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Factors influencing investment decisions of individual investors at Nepal stock exchange

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Abstract

The behavior of individual investors is concerned with choices regarding purchasing small quantities of securities for their own account. Investment options are also supported by decision-making instruments. It Is assumed that information structure and the market related factors systematically affect the investment decisions of individuals as well as market outcomes. The main purpose of the analysis was to identify the factors affecting individual investors' investment decisions on the Nepal Stock Exchange. The study was conducted on the 214 responses received from the individual investors based on the random sampling method Data for the research were collected using a structured questionnaire distributed to the respondents. The questionnaire constituted 35 items. The respondents were individual investors. In this study, data were analyzed using frequencies, mean scores, standard deviations, percentages, and factor analysis techniques. The study confirmed that there appears to be a certain degree of correlation between the factors defined for the average equity investor by behavioral finance theory and prior empirical evidence. The researcher explored that the most significant factors shaping individual investment decisions were: statement of the government officials, expected capital increase, firm's status in industry, diversification purpose, the attractiveness of non-stock investment, ease of obtaining borrowed funds, opinions of the firm's majority stockholders, family member opinions, recent price movement in a firm's stock, fluctuations in the stock index, rumors, expected corporate eating, stock marketability, the results of technical analysis, the dividend paid, perceived ethics of firm, the reputation of the firm's shareholders, and feeling for a firm's product and services. The results of this research will provide an understanding of the different decisions to be taken by investors on the basis of the prevailing factors and the possible consequences of each decision. The analysis would also help to recognize the most significant factors in the behavior of the company's investors as their potential policies and plans will be impacted as the investment decisions of investors will determine the strategy to be used by the company.

Keywords: *Nepal Stock Exchange, Investment Decision, Individual investor, investment behavior.*

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Introduction

Investors' investment decisions are normally based on fundamental analysis, technical analysis, and judgment. Investment refers to the current commitment of rupees for a period of time in order to derive potential payments that will compensate the investor for the time the funds are committed, the rate of inflation anticipated during that period, and the uncertainty of future payments (Reilly & Brown, 2011)

Diversification of the stock market encourages institutional and individual investors to invest in a larger variety of financial products. It also helps investors to decide and select among various investment options. In order to decide among various investment choices, the investor's preference is based on both economic and behavioral variables (Ali & Tariq, 2013). Investor market behavior stems from psychological principles of decision making that describe why individuals purchase or sell stocks. These variables would concentrate on how investors view and use data to make investment decisions (Mutswenje, 2009). As described by Shefrin (1999), behavioral finance is a rapidly growing field that studies the impact of psychology on the actions of financial practitioners. No matter how well informed an investor is and how extensively he has researched and studied the stock before investing, he also acts irrationally with the fear of loss in the future. This different behavior in individual investors is caused by various factors that influence investor rationality. An individual investor is one who purchases a generally small number of securities for his or her own account.

According to traditional financial theory, investors want to maximize their wealth according to basic financial principles and rely solely on risk-return consideration for their investment strategies. In fact, however, the degree of risk that they are willing to take is not the same for all investors. This relies primarily on their personal attitudes towards risk. In recent years, behavioral finance research has progressed rapidly and provides evidence that the financial decisions of investors are often influenced by internal and external behavioral factors (Shefrin, 1999).

Statement of problem

Investment decisions are commonly assumed to be a result of many variables, such as market features and individual risk profiles. The disposition error suggests that investors are impacted by sunk cost factors and asymmetrical risk preferences for gain/loss situations, regardless of accounting information. Nagy and Obenberger (1994) analyzed variables influencing investor behavior and concluded that for investors, classical wealth-maximization criteria are key, while investors use different criteria when selecting stocks. Only cursory consideration appears to be given to contemporary issues such as local or foreign activities, environmental track record, and the ethical stance of the company. The suggestions of brokerage houses, individual stockbrokers, family members, and coworkers go largely overlooked. Many individual investors ignored the benefits of valuation models when evaluating stocks.

Riley and Chow (1992) viewed that risk aversion decreases not only as wealth rises, but also as age, income, and education rise. Baker and Haslem (1973) found that the key investment

considerations for individual investors are dividends, projected returns, and the financial stability of the company. Baker, Haargrove, and Haslem (1977) studied further considering the risk/return tradeoff of the investment and recommended that investors behave rationally.

