

**“IMPACT OF BEHAVIOURAL FINANCE ON PORTFOLIO  
DECISION THROUGH FINANCIAL INSTRUMENTS-A STUDY OF  
(PRIVATE PRACTISING GRADUATE DOCTORS)  
SELECTED PROFESSIONAL IN MUMBAI CITY.**

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**Abstract:**

**Purpose:** *This study examines Behavioral factors like herding, mental accounting ,gambling etc.on portfolio decision of diffiernet professionals.Here Medical professional (Graduate Doctors are considered for study).This paper study the impact of different behavioral finance factors on investment decision of medical professionals.Medical professionals are highly intellectual people with strong domain knowlegde. Behavioral Finance study the psychology of an individual investor and his decision making ability in the existing market conditions.*

**Design/Methodology/Approach:** *The data on the subject of Behavioral Finance and portfolio decision of medical professional was collected through a questionnaire. The responses were received from registered graduate doctors in Mumbai city.*

**KEYWORDS:**

Behavioral Finance.Portfolio Decsion, Medical Professional.

**INTRODUCTION**

Foundations of behavioral finance can be traced back over 150 years.Behavioral finance emerges as a field in the early 1980s with contributions by, among others, David Dreman, Robert Shiller, Hersh Shefrin, Meir Statman, Werner De Bondt and Richard Thaler. Behavioural finance is a new academic discipline which seeks to apply the insights of the psychologists to understand the behaviour of both investors and financial markets. It focuses upon how investor interprets and acts on information to take investment decisions it explains that individuals do not always act rationally in their financial decisions and that their behaviours cause them to make different choices about their financial decisions. The two building blocks of behavioral finance are cognitive psychology (how people think) and the limits to arbitrage (when markets will be inefficient).

Behavioral finance is based on three major building blocks, namely sentiment, behavioral preferences, and limits to arbitrage.

Existing studies on investors' decision-making often rely on evident socio-demographic variables to proxy for underlying psychological processes that drive investment choices. Doing so perfectly ignores the latent heterogeneity amongst investors in terms of their preferences and beliefs that form the underlying drivers of their behavior. To gain a better understanding of the relations among individual investors' decision-making, the processes leading to these decisions, and investment performance, though this research it will focus on how systematic

differences in investors' investment objectives and strategies impact the portfolios they select and the returns they earn.

Traditional finance theories offer investment strategies on the basis of risk-return evaluation. But an investor must keep in mind that risk is associated not only with the prices of and returns from an investment, but also it lurks inside an investor mind. Investors do not act wisely in taking decisions relating

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to investment. They have certain weaknesses like cognitive and emotional which take a predominating role in taking investment decision of individuals.

A financial instrument is a tradeable asset of any kind; either cash, evidence of an ownership interest in an entity, or a contractual right to receive or deliver cash or another financial instrument. According to IAS 32 and 39 it is defined as "any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity".

Portfolio investment related financial instruments:

Equity based- short term and long term

Debt based - short term and long term

A professional is a person who is engaged in a certain activity, or occupation, for gain or compensation as means of livelihood; such as a permanent career.

### LITERATURE REVIEW

**Behavioural Finance:** (Gail F., 1972) Examines the behavioral science approach to financial research. Such application seems evident when financial and investment decision-making is seen as a circular process in which the last step is linked to the first step.

(Nicholaes barbaries, 1997) Presented the model on investor's sentiment like investment related beliefs and individual judgements. The model is also constant with experimental evidence on both the failures of individual judgements under uncertainty and the trading patterns of investors in experimental situations. Results of this model was matching with the results of Kahneman and Tversky (1974) on the important behavioral concepts as representativeness. In the stock market investors might categorize some stocks as growth stocks based on recent history, ignoring the chances that there are very few companies that just keep growing.

Another concept of behavioral finance as well as psychology namely conservatism defined as slow updating of models in the face of new evidence (Eduwards 1968). Conservatism states that once individuals have created impression they are slow to change that impression in the face of new evidence. Eduward benchmarked a subject's reaction to new evidence against that of the idealized rational Bayesian in experiments where the true normative value of a piece of evidence is well defined.

(Bondt, 1998) Studied small individual investors' behaviour towards trading of stocks and found that decision process influences decision outcomes. Many economists, particularly in Finance, are skeptical towards the new behavioral approach and the alleged shortcomings in individual rationality. They offered a brief survey of prior research and illustration of actual decision making in a financial context.

(Fama, 1998) Studied the relationship between Market efficiency, long-term returns, and behavioral Finance. An efficient market generates categories of events that individually suggest that prices over-react to information.

(Clearance, 1999) Examines the benefits of portfolio rebalancing to help investors achieve their investment goals and avoid the most common investment mistakes.

(Chan, Frankel, & Kothari, 2002) Examine a central psychological bias, representativeness, which underlies many behavioral-finance theories. According to this bias, individuals form predictions about future outcomes based on how closely past outcomes fit certain categories.

(Hirshleifer, 2001) Studied investor psychology as one major determinant of asset pricing.

(Wang, 2009) examine the extent to which a broad range of private investors can be classified into a small number of clusters in order to learn about group-specific needs in financial affairs. They demonstrate that by segmenting private investors on the basis of their self-stated financial attitudes and behaviour, a yield of clearly interpretable profiles can be realised. Cluster analyses, based on the results of factor analysis, indicate that private investors can be divided into five clusters with specific characteristics in their financial day-to-day behaviour and certain related socio-demographic variables (e.g., gender, age, and education). Each cluster raises key issues in meeting its needs and the use of adequate financial instruments. A segmented approach can increase customer satisfaction and reduce costs by responding specifically to the different segments.

