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# Behavioral Finance Factors Influence on Investment Decision Making of Individual Investors in PSX and PMEX

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**ABSTRACT**

**Purpose:** This paper explored how investors in PSX and PMEX make investment decisions that either contribute to the success of PSX and PMEX or seem irrational to them because of the same behavioral factors.

**Design/Methodology/Approach:** This qualitative study is aiming at the examination of new features in behavioral finance by shedding light on the representative bias, availability bias, and anchoring bias as they relate to decision making among individual investors in Pakistan. This research will select Stock Broker's Individual Investors in PSX and PMEX to be the unit of analysis for the research of heuristic components.

**Findings:** The analysis of this qualitative research explored that investor in this study use behavioral factors to make their investment decision making, but not have negative experiences using these heuristics. However, their experiences suggest that investors tend to rely on past information from companies which shows that representative heuristic effect investors decision making as well as availability heuristic in investment decision making make investors to take decision irrationally by listening to rumors and tips from broker, friends and family.

**Implications/Originality/Value:** This qualitative study is aiming at the examination of new features in behavioral finance by shedding light on the representative bias, availability bias, and anchoring bias as they relate to decision making among individual investors in Pakistan



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## Introduction

Markets (due to its characteristic high volatility, liquidity and reasons for being rewarding) are the most common and effective instruments to park investor's money; in addition, they are also major funders for the economy as a whole (Samuel, 1999). An optimistic outlook toward the economy is

given by a rising share price, which is regarded as a good sign of economic health and growth (Levine & Zervos, 1996). Therefore, an expected increase in the US interest rates leads investors to the PSX because the latter offers them a long-term investment option that is tried and tested. As the conventional finance theory goes, the investors would try to be rational and work hard to the extent of their wealth maximisation (Markowitz, 1952). On the other side, evidence implies that the investors tend to be driven by emotions during decision making. Moreover, besides that, the emotions, feelings, psyche, and instincts of any investor form the impact on their investment decisions the result of behaviour that is irrational (Zaidi & Tauni, 2012). This resulted to 38% investments return in 2021 fiscal year which turned out to be performance above average for the last seven years (Siddiqui, 2021). Hence, in order to understand and observe investor conduct at PSX and PMEX, it is important. According to the research carried out, the most common reason for investment in the stock market is to become a shareholder and to be in full control of the future financial positions (Croushore, 2006). According to the past financial theories of Gordon & Shapiro (1956) and the Black (1972), the capital asset pricing models illustrates that people take rational decision and it was based on facts. On the other hand, the legitimacy of these facts has been challenged by various other researchers (Kudryavtsev et al., 2013; Sarwar et al., 2014). The purpose to look for finance beyond usual assumptions is fundamental in the process of investing decision.

**Purpose of the Research**

Many studies have attempted to explain how age, education, gender, income, and experience affect investors' behavior (Kabra et al. 2010). This qualitative study is aiming at the examination of new features in behavioral finance by shedding light on the representative bias, availability bias, and anchoring bias as they relate to decision making among individual investors in Pakistan. This research will select Stock Broker's Individual Investors in PSX and PMEX to be the unit of analysis for the research of heuristic components.

**Research Objectives**

To ratify individual investor’s decision making influenced by availability bias at Pakistan Stock Exchange and Pakistan Mercantile Exchange.

To ratify individual investor’s decision making influenced by representative bias at Pakistan Stock Exchange and Pakistan Mercantile Exchange

To ratify individual investor’s decision making influenced by anchoring bias at Pakistan Stock Exchange and Pakistan Mercantile Exchange

**Research Questions**

What are the key behavioral factors that influence individual investment decision making at PSX and PMEX?

What role played by behavioral factors on the performance of PSX and PMEX?

**Literature Review**

**Investment Decision Making**

The process of utilizing money for the purpose of receiving profits in the long run is called investment. Through conducting detailed research, accumulating background information, and being aware of what you are doing when investing your own money, the investors can increase their earnings. Comparative analysis between two investment decisions and reference portfolio can be made, using a maximum risk level and expected return (Sharpe, 1964). Such researches over the past few years showed that the more financial information is available to people, the higher will be the likelihood of rational decisions (Merton, 1987). The researchers, on the other hand, placed an emphasis on the investors' psyche by looking at behavioural phenomenon through the lens of "cognitive unconsciousness," which refers to the linking of thoughts, memories, and perceptions without having proper knowledge or awareness, and they considered this to be a reason that led some investors to make mistakes while making decisions for investment (Hilton, 2001). In addition,

it might happen that investors take the simplest way in their decision making even when they know it could lead to short term results deprived of any long-term values (Baker and Nofsinger, 2002). Theory of conservative finances says that investors act rationally but in practice many factors affect their decision process that include behavioural and psychological factors that limit decision process due to rationality. Behavioural finance is an endeavour to elicit the reason behind this by studying some of the aspects of human nature in relation to monetary models (Barber & Odean, 19) and the figures show that investors do not always show informational efficiency (Ritter, 2003).

