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Social Biases and Equity Investment Decisions of Individual Investors: Behavior Finance Perspective

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Abstract

Individual investors may not always pose a rational decision on stock market and heavily guided by their behavioral and social biases. This study is delineated to examine the role of social factors in the decision-making process of individual investors. This study is based on quantitative research approach and utilized a 5-points Likert type closed-end structured questionnaire survey to collect the data from 269 individuals, invested in the firms listed at Nepal Stock Exchange (NEPSE). This study utilized reliability analysis, descriptive statistics, Pearson correlation coefficient and ordinary least square (OLS) method. Evidence indicates that herding, social interaction and media effect shows the positive influences on equity investment decision process of the investors. Finally, this study justified that social biases play the significant role for equity investment decisions of the individual investors through excessive follow the humor of the market place, over or under reaction of the information about securities, follow the suggestions and recommendations of peers, friends, family members and neighbors along with highly depend upon news, social medias and information of so-called experts of capital market that leads to investment mistakes. Hence, investors should strongly follow the proper information about stock and market, utilize their own knowledge about information processing and analysis, and try to reduce the biases while making decisions through information analysis and processing that may downsize the irrational decisions.

Keywords: Behaviour finance, herding, investment decision, media effect, social interaction.

1. Background of the study

Financial decisions can have lasting consequences for investors welfare and other important decisions (Greenberg & Hershfield, 2019). Financial decisions are among the most fundamental transformative decisions that people make (Frydman & Camerer, 2016). Cognitive traits play the dominant role for financial decisions (Smith et al., 2010). Most financial decisions are the product of multiple factors, including ambiguity, instinct, habit, emotion, reason, social influence, social interaction, cognitive factors, judgement and choice (De Bondt et al., 2013). In addition, equity investment decisions are influenced by behavioural biases of the individual investors (Sapkota, 2022; Sapkota, 2023; Sapkota & Chalise, 2023).

Standard finance presumed that investors are rational and act financial decisions rationally including modern portfolio theory (Markowitz, 1952), capital assets pricing

model (Sharpe, 1964) and efficient market hypothesis (Fama, 1970). While making financial decisions, people generally make observations, process data, and come at judgements based on individual portfolios, range of securities profound in the market and the character of earning forecasts (Shefrin, 2008). Similarly, Simon (1955) described that due to psychological limits with respect to computational and predictive ability, investors fail to exhibit rational behaviour. Likewise, Kahneman and Tversky (1979) profound the prospect theory describes that how individual investors make decisions between risk and unknown outcomes that leads to make irrational decisions.

Behaviour finance deals with the study of investors psychology (Sapkota, 2022) and role of psychological biases in making financial decision making that leads to market disruptions termed as market anomalies (Kapoor & Prosad, 2017). Shefrin (2000) describes behavioural finance as the interaction between psychology and sociology with the financial actions, decisions and performance of financial practitioners. Behavioural finance will understand the investors behaviour, beliefs, motives and psychology to improve the decisions (Statman, 1995). Behavioural finance biases of the ordinary investors contain ample cogitation in the financial market (Calzadilla et al., 2021; Sapkota, 2022; Sapkota, 2023). Behavioural finance challenges the validity of modern portfolio theory, the positive risk-return trade-off theory, and efficient markets (De Bondt et al., 2013). Likewise, the focal point of behavioural finance states that, in contrast to the efficient market theory, real world arbitrage is risky and therefore limited as well as there is affect in stock price due to noise trading of availability of close substitutes of the securities (Shleifer, 2000).

The predominant emphasis in behavioural finance research regarding investor decision-making has centred on the emotional and psychological aspects of the investor (Pompain, 2012). However, numerous social interactions can influence these emotions and, in turn, have the potential to directly impact investment decisions (Baker & Nofsinger, 2002). Simply, people learn through interacting with others, they analyse the behaviour of others and interpret their beliefs and thoughts. Ellison and Fudenberg (1995) documented that individuals gather the information through interaction with others. Investors interaction with information sharing to others affect the investment decisions through herding behaviour (Baker & Nofsinger, 2002; Banerjee, 1992; Bikhchandani et al., 1992; Shiller & Pound, 1989). In addition, Moueed and Hunjra (2020) found that social factors have significant influence on stock investment decision of individual investors in Pakistan. Hence, social factors are the fundamentals for investment decisions of the individual investors. Furthermore, social factors including internet, media are the real key factor which influences investment decisions of individuals (Ahmed, 2021).

