FROM RATIONALITY TO BIAS: FACTORS INFLUENCING RETAIL INVESTMENT IN NEWLY LAUNCHED INVESTMENT PRODUCTS

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Abstract

Post sub-crime crisis, there has been a spike in innovations in new investment products introduced for retail investors. The investment decision of an Individual depends on many factors. However, there must be classified literature on factors affecting investment decisions in a newly launched investment product. The current research attempts to enlist the common factors affecting this decision based on the limited literature available for new products and then the literature for existing products, classifying them into economic factors, behavioral factors, and consumer behavior constructs applicable to financial services categories. The study tries to assess the presence of rationality in the investment decision based on the three categories of factors and the information available. The current study finds that behavioral and consumer behavior factors look more applicable to the newly launched product based on the available information at launch. The study finds a possible absence of rational decisions and concludes that the decision is more based on personality traits and psychological biases. A construct is created based on the commonalities of the three broad areas of study. This unique study can benefit the design-makers and marketers of the newly launched investment products.

Keywords: Economic Factors, Behavioral Factors, Consumer Behavior Constructs, Newly Launched Investment Products

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1. INTRODUCTION

Investment in financial assets is the base for creating capital stock in the economy. It gives an individual investor an avenue to park their savings and, in turn, gives them the power to cope with inflation and earn returns. On the other hand, it helps the economy to be productive in the long term. Many financial instruments are available in the financial market, specifically from an investment point of view, which can be called investment products. In their report regarding the regulation of retail structured products, the International Organization of Securities Commissions (IOSCO, 2013) discussed an investment product as a financial instrument or security offered to investors to earn returns. The specific definitions can vary based on jurisdictions and regulatory frameworks, but the products can be broadly classified into the following categories based on their characteristics:

- securities;
- collective investment schemes;
- insurance-based investment products;
- derivatives (Office of Investor Education and Advocacy, n.d.).

Regulatory bodies often define and oversee these products to ensure they meet specific standards, protect investors, and maintain market stability. From a regulatory perspective, these products are subject to disclosures, rules on pricing, investor protection, risk assessment, and periodic reporting to ensure compliance with laws to ensure transparency and fairness, prevent fraud, and protect the interests of retail investors.

A few of these products have been around for decades, whereas a few have only a few months' history.

Bodie et al. (2021) state that a new financial instrument refers to a newly developed financial asset or contract that offers an innovative way to invest, lend, borrow, or transfer risk. The instrument might be in the form of any of the categories mentioned above and is created to address emerging needs in the financial markets or take advantage of regulatory, economic, or technological changes. New financial instruments provide investors with new opportunities for returns, risk management, or portfolio diversification. In the absence of a specific definition for "new investment products", catering only to investment needs, the above definition covers the same scope.

With the change in needs and dynamic nature of investment and investment patterns, various new products, which are primarily hybrid, are introduced occasionally. Investors choose the appropriate avenue based on many factors; the success of these newly launched financial products is specific to this study, and investment products depend on how many of these factors they can satisfy (Shafi, 2014).

Many detailed studies are available in the literature, and many theories have emerged because of the analysis of behavior and actions corresponding to it. The evolved theories have concluded with the list of factors that become part of decision-making while making an investment decision.

The systematic construction of theories can be said to have started with the evolution of conventional theory, which assumes investors to be rational wealth maximizers. These theories assume the investors follow the risk-return consideration for deciding upon the investment strategies as provided by Markowitz (1952) and followed by Tobin (1965) and Sharpe (1994).

These are the pioneering studies about identifying factors influencing individuals in their investment decisions. These theories categorize the significant factors affecting the investment decision as "economic factors" based on the theory of the investor being a rational decision-maker. Further, researchers have explored this theory, experimented with conventional theory on various existing products, and identified the specific economic factors that, as per studies, have a considerable effect.

The second phase in the development of theories about factors affecting the decision-making of an individual investor came with the evolution of behavioral analysis of individual investors. The theory considers the investor irrational and assumes that non-economic factors also affect an individual's decision-making when it comes to investment decisions (Mishra & Kumar, 2012). The theory was further explored to add to the non-economic factors in the list.

The most recent perspective added to the development of the theory about individual investors came with adding consumer behavioral constructs into the financial services sector. These theories have tried to bring in the consumer buying behavior factors and their presence in individual investment decisions into various products. The additions to the theories have also concluded that the buying behavior factors change from product to product depending on the characteristics of the product chosen by the investors and the stage of purchase, i.e., pre-buying factors and post-buying factors (Beckett et al., 2000).