Investment decisions need to undergo a detailed review of the prevailing circumstances based on a variety of factors, but investors are keen to avoid uncertainties associated with the final decisions they make regardless of the varied knowledge available that justifies rationality and irrationality. It is against this context that this research attempted to fill the gap by defining the variables that tend to affect individual investment decisions, and included not only the variables examined by previous studies and derived from prevailing theories of behavioral finance, but also added additional variables that have been found to influence the investment decisions of stockholders in the emerging local market, NEPSE. The study deals with the following issues:

1. To what extent accounting information like financial statement condition and stock marketability effects individual investor decision-making?
2. To what extent self-image/ firm image factors affect the individual investor decision-making of retails equity investors in Nepal?
3. To what extent neutral information factors affect individual investor decision making?
4. To what extent advocate recommendation factors like opinions of the firm's majority stockholder and Broker's recommendation effects individual investor decision making?
5. To what extent personal financial needs factors like diversification needs and attractiveness of non-stock investment effects individual investor decision making in Nepal?

Objectives of study

The main objective of the study is to determine the most influencing factors on individual investment decisions of investors in the Nepalese stock market. Some specific objectives of this study are:

1. To examine whether the factors related to self-image/firm image coincidence have an effect on the behavior of the individual investors in NEPSE
2. To assess whether the factors related to accounting information have an effect on the behavior of the individual investor in NEPSE.
3. To analyze whether the factors related to neutral information have an effect on the behavior of the individual investor in NEPSE.
4. To examine whether the factors related to advocate recommendation have an effect on the behavior of the individual investor in NEPSE.
5. To evaluate whether the factors related to personal financial needs have an effect on the behavior of the individual investor in NEPSE.

Review of literature

In describing the behavioral aspects of investment decisions, behavioral finance has made remarkable strides. Under uncertainty, behavioral finance explores preference. Three major theories frame behavioral finance: Regret-theory, the theory of mental accounting, prospect/loss-aversion-theory, over/under-reacting theory, and theory of overconfidence. Each theory captures the behavioral attributes of individual investors.

Using the investor survey method taking the sample size of 185 investors, Kadariya (2012) analyzed the factors affecting investor decision-making on the Nepalese capital market and found that the capital Structure and average pricing strategies are one-factor shaping investment decisions, the next is political and media interest, trust in luck and financial education is the third factor, and trend analysis is finally the fourth aspect of the stock market movement. It is, therefore, concluded that both tangible and intangible information is important to get success in the Nepalese capital market.

Another study conducted by Pokharel (2018) also analyzed the factors affecting investment decision of individual investors in the Nepalese stock market employing investor's opinion survey method of data collection and revealed that the advice of brokers and movements in NEPSE Index are the most influencing factors and news in the daily newspaper and market sentiments are viewed as the least influencing factors.

The overconfidence of investors in the accuracy of private information and biased self-attribution brought asymmetric changes in investor confidence as a function of their investment performance (Subrahmanyam, Hirshleifer, & Daniel, 1998).

The neutral-information

Kadiyala and Rau (2004) examined investor reaction to corporate event announcements. They concluded that investors seem to be under-reacting to prior information as well as to the information conveyed by the event, leading to different patterns. Behavioral finance literature has presented two contradictory models of irrational investor behavior. In the first model, investors appear to overreact to information, leading to a pattern of long-term return reversals when companies announce corporate events such as new issues of stock. In the second model, when businesses announce corporate events such as open market share repurchases or repurchases via tender offers, investors underreact to information, resulting in the long-term continuation of return. Behavioral models have been viewed with uncertainty partly because they do not reconcile why investors tend to overreact to a corporate event such as a further public offering while appearing to underreact to an event such as a share repurchase.

The accounting-information

Baker and Haslem (1974) concluded that, based on historical evidence, investors were mainly concerned with prospective earnings expectations. On the other hand, research conducted by Lee and Tweedie (1975, 1976, 1977 & 1981) found that financial reporting in the corporate

sector is difficult for the general public to grasp. Blume and Friend (1978) found proof that the key risk measures employed by individuals are both price and earnings uncertainty. In addition, Lewellen et al. (1977) disclosed that the key source of information for investors is through fundamental or technical analysis. Nagy and Obenberger (1994) examined the degree to which the perception of shareholders was influenced by a list of 34 variables and presented proof of a role for a combination of financial and non-financial variables.