Real investors are inclined by where they live and work. They tend to grip stocks of companies close to where they live and invest heavily in the stock of their employer. These behaviors lead to an investment portfolio far from the market portfolio stated by the CAPM and debatably expose investors to unnecessarily high levels of distinctive risk. Real investors are impressed by the 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. The broad topics are covered under this study are the performance of individual investors, the disposition effect, buying behavior, reinforcement learning, and diversification. (Timotej Jagrica and Sebastjan Strasekb, 2011 ) Developed a model for predicting market psychology which is based on the application of a self-organizing network algorithm. The estimated model is applied to a mechanical trading system, which independently adopts investment decisions based on the current daily data.

(Gokhan,2011) Found that gender has interaction with five of the financial behavior factors (overreaction, herding, cognitive bias, irrational thinking, and overconfidence). The level of individual savings has an interaction with four of the financial behavior factors (overreaction, herding, cognitive bias, and irrational thinking).

(Everton Anger, 2012) explored the relationship of basic assumption of human psychology with modern finance. The basic assumption of modern finance states that man is a rational being and a take full advantage of expected utility. The idea that markets could behave in an irrational manner was against the principles of expected utility. Financial decisions are made in times of high difficulty and great uncertainty. Often, the moment's emotional stress at the moment of financial decision is vast. For Behavioral Finance, decisions made according to a problem follow, in some cases, an identifiable pattern that can and should be contemplated by an economical and financial model. The field of Behavioral Finance is specifically the identification of how emotions and cognitive mistakes may influence the decision making process and of how such behavioral patterns can decide changes in the market. Materialism, due to the need for consuming expensive objects, has shown to be positively and significantly linked to risk tolerance. Taking a risk absolutely for the wish of a new standard of wealth, without parameters or final objective may make individuals presume more and more risks without realizing the potential damage associated to their decisions.(singh, 2012) Posited investment decision-makers as rational, utility-maximizing individuals. Cognitive psychology, on the other hand, suggests that human decision processes are inclined to several illusions.

#### PORTFOLIO DECISION

( Dowling, 2005) research on the influence of investor feelings on equity pricing and also build up a theoretical basis with which to understand the emerging findings of this area. Their studies broadly describe as investigating whether variation in feelings that are extensively practiced by people influence investor decision-making and consequently, lead to expected patterns in equity pricing.

Two recent areas of stock market research have addressed the impact of feelings on investor decision-making. The first area covers mood misattribution. This research investigates the impact of environmental factors, such as the weather, the body's biorhythms and social factors, on equity pricing. The second area of research looks at the impact of image on investor decisionmaking, the argument here being that the image of a stock induces emotions in investors that partially force their investment behaviour. The traditional point of view of how people make decisions involving conditions of risk and uncertainty assume what Loewenstein et al. (2001) portray as a 'consequentialist perspective'. In this traditional model, the decision-maker is implicit to quantitatively weigh the costs and benefits of all possible outcomes and choose the outcome with the best risk-benefit trade-off. This perspective can be seen in the traditional finance theories of Markowitz portfolio theory (Markowitz, 1952) and the Capital Asset Pricing Model (e.g. Sharpe, 1964).

(Campbell, 2006) Argue that although many households find adequate solutions to the complex investment problems they face, some households make serious investment mistakes. These mistakes come in a variety of forms. Investment mistakes have a number of interesting characteristics that make them central to the study of household finance. Many investment products allow some degree of cross-subsidization from naive households to sophisticated households that optimally exploit embedded options. It may be difficult for new investment products to gain acceptance if sophisticated households, who are the natural early adopters, must give up the benefit of a cross-subsidy when they move from an existing product to a new product.

(Riza Demirer, 2006) Demonstrates how Bayesian networks, a graphical modeling tool, can improve analysts' forecasts, portfolio decision-making, and risk analysis. Bayesian networks combine historical quantitative information with qualitative information in a systematic way. In portfolio management, analysts must assess a large amount of sometimes conflicting data to make a decision based on uncertain information. Bayesian networks are especially well suited for this task.

(Lemont, 1999 ) Studied the relation between an economic tracking portfolio is a portfolio of assets whose returns are economic variables, such as inflation, returns, or expected output. Using tracking

portfolio returns as a financial instrument to predict future economic variables increases the estimated sensitivity of asset prices to news about future economic variables.

(Martin, 1955) Thrown light on the problem of selecting securities for managing an investment portfolio. The field of investment has a long history of detailed analysis by economists and investment analysts. This has resulted in theory of economic behavior. The keystone of this theory is the proposition that the "value" of a security is equivalent to the discounted value of its anticipated yield. Thus, in selecting an investment portfolio, the investor should search for to maximize the discounted value of the portfolio's yield. For a more adequate approach to the portfolio selection problem, Markowitz suggests the "Expected return-Variance of return" theory (E-V). The theory assumes that expected return is desirable and that variance (risk) is undesirable. The ability of the E-V theory to yield useful results depends upon the ability of the investor to formulate his probability beliefs precisely.

(Markowitz, 1952) Studied the process of selecting a portfolio or investment. The process of selecting a portfolio is divided into two stages. The first stage begins with observation and experience and ends with ideas about the future performances of available securities. The second stage begins with the relevant beliefs about future performances and ends with the choice of portfolio.

#### **Literature Gap:**

Review of the literature indicated that a gap exists between understanding of different behavioral Finance factors and portfolio decision. To address the gap the current study has been taken to find out what is impact of behavioral finance factors on portfolio selection and decision of medical professionals.

The results of this research will add to the body of knowledge in the Behavioral Finance field. This may be utilized in both the academic and professional field to understand factors that most likely has impact on portfolio decision.

#### **RESEARCH FRAMEWORK**

The current research seeks to address following research questions.

What is the relationship between behavioral finance factors (the independent variables) and portfolio decision (the dependent variable) in terms of investment?

#### **Research Objectives:**

Based upon research questions, following research objectives were developed.