So far, the theories have identified a list of factors based on the above classification and for many investment products with known records of existence separately, from equity and mutual funds to fixed-income securities. All these products have been known in the market for many decades with known characteristics, records of performance, and identifiable risk-return analysis.

Accordingly, this paper tries to list out the factors affecting the investment decisions of an individual as explored by various researchers and filter their application to the new product launched with declared characteristics, no record of performance, and, so far, unidentifiable risk-return analysis, which can be said to be the research gap identified. In addition, it tries to identify which factors affect the investor's decision most when investing in a newly launched product.

RQ: Do all the economic, psychological, behavioral, and consumer behavior factors affect the investment decision-making for a newly launched investment product for a retail investor?

The rest of the paper is divided into five sections. The literature review is provided in Section 2, followed by the methodology in Section 3. The applicability of the factors identified through the literature on new investment products is discussed in Section 4. The conclusion is presented in Section 5.

2. LITERATURE REVIEW

2.1. Economic factors

The most recognized formal existence of the study on factors affecting individual investment decisions came in the form of a theory from Markowitz (1952). Researchers have made many contributions to this field through research articles and theory models. The studies predominantly supported the fundamental theorem of the Markowitz model that investors are rational wealth maximizers, and the risk and return consideration are the major factors in the investment decision (Tobin, 1965; Sharpe, 1994).

Over a period with additions of studies in the area, more economic factors were added, and most of the cases were classified based on the applicability of those based on the product selected for the study.

Maditinos et al. (2007) identified separate factors affecting professional and non-professional investors in their study. As per his studies, individual investors who can be classified as non-professional investors are affected more by newspapers/media and buzz in the market, while professional investors follow a systematic, study-based approach based on fundamental and technical analysis when making their investment decisions.

Shiundu (2009), in his study about significant factors affecting investment decisions in the National Stock Exchange (NSE), ranked the reputation of the firm, the firm's status in the industry, expected corporate earnings, profit, and condition of the statement, past performance firm's stock, price per share, feeling on the economy and expected dividend by investors, as the most crucial factors affecting investors decisions at NSE. The study was based on a structured survey. Similar results were found by Baker and Haslem (1973). In their study, they discovered that expected dividends, which are nothing but the expected returns from the investment and further the firm's financial stability, are the most rated investment decision factors. Further, on similar lines, six factors were discovered by Potter (1971), those being, as quoted, "dividends, rapid growth, investment for saving purposes, quick profits through trading, professional investment management and long-term growth that affect individual investors' attitudes towards their investment decisions" (pp. 43–44).

In particular, recent studies carried out by a few researchers' common factors like the corporation's expected earnings, past stock performance record, recent price movements, and current economic indicators were identified as the most influencing factors (Merilkas & Prasad, 2003). Along with this, factors like "get rich quick, stock marketability, government holdings and the creation of the organized financial markets" by Al-Tamimi (2005, p. 19).

Samal and das Mohapatra (2017), in their study, added to the above standard list of economic factors with factors like "mediators influence, fear of loss and income level of the investors" (p. 4). These factors are a mix of economic and behavioral factors. This study also pointed out certain sub-factors that influence decision-making. A few of them listed above additional factors being "insider information, recommendation of financial advisors and analyst, loyalty of company product, rumurs" (p. 4), and the study suggested that few of the non-economic factors like level of publicity, religious reasons, and few economic factors like expected losses from other investment, best opportunities for speculation had a minimum influence.

Merikas et al. (2004), about the Greek Stock Exchange, found the above-listed common factors as the major influencing economic factors and concluded that "experienced investors rely and emphasize rational decision-making criteria, assigning a high value to this particular set of variables" (p. 96).

Al-Tamimi (2005) supported all the factors as major influencing factors identified by factors Merikas et al. (2004). Al-Tamimi (2005) further added that "expected losses in other local investments, minimizing risk, expected losses in international financial markets" and a few non-economic factors like "family member opinions, gut feeling on the economy" (pp. 19–20) as the least influencing factors, along with two unexpected factors in the list namely "the religious beliefs and family member opinions" (p. 20) which come under behavioral aspects of the study. All the above studies were about investment in stocks at various stock exchanges.

