor is more dominant. The research is explorative in nature and sources of information used for this research are primary as well as secondary one.

Keywords:
Behavioral Finance;
Attitude;
Financial Literacy;
Indian Stock Market;
Investment Decisions.

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1. Introduction

Behavioral finance is now widely accepted theory in financial research field.Psychology and evolution in field of behavioral finance is developing at astonishing pace. When it comes to risk taking and performance of financial investment evidence reveals that individual behavior differs from group behavior. Earlier research on role of behavioral finance in stock market is evident but lacks study of various contributing factors of behavioral finance.One of the major cause could be that, many analysts seem to treat financial markets as a bunch of statistical observations like technical and fundamental analysis. Understanding of how financial markets are also affected by the financial behavior of an individual investor is complicated area.

To be very precise, behavioral finance is a study of investor's psychology with reference to financial decisions. Emotions play very important role in financial decision making and investors become victim of their own mistakes.

Behavioral finance makes effort to explain that, how investors fail to remember and follow fundamentals of investing and follow only emotions. Behavioral financetheoryis focused on how thinking process and cognitive errors influence investor decision and stock market prices.

The crux of the behavioral finance is combination of individual and social psychology principles with classical finance theory to explore and emphasize the stock market performance. According to some researchers, behavioral finance outlines the features of individual interpretation and action taken based on that data for organized investment by individuals.

This study particularly deals with attitude – an aspect of behavioral finance which plays important role in stock market investment with financial literacy.It is an effort to evaluate the role of attitude over financial literacy in stock market investment.

Definitions of behavioral finance

Olsen R. (1998) states that "behavioral finance seeks to understand and predict systematic financial market implications of psychological decision process."

Beslky&Gilovich (1999) states that “behavioral finance is a behavioral economics. Behavior economics is a combination of two discipline i.e. psychology and economics. This combination is to explain why and how people take irrational or illogical financial decisions when they save, invest, spent and borrow money.”

M Sewell (2007)“Behavioral finance is the study of the influence of psychology on the behavior of financial practitioner and subsequent effects on market.” He studied the behavioral finance and theory of market efficiency with a different insight. He focused on how and why market can be inefficient because of irrational behavior of humans.”

By referring above definitions, the difference between traditional finance and behavioral finance can be analyzed. According to traditional finance, people process data correctly, whereas behavioral finance states that people employ imperfect rule of thumb considered as heuristics. Traditional finance assumes that people follow reason and logic while investment, whereas behavioral finance says that emotions and herd instincts are having important role in decision making.

2. Research Objective

“To explore importance of attitude over financial literacy in stock market participation.”

3. Literature Review

Schiller (2000) advocated that the stock market is strongly controlled by the market information. This information affects the investment behavior of the investors directly.

Barber and Odean (2001) explored that investing is traditionally done by men in the U.S.A. and because of it male could be considered to be more comfortable with investing than female. This study also evidenced that men does possess overconfident characteristics like excessive trading and higher risk trading.

Hong et al., (2004) found that, social interaction is a big influencing factor on stock market participation. As per their research, any social investor would find a market more attractive when more of his peers, family and friends participate in it. They applied this theory and it was found that social households those who interact to their neighbors and attend church were considerably more prone to invest in the stock market compared to other non social households, controlling for wealth, education risk tolerance and race.

According to **Barberis and Huang (2001)**loss aversion (i.e. tendency to be more sensitive to losses than to gains) and narrow framing (inclination to focus on narrowly defined gains and losses) are important factors in determining how people weigh up risky gambles.

Meng Chen Gong et al. (2004) studied howinvesting behavior and trading performance get influenced by investor's experience. This study also explored that those who are experienced in stock market investment are more prone to make trading mistakes and suffers from the representative bias.

Wood R (2004) focused on attitude and trading behavior of stock market investors by a survey among 90 individual investors. Four main parts of individual investor were identified which is as follows: risk intolerant traders, confident traders, less risk averse young traders and conservative long term investors. Cluster segment analysis was done and findings show that each part engaged in purchasing different types of stock and had variation in trading behavior.

4. Research Methodology

This study was explorative in nature and findings were based on primary and secondary data. Primary data was collected from stock market participants of Pune city in India. As for this research attitudinal investing was measured considering their levels of financial literacy, questionnaire was designed to accommodate this. First respondents financial literacy was measured with few questions related to stock market and and these respondents were categorized under four groups according to their financial literacy scores. These four groupswereHighlyFinancially illiterate, financially illiterate, Financially literate and Highly Financially literate. After that attitudinal questions were asked and responses were assessed. More importance was given for attitude related analysis. For secondary data - different books, journals, newspapers, reports were reffered. Geographical scope of the study was confined to Pune city only.

5. Results and Analysis

As mentioned in research methodology, respondents were categorized in four groups according to their financial literacy scores and later attitude related question were asked and assessed. To test the data according to statistical methods, cross tabulation form was used.

