An investigation on the effect of investor’s behavior on fund management

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**ABSTRACT**

There are many evidences to believe that investors’ personal characteristics influence on their financial decisions when they purchase stocks, bounds, etc. In this paper, we present an empirical investigation to study the effects of 20 personal characteristics on 52 managers of mutual funds in Iran. Using Pearson correlation test, the study has detected that seven factors including anchoring & adjustment, framing, over confidence, illusion of control, hindsight, recency and self-attribution positively influence on investors’ behaviors. In addition, five factors including consistency, self-control, loss aversion, regret aversion and availability negatively influence on investors’ behaviors. However, the study did not find any evidence to confirm any kind of relationship of representativeness, conservatism, ambiguity aversion, optimism, mental accounting, confirmation and status quo on investors’ behaviors.

**Keywords:** Mutual fund, Investor behavior, Tehran Stock Exchange

1. Introduction

There are many evidences to believe that investors’ personal characteristics influence on their financial decisions when they purchase stocks, bounds, etc. (Nagy & Obenberger, 1994; Thaler, 2005). In some events, there are some extraordinary interest in investing on bounds and stock market called irrational exuberant (Shiller, 2005; Parisi & Smith, 2005; Sultana, 2010). Some investors do not sell their poor performers on time and end up writing significant amount of loss despite the fact that financial data as well as technical charts give sell signals (Pompian, 2011). On the contrary, many fund managers sell some high flyers on early stage and reduce their profits, significantly. These are just simple evidences to believe that it is possible to do a good due diligence but make wrong investment decisions; buy/sell emotionally and end up having unpleasant consequences. Therefore, fund manager organizations need to select appropriate people when they hire fund managers and consider employees’ personal characteristics along with other professional backgrounds.

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Xiao (2007) performed an empirical investigation on irrational exuberance and stock market valuations by looking into evidence from China. The study evaluated the fundamental efficiency of stock market valuations in China and reported stock valuations in China had deviated significantly from underlying firm-level fundamentals. Given the effect of the stock market for assigning investment funds in China, the results suggested that China's stock market development might generate an inefficient resource allocation and it could cause detrimental impacts on the real economy.

Goedhart et al. (2005) performed an investigation to find out whether fundamentals or emotions drive the stock market. They stated, “some behaviorists would even assert that stock markets lead lives of their own, detached from economic growth and business profitability”. Hong et al. (2005) performed an investigation on the effects of word-of-mouth in the holdings and trades of money managers.

Leong et al. (2002) provided a comprehensive discussion of the psychological and behavioral investor perspectives responsible for the phenomenon of stock price momentum. Anchoring, overconfidence, herding, mental accounting, myopic loss aversion, regret aversion, prospect theory, over-reaction and under-reaction, representativeness, non-transitivity and question framing, hindsight bias and pride, barn-door closing, sensation seeking, and response to market consensus estimate were all investigated to offer description for the abnormal superior performance of value stocks over growth stocks. They applied empirical examination to describe that enough overconfident investors and financial analysts anchor on past EPS growth rates and systematically over-extrapolate to over-estimate the EPS of growth stocks and under-estimate the EPS of value stocks. As stock value correction sets in over time horizon, value stocks would more likely outperform growth stocks. They also examined the effect of firm size and reported that large-cap investing could work better with the growth style strategy and that small-cap investing could work better with the value style strategy.

2. The proposed study

This paper presents an empirical investigation to study the effects of 20 personal characteristics on 52 managers of mutual funds in Iran. There are 20 characteristics associated with managers of mutual funds including anchoring & adjustment, framing, over confidence, illusion of control, hindsight, recency, self-attribution, consistency, self-control, loss aversion, regret aversion and availability, representativeness, conservatism, ambiguity aversion, optimism, mental accounting, confirmation and status quo. The main hypothesis of this survey investigates whether there is any meaningful relationship between these 20 factors and investors’ behavior. The survey designs a questionnaire in Likert scale and distributes it among 52 managers of some Iranian mutual funds over the period 2012-2013. Cronbach alpha was calculated as 0.76, which is within an acceptable level and therefore, we can perform statistical test to find the relationship between two managers’ personal characteristics and investment decisions. The study uses Kolmogorov-Smirnov test to for normality test and Table 1 summarizes the results of our survey.

<table>
<thead>
<tr>
<th>Number</th>
<th>Normal parameters</th>
<th>Maximum deviation</th>
</tr>
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<tbody>
<tr>
<td></td>
<td>Mean</td>
<td>Std. dev.</td>
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<tr>
<td>44</td>
<td>3.92</td>
<td>0.34</td>
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</table>

The result of Table 1 demonstrates that all data are normally distributed and we can use Pearson correlation test to verify the hypotheses.
3. The results

In this section, we present the effects of Managers’ personal characteristics on investment behavior.

3.1. The positive factors

In our study, there were positive and meaningful relationship between seven factors including anchoring & adjustment ($r = 0.44$, Sig. = 0.000), framing ($r = 0.40$, Sig. = 0.000), over confidence ($r = 0.39$, Sig. = 0.000), illusion of control ($r = 0.39$, Sig. = 0.000), hindsight ($r = 0.34$, Sig. = 0.000), recency ($r = 0.30$, Sig. = 0.000) and self-attribution ($r = 0.30$, Sig. = 0.000) positively influence on investors’ behaviors.

3.2. The negative factors

In addition, five factors including consistency ($r = -0.30$, Sig. = 0.000), self-control ($r = -0.31$, Sig. = 0.000), loss aversion ($r = -0.36$, Sig. = 0.000), regret aversion ($r = -0.38$, Sig. = 0.000) and availability ($r = -0.38$, Sig. = 0.000) negatively influence on investors’ behaviors.

3.3. Other factors

The present study did not find any evidence to confirm any kind of relationship of representativeness, conservatism, ambiguity aversion, optimism, mental accounting, confirmation and status quo on investors’ behaviors.

3. Conclusion

There is no doubt that investment decision making needs discipline and proper attitude, however, there are many evidences, which indicate people make their financial decision without considering facts and figures. Some investors do not sell their poor performers on time and end up writing significant amount of loss despite the fact that financial data as well as technical charts give sell signals. On the contrary, many fund managers sell some high flyers on early stage and reduce their profits, significantly. In this paper, we have presented an empirical investigation to study the effects of personal characteristics on their investment decisions. Using Pearson correlation test, the study has detected that seven factors including anchoring & adjustment, framing, over confidence, illusion of control, hindsight, recency and self-attribution positively influence on investors’ behaviors. In addition, five factors including consistency, self-control, loss aversion, regret aversion and availability negatively influence on investors’ behaviors. However, the study did not find any evidence to confirm any kind of relationship of representativeness, conservatism, ambiguity aversion, optimism, mental accounting, confirmation and status quo on investors’ behaviors. The results of this survey are somewhat consistent with findings of Leong et al. (2002).

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References