**Representative Heuristic and Investment Decision Making**

The degree of resemblance with the parent population is the principal demonstration of the representative heuristic (Bondt & Thaler, 1994). This process can be observed when a trader wants to generalize a phenomenon linked to the stocks or another person by relying on a set of traits (Bazerman & Moore, 2009). Investment decisions on a company involve shortcuts and rules of thumb that are based upon the assumption that the company has some representative qualities such as historical returns, popularity, or type of management. Representative heuristic is used to show the degree to which a particular setting is similar to its target population, which is a function of people's beliefs and social norms (Bondt & Thaler 1994). This finding comes to mind if a trader wants to generalize the phenomenon or the others related to stocks by finding an underlying trait (Bazerman & Moore, 2009). Investors use mental shortcuts and rules of thumb while trading; they assume that these companies possess a variety of traits associated with them, for instance, past earnings. Investors have extrapolated the company's corresponding long-term growth rate in representative by focusing on recent successes (Waweru et al., 2008). As a result, investors make illogical decisions when they try to acquire "hot" equities instead of ones that are underperforming (Bondt & Thaler, 1994). On the basis of their previous experiences, the decision taken by investors seems to them mostly right and led them to take rational decision for future investments (Rosman et al., 1994). It also, influence them to follow a same investment pattern consistently which obstruct the view of an investor to judge current scenario of investment (Prechter, 2001).

**Availability Heuristic and Investment Decision Making**

The investment of decision maker in the available stock is an availability heuristic, a bias that results in people's irrational decision rather than investigating the processes and alternatives (Tversky & Kahneman, 1973). The investor, with more access to the information about the company and their belief of a deeper understanding, will be willing to invest in more local companies (Haley & Stumpf, 1989). Furthermore, availability bias could affect the investor's evaluation of the stock retun and risk and this could lead to wrong investment decision (Ganzach, 2000). Researchers examined a number of potential influential factors which had the effect of growing availability bias during the 20th century. We know that in those cases when the CEO of a company is appointed or a new CEO is hired, the financial investors and stakeholders react differently (LUBATKIN et al. , 1989). The known behaviour of investors is making the decision without taking all the necessary information into their account (Scharfstein & Stein, 1990). Contrary to a market, investors instead are the ones who suffer as a result of financial crises because they, being vulnerable to the availability bias, are subject to record losses (Marcus & Goodman, 1991). The effect of the investors' impulsive reaction to news on the layoffs and their securities is that they end up on make irrational decisions (Worrell et.al., 1991). Just like most other traders, they normally spend their attention on stocks that have been talked about in the news recently, stocks that have delivered remarkable returns over the past few days or weeks, or stocks that are trading at extreme highs or lows (Barber & Odean, 2007).

**Price Anchoring Heuristic and Investment Decision Making**

The anchoring heuristic that was first explained in the context of human judgment by Slovic was one of the most solid and known phenomenon known as anchoring effect (Slovic, 1967). A mental process in which some people rely on a fixed value as a reference point to find something biased

(Tversky & Kahneman, 1975). The anchoring heuristic occurs whenever a scale value is based on the present market observations and the investor tends to anchor the purchasing value as a reference point during the assessment and sale of stocks and contracts. Hence, anchoring heuristic restricts investors from seeing sudden shifts in firm's share price or earnings as they follow the prior trends (Waweru et al., 2008). In other words, the investor can engage in anchoring behaviour even if it is not associated with what is really happening (Jayaraj, 2013).

**Methodology**

This research utilizes existential- phenomenology of qualitative technique for the data collection to attain in-depth understanding of behavioral factors influencing individual investors decision making in PSX and PMEX through interrogating reports of respondents that are interviewed. This method epistemologically practical for evaluating experiences of individual investors lived event, but because not all the people in Pakistan invest in PSX and PMEX, purposive sampling has been used on individual investors that have trading experience in PSX and PMEX. This technique of data collection encourages investors in PSX and PMEX to describe their personally experienced in depth phenomenon.

