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Cut your losses and let your profits run: How shifting feelings of personal responsibility reverses the disposition effect☆

Jaakko Aspara[a], Arvid O.I. Hoffmann[b,c,*]

[a] Department of Marketing, Hanken Swedish School of Economics, P.O. Box 479, FI-00101, Helsinki, Finland

[b] Department of Finance, School of Business and Economics, Maastricht University, P.O. Box 616, NL-6200 MD Maastricht, The Netherlands

[c] Network for Studies on Pensions, Aging and Retirement (Netspar), P.O. Box 90153, NL-5000 LE Tilburg, The Netherlands

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ABSTRACT

The disposition effect refers to individuals' tendency to sell their winning investments too early, while holding on to their losing investments too long. This behavioral bias has negative consequences for individuals' wealth, because losing investments usually continue to underperform, while winning investments typically continue to outperform. The present research demonstrates that shifting feelings of personal responsibility can reverse individuals' susceptibility to the disposition effect. In particular, results from three experiments indicate that the disposition effect is reversed when (i) prior investment gains are attributed to external factors while prior investment losses are attributed to individuals' own faults, (ii) individuals invest someone else's money instead of their own, and (iii) when individuals have an alternative, socially oriented investment goal, such as self-expression besides a financial gains goal. The results have implications for financial service professionals, such as financial advisors.

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1. Introduction

Individuals currently face an increasing self-responsibility for making such consequential financial decisions as investing for their retirement (van Rooij et al., 2011). In taking on this responsibility, however, they suffer from behavioral biases that limit their investment success (Shefrin, 2007). In this regard, the disposition effect, as first studied by Shefrin and Statman (1985), is probably the most pervasive bias, and is systematically observed in both lab settings (Weber and Camerer, 1998) and field studies (Odean, 1998). The disposition effect refers to individuals' tendency to sell their winning investments too early, while holding on to their losing investments too long. As the losing investments that individuals hold on to typically continue to underperform, while the winning investments they sell typically continue to outperform (Odean, 1998), the disposition effect negatively affects individuals' wealth.

Recent research has started to identify conditions that qualify individuals' susceptibility to the disposition effect.

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* Corresponding author at: Department of Finance, School of Business and Economics, Maastricht University, P.O. Box 616, NL-6200 MD Maastricht, The Netherlands. Tel.: +31 43 388 4602.

E-mail address: a.hoffmann@maastrichtuniversity.nl (A.O.I. Hoffmann).

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Mitigating factors identified so far include financial sophistication (Dhar and Zhu, 2006), investment experience (Chen et al., 2007), whether individuals invest for themselves or on behalf of another person (Lee et al., 2008), whether individuals invest in non-delegated assets like individual stocks or delegated assets like mutual funds (Chang et al., forthcoming), the salience of information on an investment's purchase price (Frydman and Rangel, 2014), and whether individuals own a stock through their own choice or not (Summers and Duxbury, 2012). What is missing, however, is an examination of more fundamental social and psychological conditions that would systematically predict a reversal of the disposition effect, such that individuals would rather sell their losing investments and hold on to their winning investments.

To examine such social and psychological factors, we focus presently on the observation that the disposition effect is, at least partly, determined by individuals' feelings of personal responsibility regarding the causes of their investments' past performance. Indeed, the seminal work of Shefrin and Statman (1985) loosely noted – albeit did not theorize in detail – that the emotions related to one's losses vs. gains might be related to the decision-making context (e.g., whether one is investing the money professionally or not). We are unaware of any study, however, that would examine the framing of a decision's personal responsibility as a moderating condition that may eliminate or reverse the disposition effect. In this regard, the studies closest to ours are Lee et al. (2008), who show in one of their experiments that the disposition effect is reduced when individuals are requested to imagine investing as an agent for someone else—and Shapira and Venezia (2001) and Chu et al. (2014), who show that professional investors are less susceptible to the disposition effect than non-professional investors. None of these studies, however, identifies empirically a clear set of boundary conditions that actually *reverses* (rather than merely attenuates) the disposition effect, or theoretically explicates how personal responsibility (and the related attributional considerations) would explain this reversal.

To address this gap in the current literature, we theorize and test the role of three factors related to personal responsibility in reversing individuals' susceptibility to the disposition effect: (i) personal responsibility in terms of the attributed cause of an individual's prior gains and losses (self-caused vs. externally caused), (ii) personal responsibility related to the source of money invested (own money vs. other people's money), and (iii) personal responsibility connected with having alternative, socially-oriented goals, such as self-expression besides a financial gains goal.

Regarding these three boundary conditions pertaining to personal responsibility, we briefly detail our predictions in the following. With respect to personal responsibility in terms of the attributed cause of prior gains and losses (i), a large body of consumer research shows that individuals naturally attribute good events or successes to themselves, while they tend to attribute bad events or failures to external/social causes (e.g., Folkes, 1988; Hoffmann and Post, 2014 and Mizerski et al., 1979). Accordingly, we propose that the baseline disposition effect occurs partly because of individuals' feeling that they are responsible for a winning investment, and not responsible for a losing investment. These attributions lead to a willingness to sell the winning investment (to achieve mental closure for one's personal, winning investment choice), and a willingness to hold on to the losing investment (to hope luck will turn for a bad investment one does not feel personally responsible for). If this is indeed the case, we expect that the disposition effect will be reversed when reversing this causal attribution—that is, when individuals are led to believe that the winning investment performed well because of external events while the losing investment performed poorly because of their own fault (H1a).

Regarding personal responsibility due to the source of money invested (ii), Lee et al. (2008) speculated that a possible explanation for the attenuation of the disposition effect when people invest other people's money is that they feel more "accountable" (Tetlock, 1992). Continuing this line of thinking, we theorize that individuals who invest other people's money are likely to feel more responsible for the performance of an investment. This feeling of responsibility is expected to lead to making more "rational" decisions that are more in line with the normative recommendations from standard finance, which in the context of the present paper means being less susceptible to the disposition effect. Thus, we expect that having individuals imagine that they invest someone else's money instead of their own also reverses the disposition effect (H1b)—similarly as suggesting that a winning investment performed well because of external events while a losing investment performed poorly because of their own fault (per H1a).

Finally, considering personal responsibility due to the presence of alternative investment motivations (iii), it can be noted that individuals often have alternative investment goals besides a financial gains goal. These include the goal to express oneself socially with an investment in a company whose products are likeable or socially desirable, for instance (see Aspara and Tikkanen, 2010; Hoffmann and Broekhuizen, 2009 and Statman, 2004). We expect that having such an ulterior, self-expressive goal may also reverse the attributions of responsibility related to the winning and losing investments. Specifically, if an individual had an ulterior self-expressive goal to make an investment that ends up performing well financially, she is *less* likely to feel responsible for this financial success (because she made her initial choice partly based on the ulterior, non-financial, goal). In turn, when the individual had an ulterior self-expressive goal to make an investment that ends up performing financially poorly, she is *more* likely to feel responsible for the loss—feeling that her very *self*-expression goals indeed led her to fail financially. Thus, we expect a reversal of the disposition effect when individuals are guided by alternative goals such as self-expression when making their investment decisions (H1c).

The following three experiments each test one of these options how personal responsibility can reverse the disposition effect (H1a–c).

2. Experiments

Three experiments (A–C) test the role of personal responsibility in reversing the disposition effect. Each

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