

# Does the Investor Investigate? Antecedents of Investment Decision

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## Abstract

This article explores the antecedents of behavioral and emotional factors: heuristic, prospect, herding, pleasure, arousal, and dominance towards Investment Decision. The study also emphasizes the influence of socio-demographic in making a Ponzi scheme investment. All these empirical phenomena are discussed by explicating a conceptual framework - "JAIKO Investment Decision Model". The conceptual model is tested using structural equation modeling (SEM) as the primary statistical technique. The survey yielded 294 completed and valid questionnaires. Furthermore, this study explores the role of behavioral and emotional factors in the investment decision. The empirical results incorporate versatile insights of behavioral and emotional parameters to explain investment decision towards the Ponzi schemes. Implications for investors and policy makers are also addressed in this article, and suggestions made for future research.

**Keywords:** Behavioral & emotional factors, Investment decision, Ponzi scheme

## 1. Introduction

Despite the assumption in classical theories of finance that investors act entirely rational while making investment decisions, the modern theories have contrasted that investors often act irrationally, as a consequence of various influences (Grinblatt and Keloharju, 2000; Opaluch and Segerson 1989; Ritter, 2003; Tseng, 2006). Generally, decision-making process is a complex procedure that includes various factors of different measures. It is a long assumption that the investor has adequate resources to evaluate the alternatives prior to constructing an investment decision. Investor behavior can anticipate and respond in a similar manner towards the investment decision process (East, 1993). Dimitrios, Zeljko and Prodromos (2011) observed the changing behavioral patterns in the financial decisions by explaining the market anomalies. While traditional finance theory perpetually expresses evaluation of risks and expected returns as the base of investors' investment decisions, behavioral and emotional factors may play critical role in investment decisions (Bhat and Dar, 2013; Charles and Kasilingam, 2014; Jing, Hao and Xian, 2013; Riaz, Hunjra and Rauf-i-Azam, 2012; Xiao, Kan and Hong, 2006).

### 1.1 Problem Statement

In this present financial market backdrop, the approachability of the investors has intensified to make the apt investment decision. It is essential to investigate the behavioral and emotional factors of the individual investors in order to have an in-depth insight into the investors' decisions making process. Given the importance of the behavioral and emotional factors towards the investment decision, it is astonishing to know how very few researches have concentrated in this area. Fortunately, this present research will shed light on this very important but less researched area.

### 1.2 Purpose of the Study

Over the recent decades, the understanding of the individual investments has been malingered. In spite of having a plenty of legitimate investment options, the individual investors are found to be trammled by deceitful Ponzi schemes. Such schemes are disguised as a legitimate company that pays returns to investors from their own money or money paid by subsequent investors, rather than from any actual profit earned. This paper concentrates on the behavioral and emotional factors of the individual investors towards the decision making process. The primary purpose of this study is to ascertain the constructs constituting the behavioral and emotional variables. Existing literature will be examined to understand the contributions made so far, by which, the research gap could be established. The researcher suggests a conceptual framework, indulging the constructs of the investment decisions.

### 1.3 Research Questions

Considering the background of the study, it is found that there is only a little knowledge about the attributes. Hence the present research has elicited the following research questions:

- What is the association between behavioral factors and emotional factors?
- What is the contribution of behavioral and emotional factors in the investment decision?

- Do the socio-demographic factors ascribe the investment decision?

#### *1.4 Objectives*

Following objectives have been framed for the study with regard to the above mentioned research questions:

- Impact of behavioral factors on emotional factors.
- Role of behavioral and emotional factors in the investment decision.
- Influence of socio-demographic factors towards investment decision.

## **2. Theoretical Background and Hypotheses**

There are quite a few researches available on the factors that determine the investment decision. A focus on researches that substantiates the research questions are made in this following section. Literature associated with behavioral factors, emotional factors, and investment decision is discussed.