In most of the cases, investors learnt from the experiences and decisions of the others through they closely observe and scrutinise the behaviour of the others. So, this study provides the fundamentals about how individual investors decisions are affected by other investors recommendations and decisions due to investment decisions of

the individual investors are affected by social factors like herding behaviour, social interaction, and media effect. Herding is related to adaptation and follow of rumour and crowd, social interaction is related to interaction group like family, spouses, friends and relatives affects the decisions making process of the individuals, and finally media is the sources of information which directly or indirectly affect the investment decisions of the individual investors. This study provides the relevance of social factors for individual's stock investment decisions.

Poor number of literatures are available about covering the influence of social biases on equity investment decision in Nepalese context. However, the study about influence of herding bias (Risal & Khatiwada, 2019; Pandit, 2021; Sapkota, 2022) and social interaction (Janzen et al., 2017) on investment decision is nominal. To the best knowledge of the researcher, the influence of media effect on equity investment decision has not yet been incorporated as a variable of the literature in Nepalese context. In addition, individual investors of developing countries are heavily guided by negative emotions that leads to irrational decision making. Finally, the basic objective of this study is to access the influences of social biases on equity investment decision of the individual investors in Nepal.

The rest of this study has been segregated into the following sections. Section two carries the literature review and hypothesis. conceptual framework is presented into section three, section four is embraced into research methodology, results and discussions are presented into section five, section six incorporates the conclusion and implications. Finally, references are documented at the end of the study.

2. Literature review and hypothesis

2.1 Herding theory

Scharfstein and Stein (1990) concluded that the rational efforts of decision makers, whether they are analysts or managers, to bolster their reputation can result in herding behaviour. Similarly, Trueman (1994) suggested that prior sound forecast earnings will be followed by weak earnings forecast through herding behaviour. In addition, Clement and Tse (2005) opined that that analysts with a weaker track record tend to prioritize their reputation over those who are stronger, consequently making them more prone to herding behaviour. Moreover, Spyrou (2013) described that in the realm of economics and finance, "herding" or "herd behaviour" refers to a phenomenon in which economic agents mimic one another's actions and make decisions based on the actions of others. Hence, in the financial market, small, weaker and who does not able to proper analysis of financial market will follow the herding behaviour of other investors.

2.2 Social interaction theory

The interactions between the behaviour of certain individuals and various characteristics of others are fundamental due to family, charitable behaviour and other activities directly affect the decision-making process of the individual (Becker, 1974). The individual's social network consists of those persons with whom they maintain contact and have some form of social bonds. Theories of interaction involvement usually begin with a

posited relation between affection and interaction (Adams, 1967). Individuals are not always guided by rationality and follows the social interaction to others (Colman, 2003).

2.3 Herding and equity investment decision

Herding behaviour can occur when firms face a common source of variability including uncertainty and faces inferior indications about the future (Khanna & Mathews, 2011). Under certain circumstances, managers simply impersonate the other managers investment decisions, ignoring their genuine private information called herding behaviour (Scharfstein & Stein, 1990). Herding refers to buying (selling) simultaneously the same stocks as other investors buying (selling) including buying the past winners and selling the past losers linked to positive feedback trading of the securities (Lakonishok et al., 1992). Investors exhibits herding behaviour through they release forecasts similar to that previous information announced by other analysts, even which is not justified by their information (Trueman, 1994; Sapkota, 2022). Laknoshok et al. (1992) further described that herding behaviour occurs among individual investors compare to institutional investors due to institutions have more trading information of each other's compare to individuals tend to greater extent, institutions have unique investment strategy and agency problems compare to individuals, institutions might react to same signals like changes in dividends or analysts' recommendations and herd as a result that leads to excess demand for the stocks and slopes down.

Rahayu et al. (2021) found that most Indonesian investors tend to follow herd behaviour while making investment decision-making process after they obtained positive social influence and information about BVPS increase, which is divergence about inverse situation about social influence and BVPS. Shanmugham and Ramya (2012) documented that herding behaviour has positive influences of trading frequencies of the investors. Similarly, Haritha and Uchil (2020); Sapkota (2022) found that herding behaviour positively influences the investors decision about stock investment through their sentiments. However, Moueed and Hunjra (2020) found that herding has significant negative influence on stock investment decision of Investors of Pakistan.