The self-image/firm-image coincidence

Epstein & Freedman (1994) studied the demand for social information by individual investors. The findings demonstrate the importance of annual reports to corporate shareholders. In addition, a majority of the shareholders surveyed also want the company to report on corporate ethics, employee relations, and community engagement.

The advocate-recommendation

The investor already holding stock may respond to the recommendation of the analyst in one of four ways: the investor may hold stock on a recommendation to sell, the investor may sell a stock on a recommendation to hold, the investor may hold stock on a recommendation to hold, or the investor may sell a stock on a recommendation to sell. Krishnan and Booker (2002) studied the variables affecting investor decisions that use recommendations from analysts to arrive at a short-term decision to hold or sell a stock. The findings revealed that a strong form of the recommendation summary report of the analyst, i.e., one with additional details further supporting the position of the analysts, reduces both disposition errors for-profits and disposition errors for losses.

The personal-financial-needs

Prospect theory proposes that certain outcomes are overweighted relative to uncertain outcomes and that the value functions are different for gains and losses Rational logic implies that individuals should sell the stock regardless of their current benefit or loss status when dealing with a stock of unfavorable potential expectations. Previous research on sunken costs and increased participation, however, shows that individuals may become trapped in losing courses of action even to the point of throwing good money after bad money (Arkes & Blumer 1985; Brockner 1992; Staw & Hoang 1995). Thus, rather than selling and taking a certain loss, people may choose to hold a losing stock and bet on the future and may even become more committed to holding the stock.

Despite a large number of studies on understanding factors influencing investment decisions of individual investor's behavior carried out in developed economies, there have been very few empirical studies available in under-developed countries like Nepal.

Conceptual framework for the study

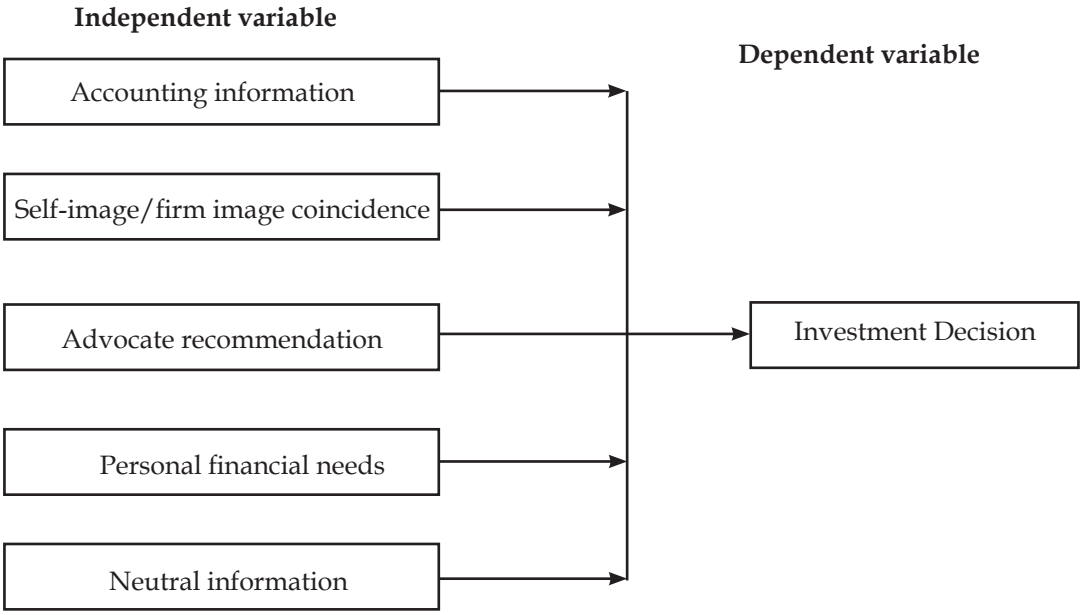

Figure I: Individual Equity Investor Decision Making Model

Methodology

Method of data collection

The research design of this study has been based on a structured questionnaire. This style of research design does not have influence over the variables from which respondents' opinions are generated. It enables hypotheses to be tested empirically and local conclusions can be generalized from the entire sample used for the study. For the purpose of this study, secondary data will also be used to some extent. Secondary data will be obtained from several sources, such as journal articles, newspapers, websites, textbooks, annual reports, and other related publications.