Table No. 1. The cross tabulation of groups according to financial literacy & Question, 'In which of the following options would you like to invest in stock market?' is as given below.

Crosstab					
Count					
	Groups				Total
	Highly Financially Illiterate	Financially Illiterate	Financially Literate	Highly Financially Literate	
I would like to Buy stocks that are cheap in price	10	21	40	65	136
I would like to Buy stocks that are costly in price	4	17	15	16	52
I would like to Buy Share of which prices are stable	6	19	41	53	119
Don't know	18	20	25	48	111
Total	38	77	121	182	418

Findings :Here the highest frequency is for the option I would like to buy stocks that are cheap in price i.e. 65. It clearly shows the attitude of investing fewer amounts in stock. Price consciousness is observed in this analysis. What is a worth of costly stock, is being ignored by both financial literate categories. It indicates that risk aversion attitude plays more important role in stock market investment than financial literacy. But here investors overlook the fact that investing in cheap stock itself is a big risk. And they are exposing themselves to a higher risk by investing in cheap stock due to price consciousness.

Table No.2: The cross tabulation of groups according to financial literacy & Question 'Do you think people invest in stock market based on their intuitions rather than calculations?' is as given below.

Crosstab					
Count					
	Groups				**Total**
	Highly Fin. Illiterate	**Fin. Illiterate**	**Fin. Literate**	**Highly Fin. Literate**	
I think Majority invest according to intuitions	11	26	35	73	145
I think majority invest according to calculations	6	16	32	32	86
I think majority invest according to intuitions and calculations	11	26	41	70	148
Don't know	10	15	16	10	51
Total	38	83	124	185	430

Findings :This crosstab indicates that highly financial literate people think that majority investors invest according to intuitions. Highest frequency is segregated in to this option. Second highest frequency indicates that majority investors invest according to intuition as well as calculations. Though the difference is not great enough but still it can be said that intuition based investing does exist and popular in investors.

Table3: The cross tabulation of groups according to financial literacy & Question. 'Answer the following' is as given below.

Crosstab					
Count					
	Groups				Total
	Highly Financially Illiterate	Financially Illiterate	Financially Literate	Highly Financially Literate	
I would never make a high risk investment	13	26	32	43	114
I have experienced considerable gain from risky investment	8	18	19	24	69
Even if I could get high return I would not prefer to invest my money that might decline in value	6	10	37	18	71
For maximising long term investment, I would be willing to accept dramatic, short term drops in value	11	26	35	97	169
Total	38	80	123	182	423

Findings 3 : These figures shows that highest frequency is allocated to the option "Maximizing long term investment I would be willing to accept dramatic, short term drops in value." Highly financial literate investors have selected this option. Again this result is contradictory with the results of previous question. There could be three reasons for this. First, being literate does not always guarantee that people will understand the question correctly. Second,respondents are quite overconfident about their risk taking ability. And third, it might be possible that people have responded haphazardly. Another highest selected option (second highest) is I would never make a high risk investment. This again throws the light on the risk aversion nature of stock market investor. Probably it can be considered as a true response from respondents with reference to previous results.

Table 4: The cross tabulation of groups according to financial literacy &Question 'If market is on positive side, how would a good investor react?' is as given below.

Crosstab					
Count					
	Groups				Total
	Highly Financially Illiterate	Financially Illiterate	Financially Literate	Highly Financially Literate	
I will Book the profit	12	24	29	53	118
I will Back my opinions by cash when they are confirmed by market actions	4	12	10	16	42
I will withdraw half of the profit every month and that withdrawn amount should be invested somewhere else	7	17	41	56	121
I will just wait and watch the market closely	9	12	19	31	71
I will follow tips given by trusted source and invest accordingly	6	16	23	25	70
Total	38	81	122	181	422

Findings 4: Above cross tabulation reveals that 56 investors will withdraw half of the profit every month and will invest somewhere else followed by the book the profit option. This indicates that investor doesn't want keep their profits in the market. Due to fluctuations in share prices, investors want to withdraw profit and invest it in some other, more secure investment avenue. It indicates that people do not trust stock market like other investment options. Those who are trained in stock market, their portfolio is expected to be well maintained and profitable. But those who are not trained , surely they will be very conservative about stock market

investment and they will try hard to invest more amount in some other investment options rather that stock market.

Further statistical analysis shows that 58% of the respondents werenot having any formal education regarding stock market investment. They have not attended any stock market related workshop, short courses, online modules or any BSE/NSE certification. Only 43% respondents were ready to participate in training programme related with stock market participation.

Being financially literate is important for taking informed decision. But the results show that attitude of people towards learning / training themselves for better participation is negative.

