Proposal on

FACTORS INFLUENCING INVESTMENT DECISIONS:

A Study of Nepalese Investors' Perspectives

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TU Registration Number**: 7-2-271-32-2009**

Submitted to:

Office of the Dean

Faculty of Management

Tribhuvan University

In the partial fulfillment of the requirement for the degree of

Masterof Business Studies (MBS)

Kathmandu, Nepal

February, 2018

General background

Financial market is a means through which institutional and individual investors are provided with wide range of financial products by which they can facilitate their funds in various investment options. Investment is considered as a rational decision process where investors try to maximize their future gains by sacrificing at present. A rational investor will always try to maximize their future returns based on expected risks and returns. Many economic theories are based on the conviction that individuals behave in a rational way and make their decisions on existing and prevalent information. But when it comes down to investing, investors are not always rational as we might think they are.

While making investment decisions, investors are faced with a number of factors that influence their investment decision. In this context, behavioral finance has gained attention in recent years. It has made efforts in explaining how investors' decisions are influenced by human emotions and psychology that lead investors to behave in irrational ways.

Behavioral finance has been defined as "a rapidly growing area that deals with the influence of psychology on the behavior of financial practitioners"(Shleifer, 1999).

Behavioral finance is a new paradigm of finance, which seeks to supplement the modern theories of finance by introducing behavioral aspects to the decision making process. It focuses on the application of psychological and economic principles for the improvement of financial decision-making.(Olsen, 1998).

According to Fromlet behavioral finance closely combines individual behavior and market phenomena and uses knowledge taken from both the psychological field and financial theory (Fromlet, 2001).

Historical Background

The history of investing can be traced back to the famous Code of Hammurabi, written around 1700 BCE. That code provided the framework for a lot of civilization's most crucial laws. The law established a way to pledge collateral in exchange for investing in a project. In the Code of Hammurabi, land was required to be pledged as collateral. Anyone who broke their obligation as debtor/creditor was punished. In early 1600 Amsterdam Stock Exchange was established by the Dutch East India Company as the first stock market. The Amsterdam Stock Exchange worked much like other stock exchanges: it connected potential investors with investment opportunities while simultaneously allowing businessmen to connect with willing investors. The market offered liquidity, publicized value, broadcast availability, and lowered transaction costs. In short, it made investing easier and more standardized. Soon after the successful experiment of the Amsterdam Stock Exchange, other stock markets began to appear throughout the rest of Europe. For years, it was accepted as fact that the Amsterdam Stock Exchange was the world's first stock market. However, many historians disagree, stating that stock markets could be found in various forms throughout Europe during the Medieval and Renaissance ages. In Fernand Braudel's 1983 text, "The Wheels of Commerce", for example, he claims that the roots of stock markets could more accurately be traced back to the Mediterranean. Generally speaking, investing is as old as human civilization. However, the stock markets of Medieval, Renaissance, and Enlightenment-era Europe all brought investing to the forefront of civilization in a more organized and standardized way than we had ever seen before.

The First Modern Pension Fund was established in 1759 by the First Presbyterian Church in Philadelphia. The fund was the first modern-style pension fund. Throughout the following centuries, companies and organizations began to realize the value of a good pension fund – including how a pension fund could change the global investment landscape. We owe that system to a church in Philadelphia. Then the Industrial Revolution hit Europe in the mid-18th century. This period had a profound impact on the history of investing. For the first time in history, the general population began to share in economic surplus. People started to have savings from their jobs. This enormous change in history also encouraged the development of the banking industry. Soon after the end of the first industrial revolution, the Second Industrial Revolution took place (1860 to 1914). The First and Second Industrial Revolution were responsible for introducing investing and banking to an enormous portion of the population. Then in1800s, Modern Banking and Investing rose. Some of the world's largest financial institutions and banking firms were developed. Starting in the 1850s, merchant bankers in London and Paris began to finance industrial expansions throughout the United States, leading to successful investment projects like the Transcontinental Railroad.

A decade later, those same financial institutions sold millions of dollars' worth of bonds to help the federal government finance the American Civil War. Banks provided an easy way for investors – including everyone from major backers to individual investors – to back projects like this, regardless of where the projects were taking place around the world. The idea of international investing began to blossom.