H_{1A}: Herding positively influences the equity investment decision.

2.4 Social Interaction and equity investment decision

Social interaction with peers, neighbours, relatives, co-workers, friends and media plays the vital role of sharing information, ideas and opinion. Generally, most individuals make decision on the basis of their past experiences along with experiences of their relatives, friends, peers, and neighbours due to individuals are surrounded, or some extent bounded by social groups (Bala & Goyal, 1998). Similarly, social interactions are perceived as quality indicators on crowdfunding platforms which helps to reduce the risks associated with their investment decisions of the consumers (Thies et al., 2016). Social interaction assists to increase stock market participation due to it helps to interact with their neighbours or church, the influence of sociability is much sound than those other states (Hong, 2004). Further, Kokinov (2003) described that people

will follow previous experience if previous experience has been successful as well as people will follow the game in case of social interaction with same individual or analogous individuals.

Shanmugham and Ramya (2012) found that social interaction has significant positive influences of trading frequencies of the individual investors in India. Haritha and Uchil (2020) found that social interaction positively influenced to the investment sentiments which leads to positive influence on investment decision. Nareswari et al. (2021) found that social interaction positively moderates the relationship between personality trait and investment decision and they further concluded that individual investors are easily influenced by social interaction that ultimately affects their investment decisions positively. Similarly, Ambrosius et al. (2019) explored that social interaction about investment strategies of financial welfare are highly adopted by the pork farming stakeholders. Likewise, Fang et al. (2022) found that social interaction has limited contribution in facilitating superior retirement saving decisions. However, Moueed and Hunjra (2020) found that social interaction has significant negative influence on stock investment decision of Pakistani individual investors.

H_{1B} : *Social interaction positively influence the equity investment decision.*

2.5 Media effect and equity investment decision

Media, the means of communication, has important role that affects investors decisions, is felt necessary to examine the role of media for stock price and investment decisions of the individual investors (Harita & Uchil, 2020). Strauß et al. (2018) argued that media is the means, can influence the emotions associated to stock market. Media news affects the investors' awareness, sentiments, noise and liquidity trader that affects the stock price (Kleinnijenhuis et al., 2015; Tetlock, 2007). Similarly, Xu et al. (2020) concluded that when the degree of company's media coverage or analysts' coverage is minimal, investors get the information in alternative way which is more pleasant to investors through detailed interaction. Similarly, various studies found the significance of role of media in stock market and investment decision like social media and investment decision (Tatpornpan et al., 2022), Twitter news and stock price and market (Bollen et al., 2011), mass media and financial markets (Carretta et al., 2011).

Haritha and Uchil (2020) found that media positively influenced to the investors sentiments that positively affect investment decision of the individual investors. Similarly, Gao et al. (2021) found that media coverage and visibility encourages more over-investment than under-investment.

H_{1C} : *Media effect positively influences the equity investment decision.*

3. Conceptual framework

This study examines the influences of social biases on equity investment decision of individual investors. Conventional financial theory including efficient market hypothesis is focus on investors are rational for financial decisions (Markowitz, 1952; Sharpe, 1964; Fama, 1970) but behavioural finance is motivated by the fundamentals

of standard finance that assumes investors present rational behaviour. However, there are numerous conditions where investors feelings, crowds, media as well as their neighbours, relatives, peers and groups which influences the behaviours, judgements and decision-making processes of investors that leads to inconsistent or irrational decisions. Behaviour finance is focus on investors are normal, it substitutes the mean-variance portfolio theory (Markowitz, 1952) by behavioural portfolio theory, capital assets pricing model (Sharpe, 1964) by behavioural capital assets pricing model (CAPM) and market efficiency (Fama, 1970) to behavioural market efficiency (Statman, 2014); investors present cognitive errors while making investment decision (Shefrin & Statman, 1994); herding behaviour (Lakonishok et al., 1992; Trueman, 1994). According to the theoretical and empirical evidences, different factors including herding, social interaction and media effect are developed in accordance with the influences of investment decisions irrationality of the individuals. The detail of the conceptual framework is documented into Figure 1.

