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Factors Influencing Investors Behavior to Become Overconfident While Stock Confrontation

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ABTRACT

The rationale of this study is to explore the correlation between the characteristics of individual and financial institutional investors such as their Age, Experience, External information, knowledge, Self indulgence and Triumph analytically have persuade individual and institutional investors' investment decisions and prop up overconfidence among them while confronting stock. The rationale of this study is to categorize the factors that manipulate the Pakistan's individual and institutional investors to become overconfident while confronting stocks. Twenty items under the five categories of variables were taken as independent that influences the individual and institutional investors' overconfident. Data collection is made with the help of structured questionnaires. Sample size of 100 investors out of which 60 were individual investors (40 were male and 20 were female) and 40 were financial institutional investors registered at LSE. The statistical tools that were used for data scrutiny were mean, standard deviation, frequency distribution table of variables that have soaring and stumpy influence on decision making**.** Results of the calculated mean shown that all the variables are somewhat upsetting the behavior of investors to become overconfident and the presence of experience, knowledge, external information categories of variables are most influencing for institutional investors which do not prop up overconfidence while stock confrontation and self indulgence and triumph are least influencing for them. This research has concluded that institutional investors are more experienced, having high degree of knowledge and external information and low degree of self indulgence, are less overconfident while stock confrontation as compared to individual investors which are less experiences, having low degree of knowledge, external information and high self indulgence among themselves.
Keywords: Stock confrontation, overconfidence, behavior, self-indulgence, triumph.

INTRODUCTION

In past a number of studies examine investor trading decisions. Odean (1998) discovered that, as predicted by Shefrin and Statman (1985), individual investors exhibit a outlook effect—investors tend to sell their high prices stocks and hold on to the stock which is fluctuating. It is observed that both individual and professional investors behave similarly with several types of assets including real estate (Genesove and Mayer, 2001), company stock options (Heath, Huddart, and Lang, 1999), and futures (Heisler, 1994; Locke and Mann, 1999) (also see Shapira and Venezia, 1998).

Stock volume increases if the information came or price moves (Bamber, Barron, and Stober (1997); Karpoff (1987)). For example, when Maria Bartiromo mentions a stock during the Midday Call on CNBC, volume in the stock increases nearly fivefold (on average) in the minutes following the mention (Busse and Green (2002)). Yet, for every buyer there is a seller. Generally it is seen that studies do not probe who is buying and who is selling the stock. One exception is Lee (1992). Lee examined trading activity of almost 230 stocks in a one year period that was pronouncing earnings. His research demonstrated that the investor, those who place market orders of less than $10,00, are remaining buyers following to both good and bad earnings surprises.

Hirshleifer, Myers, Myers, and Teoh (2002) also stated that individual investors are remaining buyers following both optimistic and harmful earnings surprises. Lee (1992) guessed that news about stock may attract investors and retail brokers who are likely to make more buy than sell and may contract their clients on daily basis. Odean (1999) examines trading records of investors at a large concession brokerage firm. He researched that, on average, the stocks these investors buy underperform those they sell, even before taking into account communication costs. He finds that investors buy stocks that have practiced greater complete price changes over the previous two years than the stocks they sell. He points out the difference between buying and selling decisions for individual investors and the search problem they countenance when choosing from among thousands of stocks. He suggests that many investors limit their search to stocks that have recently captured their attention.

Looking at all common stock contact, investors at this brokerage make slightly more purchases (1,082,107) than sales (887,594).

Merton (1987) notes that individual investors tend to hold only a few diverse common stocks in their portfolios. He said that gathering information on stocks requires capital and suggests that investors preserve these resources by actively following only a few stocks. If investors behave this way, they will buy and sell only those stocks that they keenly follow. They will not unwisely buy stocks that they do not follow purely because those stocks occur to catch their attention. Thus their purchases will not be biased toward exciting stocks.

In recent work, Sea sholes and Wu (2004) test our hypothesis in a unique out-of-sample setting. They observe that on the Shanghai Stock Exchange individual investors are remaining buyers the day after a stock hits an higher price boundary. Sea sholes and Wu's interpretation of this behavior was that , the attention of individual investors is attracted by the event of striking a price limit , constant with our theory, individuals become remaining buyers of stocks that catch their attention. Also consistent with our theory, Sea sholes and Wu manuscript a temporary impact on prices with decline to prevent levels within ten trading days. Finally, they categorized a small group of skilled investors who enjoy profit at the expense of individual investors by anticipating this momentary heave in price and demand.