The phenomenology is widely used in research to explore human lived experience due to contextualized description in the lights of positivist tradition to fit responses from respondents into categories that are predetermined from assumption of researchers. Phenomenology is used in this research over case study, grounded theory and ethnography because it is more focused on respondent's individualistic approach and subjective expression of the lived and actual experience. This research will encourage respondents to express their experience in specific lived event that will explore patterns of experiences (Thompson et al., 1989). Interviews from the respondents have been conducted to get in depth understanding of their lived experience from their personal experiences while making investment decisions (Kvale, 2006). The validity of this qualitative research analysis is based on interview driven information as it gives legitimate understanding of respondents lived experience in their own wording (Feagin et al., 1991). The open-ended questions were asked from the respondents that were designed to encourage them to describe and discuss their investment decision making influenced by representative, availability and anchoring heuristics. This study is focused on gaining information regarding investment decision making of individual investors in PSX and PMEX that is influenced by heuristics.

Interviews with 13 individual investors working in PSX and PMEX are conducted to gain deeper understanding of Pakistani investor's experiences regarding their investment decision making influenced by heuristics. However, because of distance and Covid-19 restrain, interviews are conducted through internet using Skype, Microsoft Teams, Zoom, Whats App and Google Meet which support both webcam and voice, so interviewees and interviewers can interact with each other. Semi-structured interviews are conducted because they are less standardized and provides an opportunity to interviewers to probe answers whenever it is required to get explanation from interviewees (Saunders et al., 2009, p.320). The list of the questions and topics are prepared by researcher in this type of interviews, though these questions can be added or removed by looking at the conversation flow (Bryman & Bell, 2007, p.474). Although the sample size is not clearly representative of the investors at large, it corresponds with sample profile by identifying investment decision making of investors referring to the recommendation of (Malterud et al., 2016) and (Guest et al., 2006) that 6 to 10 interviewees for purposive sampling with diverse experiences may sufficient for providing information in a study that is interview based.

**Table 1. Investors Demographic Descriptions**

| Respondents Name | Demographics Information | | | | |
|---|---|---|---|---|---|
| | Age | Gender | Education Level | Experience | Invested Amount |
| Investor AB | 40 | Male | Post Graduate | 15 years | PKR Rs.20,000,000 |

| | | | | | |
|---|---|---|---|---|---|
| Investor CD | 38 | Male | Graduate | 15 years | PKR Rs.30,000,0000 |
| Investor EF | 31 | Male | Graduate | 6 Years | PKR Rs. 5,000,000 |
| Investor GH | 50 | Male | Senior Executive | 20 Years | PKR Rs. 200,000,000 |
| Investor IJ | 42 | Female | Post Graduate | 6 years | PKR Rs. 5,000,000 |
| Investor KL | 33 | Male | Post Graduate | 3 years | PKR Rs. 1.000.000 |
| Investor MN | 46 | Female | Post Graduate | 10 years | PKR Rs. 10,000,000 |
| Investor OP | 37 | Male | Post Graduate | 6 years | PKR Rs. 5,000,000 |
| Investor QR | 48 | Male | Post Graduate | 18 Years | PKR Rs. 100,000,000 |
| Investor ST | 29 | Male | Graduate | 4 Years | PKR Rs. 4,000,000 |
| Investor UV | 39 | Female | Graduate | 5 Years | PKR Rs. 3,000,000 |
| Investor WX | 49 | Male | Post Graduate | 10 Years | PKR Rs. 60,000,000 |
| Investor YZ | 55 | Male | Post Graduate | 20 Years | PKR Rs. 10,000,000 |

After the assurance of investors confidentially and protection of investor privacy, each interview, lasted for 13 to 18 minutes and was recorded from the consent of investors. The questions begin with open ended questions which are posed in a way to develop dialogue by encouraging the respondent so the investment decision making experience of investor can be recorded in detail and in free flow. The beginning questions were developed to inaugurate domains that are understandable to begin with dialogue, and additional questions were emerged impulsively from the dialogue that was ongoing. Therefore, investors are not only encouraged to share their experience about their investment decision making but also the influence of heuristics in their decision making.