1. To study the different behavioral finance factors influencing the investment behavior of selected respondents.
2. To categorize the factors influencing the risk taking ability of selected respondents.
3. To study the relationship between Private Practicing Graduate Doctors and their investment in different financial instruments.
4. To study the relationship between residential locations of the Private Practicing Graduate Doctors and their investment pattern through different financial instruments.
5. To study and analyze the different investment pattern of the respondents with risk and return factors.
6. To offer suitable suggestions to the investors to make their investment in better way.

#### **Research Hypotheses:**

The purpose of the current quantitative, correlation study is to investigate behavioral finance factors and their impact on portfolio decision. The research paper determines the degree of relationships between the 8 behavioral finance factors and portfolio decision of Graduate Doctors in Mumbai City.

The dependent variable is Portfolio decision The 8 behavioral finance factors are independent variables.

In order to conduct the research into the portfolio decision success model, the following hypotheses was investigated.

Hypothesis H01: No significant relationship between behavioral finance factor Representativeness and portfolio decision.

Hypothesis H11: A significant relationship between behavioral finance factor Representativeness and portfolio decision.

Hypothesis H02: No significant relationship between behavioral finance factor ‘Herding and portfolio decision.

Hypothesis H22: A significant relationship between behavioral finance factor ‘Herding and portfolio decision.

Hypothesis H03: No significant relationship between behavioral finance factor Overconfidence and portfolio decision.

Hypothesis H33: A significant relationship between behavioral finance factor Overconfidence and portfolio decision.

Hypothesis H04: No significant relationship between behavioral finance factor ‘Cognitive conflict and portfolio decision.

Hypothesis H44: A significant relationship between behavioral finance factor ‘Cognitive conflict and portfolio decision.

Hypothesis H05: No significant relationship between behavioral finance factor Fear of Regret and portfolio decision.

Hypothesis H55: A significant relationship between behavioral finance factor Fear of Regret and portfolio decision.

Hypothesis H06: No significant relationship between behavioral finance factor gamblers myth and portfolio decision.

Hypothesis H66: A significant relationship between behavioral finance factor gamblers myth and portfolio decision.

Hypothesis H07: No significant relationship between behavioral finance factor mental accounting and portfolio decision.

Hypothesis H77: A significant relationship between behavioral finance factor mental accounting and portfolio decision.

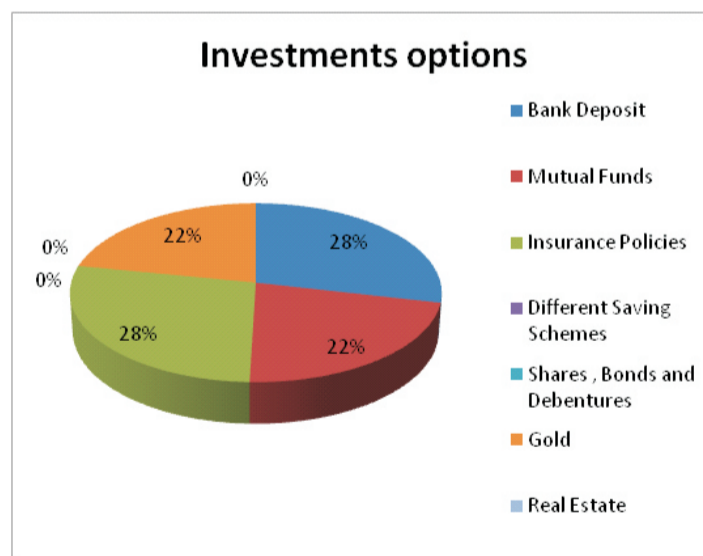
Hypothesis H08: No significant relationship between behavioral finance factor ‘hindsight and portfolio decision.

Hypothesis H88: A significant relationship between behavioral finance factor ‘hindsight and portfolio decision.

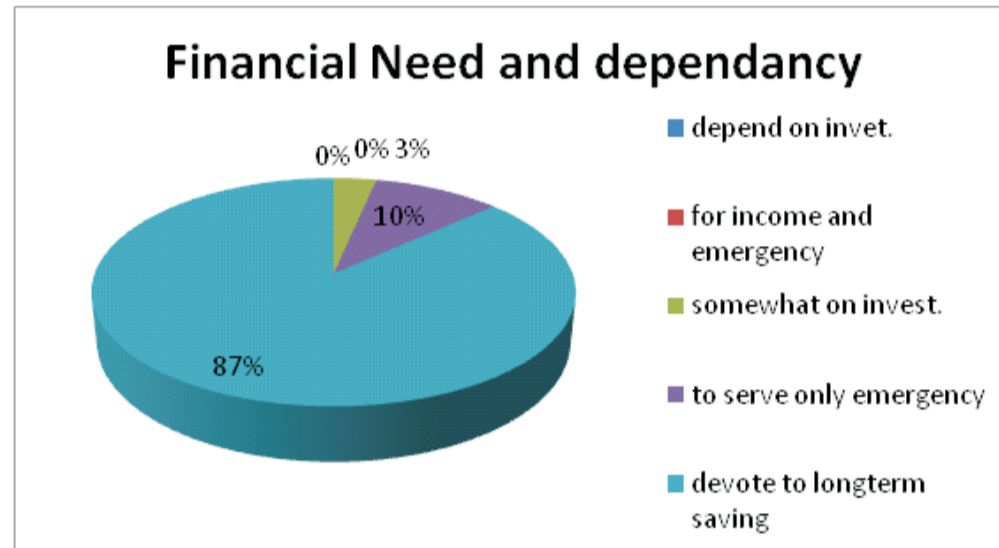
#### RESEARCH METHODOLOGY

The data on the subject of Impact of behavioral finance factors on portfolio decision was collected through a structured questionnaire. This study included questions on different research variables which have been compiled and consolidated from the academic and professional literature. A questionnaire was sent out to around 100 private practising doctors in Mumbai city.