This research had been demeanor to gaze at that we aim to identify the factors which are influencing the individual and institutional investor's decision making behavior and make them overconfident while stock confrontation. We have conducted this study for Pakistani investors who are more overconfident and they do not know somehow that what are the factors which influence them to decide to invest in such a stock which will make loses in coming future. We hypothesized and assumed that individual investors are less experienced and they have also stumpy amount of knowledge and external information as compared to institutional investors in Pakistan. Institutional investors always take more advantage of their best knowledge, experience and external information than individual investors in Pakistan.

So looking upon this we take 100 investors which are registered on LSE (Lahore Stock Exchange) of Pakistan. Out of 100 investors 60 were individual investors and 40 were institutional investors. We conducted this research through structured questionnaire which was distributed among investors. The research tools are descriptive statistics such as mean, standard deviation and frequency distribution. Finally we concluded that our hypotheses were proved true and individual investors are overconfident as compared to institutional investors because they are high self indulgence and having less experience, knowledge and external information. But institutional investors do not believe on present conditions of market, they invest in such a stock which have average performance because according to them it will happened that the stock which is giving them soaring return today will give them stumpy or even no returns. They take decisions on the behalf of their experience, knowledge and external information.

LITERATURE REVIEW

The Research article of Barber, Terrance and Odean, (1991-1997), demonstrated that overconfident investors trade excessively. Investors trade more excessively than women. Data of 35000 households from the large discount brokerage was used. Greater overconfidence leads to greater trading and to lower the expected utility. Research showed that average turnover rate for common stocks is nearly one and half times that for women. Odean (1999) finds that individual investors are more likely to both buy and sell particular stocks when prices of these stocks rising. Men lower their return more through excessive trading than do women. Modern financial economics assumes that we behave with intense rationality but we do not. Psychological research has established that men are more prone to overconfidence that do women. They document that men trade 45 percent more than women. Trading reduces men's net return by 2.65 percent points a year as opposed to 1.72 percent points for women. This difference in overconfidence yield two predictions: Men will trade more than women and the performance of men will be hurt more by excessive trading than the performance of women. Single men trade 67 percent more than a single women thereby reducing their return by 1.44 percent per year more than do women.

Theoretical models predicted that overconfident investors will trade more than rational investors. They directly test this hypothesis by correlating individual overconfidence scores with several measures of trading volume of individual investors (No of trades, turnover). The measure of trading volume were calculated by trades of 215 individual investors who answered the questionnaire, they find that individual investors who think that they are above average in terms of investment skills or past performance, trade more. Trading volume emerge high in financial markets. One quarter of the volume of the value of annual worldwide trade and investment flow is traded in the foreign exchange markets (Including Swaps, Forwards, Spot transactions) each day. Difference in opinion can arise due to difference in prior beliefs or due to difference in the way investors interpret public information. Psychologists have found several judgment biases but it remain unclear which bias affects the economic behavior the most. They concluded that usual way of motivating and modeling overconfidence which is based on the calibration, literature has to be treated with caution. Taylor and Brown (1988) document that people have unrealistically positive views of self. (Markus Glaser, Martin Weber)

In another research which was conducted by (Denis Ditterich Maciejovsky) the researcher observed two aspects of overconfidence one person who have only one risk Asset and the other person with two risky assets. They induce risk aversion by binary lottery method (berg et al.1986) They researched that own investment choice can be substituted for (1) Optimal investment solution (2) A risk averse (3) A risk loving investment choice. They took 149 participants. According to their results overconfidence increases with the deviation of actual from optimal investment indicating that the less accurate their investment decisions are the more prone are the participants to exhibit overconfidence. They concluded that overconfidence increases in case of two risky assets case (overconfidence increases with task complexity). They concluded that people whose life are more controlled by external factors are less often classified as overconfidence means people who have more knowledge about external factors are less overconfident. Males are less prone to overconfident than females. They observed that age is negatively correlated with overconfidence means older persons will be less overconfident than the younger ones. They also admitted that their binary lottery method is not good for their research.