### *2.1 Behavioral Factors*

Olsen (1998) acquainted the concept of behavioral finance explaining the behavioral expressions of psychological and economic principles for the improvement of individual financial decision-making process. Peterson (2007) analyzed the role of behavioral factors on financial decisions. It was evidenced that the existence of separate behavioral pattern was responsible for risk-taking and risk-avoiding behaviors in financial settings. Luong and Ha (2011) explored the behavioral factors determining individual investors' decisions. The relations between these factors and investment performance were examined. Five behavioral factors affecting the investment decisions of individual investors: Herding, Market, Prospect, Overconfidence-gamble's fallacy, and Anchoring-ability bias were found to be significant. Parsaemehr et al., (2013) attempted to interpret the behavior factors and perceptions of the investors in Iran inclining to make the investment decision. Rauf (2014) considered overconfidence, representativeness, loss aversion, regret, and group behavior as the constructs to examine the behavior of investors. There was a positive association between regret and herding behavior in making investment decisions.

### *2.2 Emotional Factors*

Considering the role of emotional behavior in investment decisions that has attracted attention in economics, in the recent years, there have not been many efforts to associate emotions with investment decisions (Frank, 1988; Elster, 1996; Hopfensitz and van-Winden, 2005; Loewenstein, 2000). Apparently, financial decisions are impacted by human emotions. Positive emotional makes people empower more by accepting the risk and the reverse for negative emotional (Kuhnen and Knutson, 2011; Wu, Bossaerts, and Knutson 2011). Bhat and Dar (2012) distinguished the psychological factors in the investment decision process by contemplating the new area of research to empathize the modifying emotional behavior. It was established that the emotions play a vital role in investment decisions. Brundin and Gustafsson (2013) found that emotional factors increase the tendency to continue investments even in uncertainty.

### *2.3 Investment Decision*

Lee et al. (2010) investigated the impact of investment behavior in decision factors. The study derived to the fact that there existed significant differences on investor decision making on market selection and the investor behavior Chandra and Kumar (2012) used a survey data of 350 individual investors and confirmed that the investors make investment decisions based on heuristics by admitting price as decision-anchor and were overconfident in their judgments. De-Bondt, Mayoral, and Vallelado (2013) exemplified that each financial decision was the product of diverse factors like instinct behavior, habit, emotion, reason, and social interaction. Hassan et al. (2013) identified that the investors behave rationally while making the investment decisions at similar market price.

### *2.4 Research Hypotheses*

Following hypotheses are developed after reviewing the extant literature on behavioral factors, emotional factors, and investment decision:

- H<sub>1</sub>: There is a significant relationship between behavioral factors and emotional factors.
- H<sub>2</sub>: There is a significant relationship between behavioral and emotional factors towards the investment decision.
- H<sub>3</sub>: There is a significant relationship between socio-demographic factors and investment decision.

### *2.5 Conceptual Model*

The conceptual framework, "JAICO Investment Decision Model", of this study is presented in Figure I:

### 3. Research Methodology and Research Strategies

#### 3.1 Subject and Procedure

In this study, respective evaluates that are typically adopted in studying research problems are considered. Ex-post facto research, which is a descriptive research that does not have direct control of independent variables, is selected to examine the determined hypotheses by applying the primary data (Creswell, 2003, 2008; Cohen, Manion, & Morrison, 2003; Dawson, 2002; Kothari, 1985; Kumar, 2005; Malhotra and Birks, 2000; Picciano, 2004; Salkind, 2010). Snowball sampling technique that belongs to the category of non-probability sampling is habituated to select the potential unbiased respondents into the sample.

An inductive method is employed by reviewing the existing literature (Balaghar et al., 2012; Kengatharan & Kengatharan, 2014; Kreijns et al., 2007; Lang, Bradley, & Cuthbert, 1990; Mehrabian and Russell, 1974; Mohammadi et al., 2012; Ngoc, 2014). The initial part of the questionnaire constitutes the socio-demographic factors and the later part of the questionnaire deals with behavioral and emotional factors towards and the final part of the questionnaire establishes the investment decision of the respondents. Nevertheless, all the selected constructs are subjected to validity and reliability tests using Cronbach's alpha and Confirmatory Factor Analysis (Anastasi, 1988; Denzin & Lincoln, 2005; Gravetter & Forzano, 2009; Holden, 1983; Knapp, 1985; Kimberlin & Winterstein, 2008; Lincoln and Guba, 1985; Lynn, 1986; Nunnally, 1967; Polit & Beck, 2004). Initially, the study was pilot tested and reviewed for clarity by panel of experts.