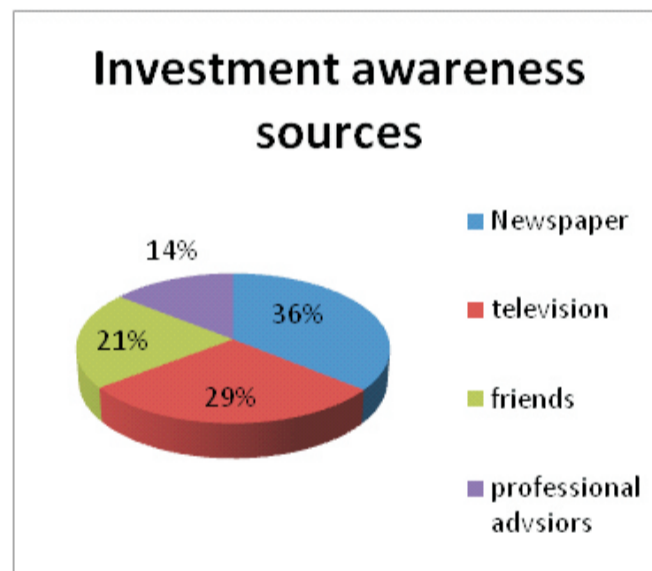
#### DATA INTERPRETATION/ANALYSIS:



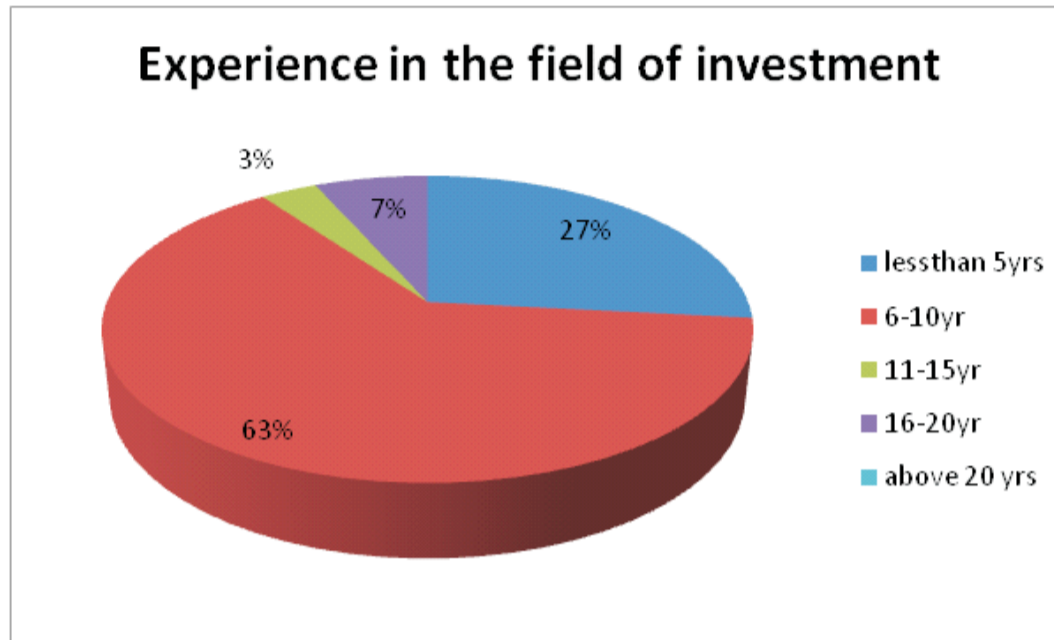
28 % of respondents know Bank deposit and insurance policies as investments options for portfolio decision and 22% people know mutual and Gold as investment options.



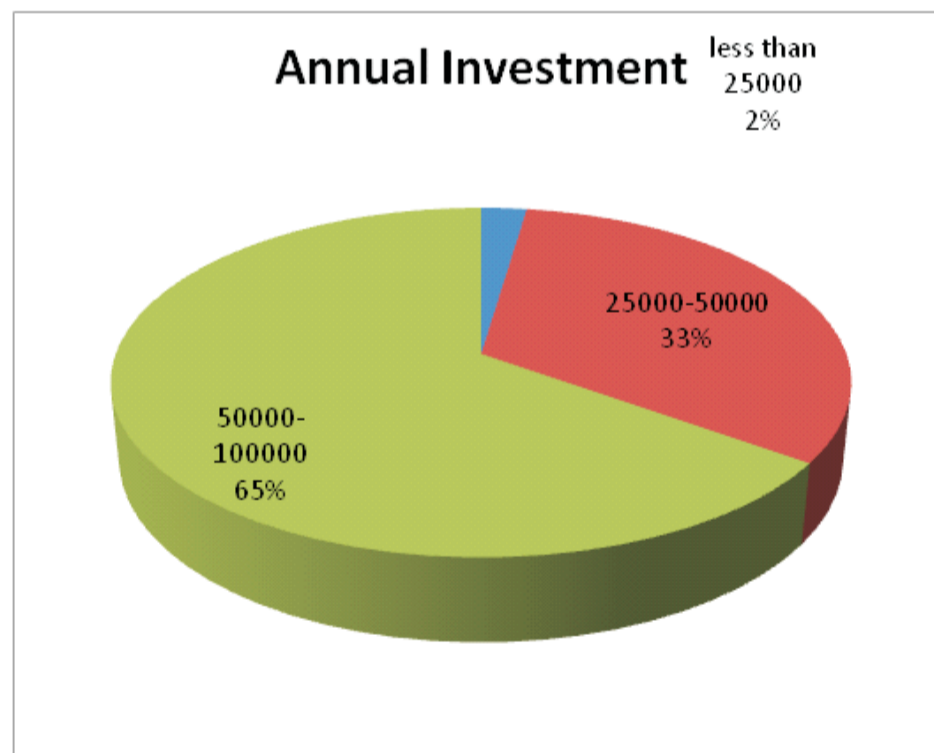
Maximum 87% respondents want to devote their investments for longterm saving and 10% want to keep to serve only emergency where as minimum 3% of total respondents somewhat depend on investment.