6. Discussion

From above analysis it can be observed that, attitude does play an important role in stock market investment compared to financial literacy. It has an influence on investor's decision making regarding financial matters. In the other context it can be said that markets are efficient but never move efficiently. If any company declares big investment over the next few years in initial period, investors start investing immediately without crosschecking the future prospects, return on investment on this project. In this way stock prices are moved by investor's behavior. Stock market participation is highly influenced by attitude of stock market investors. Some major factors that affect the stock market participation are:

1. Lack of Risk attitude,
2. Lack of Trust
3. Lack of Social interaction
4. Peer Performance in Stock Market
5. Inclination towards other investment avenues
6. Past losses due to wrong investment choices
7. Confidence level
8. Price consciousness

Therefore, one should carefully workout on a positive attitude which is right and be committed to that. This is bit difficult to analyze and control one's attitude by himself but not impossible. At the same time it is an emotionally difficult work.

It is proven fact that other factors like age, gender, income, education and experience in investment, does affect your attitude. These factors determine investor'sattitude but one has to be more concerned about the market changes and modify the attitude as required. Market information, social interaction and loss aversion are important factors in stock market investment.

These findings also suggest that attitude and trading behavior of stock market investor are determined by some major factors. Such as confidence/ overconfidence/ under confidence of investors, risk taking ability, conservative / return oriented mentality and more expectation. Other than these factors there are few important factors which affect investor's behavior are mensionedbelow.

1. A very high proportion of respondents are interested in purchasing cheap price stocks. But they are not aware that investing in cheap stocks is nothing but embracing the volatility of the underlying shares. Thought the potential to make significant moves very quickly appeals to the investors, it also lands them in equivalent downside risks. One of the accepted reasons behind purchasing cheap stocks is impatience. This attitude or character trait can cause a great damage. Many times impatient investor sells shares at very odd situations and timing. Such as just before the stock is about give good operational results. They keep switching from investment to investment for constant hunt for profit. And this will lead them to poor trading choices.

2. Intuition is considered simply as a feeling, a kind of inner "autopilot". It keeps control on human actions without deliberate decision making process. It is considered to be a tacit or implicit knowledge. Many times intuition takes the form of brainwave. Without thinking consciously about a problem, solution suddenly appears in one's mind. Many people have an inclination towards do and don'ts about something. Some people will think that strategy is ill advised and some will think that same strategy is outstanding, without really knowing why. It is

not a coincidence, it reflects people's intuition. It may be that people do not trust a certain people or strategy even though he/she has not really done anything wrong. Analysis shows that majority think that intuition based investment is there, and almost 51% investor have accepted that they do have such loss making shares (which was purchased based on intuition) in their portfolio.

3. In the risk taking attitude question, investors have chosen option "for maximising long term investment I would be willing to accept dramatic, short term drops in". In this option investors are aware that there is an ambiguity. It means there will be shortfalls or dropdown of investments. The ambiguity effect is a cognitive bias in which decision making gets affected due to unknown outcome. The effect states that people tend to select options for which the probability of a favourable outcome is known, over an option for which the probability of a favourable outcome is unknown. Whereas second highest frequency is of "I would never make a high risk investment". This shows the risk aversion attitude. These groups of investors prefer lower returns with known risk rather than higher returns with unknown. It means they will always prefer to the known investment avenue with least interest.

4. It is important to book profits at regular intervals. Long term investment and long term investment strategy is totally different. Whenever investment is made in stock market, investor should be well aware about the factors which make impact on stock market. Besides this, investors must be aware of factors which can impact his/her stockholding. Many times investors lose money instead of making profit. The main reason is failure of booking profits on time. Majority of investors have said that they would prefer to invest half of the profit somewhere else. This again indicates that investor doesn't trust stock market compared to other investment avenue.

7. Conclusion

The most recognized contribution of behavioral finance is the careful examination of stock market's role in aggregating various attitudinal behaviors. There are many gaps in finance and economic theories but considering findings from different attributes of behavioral finance is encouraging solution to fill these gaps.

Rational investors do have perfect information many times. But this information seems toused by these investors based on their attitude and behavior pattern. Behavioral finance explains us about why the markets behave as it does. It is accepted fact now that emotions do affect our investment decision. People generally acknowledge the role of greed and fear in stock market but role of attitude is still an understudied field. Behavioral finance gives various attributes to analyze the factors which determine the stock market investment like biases in decision making. It also states the importance of psychology in behavioral decision making.

By explaining cognitive errors and emotions, behavioral finance stands out in all financial and economic theories. It suggests that while making financial decisions, humans are tend to do cognitive errors and emotions hinder the proper decision process.

This was an attempt to explain the human behavior while investing in stock market and how stock market movements affect the investor's perception as well as age, gender, income, education and experience in investment also plays an important role in determining the attitude.

Financial literacy has an important role in decision making, but attitude is playing a more important role. This indicates that people need not be financially literate only, but they should be trained to develop right and positive attitude, for better decision making at stock market participation. This would help in two ways. Investors will be able to take decision based on financial literacy and proper attitude. Second, stock market will surely give good returns for such strategic investment. If well informed investors do participate in stockmarket, there investment will give positive returns as well as credibility of stock market will be maintained at higher level.

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