Tape-recorded interviews transcriptions are utilized for the analysis by doing thematic analysis that is used for hermeneutic phenomenological studies (Kvale, 2006). This technique has been acknowledged with increased attention due to its interpretevism by information research systems (Thompson et al., 1989; Markus and Lee 2000).In this research, the investor's interviews transcription text is treated as body of data stand alone and through thematic analysis the themes were identified by looking at respondent's point of view through individually studying the text. The researcher unconscious biases about the phenomenon (investment decision making) were held aside or bracketed to make sure interpretevism is not affected by biases and not different from investors experiences or point of view.

**Results**

The act of a respondents in reality expressing in-depth specific experience, constantly results in the derivations of respondents and further emerges personal insights description from the resurgence of the experience. In this research, description of investors trading experiences in PSX and PMEX have provided the insights to researchers in to behavioral factors in general, that are unlikely to be happen in quantitative research. The themes that emerge from the 3 interviews are describes in detail in the below paragraphs with separate headings that include representativeness of past prices in decision making, availability of tips in decision making, price anchoring through brokers in decision making. In the discussion, the themes are individually treated as much as possible and overlapping themes were paired. The themes have been representative of lived experience of real investors in the description of themes. Investor experience in a following paragraph is code that identified from investors interview.

**Representativeness of Past Prices in Decision Making**

ST explained that "it's crucial to check past performance of firm because if he will not see a past performance, he will not get idea about the past prices of stock". YZ reported that "past performance is crucial because from that you will get an idea about the high it can maintain". Other investor EF also said similar things like ST and YZ "its useful to have past performance of stock to invest in a company". AB give an example "in past the oil price was going up, but due to corona it went down, and if we could have bought oil that time without seeing past performance we would

have ended up in loss". CD give an example "OGDC in 2007 its rate was 140 and then after crises it went down to 70 and even it went down to 50 and from that point people went out from the market, but it was a time to invest because OGDC stock went up now till 200".

**Availability of Tips in Decision Making**

According to MN "stock exchange rumors tend to effect the market to go up and down and there is an impact of news as well". EF said "rumors and insider information from brokers and have an impact on market, whereas OP said "there are lot of tips and rumor news and there is news that Aqeel bhai has bought something and Atif bhai have bought some thing and due to this if we make some of the money, we will go for that". AB also reported "sometimes you have to look for the irrelevant information, but in stock exchange rumors tend to effect the market to go up and down and there is an impact of news as well. It shows that irrelevant informant can lead to irrational decision. For example, CD explains "we have our knowledge and if there are some good news from somewhere for the item we do buying for that item. In other context AB reported "if broker will provide you technical analysis with low point for example if you want to sell the contract technical analysis will help you to get entry from high level for sell and from low points to buy". This statement from AB endorsed CD reporting that "definitely technical analysis and fundamentals play crucial role".

**Price Anchoring in Decision Making: Broker's Suggestion**

GH says "stop loss secure me from many losses when I have start trading in PSX and I use it after a suggestion from brokers to save myself from extreme losses". This statement from GH is endorsed by IJ as he said "stop loss is very necessary in trading because it can protect you from big loss, and without stop loss doing trading is risky and we place stop loss in trading". However, according to AB he prefers to invest on those stocks that have good financials for example "if the prices go down, I can average stocks without hitting stop loss", again here stop loss is a reference point in mind of investor. Other respondent CD explained "if the broker is providing good levels and stop loss definitely, we follow them". One the other hand, AB says "it depends if we have 10 calls from stock broker, from those 10 calls only I will work on 3 to 4 stocks and I will not go more than this".

**Conclusion and Future Recommendations**

This study stops collecting data after 13 interviews as themes were saturated and further interviews were not required to have more insights (Charmaz, 2006). The analysis of this qualitative research explored that investor in this study use behavioral factors to make their investment decision making, but not have negative experiences using these heuristics. However, their experiences suggest that investors tend to rely on past information from companies which shows that representative heuristic effect investors decision making as well as availability heuristic in investment decision making make investors to take decision irrationally by listening to rumors and tips from broker, friends and family.

Lastly, price anchoring heuristic set a reference point in mindset of investors and manipulate their decision making by relying on broker's recommendation as a reference price to trade in PSX and PMEX. Behavioral finance metrics should be improved and tailored for the Pakistan security market; it is advised that additional study be carried out. Additionally, behavioural finance is suggested as a method for future research into what influences institutional investors at Pakistan Stock Exchange to make judgments. The results of these studies can be used to examine whether behavioural finance can be applied to a variety of securities markets and to a diverse group of investors. A wider range of respondents required to corroborate these findings in future studies with more female investors as demographics influence more better and accurate results.

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