Brad M. Barber researched the behavior of individual investors on stock trading (2011). They research that individual investors (1) underperform standard benchmarks (low cost index fund) (2) selling winning investments while holding losing one's (3) are heavily influenced by limited attention and past return performance in their purchase decisions (4) engage in naïve reinforcement learning by repeating past behaviors that coincided with pleasure while avoiding past behaviors that generated pain (5) tend to hold undiversified stock portfolios. They use capital Assets pricing Model in this research They covered five board topics the performance of individual investors, the disposition effect, buying behavior, reinforcement learning and diversification. Real investors are influenced by Media. They tend to buy rather than sell, Stocks when those stocks are in the news. This attention based buying can lead investors to trade too speculatively and has the potential to influence the pricing of stocks. They concluded that the aggregate (average) performance of individual investors is poor. Individual investors also seem to lose money on their trades before cost.

Terrance, Brad M, Barber (2005) ordeal and substantiate the hypothesis that individual investors are net buyers of attention grabbing stocks, stocks in news and stocks with extreme one day return. They seize data from four sources a large discount brokerage, a small discount brokerage, a large full service brokerage and the plexus group. Unlike individual investors, institutional investors do often face a significant search problem when selling. They premised that (1) buying behavior of individual investors is more heavily influenced by attention than is their selling behavior (2) the buying behavior of individual investors is more heavily influenced by attention than is the buying behavior of professional investors. Important news about a firm often results in significant positive or unconstructive results.

The research study on risk level, age, job level, education of individuals conducted in Baharin by Jasim Y.A (2011). This study investigated that more affluent and properly educated people are more risk seeker as compare to others who are less wealthy and less educated. It states that at the early age or in youth people like to seek more risk and when the age grow up and reach to retirement age they become less risky.

The residents of behavior are less risk tolerance as compare to non behavior people. The masculinity difference risk tolerance research also made in this research paper the findings and results of research justify their hypothesis that edification is necessary to invest in securities like stock, bond, debenture etc. The people are not aware of level of risk and not aware to nature of securities, were not willing to invest or more risk averse. They concluded that females are more risk averse than males. And also the people who are educated and wealthier take more risks as compare to uneducated persons who do not have knowledge and awareness that what is going in the markets.

In past a number of studies examine investor trading decisions. Odean (1998a) finds that, as predicted by Shefrin and Statman (1985), individual investors reveal a outlook effect—investors tend to trade their elevated prices stocks and hold on to the stock which is fluctuating. It is observed that both individual and professional investors behave similarly with several types of assets including real estate (Genesove and Mayer, 2001), company stock options (Heath, Huddart, and Lang, 1999), and futures (Heisler, 1994; Locke and Mann, 1999) (also see Shapira and Venezia, 1998). Stock volume increases on days as the information came or large price moves. (Bamber, Barron, and Stober(1997) Karpoff (1987)). For example, when Maria Bartiromo mentions a stock during the Midday Call on CNBC, volume in the stock increases nearly fivefold (on average) in the minutes following the mention (Busse and Green (2002)). Yet, for every buyer there is a seller. Generally it is seen that studies do not investigate who is buying and who is selling the stock. One exception is Lee (1992). Lee examined trading activity of almost 230 stocks in a one year period that was announcing earnings. His research shows that the investor, those who place market orders of less than $10,00, are remaining buyers following to both good and bad earnings surprises.

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The theoretical finance literature of Elena Pickumlina, et al (2013) forecasted that overconfidence investors overinvest in risky Projects and exert more efforts to learn about potentially worth ornamental projects in comparison with their unbiased peers. Self confidence or believing in one's own abilities is fêted as a prerequisite for success. From a temporary Henry fort's whether you think you can or think you can't you are right. To a new spirited yes we can, used by Barack Obama in his campaign in 2008. In this study they investigated the potentially beneficial effects of modest overconfidence on effort provision. Self confidence is considered as a valuable individual trait because it boosts motivation.

(Kent Denal, Hirshlifer, Avanidhar) projected a theory of overconfidence and self attribution bias to explain several of the securities return. This theory is based on two premises; the first is that individuals are overconfident about their abilities to evaluate securities and they mostly rely on private information signals. The second is that investor's confidence changes in biased Fashion as a function of their decision outcomes. The second aspect of theory is based on self attribution the confidence of investor in their model nurture with the private information. The psychological evidence indicates that people tend to credit themselves for past success and blame external factors for success.

