



What factors affect behavioral biases? Evidence from Turkish individual stock investors



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ABSTRACT

This paper investigates behavioral biases among Turkish individual stock investors during 2011. Using transaction data, we analyze how common disposition effect, familiarity bias, representativeness heuristic, and status quo bias are, what factors affect these biases and how these biases relate to each other including overconfidence and return performance. We find that biases are common among investors. Male, younger investors, investors with lower portfolio value, and investors in low income, low education regions exhibit more familiarity bias. Female, older investors and investors with high portfolio values are more subject to disposition effect and representativeness heuristic. Individuals in the opposite edge of overconfidence are subject to status quo bias. Overconfidence is positively correlated with familiarity bias. Representativeness heuristic deteriorates wealth while status quo bias results in higher trade performance. Familiarity bias has a nonmonotonic effect on return; lower (higher) levels of familiarity bias have a negative (positive) effect on return. To the best of our knowledge, this is one of the few studies that focus on nationwide data and analyze the biases simultaneously. Using a unique dataset, we extend the findings of the behavioral finance literature to emerging markets. Besides, analysis of multiple biases helps us better understand the relationship among biases.

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1. Introduction

Empirical evidence in the behavioral finance literature show that individuals do not behave rationally. Barberis and Thaler (2003) provide a summary of models that try to explain the equity premium puzzle, excess volatility, excessive trading, stock return predictability using both Prospect Theory of Kahneman and Tversky (1979) and beliefs. Literature¹ shows that investors are not rational, markets may not be efficient and prices may significantly deviate from fundamental values.

Investor irrationality may depend on individual characteristics. Vissing-Jorgensen (2004) finds that irrational behavior is weaker for more sophisticated investors. Cultural differences such as degree of individualism or collectivism has also impact on risk attitudes and behavioral tendencies as shown by Fan and Xiao (2005) and Statman (2010). Moreover, Antonczyk and Salzmann (2014) find that cultural traits affect capital structure choices. Individualism is more evident in western countries,

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¹ Black (1986), De Long et al. (1990), Shleifer and Vishny (1997), Barberis et al. (2001), Hirshleifer (2001), Daniel et al. (2002), and Subrahmanyam (2007) to name a few.

whereas eastern countries like China and India tend to exhibit collectivism more. Individuals in collectivist societies tend to be more risk tolerant. Hofstede (2001) finds that Turkish people are more collectivist compared to USA, and UK.

Majority of the behavioral finance literature analyzes individual investors in developed markets and dataset that is limited to the subsamples of overall investor groups or a specific bias. However, to the best of our knowledge, this is the first study to focus on nationwide data taking into account each transaction on every stock to analyze multiple biases. Turkey as an emerging market, and the Istanbul Stock Exchange (ISE) have important characteristics that are worth analyzing. ISE has one of the highest turnover ratios among world stock markets, which may be related to the biases among Turkish stock investors. Besides, trading volume and liquidity is mostly provided by local individual investors. In this study, we look at demographic factors; age, gender, wealth, experience and region of residence, and using a unique database we examine how these factors affect behavioral biases of individual investors in a collectivist country.

We focus on behavioral biases of all the Turkish individual stock investors that may have effect on the portfolio selection process of the investors; disposition effect, familiarity bias, representativeness heuristic, and status quo bias. Overconfidence and disposition effect are more widely studied in the literature.² We use results of Tekce and Yilmaz (2015) for overconfidence and look at the relationship among biases including overconfidence. Using transaction data for the year 2011, we analyze how prevalent these biases are among investors, what factors affect these biases, and how these biases relate to each other and investor return performance using the same data set Tekce and Yilmaz (2015) focused on overconfidence.

We find that behavioral biases are common among Turkish individual investors. Disposition effect is higher among female, older investors and investors with high portfolio values. Familiarity bias is higher among male, young investors and investors with low portfolio values and investors in less developed regions. Representativeness heuristics estimates show that Turkish individual stock investors do not seem to be positive return chasers. Although statistically significant, representativeness heuristic is not economically different across different investor groups. Our findings for status quo bias are consistent with overconfidence results presented by Tekce and Yilmaz (2015); individuals exhibiting status quo bias are in the opposite edge of overconfidence scale. Results are robust to the use of different proxies, various subsamples and regression models. Investors exhibiting disposition effect have higher returns. Positive relationship is expected due to calculation methodology, which simply says that the investors exhibiting disposition effect tend to sell stocks at gain, and refrain from realizing losses. At moderate levels of familiarity bias, investors have lower returns; however mean return increases at high familiarity bias levels, possibly due to information effect as the more investors are familiar with the stock, the better decisions they may make. Chasing stocks with positive past returns end up with lower returns. These investors are probably late in catching the momentum train and have poor timing in investment decisions. Our findings show that higher status quo bias leads to higher returns as opposed to overconfidence presented in Tekce and Yilmaz (2015).

The findings of this paper contribute to the behavioral finance literature in a number of ways. There are several studies focusing on multiple biases using a subsample of investors or focusing on a single bias using nationwide data. However, we use a unique nationwide data set taking into account each single transaction on each stock and study different biases as well as the relationships among them. We also focus on an emerging market with high collectivist attitudes as opposed to the more frequently studied developed countries with individualistic attitudes in general in order to better understand the behavioral biases of investors in such countries. Our results also confirm the findings in behavioral finance and psychology literature that markets are not efficient. Besides, cultural differences may intensify the level of deviation from efficiency in different markets. Hence, personal as well as cultural differences have a significant impact in price formation; so any analysis in stock markets should incorporate these factors, to the extent possible to come up with a more realistic rather than normative view.

2. Literature review and hypothesis development

Disposition effect is the tendency to sell winners too early and hold onto losers too long. Disposition effect can be most easily observed in equity trading.³ Shefrin and Statman (1985) argue that disposition affect stems from loss aversion, mental accounting and regret aversion. Odean (1998) finds that investors demonstrate a strong tendency to realize winners rather than losers. The author argues that disposition effect is the main reason for this tendency. The findings are robust to different reference points (highest purchase price, first purchase price, most recent purchase price). Literature⁴ confirms that individuals display disposition effect and disposition effect is persistent over periods in different countries. In line with findings, we hypothesize that a Turkish individual equity investors exhibit disposition effect.

Shapira and Venezia (2001), Brown et al. (2006) and Dhar and Zhu (2006) discuss that sophisticated investors exhibit less disposition effect. Therefore, we expect that investors who are sophisticated are less prone to disposition effect.

² Shefrin and Statman (1985), Odean (1998), Odean (1999), Barber and Odean (2000), Grinblatt and Keloharju (2001b), Barber and Odean (2001), Chen et al. (2007), Grinblatt and Keloharju (2009), Barber et al. (2009b) and Tekce and Yilmaz (2015) are to name a few.

³ There are several studies showing that disposition effect is also common, for example, in stock option exercise (Heath et al., 1999) and housing markets (Genesove and Mayer, 2001).

⁴ Barber and Odean (1999), Shapira and Venezia (2001), Brown et al. (2006), Barber et al. (2007), Grinblatt and Keloharju (2001b), Chen et al. (2007), and Barber et al. (2009a) to name a few.

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