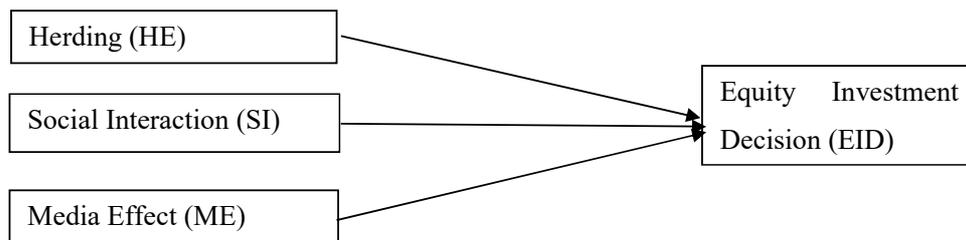


Figure 1: Conceptual framework

Table 1 Description, sources and expected sign of the constructs

Notation	Description	Sources	Expected Sign
EID	Equity investment decision	Wood and Zaichkowsky (2004); Kourtidis et al. (2011); Khan et al. (2021); Sapkota (2022); Sapkota (2023); Sapkota and Chalise (2023).	
HE	Herding	Rahayu et al. (2021); Shanmugham and Ramya (2012); Haritha and Uchil (2020); Sapkota (2022); Kengatharan and Kengatharan (2014); Hossain and Siddiqua (2022)	+
SI	Social interaction	Shanmugham and Ramya (2012); Haritha and Uchil (2020); Ambrosius et al. (2019); Nareswari et al. (2021)	+
ME	Media effect	Gao et al. (2021); Haritha and Uchil (2020).	+

Sources: Researchers' Collection

4. Research methodology

This study is based on quantitative research approach and followed an analytical design. The population of the study was the total number of investors who are trading the equity shares of the firm listed in Nepal Stock Exchange (NEPSE) from Chitwan district is unknown. Cochran (1977) mentioned that there should be minimum 385 respondents for unknown population. This study utilized 400 sample based on 133 respondents from 2 branches and 134 respondents from 1 branch (3 branches of brokerage firm named as Sani, Oxford, and Trishul securities respectively) of stock brokers in Chitwan district. The sample was collected as first come first basis on each firm. The total collected responses were 291. However, the usable responses were 269, representing the response rate of 67.25 percent. Data were collected through survey technique of 5-points Likert type self-administered close-end structured questionnaire. The data were collected from March 2022 to August 2022. For the study purpose, social biases are represented by herding, social interaction and media effect.

This study utilizes questionnaire of equity investment decision from (Wood & Zaichkowsky, 2004; Kourtidis et al., 2011; Khan et al., 2021; Sapkota, 2022, Sapkota, 2023; Sapkota & Chalise, 2023) study, herding from study of (Kengatharan & Kengatharan, 2014; Hossain & Siddiqua, 2022; Sapkota, 2022), social interaction from (Krueger & Zeiger, 1993) study and media effect from (Haritha & Uchil, 2020; Al Atoom et al., 2022). Similarly, these questionnaires were contextualized in the Nepalese context by the help of experts includes academicians and financial market practitioners. Pilot testing of the questionnaire was conducted to 50 individual investors from sample to validate the questionnaire for the study, pilot testing was constructed through divided the 50 responses into odd-even group and then compare the mean between the group and found that there is no significant different between the mean value of both groups, considered as valid the questionnaire. Reliability analysis was conducted using Cronbach alpha with minimum coefficient of 0.70 (Sekaran & Bougie, 2017), multicollinearity test was conducted using Variance inflation factor (VIF) of 10 (Sekaran & Bougie, 2017). Data were analysed through SPSS version 25 and MS excel by computing descriptive statistics to describe the phenomenon, Pearson correlation coefficient is used to access the relationship among the constructs. And finally, multiple regression is used to examine the influences of social biases measured by herding, social interaction and media effect on equity investment decision of the individual investors. Specifically, the fitted regression model is,

EID = f (Herding, Social Interaction and Media Effect)

Symbolically,

$$EID = \beta_0 + \beta_1 HE + \beta_2 SI + \beta_3 ME + e_i \quad \dots (1)$$

Where, β_0 = Intercept term

β_1 , β_2 and β_3 = Regression coefficient of explanatory variables and e_i = Error term

This study is only based on social factors of investment decision and ignores other

behavioural factors related to investment decision, samples are collected only from Chitwan district and considers experienced investors only are the basic limitations of the study.

5. Results and discussion

In this section, collected data are presented into tables and data are analysed using required tools and techniques like reliability analysis, descriptive and inferential analysis including hypothesis testing and multiple regression analysis.