In Helsingin Cauppakorkeakoula (2009) Researched that venture advisors are professionals who assist their clients in Financial decision making issues such as investing, insurance ,borrowing, taxation, retirement planning. Thus investment advisors have a great impact on their client's decisions. The recommendations the investment advisors give to their clients are naturally affected by the beliefs and notion. Biases in these beliefs and conceptions can strongly affect decision making of the clients and thus it is important to study investment advisors behavioral biases. Hindsight bias and overconfidence bias are same in meaning. Hindsight bias refers to the tendency to own performance better than it actually is, after learning the realization and overconfidence refers to the habit of overestimating own ability to perform in given tasks. People tend to be overconfident about their own capabilities and level of knowledge, Overconfidence has several forms such as "better than average" optimism bias, setting too narrow confidence limits. Data which they used was collected from three sources financial, professional, university students and employee of the engineering company. According to the Barber and Odean (2000) overconfidence causes excess trading which can be risky to the financial well being.

Kotov (2013) investigated the role of biases in making communal decisions on investing abroad. The study is supported by the results of a survey made in (2008) and structured interviews taken in the spring and the summer of (2013). The survey was carried on among German firms doing business in Russia. Interviews covered not only investments to Russia, but also investments of Russian investors in Europe as well as transatlantic foreign direct investments made in the last three years. Their research work formulated the conditions of a precise investment performance under which a decision on investing abroad is least exposed to an influence of heuristics. These are existence of an internal routine which is capable to recognize what information is relevant for decision making and how it should be processed, availability and reliability of relevant information, predictability of business environment & appropriateness of investment execution strategy.

Diebold & Yilmaz (2008) studied on international cross sections obtained by averaging over time. They investigated the broad international cross section of stock markets covering approximately forty countries. They found a clear link between macroeconomic fundamentals and stock market volatilities, with volatile fundamentals translating into volatile stock markets. Their research work can illustrate not only advocating more exploration of the fundamental volatility or return volatility interface but in addition to particular as a call for more exploration of volatility at medium frequencies.

HYPOTHESIS

1) Age is considered as a factor which influence investor to become overconfident when they choose a stock.
2) Experience is foremost factor which influences investor's behavior while stock confrontation.
3) Knowledge has influence for becoming overconfident about Stock.
4) External information as (Political, social Legal and economical, cultural) related influence investor to become overconfident while stock confrontation.
5) Self Indulgence, greediness and voracity also have influence on investor while stock confrontation and to become overconfident.

RESERCH PREDICAMENT

As Human being we have affinity to over-estimate our own dexterity and predictions for success. Operationally, it is revealed by comparing whether the specific probability assigned is greater than the portion that is correct for all assessments assigned, that given probability. Why people become overconfident while stock confrontation? And how individual (male and female) and financial institutions respond while obtaining a particular stock. How the Age, Experience, Knowledge, External Information and Self indulgence influencing investors to become overconfident while stock confrontation.

SIGNIFICANCE OF STUDY

The importance of this study is categorized for individual investor (Male, Female) Financial institution, listed companies on all brokerage firms of Pakistan, financial advisors, general public and Govt. For individual investor, they should know that what will be the effects of their age, knowledge, experience, self indulgence, for investing in a particular stock and their related instruments of a firm. For Financial institutions credentials of these factors will help them to suggest investment for themselves which will best suitable for them. For Companies credentials of such factors and variable which will effect and influence their investor behavior will affect their present actions and future plans and strategies. Last but not the least for government, credentials of the most influencing factors will help it to modify the require law and legislation and other procedures that are need for satisfying the desires of investor and also giving more support to the market efficiency. For General public these factors will guide them if they choose any stock for investment in Future.

DATA AND METHDOLOGY

We analyze the behavior of 100 investors out of which 60 were Individuals (40 male and 20 female) and 40 were the financial institutions. Our primary data set includes information from large discount brokerage firm LSE (Lahore Stock Exchange) we demeanor this research with the help of structured questionnaires. Sample size of 100 was considered for the study out of which 40 were Financial Institutions and 60 Individuals (40 male, 20 female) registered as investors on LSE. To Test the reliability of instruments and Questionnaires of this research we use SPSS 16.0.