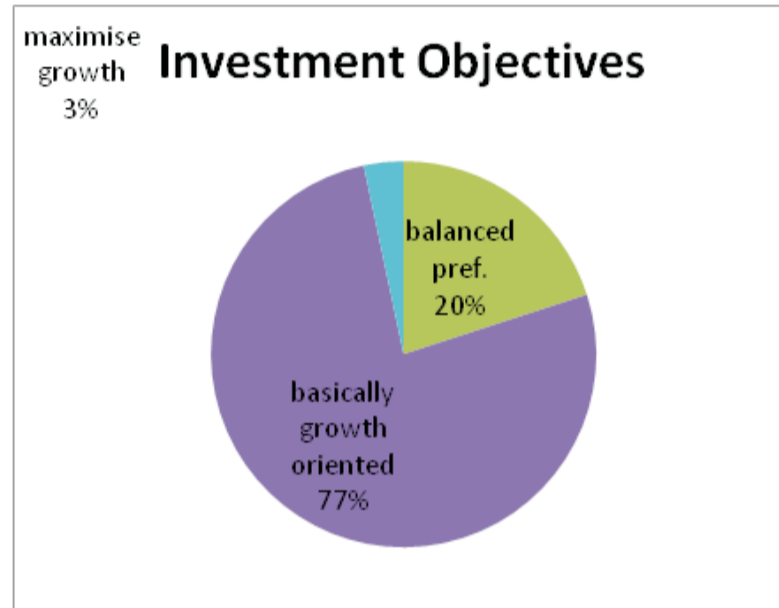
36% of respondents are aware of different investment options through newspaper and 29% of respondents are aware of through television where as 21% get information through friends and only 14% are getting information from professional advisors.



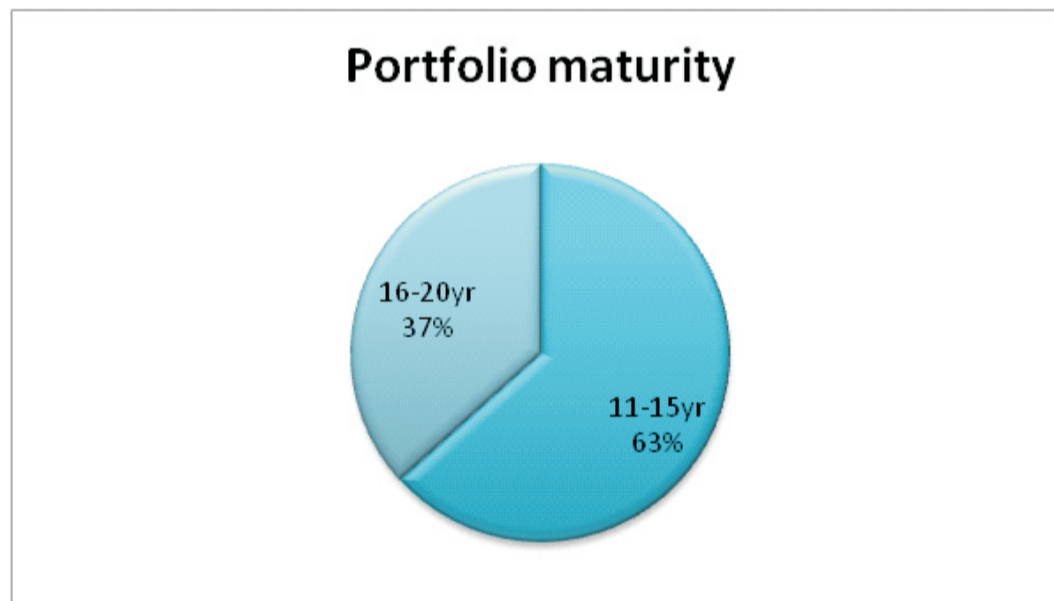
63% of respondents have experience in the field of investment between 6-10 years whereas 27% of the respondents have experience less than 5 years .7% of respondents have investment experience between 16-20 years and 3% have investment experience between 11-15 years.



65% of respondents are doing annual investment between Rs.50,000-100,000 whereas 33% of respondents do between Rs.25,000-50,000.Only 2 % of respondents invest below Rs.25000 annually.

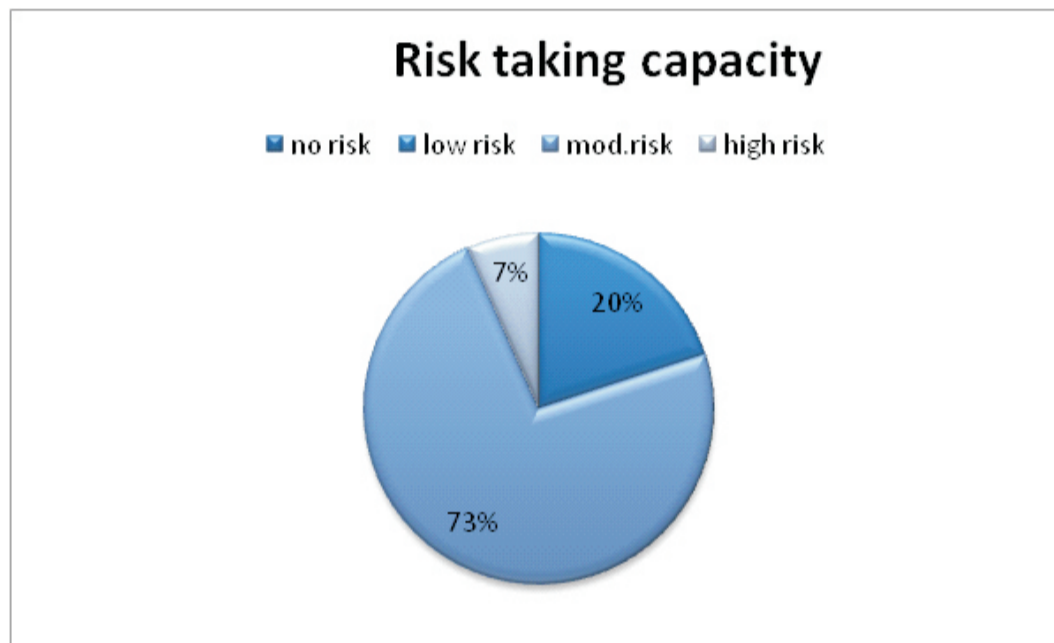


Maximum 77% respondents have their investment objective as growth and 20% of the respondents have balanced preference for growth and income.