Population and sample

All the individual investors participating in NEPSE, which are approximately 3 lakhs, are the target population of this study (Source: Nepal Stock Exchange market report published on Aug. 13, 2020). The stock investors have been randomly selected from 50 brokerage firms and a total of 250 questionnaires have been distributed for their responses. Out of them only 214 responses have been received.

Techniques of data analysis

The collected data have been entered into the SPSS sheet for onward analysis. First, the reliability and validity of the data have been tested using Cronbach's Alpha and then the

data have been analyzed using descriptive statistics and factor analysis techniques with the help of the SPSS package.

Result and discussions

It deals with data analysis and interpretation of the research findings. The data were analyzed using Factor analysis techniques with the help of the SPSS package which enabled data interpretation and the making of statistical inferences. The study documents the factors that influence individual investment decisions in NEPSE. Out of the two hundred fifty investors targeted, only thirty-six investors were not reached to provide a response. Therefore, the response rate is 85.6 percent. The results of the analysis presented in table 1.1 show that 91.1 percent of respondents are male and only 8.1 percent are female. Regarding the level of education of the respondents, table 1.2 shows that the majority number of respondents (36%) have bachelor level followed by 26 % master and above, 18.7 percent primary level, 9.3 percent intermediate level, and 9.3 percent primary level education. The result of table 1.3 shows that 100 percent of respondents are married. Moreover, the results presented in Table 1.4 show that the vast majority number of respondents (81.8%) are service holders in different sectors and a small number of respondents (18.2%) are self-employed. From the results shown in table 1.5, it is known that a majority number of respondents (36.9%) were earning monthly income in the range of Rs. 15,000-30,0000, followed by 35.5 percent responding investors were earning in the range of above 30,000-45,000 and 27.6 percent of respondents were earning more than Rs. 45,000. Regarding the working area of responding investors, table 1.6 shows that 91.1 percent of respondents are associated with non-financial institutions, and only 8.9 percent are associated with financial institutions. Finally, results presented in Table 1.7 shows that a huge majority number of respondents (72.9%) have more than 5 years of investment experience, while 17.8% of respondents have more than 2 years to 3 years' experience and 9.3% of respondents have more than 3 years to 4 years' experience.

Test validity and reliability

With the use of Cronbach's alpha, the reliability of the measurements was judged. The alpha of Cronbach helps one to calculate the reliability of the distinct groups. It requires estimates of how much variance is due to chance or random errors in scores of different variables (Selltzm, et al, 1976). A coefficient greater than or equal to 0.5 is generally considered a good indicator of the construct reliability (Nunnally, 1978). For the five groups, the overall Cronbach alpha is 0.750. Cronbach's Alpha is 0.626, 0.889, 0.615, 0.680, and 0.760 for the five groups, namely, self-image/firm-image, accounting information, neutral information, advocate advice, and personal financial needs.

Factor analysis: Factors summaries and component grouping

Factor analysis was performed on the results of the importance attached to each of the factors influencing individual investment decisions in NEPSE. Correlation analysis was initially carried out to search for interdependence between the variables after which Principal Component Analysis (PCA) was run. The purpose of performing PCA was to transform a set of interrelated variables into a set of unrelated linear combinations of these variables into a set of

uncorrelated linear combinations. In order to define and reduce the variables to interpretable components, Varimax rotation along with Kaiser Criterion was used. Communality is the square multiple coefficients of correlation for variables that use the variables as predictors. The communality calculates the percentage of variance in a given variable, which can be interpreted as the reliability of the predictor and is explained collectively by all the variables. It is the proportion of variance that each entity or variable has in common with other objects. For instance, 97.8% communality is the highest variability in the factor "Statements from government officials", while the lowest variability was captured for the factor "Reputation of the firm" with a communality of 0.549 %. A total of 5 components were extracted from the factors. Component 1 describes the greatest variation found, followed by component 2 and so on. From the table, component 1 accounts for 23.041% of the total observed variability while component 2 explains 20.715%, component three 14.189%, component four 11.929 %, and component five 10.017 %. The five extracted components explain 79.890 % of the total variability for all the 35 variables.

