DOI: 10.31357/fmscmst.2013.00251

# FACTORS INFLUENCING INVESTOR BEHAVIOUR: THE CASE OF COLOMBO STOCK EXCHANGE

By

Chandra Jayalal Ponnamperuma

(5266FM2010086)

**Research paper submitted to the University of Sri Jayewardenepura in partial fulfillment of the requirements for the Degree of Master of Business Administration (Finance) on 31 January 2013**

## Declaration Statement

"The work described in this research was carried out by me under the supervision of Mr. Chandana Gunatilake (Senior Lecturer, Department of Finance , Faculty of Management Studies and Commerce, University of Sri Jayewardenepura), and a report on this has not been submitted in whole or in part to any University or any other institution for another Degree/Diploma."

..........................................................

Chandara Jayalal Ponnamperuma

**Academic Advisors' Declaration Statement**

"I certify that the above statement made by the candidate is true and that this research is suitable for the submission to the University for the purpose of evaluation."

................................... 21/5/13

Mr. Chanadana Gunatilake
(Supervisor)
Senior Lecturer
Department of Finance ,
Faculty of Management Studies and Commerce,
University of Sri Jayewardenepura,
Gangodawila,
Nugegoda.

## Acknowledgement

I would like to convey my utmost respect and gratitude to my academic advisor Mr. Chandana Gunatilake (Senior Lecturer, Department of Finance, Faculty of Management studies and Commerce, University of Sri Jayewardenepura) who guided me throughout this study in an exemplary way and helped me great way in every aspect in terms of making this study a success.

Secondly, I would like to extend my deep gratitude and respect to all the lecturers who lectured me on a wide spectrum of topics during the course of this MBA program. The knowledge provided by these lecturers not only improved my academic knowledge but also went a long way in terms of improving my personality to be in line with a master's graduate and was the foundation in which this study was carried out in a successful manner.

I would also like to express my deep gratitude to Dr. P.D. Nimal, (Coordinator, M.Sc. in Management Program, Faculty of Graduate Studies, University of Sri Jayewardenepura) for all the help and assistance given to me in the process of completing this study.

Finally, I would like to thank my wife and parents for having the patience and the understanding in helping me complete this study successfully.

**Contents**

## LIST OF TABLES

## List of Figures

## LIST OF APPENDICES

**FACTORS INFLUENCING INVESTOR BEHAVIOUR :**

**THE CASE OF**

**COLOMBO STOCK EXCHANGE**

**BY**

**CHANDARA JAYALAL PONNAMPERUMA**

## ABSTRACT

The aim of the study is to identify the factors that influence individual investor behaviour in stock selection. To achieve this aim, this study investigates the individual investor behaviour in Colombo Stock Exchange.

Accordingly, the study examines the impact of accounting information, consultation, firm image, self-image, personal financial needs and common information on investor stock selection process. It is hypothesized that accounting information, consultation, common information, self image, personal financial needs and firm image influence on individual investor behaviour. The study analyses the perception of 300 survey responses. In addition, the views of a further sample of 50 executives obtained through interviews are analyzed. The survey is carried out from September to November 2012. The investor behaviour is measured by using five points likert scale and the data is analyzed using one sample t-test and independent sample t-test.

The results of the study convey that company stability is the most influencing factor of equity selection on individual investors, while the past performance of the share is the second influencing factor on individual investors' behaviour. The remaining factors, in the order of influence are risk on investment, the recent share price change, and economic & political factors. The study conveys that social status, religious beliefs, "get quickly rich" and opinion of the family do not affect the equity selection. Further, the study also convey that the individual investors do not rely on the content of the annual report.

Key words : Investor behaviour and stock selection

# CHAPTER ONE

# INTRODUCTION

## 1.1 Background of the study

The research in behavioral finance has developed rapidly in recent years and provides evidence that investors' financial decisions are affected by internal and external behavioral factors (Shefrin 2000; Shleifer 2000; Warneryd 2001). Behavioral finance describes how investors' market behavior is affected by the psychological principle of decision making to explain why people buy or sell stocks (Shefrin 1999). It also focuses on how investors interpret and act on information to make investment decisions. Therefore, the equity investment selection process is one of the key elements in behavioral finance, and a substantial amount of attention has been given by researchers to the behavior and portfolio performance of institutional investors in the past. However, less attention has been given to the individual investor behavior (Prowse 1990).

The literature on investors' behavior has relies mainly on two key assumptions. First, investors make rational decisions and second they are unbiased in their predictions about future returns of the stock (Sultana 2010). However, investment decisions of the individual investors can be affected by their investment needs, goals, objectives and a multitude of constraints. Therefore, it can be assumed that it is not possible to make successful investment decisions continuously if investment decisions are always governed by psychological factors.

Past studies show that equity investment of the individual investors' are determined by many factors. For example, Somoye, Rufus and Ezekei (2009) studied on firms' specific factors. Other studies have focused on macro-economic factors (Donatas 2009; Sidra, Hussain & Ahmed 2009) and specific accounting factors (Sidra, Hussain & Ahmed 2009) of the organizations. Hodge (2003) identified that the investors' perceptions of earnings quality, auditor independence, and the important of audited financial information can influence investors' behavior in choosing the stock. The lower perceptions of earnings quality are associated with greater reliance on a firm's audited financial statements and fundamental analysis of those statements when making investment decisions. Furthermore, the key role of previous information such as return continuations to determine an appropriate behavior patterns was identified as another influencing factor on investors' decisions (Kadiyala & Rau 2004).

A number of attempts have also been made by researchers to identify the types of information that investors require to purchase shares. Malmendier and Shanthikumar (2003) attempted to answer the question: whether small investors are naive? It is revealed that while large investors generate abnormal volumes of buyer-initiated trade after a positive recommendation. Further, only if the analyst is unaffiliated while small investors in order to buy even though the positive pressure recommendations come from affiliated analysts. Therefore, according to this study the factors that influence the equity selection decision of individual investors are return on equity, quality of management, return on investment, and price to earnings ratio.

The perception of the individual investor is also influenced by various factor such as, dividend, 'Get Rich Quickly' strategy, stories of successful investors, online trading,