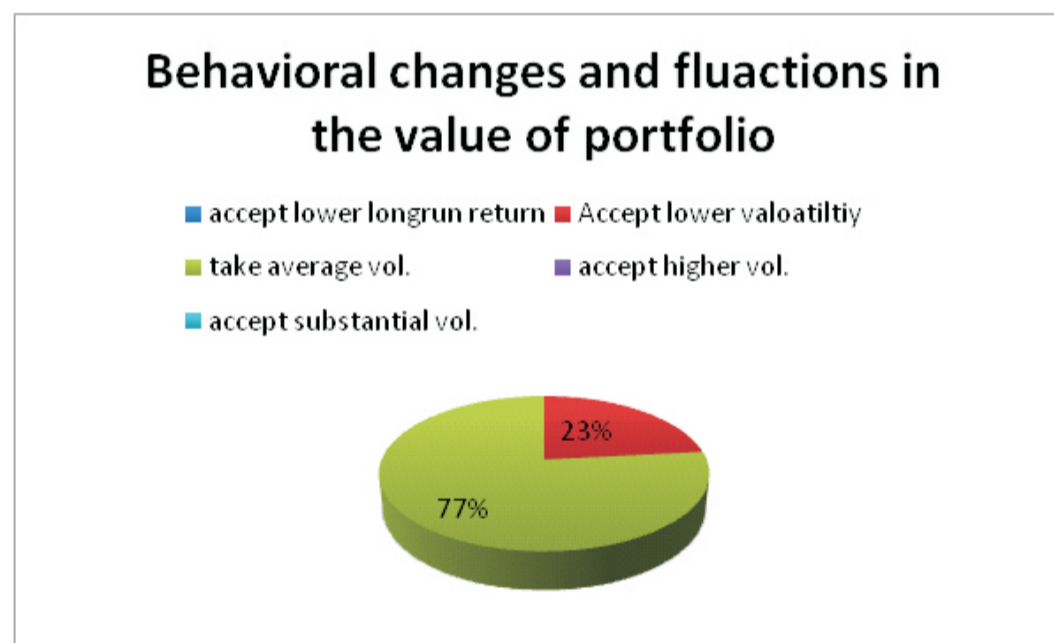


63% respondents think that their portfolio should mature within 11-15 years and 37% respondents think that it should mature during 16-20 years.