#### 3.2 Analysis Methods

The investors of South-India based Ponzi schemes that functioned under 'Emu Farms, Poultry Farms and Copra Farms' are selected as samples. So far, 17,194 complaints have been registered from the investors to the tune of 591 Million USD (Economic Offences Wing). The sample size regarded for the study, as per Krejcie & Morgan (1970) sample size determination model, is 376 behaviors at 95% confidence interval and 5% margin of error. After eliminating/revising double-barreled, ambiguous, and leading statements (Churchill, 1979), 294 behaviors remained. All items are rated on five-point, Likert-type scales anchored at "strongly disagree" (1), "strongly agree" (5), and "neither agree nor disagree" (3). Empirical assessment of the above conceptual model is done through stepwise multiple linear regression and structural equation modeling (SEM) as the primary statistical technique, specifically using SPSS and AMOS.

### 4. Data Analysis and Findings

The Cronbach's Alpha calculated for each construct comprehends to be more than 0.720. Thus the Alpha reliability score suggests having good degree of internal consistency. Kaiser-Meyer-Olkin (KMO) value is 0.897 and Barlett's value is 0.00. As the sample adequacy criteria are found to be satisfied, the factor model is appropriate for further analysis (Bejar, 1978; Dziuban & Shirkey, 1974). The convergent and discriminant validity demonstrates evidence for good degree of construct validity (Campbell and Fiske, 1959). The conceptual model is tested by using bootstrapping analysis with 500 re-samples, and path coefficients are re-estimated using each of these re-samples.

The Pearson's correlation coefficient values between the behavioral factors: heuristic, prospect, and herding variables and the emotional factors are summarized in Table 1. The results of Pearson's correlation coefficient values are found to be significant between all the behavioral factors and emotional factors. Furthermore, the Pearson's correlation coefficient 'r' values establish positive correlations amongst the behavioral factors and emotional factors, which demonstrate that there is a strong relationship between behavioral factors and emotional factors. The coefficient 'r' value is found to be high between heuristic variables and emotional factors at 61.9%.

Primarily, to examine the association between behavioral and emotional factors towards the investment decision, multiple linear regression is performed. Subsequently, a stepwise multiple linear regression is also executed, each time removing the weakest correlated variable, and the most effective sets of independent variables that explicate the distribution best are summarized. The regression value 'R' is explained for 85.1%, the R Square value is at 65.9%, and the adjusted R Square value is at 65.4%. It is ascertained from the R Square value that the weighted combination of the predictor variables explains 65.9% of the variance of dependent variable. It can be interpreted that 65.9% variability in the investment decision is accounted by the behavioral and emotional variables. The ANOVA value for the considered variables is found to be significance. Hence the model has a good fit. From the results of the correlation coefficient, it is found that all the behavioral and emotional variables are significant towards the investment decision. Consequently, results of stepwise multiple regression shows four significant models with pleasure, arousal, herding, and heuristic to be significant with the investment decision. It is revealed from that "Pleasure" accounts for 34.6%, "Pleasure and Arousal" account for 59.6%, "Pleasure, Arousal, & Herding" account for 63.3%, and "Pleasure, Arousal, Herding, & Heuristic" account for 65.3% of variance towards investment decision. It is apprehended that when an independent variable is added to the model, the R<sup>2</sup> value experiences a substantial effect.

ANOVA is established, in order to evaluate the influence of socio-demographic factors in making the investment decisions. It is revealed that among the socio-demographic factors, gender and religion are found not to be significant with investment decision. Thus, it can be evidently determined that the socio-demographic factors, such as: age, marital status, living status, educational qualification, annual family income, employment, influencer, and source of funds play a critical role in making investment decisions.