As per the studies conducted for determining the most affecting factors in the mutual fund segment, the results show majorly economic factors like "intrinsic qualities of the product, portfolio management record" and a few non-economic factors like the brand image as given by Rajeshwari and Rama Moorthy (2002), economic factors like "growth aspects of the scheme", as per Singh and Chander (2003), and "flexible investment facilities" (Ranganathan, 2006), are the factors affecting the most the investment decision of individual investors. In their study, Dhar et al. (2017), mentioned that the "reputation of the fund manager, return performance and low risk with high returns" (p. 95) become the specific mutual fund investment affecting factors. Similar results were found in the many other studies conducted for similar product groups.

Phan et al. (2023) in their study discuss the influence of large investors, including domestic and foreign institutional investors, due to their exposure and strong investment expertise. Taking a background of COVID-19, Ritika et al. (2023) argued that crisis situations negatively impact investors' investment decisions.

2.2. Behavioral factors

As per Islamoğlu et al. (2015), in the case of already existing products, significance, risk, and returns are a few principal factors, as past data is available in most cases. However, in the case of a new product with no background and past data, these factors have a minimal role to play. It makes it more important to study the aspect from a behavioral finance point of view and test economic factors. Similarly, Mutswenje (2009), verified that the personal attitude of individual investors to risk decides the willing risk tolerance capacity of the investor. The researcher added that characteristics of the financial market, accounting information, and an individual's risk profile are affecting factors. Further, "sunk cost considerations and asymmetrical risk preferences for gain/loss situations" (Mutswenje, 2009, p. 2) are also added as the affecting factors.

The above discussion gives rise to the need to review the other aspect of the study, in the form of behavioral finance, which considers the investor to be irrational, and many theories and studies in the area have concluded that non-economic factors along with or in addition to economic factors play a more critical role in the individual investor's decision-making. Shefrin (2002), in his study, has defined "behavioral finance" as "a rapidly growing area that deals with the influence of psychology on the behavior of financial practitioners" (p. 3). Odean (1999) added that individual investment behavior is concerned with choices about purchases of small amounts of securities for his or her account.

As per Islamoğlu et al. (2015) and Kourtidis et al. (2011), investors do not always behave rationally as per behavioral finance. Psychological factors also affect an individual investor's decision to invest.

The recent literature gives more importance to social and behavioral finance factors and finds "psychological biases and personality traits" as of over significance to an individual investing along with "risk tolerance, self-monitoring, and social influence".

Shanmugham and Ramya (2012), in their study, tried to explain the influence of social factors like interactions and media on individual investors' trading behavior. The study took the base of "behavior in the context of the theory of reasoned action" which explains the "relationship between attitudes and behaviors within human actions" as given by Fishbein and Ajzen (1975) and the theory of planned behavior, which explains the behaviors of people which can bring self-control as given by Ajzen (1985) and Ajzen (1991).

Only some studies comparing the economic and behavioral factors yielded varied results. According to Lodhi (2014), the factors that investors invest in risky products by reducing information asymmetry are namely empirical results, financial literacy, and accounting information. He further identified a negative relation between investors' preference for risky investments and demographic factors like age and experience.

A study by Geetha and Vimala (2014), studied the demographic aspect as a factor, and as per the study, changes in demographic factors do influence the preference for investment avenues. Kiran and Rao (2005) extended the study, wherein the researcher tested the relationship between the risk-taking attitude of Indian investors and demographic and psychographic variables, and the results were strongly affirmative.

Mishra and Kumar (2012), argued that in practice, investors behave irrationally, and non-economic factors, based on behavioral biases, affect the investment decision of individual investors. They took the base of studies done by Nagy and Obenberger (1994), Odean (1999), and Shefrin (2002).

As per Barber and Odean (2001) and Ariely (2010), in the case of mutual fund investors, chasing past performance, reluctance to sell in losses, different reactions to different forms of fund expenses, attribute successful outcomes to their skill and blame unsuccessful outcomes on bad luck are the typical behavioral attributes affecting the decision. He also reviewed a few more studies that identified the influence of risk perception and investors' knowledge on investors' behavioral biases.

Extending the studies on behavioral factors, Ferreira-Schenk and Dickason-Koekemoer (2023), added that personality traits (extraversion, openness to experience) and behavioral biases (overconfidence bias) equally affect the decision. A recent study by Bihari et al. (2023) discusses the impact of cognitive biases and heard behavior on investment decisions. Abdeldayem and Aldulaimi (2024), in their study about cryptocurrency market investments, stress the importance of behavioral and financial factors in investors' choices. The development around sustainability factors, such as environmental, social, and governance (ESG) factors, has also started impacting investors considering values as a factor for decision-making (Rooh et al., 2023).