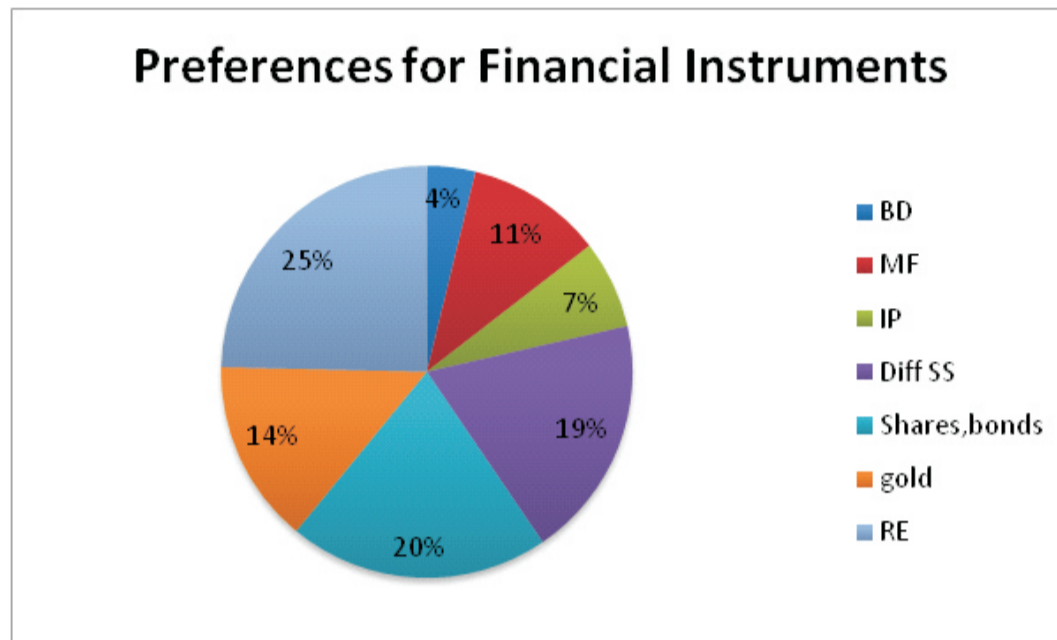




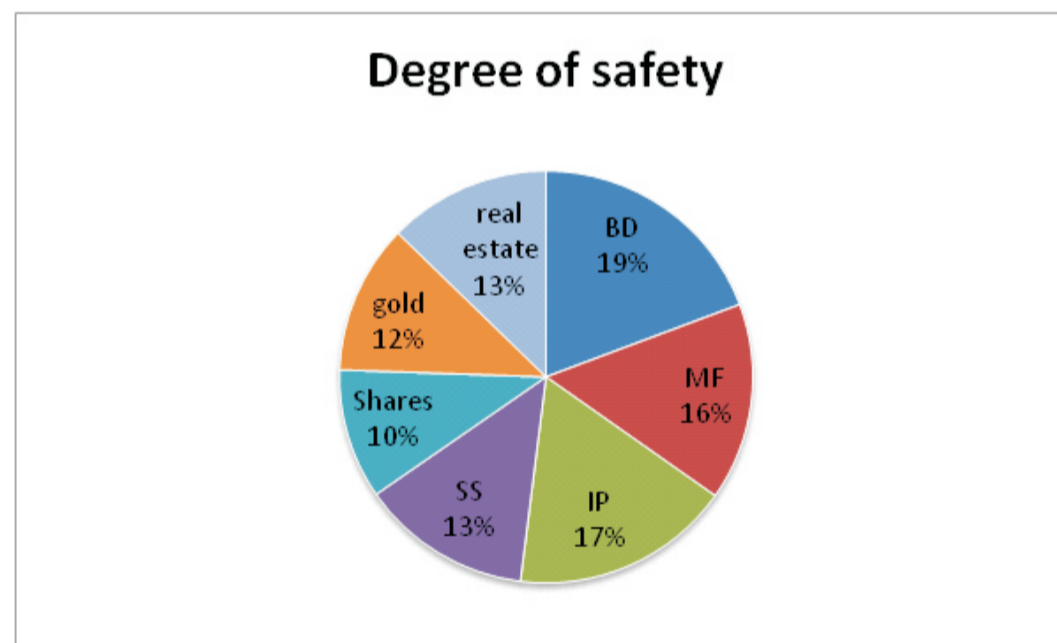
73% respondents have moderate risk taking capacity where as 20% have low risk taking capacity and only 7% have high risk taking capacity.



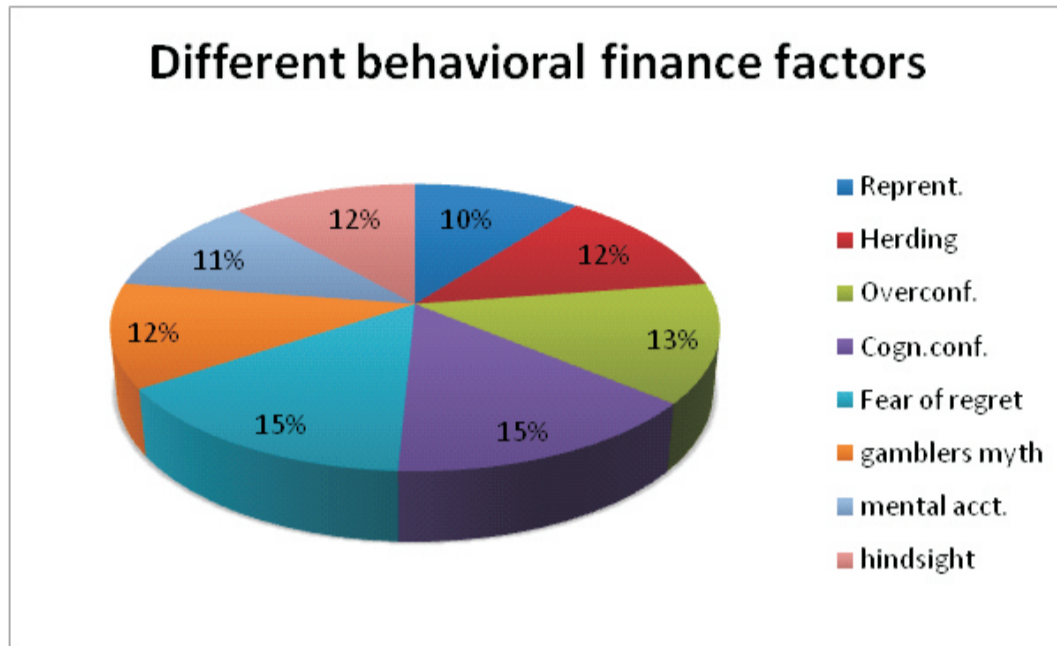
77% respondents' behavior towards fluactions and changes in portfolio is to take average amount of volatiltiy for average returns.Where as 23% respondents' behavior towards Accept higher volatilty as growth is goal.



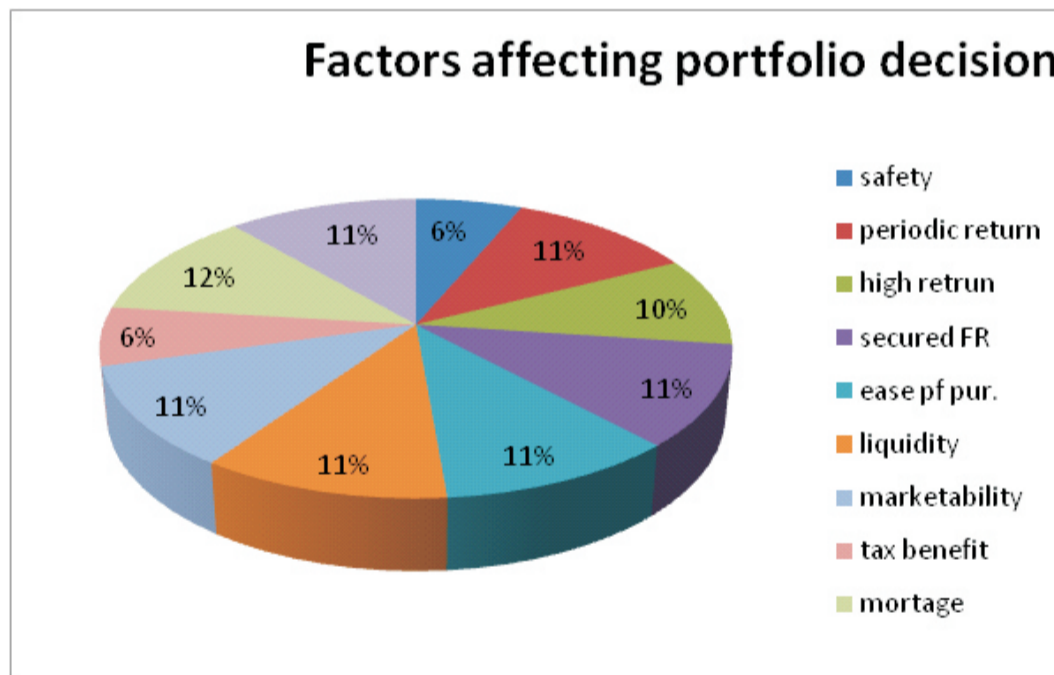
Ranking of Preferences for Financial instruments are in diverse ways, as 25% respondents gave their first rank to Real Estate.20% respondents ranked first as shares and bonds and 14% ranked first as gold.19% respondents gave their first rank to different saving schemes.



