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The Impact of Psychological Factors on Investors' Decision Making in Malaysian Stock Market: A Case of Klang Valley and Pahang

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Abstract

For years, traditional finance has always presumed that investors are rational in their decision making process in the stock market about risk return trade-offs and maximizing utility. However, behavioral finance studies revealed that human beings do not behave as rationally as economists suppose as their decisions at times are affected by their psychological feelings. Numerous studies from ASEAN, Middle East and Western countries have in fact established that psychological factors do have relationships and impacts on the decision making of investors in their stock markets. In light of this, this research attempts to bridge the gap of the differences in terms of geographical location and demographic profile between Malaysia and other countries by examining the impact of the psychological factors on investors' decision making in the Malaysian stock market. Questionnaires are distributed to a sample size of 200 investors in the Klang Valley and Pahang areas aged between 18-60 years who are involved in the Malaysian stock market. The findings show that overconfidence, conservatism and availability bias have significant impacts on the investors' decision making while herding behavior has no significant impact on the investors' decision making. It is also found that the psychological factors are dependent of individual's gender. The results of this research are mostly consistent with the evidences in previous studies. This study, hopefully, will help investors to be aware of the impact of their own psychological factors on their decision making in the stock market, thus increasing the rationality of investment decisions for enhanced market efficiency.

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Keywords: Behavioral finance; psyhological factors ; investors' decision making.

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1. Introduction

For ages, standard ordinary finance has constantly presumed that investors are typical and sensitive in their investment decision making in the stock market and therefore they are impassive about risk return trade-offs and exploiting value. They must have incorporated all the necessary information available according to the efficient market hypothesis and are impartial in analyzing securities and choosing winning stocks.

However psychologists have found that human beings do not behave as rationally as economists suppose. The occurring of stock market anomalies and empirical researches conducted by Babajide & Adetiloye (2012) and Bashir et al. (2013) revealed that investors are not always as rational as they are portrayed to be. These anomalies can be explained by a new emerging area of finance called behavioral finance. Behavioral finance considers how various psychological traits affect how individuals or groups act as investors, analysts and portfolio managers. It tries to understand how emotions and cognitive errors influence behaviours of individual investors (Kengatharan 2014). It also seeks to explain why and how investors can act beyond the boundary of rationality in ways that oppose to what they are supposed to.

Advocates of behavioral finance have been able to explain a number of psychological factors that affect the decision making of investors in the stock market. The main purpose of this research is to investigate how psychological factors, particularly the overconfidence bias, conservatism bias, herding and availability bias could possibly affect financial decisions. The decision making will be measured in terms of the degree of risk the investor is willing to take.

The overconfidence bias which is related to the self- attribution bias is the tendency of an individual to attribute his success to his own talent and ability while blaming 'bad luck' for his failure, making himself overestimating his talent. Qadri & Shabbir (2013), Lim (2012), Qureshi et al. (2012) and Bashir et al. (2013) have found overconfidence to have positive significant impact on investors' decision making. Atif (2014) and Kengatharan (2014) found overconfidence to have negative impact on decision making. The conservatism bias means investors are slow to react and to update their beliefs in response to recent evidence and development. According to Márcia et al. (2014), this means that they can initially underreact to the new information or rumours released on a company. As a result, prices will fully reflect the new information only gradually. Lim (2012) and Kengatharan (2014) found that conservatism do have positive significant impact on decision making.

The herding behavior refers to "follow the leader" mentality. It is the tendency of an individual to follow the crowd because the decisions made by the majority are assumed to be always correct. According to Luong & Thu Ha (2011), the herding individual will base his investment decision on the crowd actions of buying and selling, creating speculative bubbles phenomenon hence making the stock market to be inefficient. However the herd is almost always wrong, which contributes to excess volatility in the market. According to Hirt and Block (2012), herding is more prevalent with institutional investor than with individual investors. Wamae (2013) found herding to have positive significant impact on investment decision making. Kengatharan (2014) have found herding behavior to have positive impact on investors' decision making while Lim (2012) found that herding has no significant impact on investors' decision making. The availability bias happens when the individual acts upon recent information that is obtained easily. They have a strong tendency to focus their attention on a particular fact rather than the overall situation, only because this particular fact is more present or easily recalled in their minds (Nofsingera & Varmab 2013). Qureshi et al. (2012) found availability bias to have positive significant impact on investors' decision making. Luong & Thu Ha (2011) found availability bias to have moderate impact on investors' decision making while Nofsingera and Varmab (2013) found availability bias to have strong impact on investors' repurchase decision in United States.

Numerous studies from other ASEAN, Middle East and Western countries for example, Kengatharan (2014), Qadri and Shabbir (2014) and Nofsingera and Varmab (2013) have established that psychological factors do have relationships and impacts on the decision making of investors in their stock markets. However there have been very few studies including Lim's (2012) on the psychological biases in Malaysian stock market, let alone investigating the impact of the psychological biases on the investors' decision making. This study attempts to close the gap of the differences in terms of geographical location and demographic profile between Malaysia and other countries by examining the impact of the psychological bias on investors' decision making in Malaysian stock market. Learning more about this relationship between the psychological factors and investors' decision making should help investors to understand themselves better which leads to a phenomenon of enhanced rational decision making in the stock market. Building on the findings from previous studies, this study has two main objectives: i) to provide background