2.3. Marketing, advertising, and consumer behavioral factors

Additional studies in the area gave rise to another aspect, which can be linked to investors' investment decisions and can be linked with marketing, advertising, and, specifically, consumer buying behavior constructs. Though there is little literature available on the same, it has recently been the preferred area of research.

Hüsser and Wirth (2014), in their study, have compiled many studies that focus on the marketing and advertising aspect as factors affecting individual investor's decision-making. The study by Barber et al. (2005) has suggested that the information that grabs the attention of mutual fund investors affects the purchase decision. Most of those are funds with superior performance or funds marketed with advertising. Further, Jain and Wu (2000) and Korkeamaki et al. (2007) suggested in their studies that advertised funds attract more inflows and share a positive relationship.

Certain studies have studied consumer behavior constructs and tried to explore the commonalities in investment products and financial services, like other consumer products.

Peltier et al. (2016), along with many other studies on consumer behavior constructs done by Gronhaug and Stone (1995), Eckhardt (2002), and Cho and Lee (2006) have identified the critical constructs influencing Investor decision-making, those being product knowledge and product involvement. These are the pioneering studies involving consumer behavior constructs with investment models. The study was extended further by Lim et al. (2013), who supported the idea that the above factors have a considerable effect on intentions to invest in the stock market.

Amongst all the above, product involvement is the significant consumer behavior construct affecting decisions in the financial service industry. It has a significant impact on investors' investment intentions (Lim et al., 2013).

3. RESEARCH METHODOLOGY

The following study is a model of empirical research. The study is review-based. A systematic process was adopted to make the study more effective and efficient. The study is designed in the following sections.

The first process is designed to get suitable literature to explore the selected topic. A systematic search approach is followed by selecting suitable research articles from high-rated journals in the field of finance and financial services, marketing, management, and consumer research (i.e., *Journal of Finance*, *Journal of Bank Marketing*, *Journal of Financial Services Marketing*, *Journal of Applied Business Research*, *Journal of Consumer Research*, *International Journal of Humanities and Social Science*, *International Journal of Management and Applied Science*, and *International Journal of Economics and Financial Issues*).

As much as possible, the most recent and most impactful articles from the above list of journals and a few more have been selected for the study. The filters for selecting suitable titles were based on the keywords identified based on the selected topic of study. The keywords for selecting articles were "individual investment behavior", "factors affecting individual investment decision", "consumer buying behavior factors" for financial products and services and/or related synonyms. This process helped the researchers get only suitable articles from the large body of literature on factors affecting investment decisions.

The selected articles became base for additional thorough and systematic searches. The additional articles were selected from the references listed by the second process-selected articles. This process enlarged the base for study in the investment decision field. The process was conducted until a larger repetition was felt in the factors identified through the papers considered.

The third action was to categorize the articles based on the theories followed by the researchers and findings of the study into the three identified segments based on the content analysis. Further, the common factors identified by most of the researchers will be listed. The purpose was to identify factors affecting individual investors' decision to invest in a new financial product. The literature was then classified based on the common theories identified. The risk of bias has been kept to a minimum, and no additional filter was used to select papers for the study.