Then there was emergence of stock index. Dow Jones Industrial Average and The Standard & Poor index were introduced in this era. Dow averaged the top 12 stocks in the market from a variety of crucial industrial sectors (which consisted at the time of railroads, steel mills, mining companies, etc.). Today, it measures 30 companies from a much wider variety of industries, including companies like DuPont and Coca-Cola. The Standard & Poor index of 90 stocks (narrowed down from the original number of over 200) that acted as a market-weighted average (not price-based like the Dow). The invention of the computer later expanded the Standard & Poor 90 Index from 90 stocks to 500.

The stock market crash of 1929 and the Great Depression permanently changed the course of the world's investing history. Another big change to investing from the Great Depression was the Securities Exchange Act, which established the Securities and Exchange Commission (SEC).Modern investment theory continues to develop between the 1950s and 1990s. Alfred Winslow Jones invented the hedge fund in 1949. Harry Markowitz introduced the world to modern portfolio theory in the 1950s, while Edward Lorenz talked about chaos theory in 1960.

The rise of internet and other modern communication platforms in 1980s have had a profound impact on the history of investing. Starting in 1985, the NASDAQ introduced its own index to compete with the S&P. The NASDAQ grew in popularity throughout the 1980s and 1990s, and all that increased exposure led to investors inflating the tech bubble in the late 1990s – a bubble that eventually burst.

Today, countries around the world have their own stock markets, giving citizens an easy way to invest their money. Meanwhile, international brokers make it easier than ever to invest around the world.

Statement of the Problem

In traditional finance theory, investors are assumed to be rational and logical who seeks to maximize their wealth by considering expected risk and return factors. But many research conducted have concluded there are various behavioral factors which tend to affect investment decisions when it comes down to investing.

The performance of stock market or stock prices is said to significantly influence the economic conditions of a country. The progress in stock market will positively contribute to the growth and development of the economy and vice-versa. The investors' decision on stock market plays an important role in determining the market trend which affects the economy. It is important to discover which behavioral factors are most influential in investors' decision making and how these factors influence their investment performance.

The researcher would like to conduct this study to know which factors in general will have influence while making investment decisions and how these factors tend to affect performance of the stock market. Many researches have been carried out in understanding investors' behavior in developed economies but there have been very few studies available in underdeveloped countries like Nepal. The stock market in Nepal has grown significantly with the increase in number of companies and investors. Nowadays many investors are seen to be attracted to invest in stock market and the number of investors is seen to be in increasing number. Because of this researcher would like to undertake research study on investment behavior of investors and the reason behind investors being attracted towards the stock market. The study on investors' behavior will help in determining the most influential factors that affect their purchase and sale decisions in stock market investment by undertaking this study in investors of Nepal Stock Exchange. The study on investors' behavior will provide justifications for their reactions in investment decisions.

For this study, the researcher would like to address the following research questions -

- What are the major factors influencing the individual investors' decision making behavior?
- Do political factors have most influential impact in decision making?

Objectives of the Study

The main objective of the study will be to find out the factors that influence the investment decision of the investors.

Rationale of the Study

This study provides a general view of the influential factors that affect decision making of investors while selecting securities for investment purposes. Many research conducted in this context have shown that investors are not only influenced by analysis techniques but are also influenced and guided by different behavioral and psychological factors. The factors identified can be used in finance models and improve them so to better explain the real scenario of investors when making investment decisions.

This study is expected to be helpful for individual investors which aid them in financial planning by identifying their major influential factors in investment decision making. With this study, individual investors can be made aware about their own behavioral aspects that influence their selection of securities in investment decision making. It is expected to be useful for institutional investors for making investment strategies, plans and policies.

The study is also expected to contribute to existing literature by identifying the behavioral factors in investment decision and provide practical implications for stock market and regulators in NEPSE. In addition it is expected to be useful to stock market dealers and enable management to improve their services.

Organization of the Study

The research study will be organized into five sections. First section will include the introduction about general background of investors' behavior in selection of securities while making investment decisions. This section will also deal with the research problem, objective of carrying out the research and implication of research outcome to different stakeholders. Along with these, setting of research hypothesis, operational definition, organization of the study and limitations of the study will be outlined in this section.

