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Informed Investors and Their Risk Propensity in Capital Markets

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Abstract: *This paper analyses the investors' tendency to take risk in capital market investments after acquiring information through various sources. Perceived risk increases both the amount of information search and transaction frequency while it lowers the proportion of assets invested. Risk propensity, on the other hand, increases the likelihood of obtaining investment advice from professionals, as well as the proportion of assets invested in various investment avenues. The results revealed that there is significant difference between demographic factors and sources of fund for investment taking into consideration the two difference sources were their own savings and borrowed funds. The empirical result using chi-square test explored that there is a strong association between the risk bearing capacity of the investors and the sources of fund for their investments. It is concluded that every investor is expecting overall high return from their investment, irrespective of their age and position and their percentage of risk bearing capacity varies based on various factors.*

Keywords: risk, propensity, investment, perceived, attitude, risk-bearing, returns

Introduction

Investors worldwide have different kind of risk taking attitudes. There are four kinds of basic rick attitudes namely risk seeking, risk tolerance, risk averse and risk neutral. These different kinds of risk behavior and attitudes have a major impact on their level of investment perception. To investigate the role of perceived risk in investors risk reducing strategies in the context of household investment decisions, specifically, we need to examine the behavioral responses intended to handle both the uncertainty and importance dimensions of perceived risk, incorporating risk propensity as another construct affecting risk induced behaviors. It should be noted that higher self efficacy, greater wealth position, and risk taking propensity lower an individual's perceived risk for investing in various investment avenues. Various researchers have found that perceived risk increases both the amount of information search and transaction frequency while it lowers the proportion of assets invested. Risk propensity, on the other hand, increases the likelihood of obtaining investment advice from professionals, as well as the proportion of assets invested in various investment avenues. Perceived risk plays a crucial role in human behavior, specifically pertaining to decision making under uncertainty. Extensive research has been carried out to analyze the role of perceived risk in different decision situations, ranging from the behavioral and demographical factors.

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Statement of the problem

Investors make investment decisions before outcomes are certain. Small financial market corrections have often disintegrated into full-scale crashes as a result, fuelled by panicked investors who made rash decisions to avoid losing money in the short-term rather than focusing on an investment's long-term potential. Overconfidence influence investor to make them over optimistic about their prior knowledge and information's they used in decision making process in stock market. The fact that even the most prominent and well-educated individual investors, were affected by the collapse of the market demonstrates that something might be fundamentally wrong in investment decision making This research study focuses on risk propensity of investors and its impact on their investment decisions.

Review of Literature

Weber. E et al.,(2005) found that specific provisions of own risk and expected returns from investments but estimates that investors amount of market returns and instability, much closer to the traditional risk model and financial returns and the failure to predict the observed changes in risk. Syed TS(2010) confirms the previous findings regarding relationship between the demographic factors and risk tolerance of individual investors. This study has certain important implications for investment managers since it has come out with certain interesting aspects of the individual investor. Individual investor still prefers to invest in financial products which give risk-free returns. Barnea, Cronqvist, and Siegeln (2009) studied the principles of investment and financial risk-taking behavior among the individual investors, consistent with previous research work on the expectations of risk. Dulebohn(2002) found that individuals with high self-efficacy were likely to evaluate an inherent uncertainty in an investment situation as hardly unknown, thereby opting for a riskier alternative among the investment allocation options. Forlani et al., (2002) and Keil et al.,(2000) in their study on risk propensity as a tendency that prevails in recent studies on risk related issues have conceptualized that risk propensity as a behavioural tendency to take or avoid risk in investment decisions. Barber and Odean(1999) found that investors who have experienced the greatest past success I trading are the most likely to switch to online trading and will trade the most in future. Madrian and Shea (2000) found that people tend to stick to the default offered by their firm in deciding on 401(k) participation and saving. This is consistent with investors having limited attention and processing power and with their interpreting the option as an implicit recommendation. Daniel et al.,(1998) offered an explanation based on investor overconfidence combined with a tendency for management to take necessary actions in response to market mispricing and given an alternate explanation that investors under-react to on-time news in general. Warneryd K.N(1996) measured the relationship between different measures of risk attitude and actual portfolio choices of risky assets and found that most of the investors wanted to play safe and expecting the more than required expected value of their investments.

Objectives and Methodology

Objectives of this research

1. To analyze the risk bearing capacity of the investors.
2. To analyze the relation between the sources of funds for investment and risk bearing capacity of the investors.