Factor selection

Based on table 1.10 and 1.11, accounting information is the most influencing factor that influences Nepalese investors' investment decisions. Component 1 (Accounting Information) consists of Stock Marketability, affordable share price, insiders' information, the results of technical analysis, condition of financial statements, information obtained from the internet, expected capital increase, expected corporate earnings, the dividend paid, and rumors. Component 2(Self-Image/ Firm Image Coincidence) consists of getting rich quickly, feeling on the economy, the reputation of the firm, feelings for a firm's products and services, the reputation of the firm's shareholders, perceived ethics of firm, firm status in industry and Firm's involvement in solving community problems. Components 3 (Advocate Information) consists of family member opinions, opinions of the firm's majority stockholders, friend and co-worker recommendations, broker recommendation, and Financial advisors and analysts' recommendation. Component 4 (Neutral Information) consists of Current economic indicators, Statements from government officials, Recent price movement in a firm's stock, Coverage in the press, Past performance of the firm's stock, Fluctuation/developments in the stock index, and Government holdings. Component 5 (Personal Financing Need) consists of the expected dividends, diversification purpose, minimizing risk, and ease of obtaining borrowed funds.

Conclusions and Implications

Results of factor analysis revealed that accounting information is the most influencing factor while taking buy and sell decisions by individual investors in Nepalese stock market. Self-image/Firm image, advocate information, Neutral information, and personal financing needs are the second, third, fourth, and the last factor respectively that influence individual investors investment decisions. The researcher explored that the most significant factors shaping individual investment decisions were: statement of the government officials, expected capital increase, firm's status in industry, diversification purpose, the attractiveness of non-stock investment, ease of obtaining borrowed funds, opinions of the firm's majority stockholders,

family member opinions, recent price movement in a firm's stock, fluctuations in the stock index, rumors, expected corporate eating, stock marketability, the results of technical analysis, the dividend paid, perceived ethics of firm, the reputation of the firm's shareholders, and feeling for a firm's product and services.

The results of this research will provide an understanding of the different decisions to be taken by investors on the basis of the prevailing factors and the possible consequences of each decision. The analysis would also help to recognize the most significant factors in the behavior of the company's investors as their potential policies and plans will be impacted as the investment decisions of investors will determine the strategy to be used by the company.

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Appendices

Table 1.1: Descriptive statistics for Gender

	Frequency	Percent
Male	195	91.1
Female	19	8.9
Total	214	100.0

Table 1.2: Descriptive statistics for education

Primary level	40	18.7
High school or equivalent	20	9.3
Intermediate	20	9.3
Bachelor	77	36.0
Master and above	57	26.6
Total	214	100.0

Table 1.3: Descriptive statistics for marital status

Married	214	100%
Unmarried	0	0
Total	214	100%

Table 1.4: Descriptive Statistics for Employment Status

Business person/self employed	39	18.2
service holder	175	81.8
Total	214	100.0

Table 1.5: Descriptive Statistics for Monthly Income

Rs 15,000-30,000	79	36.9
Above Rs 30,000-45,000	76	35.5
More than Rs 45,000	59	27.6
Total	214	100.0

Table 1.6: Descriptive Statistics for Working Area

Financial institutions	19	8.9
others	195	91.1
Total	214	100.0

Table 1.7: Descriptive Statistics for Number of Years of Investment Experience

More than 2 yr.-3 yr.	38	17.8
More than 3 yr.- 4 yr.	20	9.3
More than 5 years	156	72.9

Table 1.7: Correlations

		SI	AI	NI	AD	PFN
SI	Pearson Correlation	1	.535**	.420**	.452**	.399**
	Sig. (2-tailed)		0.000	0.000	0.000	0.000
AI	Pearson Correlation		1	.941**	.529**	.365**
	Sig. (2-tailed)			0.000	0.000	0.000
NI	Pearson Correlation			1	.452**	.426**
	Sig. (2-tailed)				0.000	0.000
AD	Pearson Correlation				1	.794**
	Sig. (2-tailed)					0.000
PFN	Pearson Correlation					1
	Sig. (2-tailed)					

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

Table 1.8: Communalities

	Initial	Extraction
Feelings for a firm's products and services	1.000	0.827
Reputation of the firm's shareholders	1.000	0.868
To get rich quickly	1.000	0.710