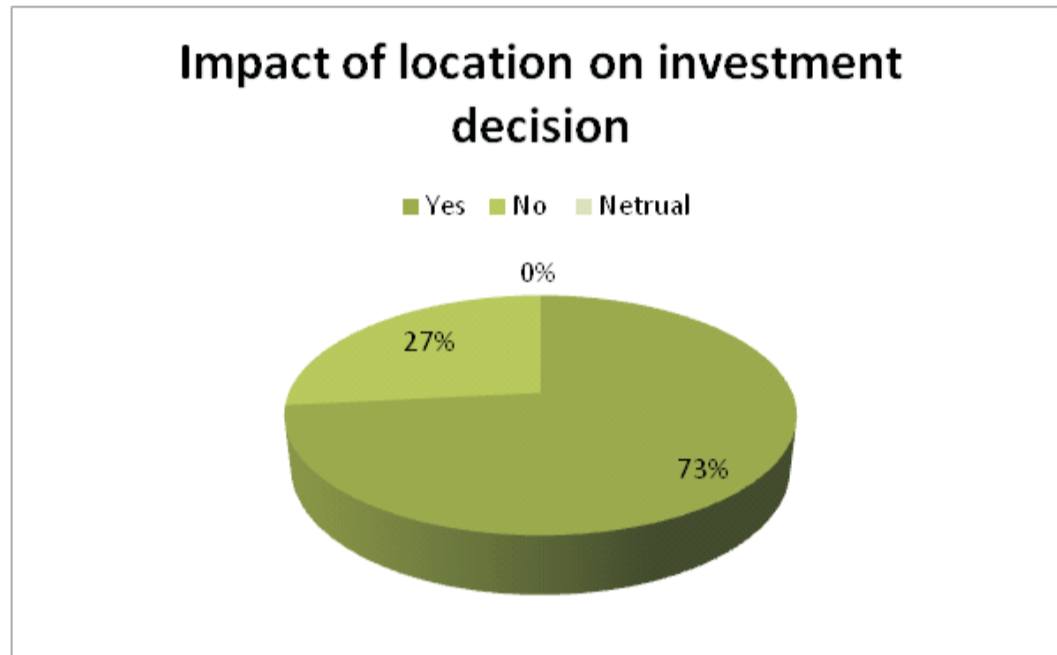
19% respondents think that degree of safety is maximum in terms of investment with respect to financial instruments is Bank deposits and 10% respondents think that degree of safety is maximum in terms of investment with respect to financial instruments are shares .



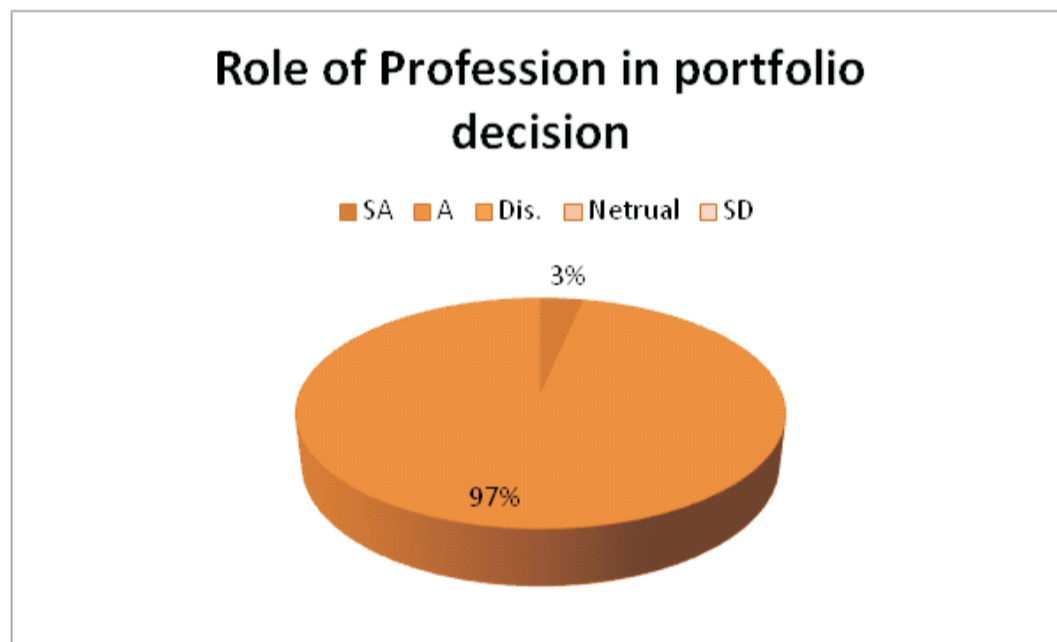
From the above pie chart we can observe that different behavioral finance factors have impact on portfolio decision.



From the above pie chart it is observed that various factors like safety, periodic return, high return liquidity etc. affect deeply portfolio decision of an investor.



73% of respondents think that residential location do have impact on investment decision, whereas 27% respondents think that it don't have imapct on investment decision.



97% respondents atrongly agree that role of profession is important in portfolio decision where as only 3% respondents think that it is not important in portfolio decision.

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