Methodology

The nature of the study is descriptive, whereby it includes survey and fact finding enquiries. To achieve the stated objectives of this research a sample of 120 investors were selected as respondents after dropping the incomplete information. The sample constitutes investors from various walks of life in Pondicherry district. The area of the samples identified was the investors / traders throughout the Pondicherry district identifying them various financial Institutions. Since the responses were received from those investors who were willing to spend time and wished to contribute for the research willingly, it constitutes judgement sampling. The study is mainly based on primary data which was collected through a well structured questionnaire consisting of 21 questions. Those investors were identified and focused since they had sufficient knowledge about investment in various investment avenues. Secondary data has been collected through various websites, research articles published in various online journals, national and international publications. To meet the objectives of the study, a well structured questionnaire was prepared. A pilot study was first administered to a random sample of 30 respondents who are mostly well aware of investments. After the pilot study some minor lay-out and grammatical adjustments were made to the questionnaire, however the various items and constructs remained the same. The final questionnaire was distributed to collect the primary data from 120 investors from various places across Pondicherry district. After the data were collected, diverse statistical tools and techniques were used to get an insight into the risk propensity of investors. Data were analyzed using the Software Package for Social Sciences (SPSS). Internal consistency of the multi-item scales was tested using Cronbach's alpha based on the reliability analysis. The alpha values were above 0.6 and therefore considered acceptable. The collected data from 120 respondents (investors) had been analyzed with descriptive statistical analysis, Inferential statistical analysis on the samples were done by framing suitable hypotheses based on the objectives stated earlier. Inferences were drawn based on Descriptive statistical analysis and inferential statistical analysis using various statistical techniques like ANOVA followed by Friedman test, Chi-square test.

Analysis and Discussion

Table 1: Sources of fund for investment

Sources	**Frequency**	**Percentage**
Savings	75	62.5
Borrowed fund	45	37.5
Total	120	100.0

(**Source:** Primary data)

The above table 1.1 shows that 75 respondents forming 62.5% of the total respondents used their savings for investments and rest of the 45respondents forming 37.5% of the total respondents used borrowed funds for investments.

Table 2: Chi square test for association between percentage of risk bearing capacity of investors and sources of fund for investment

Risk bearing capacity (in %)	**Sources of fund for investment**		**Total**	χ^2	**P**
	Savings	**Borrowed**			
Upto 10%	18	2	20	72.66	0.000**
10 to 20 %	12	10	22		
20 to 30 %	10	6	16		
30 to 40 %	11	9	20		
Above 40 %	16	8	24		
No idea	8	10	18		
Total	**75**	**45**	**120**		

**significant at 1% level

Hypothesis: There is no significant difference between percentage of risk bearing capacity and sources of fund for investment.

The above table shows the association between the percentage of risk bearing capacity of the investors' on various percentage levels with sources of fund used for investment (savings and borrowed funds). Among the 75 investors who use their savings for taking risk in investments majority 18 of them are ready to take upto 10% risk, followed by 16 of them are bearing the risk level of less above 40%. 12 of them are moderate in taking level of risk 10% to 20%. The least number of respondents (4) only ready to take high risk that is more than 50% from the owned Fund users and 8 investors are not having awareness of risk involved in investment.

Further it is observed that, among the 45 investors who borrowed funds for investment, Only 2 investors wish to bear the minimum level of risk of upto10%. 8 are willing to take maximum level of risk at above 40%. 10 investors each are moderate in taking risk of 10% to 20% and who does not have any idea. Further it is found that percentage of risk bearing capacity of the investors with chi-square value chi-square is 72.66 and significant value p=0.000 states that there is significant difference between the sources of fund for investment and risk bearing capacity of investors at 1% level of significance. Hence we reject the hypothesis and conclude that there is significant difference between sources of fund for investment and the percentage of risk bearing capacity of the investors while taking investment decision.

Findings of the study

- It is observed that among the 120 investors, 75 (62.5%) of them use their savings for making investment and 45(37.5%) of them use borrowed funds for investments.
- Among the 75 investors who use their savings for taking risk in investments majority 18 of them are ready to take upto 10% risk, followed by 16 of them are bearing the risk level of less above 40%. 12 of them are moderate in taking level of risk 10% to 20%.
- Among the 45 investors who borrowed funds for investment, Only 2 investors wish to bear the minimum level of risk of upto10%. 8 are willing to take maximum level of risk at above 40%. 10 investors each are moderate in taking risk of 10% to 20% and who does not have any idea.
- Chi-square test revealed that there is association between the risk bearing capacity of invest and the sources of fund for investment

- ❖ It is found that by analyzing the association between demographic factors and sources of fund for investments using Chi-square test there is significant difference between demographic factors and sources of fund for investment.

Suggestions and Conclusion

Suggestions

- ❖ Investors should not depend more on advices from investment advisers they themselves should create additional knowledge by surfing and reading lot of finance related magazines.
- ❖ Financial advisors and portfolio managers might be given adequate training and SEBI should be vigilant in this regard to provide better services to the investors.
- ❖ Generally the investors expected overall high return with moderate risk. The portfolio managers should advice and train their investors to understand that the risks involved in investments.
- ❖ Every investor is expecting overall high return from their investment, they should be very cautious while taking any investment decision.

Conclusion

This study investigated the risky investment behavior of the investors and their tendency to take risk while making investments. The results revealed that there is significant difference between demographic factors and sources of fund for investment taking into consideration the two difference sources were their own savings and borrowed funds. The empirical result using chi-square test explored that there is a strong association between the risk bearing capacity of the investors and the sources of fund for their investments. It is concluded that every investor is expecting overall high return from their investment, irrespective of their age and position and their percentage of risk bearing capacity varies based on various factors.

Directions for further research

- ❖ The coverage of the survey can be extended to other geographical locations in Tamilnadu India to know whether the results are consistent;
- ❖ The study can be carried out taking into consideration of other factors which influences the investment decisions of investors.
- ❖ A comparative study can be made between urban and rural investors towards their risk propensity.

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