Reliability Analysis

Internal consistency of the data is examined by using Cronbach alpha with the minimum coefficient is 0.70. The detailed of the Cronbach alpha is presented into Table 2.

Table 2 Cronbach alpha of the social factors and EID

Constructs	No. of items	Alpha
Equity Investment Decision (EID)	6	0.871
Herding (HE)	7	0.837
Social Interaction (SI)	6	0.814
Media Effect (ME)	6	0.799

Source: Field survey, 2022.

The Table 2 depicts the Cronbach alpha of all constructs are more than 0.70 indicates that there is no problem of internal consistency. The minimum coefficient of construct media effect is 0.799 and the equity investment decision has maximum coefficient is 0.871.

Demographic Characteristics

The demographic characteristics of the data are presented into this section. The detailed of the demographic characteristics of the respondents are presented into Table 3.

Table 3 Demographic characteristics of the respondents

Dimension	Characteristics	Frequency	Percent
Gender	Female	76	28.40
	Male	193	71.60
Age	Less than 25	46	17.16
	25 to less than 40	107	39.64
	40 to less than 55	78	29.00
	55 and above	38	14.20
Occupation	Student	97	36.10
	Academician	56	20.71
	Employee	41	15.38
	Business	75	27.81
Academic qualification	10 + 2 (PCL) or less	49	18.34
	Bachelor	138	51.48
	Master and above	81	30.18
Total		269	100.00

Source: Field survey, 2022

The Table 3 depicts that male respondents are 71.60 percent and the female respondents are 28.40 percent indicates that majority of the respondents are the male. The lowest age group of the respondents have 55 and above and highest of the respondents have 25 to less than 40-year age indicates that majority of the respondents are young. Highest number of respondents are the students, followed by business man and then academicians after that employees are the lowest in number. Likewise, majority of the respondents having academic qualification of bachelor and the lowest is PCL or less. Finally, majority of the respondents are male having 25 to 40 years of age and are students with academic qualification of bachelor level. The results from demographic profile indicates that most of the respondents are male having a young generation with academic qualification of bachelor and above.

5.1 Descriptive statistics

Descriptive statistics like minimum, mean, maximum and standard deviation are utilized to describe the phenomenon. The detailed of the descriptive statistics are demonstrated into Table 4.

Table 4 Descriptive statistics of social factors and EID

Constructs	Minimum	Mean	Maximum	Std. Deviation
Herding (HE)	6	22.215 (3.703)	30	5.716
Social Interaction (SI)	7	26.313 (3.759)	35	8.551
Media Effect (ME)	6	21.514 (3.586)	30	4.647
Equity Investment Decision (EID)	6	22.095 (3.683)	30	7.879

Source: Field survey, 2022.

The Table 4 shows that the minimum value of herding is 6 and maximum is 30 with the average of 22.215. the average value of social interaction, media effect and equity investment decision are 26.313, 21.514 and 22.095 respectively. The average value of all constructs is (3.703, 3.759, 3.586, and 3.683 respectively) more than neutral and striving towards agree. Hence, this indicates that social factors have agreement towards equity investment decisions of the individual investors.

5.2 Correlation coefficient

The relationship among constructs is measured by correlation coefficients and the detailed of the correlation coefficients are presented into Table 5.

Table 5 Correlation coefficient among social factors and EID

Constructs	HE	SI	ME
SI	0.451**	1.000	
ME	0.399**	0.297*	1.000
EID	0.672**	0.613**	0.597**

Source: Field Survey, 2022.

The Table 5 shows that the correlation coefficient between EID and all constructs are significantly positive indicates that equity investment decision and all independent constructs covary in same direction. The correlation coefficient between herding and equity investment decision is highest which is 0.672 and the lowest coefficient is 0.597 between media effect and equity investment decision. There is no any indication about multicollinearity due to correlation coefficient between all independent constructs have less than 0.70 (Sekaran & Bougie, 2019).

5.3 Regression analysis

The influence of all independent constructs to equity investment decision is examined in this section. The detailed of the results of the regression analysis is presented into Table 6 and 7 respectively.

Table 6 Model summary and ANOVA of the study

R	R ²	Adj. R ²	S. E.	F stat	Sig.
0.751	0.564	0.551	3.192	29.197	0.000

Source: Field Survey, 2022.