The next section will deal with literature review where this section will be divided into three sub sections. It will include review of different journal articles and research paper based on the objectives, methodology and contributions. This section will also deal with establishing research gap and theoretical framework.

The third section will consist of research methodology. Research methodology will include research design, determination of population and sample size, data collection procedure, instrumentation of data, reliability and validity, methods of analysis of data and expected outcomes from the study will be conducted.

The fourth section of the study will deal with data analysis and presentation where general profile of respondents, descriptive analysis and inferential analysis of data will be done. The last section of the study will deal with summary and conclusion where summary of findings, conclusion and recommendation will be made.

Conceptual Framework

The key paper for this research study is “Factors influencing investment decisions in capital market: A study of individual investors in Nigeria” by Obamuyi (2013). This paper has been used for drafting conceptual framework for the research study. This paper has identified certain factors that have influenced individual investors in making their investment decision in Nigerian capital market where survey was carried on 320 respondents.

The main objective of the paper was to determine and prioritize the most influencing factors on investment decisions of investors and compare the effect of socio- economic characteristics of investors on any of the most affecting factors in Nigerian capital market. Structural questionnaire was developed and distributed for collecting the required information on investors’ behavior regarding their investment decision. Investment decisions of Nigerian investors were found to be most influenced by past performance of company stock, expected stock split/capital increase/bonus, dividend policy, expected corporate earnings and get rich quick. These factors were significantly influenced by socio-economic characteristics of Nigerian investors and specifically the investment decisions of investors relating to past performance of company’s stock differ based on socio-economic characteristics. The main contribution of this research paper is that investors are found to be attracted to the factors that tend to maximize their wealth in the capital market.