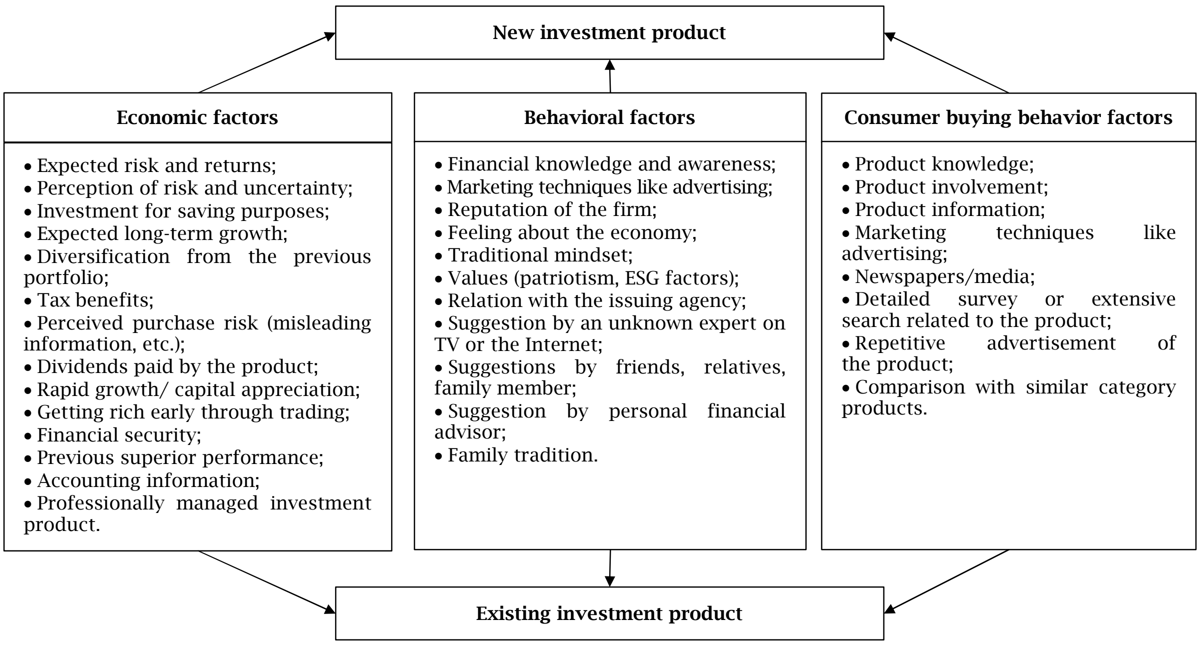
The methodology adopted comes with a few limitations. Review techniques like bibliometric analysis are not adopted for the reason that the number of studies specific to factors affecting investment decisions in new products is not a mature topic and only a handful of papers are available, making it inappropriate to use the technique (Donthu et al., 2021). Further, the factors identified through the study are based on the selected literature. A more extensive literature base may add a few more factors.

4. RESEARCH RESULTS AND DISCUSSION

Numerous factors are listed in the literature, including various theories and studies presenting the factors affecting an individual's investment decision. The factors are classified based on three phases or sections of study over a period and can be classified into economic factors, behavioral factors, and consumer buying behavior factors. The data from the above literature, if classified based on the common factors, gives us a list of a few specific factors studied and applicable to most of the products at various periods and spread at various geographic areas and financial markets. However, the basis for all the studies is the analysis of factors for investment in already existing financial products. The research gap is mentioned by Islamoğlu et al. (2015) but has not been addressed in the current available literature.

In the following part of the study, an analysis was made by enlisting the factors based on the three categories specified above. The enlisted factors are based on the above literature and apply to individual investors' investment decisions regarding existing investment products. The applicability of the same has been checked on the investment decision on the newly launched investment products based on the available information and data during the investment decision.

Figure 1. Applicability of categorized factors on investment decisions on existing and new financial products



Source: Authors' elaboration.

5. CONCLUSION

As per conventional theories, economic factors are regarded as the most impactful factors when making an investment decision. In the new product scenario, most of the required information to make an economic and rational decision is absent. The most rated economic factors reviewed in the literature, like expected risk, previous superior performance, accounting information, perception of risk and uncertainty, dividends paid by the product, rapid growth/capital appreciation, quick profits through trading, and professional investment management, become irrelevant due to lack of information but when looked into the behavioral factors and consumer buying behavior factors affect the same way. Thus, it can be said that "non-economic" factors are equally important in the investment decision-making for individual investors and more so in the case of a newly launched investment product.

It can also be concluded that in the absence of economic information, the behavioral factors and consumer buying behavior constructs more based on psychological biases and personality traits, supporting the claim by Islamoğlu et al. (2015) and Kourtidis et al. (2011). Further, the influence of marketing can be more significant in such cases, making the decision more irrational, supporting the study by Mishra and Kumar (2012).

With the spike in the number of "new financial products", it becomes necessary to understand the factors affecting probable investors more. These products' design-makers and marketers can use them to convert the probable investors to actual investors.

However, the current study is purely a review-based study and has not classified the factors affecting investment products in various categories like the stock market, mutual funds, etc. The current study has not considered product-specific factors. Further, the study does not explicitly categorize the investors generation-wise, country-wise, and gender-wise. The identified factors have not been tested on any investor group. Thus, the research study leaves scope for experimenting with the study in real-life scenarios with categorization product-wise, gender-wise, generation-wise, age and income level-wise, and region-wise.

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