Firm status in industry	1.000	0.931
Perceived ethics of firm	1.000	0.825
Reputation of the firm	1.000	0.549
Firm's involvement in solving community problems	1.000	0.753
Feeling on the economy	1.000	0.785
Past performance of the firm's stock	1.000	0.645
Dividend paid	1.000	0.820
The results of technical analysis	1.000	0.878
Stock Marketability	1.000	0.821
Expected corporate earnings	1.000	0.886
Condition of financial statements	1.000	0.561
Affordable share price	1.000	0.688
Information obtained from the internet	1.000	0.697
Insiders' information	1.000	0.788
Expected capital increase	1.000	0.942
Rumors	1.000	0.887
Government holdings	1.000	0.591
Fluctuation/developments in the stock index	1.000	0.859
Coverage in the press	1.000	0.754
Statements from government officials	1.000	0.978
Current economic indicators	1.000	0.881
Recent price movement in a firm's stock	1.000	0.894
Financial advisors and analysts' recommendation	1.000	0.533
Broker recommendation	1.000	0.841

Family member opinions	1.000	0.893
Friend and co-worker recommendations	1.000	0.758
Opinions of the firm's majority stockholders	1.000	0.893
Diversification purpose	1.000	0.932
Expected Dividends	1.000	0.788
Ease of obtaining borrowed funds	1.000	0.851
Minimizing risk	1.000	0.689
Attractiveness of non-stock investment	1.000	0.963

Extraction Method: Principal Component Analysis.

Table 1.9 Total Variance Explained

Com-po-nent	Initial Eigenvalues			Extraction Sums of Squared Loadings			Rotation Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	11.1965809	31.990	31.990	11.197	31.990	31.990	8.064	23.041	23.041
2	6.3876433	18.250	50.241	6.388	18.250	50.241	7.250	20.715	43.756
3	4.2259115	12.074	62.315	4.226	12.074	62.315	4.966	14.189	57.944
4	3.3846596	9.670	71.985	3.385	9.670	71.985	4.175	11.929	69.873
5	2.7668452	7.905	79.890	2.767	7.905	79.890	3.506	10.017	79.890
6	2.3282386	6.652	86.543						
7	1.9808841	5.660	92.202						
8	1.4743867	4.213	96.415						
9	1.2548500	3.585	100.000						

Extraction Method: Principal Component Analysis.

Table 1.10: Rotated Component Matrix

	Components				
	1	2	3	4	5
Factor 1: Accounting Information					
Stock Marketability	0.793				
Affordable share price	0.774				
Insiders' information	0.752				
The results of technical analysis	0.710				
Condition of financial statements	0.698				
Information obtained from the internet	0.648				
Expected capital increase	0.836				
Expected corporate earnings	0.661				
Dividend paid	0.814				
Rumors	0.761				
Factor 2: Self-Image/ Firm Image Coincidence					
To get rich quickly		0.580			
Feeling on the economy		0.613			
Reputation of the firm		0.570			
Feelings for a firm's products and services		0.708			
Reputation of the firm's shareholders		0.846			
Perceived ethics of firm		0.899			
Firm status in industry		0.870			
Firm's involvement in solving community problems		0.784			
Factor 3: Advocate Information					
Family member opinions			0.878		
Opinions of the firm's majority stockholders			0.878		
Friend and co-worker recommendations			0.849		
Broker recommendation			0.849		
Financial advisors and analysts' recommendation			0.718		
4. Neutral Information					
Current economic indicators				0.847	

Statements from government officials				0.770	
Recent price movement in a firm's stock				0.744	
Coverage in the press				0.666	
Past performance of the firm's stock				0.566	
Fluctuation/developments in the stock index				0.826	
Government holdings				0.565	
5. Personal Financing Need					
Expected Dividends					0.881
Diversification purpose					0.826
Minimizing risk					0.694
Ease of obtaining borrowed funds					0.604

Extraction Method: Principal Component Analysis. Rotation Method: Varimax with Kaiser Normalization.[a]

a. Rotation converged in 5 iterations.

Table 1.11: Descriptive Statistics

	Mean	Std. Deviation
AI	3.8031	0.44047
SI	3.7812	0.46303
ADI	3.7277	0.50777
NI	3.4241	0.32081
PFN	3.4196	0.39881