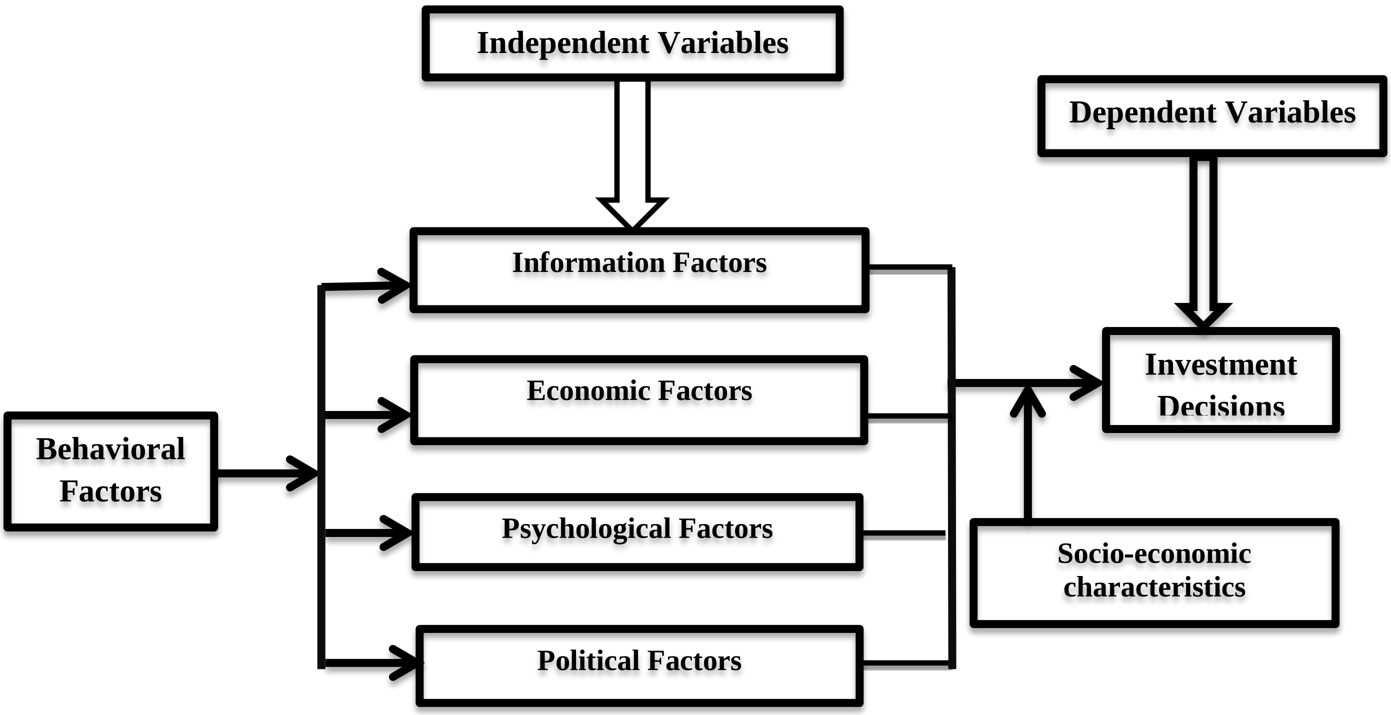

Figure 2.1 Schematic Diagram of Theoretical Framework

Specification of Variables

Independent variables

The independent variables in this research are the behavioral factors affecting investors' decisions. These variables include-

- **Information factors**

  Information factors play a vital role in influencing investment decision. Easy access to information for investors is essential as it helps them in making good decisions. It includes factors such as financial statements, past performance, reputation of the firm in industry, expected dividend and earnings and market information.

- **Economic factors**

  Different economic factors tend to influence the stock market movement and this tends to have impact on investors decision. The economic conditions of the country will have direct impact on performance of stock prices and thus influence decision of investors. Some of the economic factors include exchange rate, interest rate and inflation rates.

- **Psychological factors**

  Psychological factors are those that influence the mindset of individuals. These factors includes short term financial gain, long term financial gain, gut feeling of the economy, opinion of family and friends and opinion of stock brokers.

- **Political factors**

  Political changes also tend to have direct and indirect influence in the stock price movement. These factors include government policies, political events and political stability.

Five point likert scale will be used to measure the above mentioned independent variables where the responses from the respondents will be scaled as strongly disagree, disagree, neutral, agree and strongly agree. There are different moderating variables that will be used in this study which affects investment decision of individual investors. These variables include age, education, gender, profession, marital status and income level. These moderating variables are important for the study to show whether they have significant relationship with decision making of investors.

Review of Empherical Studies

Nagy &Obenberger (1994) made research on investment decision process of individual investors and determine which factors have the greatest influence on individual stock investor. The study also examine whether homogenous groups of variables that form identifiable constructs that investors rely upon when making decisions. For this study, questionnaires were used and mailed to 500 experienced shareholders and participants were asked to evaluate importance of 34 variables. Ranking of variables were made according to how frequently they were placed in each response category and used factor analysis to examine how they interacted. The results of the study showed classical wealth maximization criteria as the most influential factor in investment decision even though investors employ diverse criteria when choosing stocks. Local or international operations, environmental track record and firm's ethical posture appear to be given only cursory consideration. Seven homogeneous groups of variables have influenced the individual investor behavior.

Islam, Khan & Ahmed (1996) the study has aimed to find out the behavior of investors in stock market of Bangladesh. They used primary data from 409 investors who were interviewed in 1993 through questionnaire under a stratified random sampling technique. The samples included both existing and potential stock investors who represented five major cities in Bangladesh. The result showed knowledge score is the distinguishing factor between potential and existing investors. The amount of investment in stock is positively influenced by the knowledge of the investor about the stock market, investors' ability to analyze stock information, economic capacity of investors, age of investors and number year's investor has been investing in stock. On the other hand level of formal education and daily working hour influences the amount of stock negatively.

Barber & Odean (2001) the study has aimed to justify theoretical models about overconfident investors' trading excessively. For this investors were partitioned on the basis of a variable that provides a natural proxy for overconfidence-gender. For the study, over 35000 household from a large discount brokerage were selected. The analysis was made on common stock investments of men and women from February 1991 through January 1997. The results of the study showed men trade 45% more than women and thereby reduce their returns more so than do women. Furthermore these differences were more pronounced between single men and single women.

