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INVESTOR BEHAVIOUR AND INVESTMENT DECISIONS: EVIDENCE FROM PAKISTAN STOCK EXCHANGE

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ABSTRACT

This research aims to understand the influence of behavioural factors on investment decisions in the Pakistan Stock Exchange (PSX). This study gathered primary data using a survey-based questionnaire from 318 individual investors. The issue being investigated in this study is how behavioural elements, such as sentiment, overconfidence, over- and under-reaction, and perceived market efficiency, affect investment choices made on the PSX, with a particular emphasis on the limited predictive power of herd behaviour. The sample data were analysed using partial least square-structural equation modelling (PLS-SEM) based approach. Results indicate that financial knowledge, sentiment, overconfidence, over- and under-reaction, and perceived market efficiency significantly affect the investment decision. Interestingly, herd behaviour does not play a significant role in predicting investment decisions. However, we are certain that this study will provide a better understanding of the relationship between behavioural factors and an investor's investment decision in Pakistan.

Keywords: investment decision, sentiment, financial knowledge, perceived market efficiency, Pakistan

INTRODUCTION

The financial markets have observed a sharp increase in the discrete participation of investors (Calvet et al., 2016). Some of the main reasons behind this rise are: first, the flexibility of the financial market instruments means that the investors can quickly liquidate their funds that are already invested in the market; second, the diversity of the market helps investors to find a combination of assets that are suitable for their investment goals; third, the exceptional profitability in the financial markets due to behavioural aspects of investors (Clark-Murphy & Soutar, 2004). In this context, Chun and Ming (2009) and Rubaltelli et al. (2010) highlighted the importance of investment decisions in the stock market. They further argued that investment decisions have always been a debatable topic that demands balanced thinking and a clear understanding of investor behaviour. According to the NATIXIS (2016) survey (which gathered information from 7,100 individual investors about their views and understanding of the financial markets), 32% of investors are unable to understand or recognise their investment objectives and about 30% of investors twisted their views on the advice of their financial experts. The survey also revealed that general investors are misinterpreted, misguided, and disagree with what they expect and what they get. Therefore, it is a compulsory requirement of the time to highlight the factors that an individual can take to make their investment plan in the stock market.

Moreover, investors' investment choices are influenced by their awareness, previous experiences, historical performance, and expectations (Cohen & Kudryavtsev, 2012). Individual investors are more inclined toward behavioural preferences when they trade in the market, and because of these preferences, they make mistakes while trading (Chen et al., 2007). However, the market may react in an unfavourable direction due to incorrect investment choices and leave inefficient or unproductive sentiments for investors. Consequently, the prices in the stock market decline suddenly, and the flow of capital starts moving from the stock market to other investment choices such as real estate. This situation abruptly causes the removal of many investors to consider the effect of behavioural factors on investors' decisions and reactions (Ngoc, 2014).

Earlier studies mainly focused on the methods of investment that maximise the return and minimise the risk for investors in the financial market (Fama, 1965; Lintner, 1965). The findings from past studies suggested that emotional and psychological factors such as fear, financial literacy, sentiments, arrogance or overconfidence, investor perception about the market and greediness also contribute to the investment decision-making process (Al-Tamimi & Kalli, 2009;