Substantially, meeting all the basic assumptions of SEM, the proposed conceptual framework - JAIKO Investment Decision Model is tested applying AMOS. The calculated Hoelter's critical N of the model is found to be significant at 0.000 (Browne and Mels, 1992). The GFI of this model is 0.891, which shows a marginal fit (Tanaka and Huba, 1985). The AGFI of this model is 0.944, which demonstrates to be a good fit (Tanaka and Huba, 1985). The RMR is 0.027, which is a very good fit (Gulliksen and Tukey, 1958). The CFI of this model is 0.945 indicating a good fit (McDonald and Marsh, 1990). The IFI of this model is 0.905 expressing acceptable fit (Bollen's, 1989). The RFI of this model is 0.807 which is a marginal fit (Steiger and Lind, 1980). The PCLOSE is 0.000 that show an exact fit (Browne and Cudeck, 1993). Considering the fit indices, it can be concluded that the JAIKO Investment Decision Model has an adequate fit.

## 5. Results and Conclusion

This study integrates versatile insights of behavioral and emotional parameters to explain investment decision towards the Ponzi schemes. The results of this study bestow to the existing literature by ascertaining the patterns that determine the investment decision. Besides, this study corresponds the influence of socio-demographic factors towards the decision making process. A research framework – “JAIKO Investment Decision Model” integrating all the conceptualized constructs influencing investment decision is proposed. Eventually, the findings of this study offer managerial implications to investors and policy makers to understand the principle of decision making process.

Despite providing insights, this research has a couple of limitations worth addressing that could have determined the outcomes. Owing to the confidentiality of the Ponzi scheme investors who have registered their complaint, the process of data collection was a real challenge. Furthermore, the findings of the research are circumstantial and relational those depend on the answers given by the respondents. In spite of the attributes' reliability and validity are evidenced to be acceptable, the factor loadings and squared multiple correlation are observed for few constructs. All the aforesaid limitations should be regarded ahead of proceeding future research.

The proposed JAIKO Investment Decision Model demonstrated an acceptable fit to explain the investment decision. However, there is always a possibility that a better model exists. The quest to find out an ameliorated behavioral and emotional model towards making investment decisions should be continued. Nevertheless a variety of topics - stock market, mutual funds, currency market, commodity market, and international markets - stays unexplored and should be covered in the future research. By continuing to draw on the theory and findings of related studies, the authors believe that it would importantly enhance the apprehension of the important phenomenon of investor behavior.

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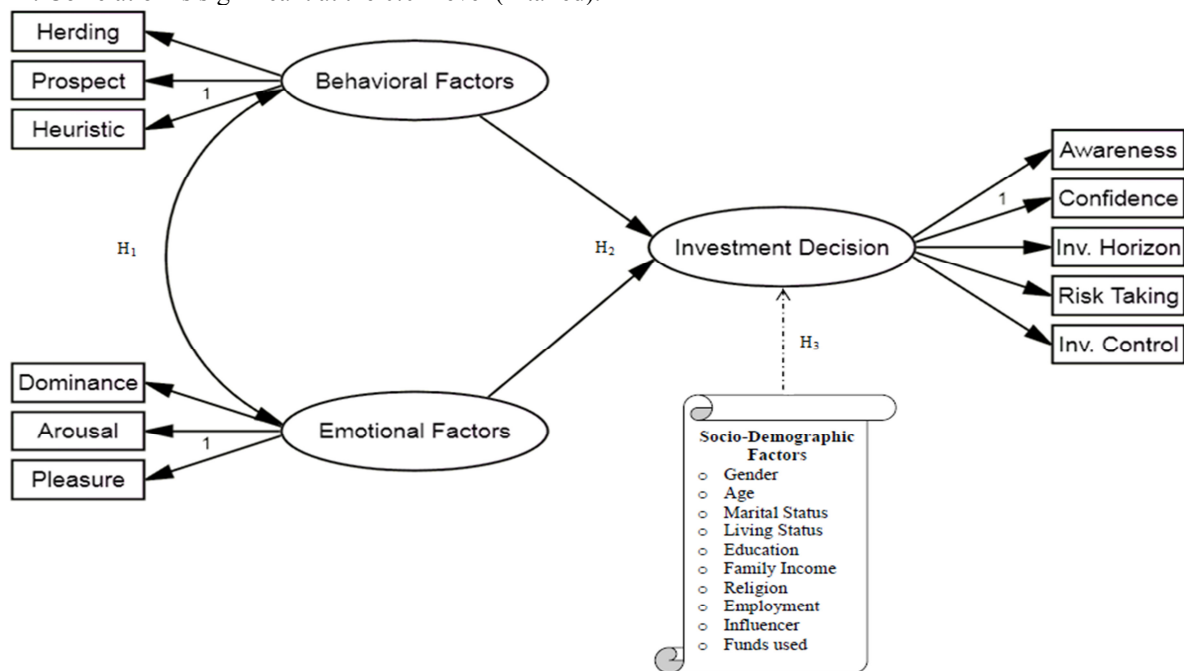
**Table 1: Sample characteristics**