Ng & Wu (2010) the study examined the evidence of peer effects in trading decisions of individual investors in Mainland, China. The study has employed new data set to examine direct peer effects, via word of mouth, in the trading decisions of groups of individual investors who placed their shares largely in person at their brokerage branch office in Shanghai. To conduct this research, primary data was collected from brokerage branches in Shanghai which were based on daily detailed records of A- shares trades executed by individual brokerage accounts for the period of April 2001- April 2002. Results of the study indicate strong word of mouth effects in trading decisions of individual investors who are in the same room at the time they place their trades. The influence of word of mouth in individual investors is more pronounced in investor buying than selling.

Kadariya (2012) made the study of Nepalese capital market with the objective of analyzing the market reactions to tangible and intangible information and examined the investors' opinions. Descriptive and correlational research design have been employed for this study. For collecting investors' opinion, structured questionnaire has been used. The questionnaires were distributed to 185 investors through email out of which only 50 were found to be useful representing 27% response rate. The result of this study revealed that majority of the respondents involved in stock market are of age below 30 years indicating young investors being attracted towards security market. There is presence of educated investors in the market where small investors has more voice in the Nepalese stock market. Media and friends have been observed as the major factors influening investment decisions. The preferred sector of investors include banking and finance followed by hydropower sector whereas manufacturing sector has been ranked the least. Fundamental analysis and market noise has been observed as the mostly used method before making investment. The tangible components such as dividends, earnings, number of equity, book to market ratio and intangible component such as political party led government have been considered as the five most important factors for investment decisions as per opinion of individual investors.

Kengatharan & Kengatharan (2014) they made similar research on behavioral factors influencing individual investors' decision. The research objective was to determine behavioral factors influencing individual investment decision at Colombo stock exchange and the impact levels of behavioral factors influencing investment performance of investors. Cross sectional design was employed for this study where data were collected through questionnaires using stratified random sampling method. The behavioral variables were classified on the basis of heuristic, prospect, market and herding theory. Variables were developed on the basis of theory. The results showed that all factors had moderate impact whereas anchoring variable from heuristic factor has high influence and choice of stock variable from herding factor has low influence on investment decision. Choice of stock from herding and overconfidence from heuristics has negative influence on investment performance whereas anchoring from heuristics has positive influence on investment performance.

Concluding Remarks

There have been several researches that have been conducted to study the investment behavior of individual investors in stock market. Most of the researches done in various parts of the world have identified and prioritized several factors that affect the investment behavior of investors. These factors include expected dividend, corporate profit earnings, market sentiments, advice from family and friends, government policies in regulating the market and maximization of wealth. Even psychological factors are considered to have major impact on decision making behavior of investors for investment. Other researchers have also found that socio- economic dimensions such as age, education, marital status, income, profession, gender tend to have influence on investment decision of individual investors.

In context of Nepal, very few researches have been conducted on the study of factors influencing investment decision of individual behaviors. The researches that have been conducted so far have considered only few factors and relationship of socio-economic factors with investment decision. Hence, the researcher in this study will determine and prioritize various factors affecting investment decision along with relationship to socio- economic factors and also determine whether investors' decisions are highly influenced by political variables. To the best of researcher's knowledge, no study has been conducted so far that shows influence of political factors in investment decisions. So this study will be carried out with a view to find out the relationship of political variables with the most influencing factor of decision making.

Research Design

The main objective of undertaking this research study is to identify and determine the most influential factors that influence individual investors' decisions in Kathmandu Valley. These factors include informational, economic, psychological and political factors. The research also intends to test the hypothesis related to relationship between behavioral factors of individuals and investment decision.

Nature and Source of Data

The research design that will be adopted for this study is descriptive research design where survey method will be used. Survey research design will be used to collect data from members of population and describe the phenomena by asking individuals about their attitudes, opinions, behavior or values.

This research design is suitable for this study as researcher here intends to collect data to ascertain facts about investment decisions in Kathmandu valley. This kind of research design helps to learn about respondents' profile, identify and define the characteristics of individual investors.

Questionnaires will be administered to the respondents to find opinions of Nepalese investors in Kathmandu valley regarding their decision making. The collected information then will be analyzed using the software Statistical Package for Social Science (SPSS). The study will cover a wide range of questions regarding investment, perception of investors, characteristics of individual investor and preferred investment avenues.