METHDOLOGY

Population: Financial Institutions and Individual Investors registered on Brokerage firms.
Sample Size: We conducted 100 questionnaires from 60 Individuals and 40 financial institutions registered on LSE.
Sample Unit: Sample includes financial institutions and Individual investors registered on LSE.

RESERCH SCRUTINY

The statistical tackles used for this research are Frequency tables, Mean and Standard deviation on data conducted by questionnaires. The SPSS 16.0 used for coding data and for finding the results. Mean and standard deviation, minimum and maximum, high and low frequencies of both individual and financial institution are calculated for this study.

Table: 1 INDIVIDUAL INVESTORS MEAN AND DEVIATION (EFFECTS)

Variables	Mean	Standard Deviation	Maximum	Minimum
Age	2.600	1.18178	4	1
Experience	1.833	1.60684	5	1
Knowledge	1.3667	0.48596	2	1
External Information	2.40	1.42615	4	1
Self Indulgence	2.940	1.71435	5	1
Triumph	2.4667	1.94384	5	1

Above mentioned table: 1 shows the mean and standard deviation of five variables age, experience, knowledge, self indulgence, triumph and external information, which is the result of Individual investor behavior. Reckoning shows that the items which are integrated in the questionnaire are someway affecting the Pakistani investor decision making in investment. This table shows our five factors effect on the decision making in investment and that overconfident behavior of individual investors while choosing a particular stock. As this research is based upon overconfident behavior of individual sand financial institutions investors which are registered on a brokerage firm which is LSE at Pakistan, so we selected and hypnotized that age, experience, knowledge, external information, self indulgence and triumph as factors which have effect on the investors behavior to befall overconfident. So, we conduct questionnaires from 60 individual investors and their responses are showed in above mentioned table. Responses are shown in descriptive statistics which are mean, standard deviation, maximum and minimum.

TABLE: 2 FINANCIAL INSTITUTIONS MEAN AND STANDARD DEVIATION

Variables	Mean	Standard Deviation	Maximum	Minimum
Experience	4.300	0.91147	5	1
Knowledge	4.4750	0.50574	5	4
External Information	4.2250	0.83972	4	1
Self Indulgence	1.844	0.85335	4	1
Triumph	1.7750	0.91952	5	1

The budding field of behavioral finance investigates the psychological and sociological issues that bang the decision making process of individual, groups, organizations. Above mentioned table shows the mean and standard deviation of five variables for the financial institutional investor. Reckoning demonstrates that the items which are included in the questionnaire are by some means affecting the Pakistani investor decision making in investment. Results depict the factors effect on the decision making in investment and demonstrate overconfident behavior of financial institution investors while choosing a particular stock. As this research is based upon overconfident behavior of individual and financial institutions investors which are registered on a brokerage firm which is LSE at Pakistan, so we preferred and hypnotized that age, experience, knowledge, external information, self indulgence and triumph as factors which have effect on the investors behavior to become overconfident. Overconfident investors overestimate the returns to their investment projects and view external funds as excessively expensive. Thus they overinvest when they have plentiful internal funds, but curb investment when they require external financing. In this regard, we demeanor questionnaires from 40 financial institution investors and their rejoinders are showed in above mentioned table. Their responses are shown in descriptive statistics which are mean, standard deviation, maximum and minimum.

TABLE: 3 FREQUENCIES AND PERCENTAGES OF INVESTORS DECISION BEHAVIOUR (INFLUECES)

Variables	Frequencies				Percentage			
	Individuals		**Financial institutions**		**Individuals**		**Financial institutions**	
	Low	High	Low	High	Low	High	Low	High
Age	14	18	-	-	22.6%	29%	-	-
Experience	12	48	2	20	19.4%	77.4%	3.3%	32.8%
Earnings per share	14	46	19	21	22.6%	74.2%	31.1%	34.4%
Growth	13	28	3	25	21.0%	45.2%	4.9%	41%
Stock flexibility	14	28	2	20	22.6%	45.2%	3.3%	32.8%
Dividend	28	32	8	18	45.2%	51.6%	13.1%	29.5%
Actual dividend	19	41	3	21	30.6%	66.1%	4.9%	34.4%
Price fluctuation	28	32	2	20	45.2%	51.6%	3.3%	32.8%

In the above Table The Frequencies of Age, Experience, Earning per share ,Growth, Stock Flexibility, Estimated Dividend, Actual Dividend is given and shows how these things affect the individual and Investor decision making behavior while Confronting Stock. High and low frequencies of individual investor and financial institutional investor are shown in the Table.