From the Table 6, the fitted model is significant due to p-value of fitted model is less than 0.01 means that the influence of herding, social interaction and media effect on equity investment decision is significant at 1 percent level of significant. The herding, social interaction and media effect explained the variation on equity investment decision is 55 percent.

Table 7 Regression result of socia factors on EID

Construct	Coeff.	S. E.	t Stat.	Sig.	VIF
Intercept	3.171	0.845	4.256	0.000	-
HE	1.293	0.316	5.041	0.000	1.162
SI	1.075	0.443	2.916	0.004	1.925
ME	0.989	0.299	3.308	0.000	2.099

Source: Field Survey, 2022.

The Table 7 depicts that the influence of herding, social interaction and media effect is positively significant. The most influencing factor for equity investment decision is herding with coefficient of 1.293 while least significant variable is media effect with the coefficient of 0.989. Finally, the fitted regression model based on equation (i) is,

$$\text{Equity investment decision (EID)} = 3.171 + 1.292 \text{ HE} + 1.075 \text{ SI} + 0.989 \text{ ME} + e_i$$

Herding is the process of making decision by following the decision of others rather than own which influences the emotional and mentality of investors while making investment. The herding has positive influence on equity investment decision and this finding is consistent with the finding of (Shanmugham & Ramya, 2012; Haritha & Uchil, 2020; Sapkota, 2022) due to Nepalese investors follow the crowd and humour of the market rather than proper analysis. However, this finding is contradicted with the finding of (Moueed & Hunjra, 2020) due to Nepalese investors are unaware about market information and financial statistics compared to rumour, noise, crowd and

herding. Social interaction plays the positive role while making investment decision due to most individual follows the information, idea, opinion and decision of friends, family members, relatives, neighbours, peers and co-workers. The social interaction has positive influence on equity investment decision due to investors are surrounded by social interact and persuade to follow the decision of them. This finding is consistent with the study of (Shanmugham & Ramya, 2012; Haritha & Uchil, 2020; Nareswari et al., 2021). However, this finding is contradicted with the finding of (Moueed & Hunjra, 2020) due to Nepalese investors frequently follow the interaction of peers, spouses, coworkers, friends and relatives which directly affect the investment decisions. The detailed of the results of the hypothesis is presented into Table 8.

Table 8 Results of hypothesis of social factors and EID

Hypothesis	Description	Decision
H _{1A}	Herding positively influences the equity investment decision	Accepted
H _{1B}	Social interaction positively influences the equity investment decision	Accepted
H _{1C}	Media positively influences the equity investment decision	Accepted

Source: Author's collection

Similarly, media, the role of information transformation play the significant role while making investment decision due to media affects the investors sentiments, moods, awareness, noise and psychology. Media has significant positive influence on equity investment decision due to it affect the investors investment irrationality through information. This finding is consistent with the findings of (Gao et al., 2021; Haritha & Uchil, 2020).

6. Conclusion and implications

This study examines the role of social biases while making investment decision. This study found that herding, social interaction and media positively influences the equity investment decision of the individual investors. Furthermore, Nepalese investors are heavily influenced by crowd and humour reflected as herding; decision, action and recommendation of their peers, family members and nears also significantly influences the investment decision. Similarly, information from media (social media and/or news media) significantly influences the investment decision of the individual investors. Finally, this study concluded that social biases play the important role for equity investment decision among the individual investors due to social biases leads to follow the other investment decision through irrationality to investors. Hence, herding theory and social interaction theory both play the significant for equity investment decisions of the individual investors which signify the current market scenario of NEPSE has the bell shape of index.

This study recommends that investors should properly consider social factors as herding, social interaction and media effect while making an equity investment decision of individual investors. Behavioural finance theories guide that investors are not rational and demonstrate the irrationality while making investment decision. Investors are recommended to avoid herding behaviour at the time of investment by relying on their own knowledge and ability rather than rumour or noise. Likewise, investors should

avoid decision making through social interaction through acceptance the suggestion and recommendation of peers, co-workers, family members and neighbours. Likewise, investors should not excessively be based on media coverage or news about stock for stock investment decisions.

The results of the study might be fruitful for the individual investors, monitoring and regulating bodies of stock market as well as stakeholders of the developing economies where investors frequently participate in irrational decisions without having proper knowledge and awareness of social factors especially herding, social interaction and media effect in predicating the market sentiments and markets inefficiency while making investment decision in the stock market.

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