Population and Sample Size

The population for this study includes all those individual investors who trade their shares in Nepal Stock Exchange. To determine investment behavior of individual investors it will not be practical to take into account the entire population. The respondents will be reached through brokerage firms where on the basis of their knowledge on financial markets, respondents will be selected. Due to resource constraints, the researcher will select a sample of 220 individuals to represent the whole population. The researcher will visit at least 5 brokerage firms where around 30 questionnaires will be distributed in each of the brokerage firms. Remaining questionnaires will be distributed on the basis of occupations such as students, housewife, business, service, retired personnel etc.

For a respondent to be included this study, they need to have at least attended the elementary school. This will help in justifying their basic understanding of the financial markets. The respondents will also be classified on the basis of their profession. The sample size undertaken for this study will justify the views of the respondents and will be a representative of the whole population.

Under sampling method, mix of both convenience and stratified sampling method will be used in this study. Convenience sampling is a method where the respondents will be selected as per convenient, accessibility and proximity of the researcher. This method has been adopted as the population for this study is infinite for individual investors and is difficult to estimate. Stratified sampling is a sampling method where the population is divided into smaller groups known as strata. In this study the strata will defined on the basis of occupation of respondents. This method is undertaken so to improve the representativeness of the sample by reducing error and making the data more reliable and valid.

Respondent Profile

Structured questionnaire will be used as one of the method for collection of data. Individuals involved in share market have been chosen as respondents for this study. The questionnaire will be designed carefully so it could best serve the purpose of the study and will be prepared with a view to measure perception of respondents regarding individual investment decision. It will consist of two sections. First section will include demographic profile of respondents whereas second section will include different factors affecting decision of individual investor.

The questionnaires will contain likert scale, dichotomous (yes/no), ranking questions as well as multiple choice questions. Likert scale with five points scale will be included in the questionnaire where respondents will have to choose appropriate answer on scale from one being strongly disagree to five being strongly agree. This indication state to what extent the investment decisions are influenced by different factors. Likert scale questions will be based on the factors identified which influences investment decision of individual investors.

Before getting response from respondents, the objective of the research and the way of filling the questionnaire will be explained to them. For secondary data collection, published literatures from NRB, SEBON, NEPSE and others sources will be used for data collection.

Methods of Analysis

The collected data will be tabulated, categorized and analyzed by using appropriate tools such as SPSS software and Microsoft Excel. Comparative analysis will be undertaken using graphs and charts. In this study, SPSS will be a major tool used for data analysis where several statistical techniques will be used to obtain the outcome of the study. Different statistical method will be used for analysis of data. Both descriptive and inferential analysis techniques will be used for data analysis and testing of hypothesis set forth. The statistical method will include arithmetic mean, standard deviation, independent t-test, percentage analysis, frequency, Analysis of variance (ANOVA) test, chi-square test and cross tabulation.

Arithmetic Mean

The arithmetic mean is a mathematical representation of the typical value of a series of numbers, computed as the sum of all the numbers in the series divided by the count of all numbers in the series.

Standard Deviation

Standard deviation is a measure of the dispersion of a set of data from its mean. The more spread apart the data, the higher the deviation. Standard deviation is calculated as the square root of variance.

T test

A T-test is a statistical examination of two population means. A two-sample t-test examines whether two samples are different and is commonly used when the variances of two normal distributions are unknown and when an experiment uses a small sample size.

ANOVA test

ANOVA provides a statistical test of whether or not the means of several groups are equal, and therefore generalizes the t-test to more than two groups. ANOVAs are useful for comparing (testing) three or more means (groups or variables) for statistical significance.

Limitations of study

- This study will be confined to individual investors of Kathmandu Valley so it cannot be generalized for all participants in the market.
- The behaviors of the participant may vary depending upon market condition and thus affecting the information that will be collected from the market.
- The analysis will be solely focused on investors' perception, knowledge and behavioral patterns while selecting securities for investment decisions.

- Because of resource constraints, extensive research on the study cannot be conducted.
- There might be presence of some biases and hesitation from the respondents while collecting information. This will affect the validity of response.
- The information collected will be based on structured questionnaire only.
- The information collected from the respondents will be assumed to be correct.

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