Table 3: Continue

Variables	Frequencies				Percentage			
	Individuals		**Financial institutions**		**Individuals**		**Financial institutions**	
	Low	High	Low	High	Low	High	Low	High
External information	28	32	1	18	45.2%	51.6%	1.6%	29.5%
Govt. stability	28	32	12	28	45.2%	51.6%	19.7%	45.9%
Social responsibility	-	60	2	20	-	96.8%	3.3%	32.8%
Economic means	14	46	9	14	22.6%	74.5%	14.8%	23%
Role of media	4	56	2	20	6.5%	90.3%	3.3%	32.8%

Table 4 is further explaining Table 3 how Knowledge, Education, Personal Experience, spouse opinion, Financial advisor and stake holder opinion is affecting the individual and institutional investors decision making behavior. Financial institutions and individual institutions high and low frequencies and percentages are revealed.

External information is very much important to be accurate, the people who have more information about the external factors are less brash because they make good and accurate decisions. While people who are not having more knowledge make wrong decisions. And they acquire the stock at high prices. Media, agent at brokerage firm are also playing a gigantic role for making people overconfident.

Table 3: Continue

Variables	Frequencies				Percentage			
	Individuals		**Financial institutions**		**Individuals**		**Financial institutions**	
	Low	High	Low	High	Low	High	Low	High
Natural calamities	4	32	2	18	6.5%	51.6%	3.3%	29.5%
Self indulgence	14	23	2	17	22.6%	37.1%	3.3%	27.9%
Cultural aspects	5	29	5	19	8.1%	46.8%	8.2%	31.1%
Innovative markets	25	35	7	19	40.3%	56.5%	11.5%	31.1%
Self esteem	18	42	2	20	29%	67.7%	3.3%	32.8%
Triumph	17	41	1	16	27.4%	66.1%	1.6%	26.2%

This research has shown that experience, age, external information, triumph, knowledge and self indulgence are considered as major variables which have effects upon individuals and institutional investors while confronting a stock of a particular firm. Table 1 and Table 2 has shown the effects of these variables upon investor but this Table has shown the influence of the above mentioned variables on Individual and institutional investors while confronting a stock of a particular firm. As we hypothesized that these variables have effects and influence the both categories of investors so it has been shown by this research that Age, Experience, Knowledge and external information, influence the Individual behavior i.e. 29%, 77.4%, 51.6%, 51.6% respectively.

RELIABILTY OF MEASURES

Table 1: Reliability measure of Individual investors Behavior

Reliability Statistics	
Cronbach's Alpha	**No of Items**
.187	**25**

CONCLUSION

This research was conducted for the identification of the factors which affect and influence the Individual and Financial institutions to become overconfident while confronting stock. We scrutinize the behavior of 100 investors out of which 60 were Individuals (40 male and 20 female) and 40 were the financial institutions. Our primary data set includes information from large discount brokerage firm LSE (Lahore Stock Exchange) we demeanor this research with the help of structured questionnaires. There were 25 variables belongs to five main categories taken as independent: Age, experience knowledge, external information and Triumph. The consequences according to the calculating mean showed that all variables are fairly affecting the decision making behavior of individual investors of brokerage firm LSE.

The high age, experience, knowledge, and external information will not persuade the overconfident behaviors in individual investors. Because the Investors who have more experience, knowledge and external information are less brash as compare to those who have least. As financial institutions have more grasp on these five variables so are less overconfident while confronting stock. They prefer only those stocks for which they have proper acquaintance and information and experience. This study supports the entire hypothesizes. Investors should prefer only those Portfolios which have different maturity Assets and characteristics as a result if anyone will lose, other will gain. Financial institutions proved less overconfident as there Mean is greater, Standard deviation is less than the Individuals.

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