MEASURES	(N=294)
<b>1. Gender</b>	
Male	216 (73%)
Female	78 (27%)
<b>2. Age</b>	
24 years or under	36 (12%)
25-30 years	47 (16%)
31-40 years	54 (19%)
41-50 years	89 (30%)
51 years or older	68 (23%)
<b>3. Marital Status</b>	
Single	65 (22%)
Married	171 (58%)
Others	58 (20%)
<b>4. Living Status</b>	
Staying Alone	37 (13%)
Nuclear Family	103 (35%)
Joint Family	154 (52%)
<b>5. Educational Qualification</b>	
Primary School/less	41 (14%)
High School	29 (10%)
Bachelor's Degree	139 (47%)
Master's Degree	54 (18%)
Others	31 (11%)
<b>6. Annual Family Income (INR)</b>	
≤ 3.0 Lakhs	164 (56%)
3.1-5.0 Lakhs	86 (29%)
5.1-10.0 Lakhs	25 (9%)
≥ 10.1 Lakhs	19 (6%)
<b>7. Religion</b>	
Christian	34 (12%)
Hindu	197 (67%)
Muslim/Islam	42 (14%)
Others	21 (7%)
<b>8. Employment</b>	
Student	9 (3%)
Homemaker	29 (10%)
Public Sector	53 (18%)
Private Sector	91 (31%)
Business	61 (20%)
Retired	37 (13%)
Others	14 (5%)
<b>9. Influencer</b>	
Self	74 (25%)
Family Member(s)	57 (19%)
Friend(s)	134 (46%)
Peer/Colleague	24 (8%)
Others	5 (2%)
<b>10. Source</b>	
Savings	129 (44%)
Selling assets	87 (30%)
Loan	29 (10%)
Others	49 (16%)

**Table 2: Impact of Behavioral Factors on Emotional Factors – Pearson’s Correlations**

		Heuristic Variables	Prospect Variables	Herding Variables	Emotional Factors
<b>Heuristic Variables</b>	Pearson Correlation	1	.563**	.464	.619**
	Sig. (2-tailed)		.000	.154	.000
	N	294	294	294	294
<b>Prospect Variables</b>	Pearson Correlation	.563**	1	.367	.595**
	Sig. (2-tailed)	.000		.135	.000
	N	294	294	294	294
<b>Herding Variables</b>	Pearson Correlation	.464	.367	1	.411**
	Sig. (2-tailed)	.154	.135		.000
	N	294	294	294	294
<b>Emotional Factors</b>	Pearson Correlation	.619**	.595**	.411**	1
	Sig. (2-tailed)	.000	.000	.000	
	N	294	294	294	294

\*\* . Correlation is significant at the 0.01 level (2-tailed).



**Figure 1: Conceptual Model - “JAIKO Investment Decision Model”**



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