Individual Investment - Risk Perception

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Abstract- **Risk is an inherent feature of all types of financial investments due to the variability in the actual and expected returns on investment. The concept 'risk perception' means the way in which investors view the risk of financial assets, based on their concerns and experience. The risk perception of investors is an important factor that influences the investment decisions. Hence, in the present study, based on the review of literature and a number of factors influencing the risk perception of investors were identified. These factors include unpredictability of returns, knowledge about the financial assets, chance for incurring loss, diversification of portfolios, and dependence on professional investment advice. The investors were provided with nine statements relating to risk, to measure their perception towards risk with relationship between risk perceptions of the investors.**

Index Terms- **Investors perception, investment, investment behavior.**

1. INTRODUCTION

The influence of risk perception on the investment decisions of a prudent investor is an promising subject in the behavioral finance literature. Risk is an inborn feature of all types of financial investments. It is the probability that the actual return on an investment will be lower than the expected return.

Investment decision generally means the determination made by investors as to where, when, how, and how much funds will be invested on various avenues of financial products/instruments with the objective of generating income or appreciation in value. Here, the concept investment decision is defined as the decision taken by individual investors while investing in mutual funds. The behavioral finance scholars found out that decisions could be influenced by unavoidable psychological and emotional factors. Better understanding of these factors will help the investors to take an appropriate investment decision and also help them to avoid their repeating mistakes in future in extracting the best financial investment avenue.. Usually, the investors are evaluating the risk and return of an investment decisions. The decision making behavior of an investor is affected by their attitude towards risk. At different levels of perception towards risk, the individual investors think differently about their investment and make decisions differently. Investors take risks according to their interpretation and perception which ultimately affect their behavior towards risky investment decisions. In this situation, in the present study an attempt is made to examine the influence of risk perception of individual investors on their investments in mutual funds.

2. LITERATURE REVIEW

Investment Company Institute (1993) conducted a study based on the objective to examine mutual fund shareholder perceptions of risk. In examining investors' perception of risk-return trade-off, the ICI findings suggested that mutual fund shareholders have a better understanding of an investments' potential return of fixed-income products. A shareholders' family history could influence his or her investment behavior and tolerance for financial risk.

Madhumarthi (1998) carried out a research to find out the preferences of the investors and their perception about the risk in the Indian markets. Three classes of investors had been identified based on their risk perception namely, risk seekers, risk bearers and risk avoiders. The result indicated that a majority of the investors were influenced by the operating performance of the companies. The risk perception influenced the investment decisions of the investors and the profit earned by them.

Swarup (2000) conducted a study on investor risk-return perceptions towards various investment avenues and based on this, the strategies that need to be adopted by mutual funds to penetrate the markets were discussed.

Diacon (2004) presented the results of a detailed comparison of the perceptions by individual consumers and expert financial advisers of the investment risk involved in various UK personal financial services' products. Factor similarity test showed that there were significant differences between expert and lay investors in the way financial risk were perceived. Financial investors were likely to be less loss averse than lay investors, but were prone to affiliation bias, believed that the products were less complex, and were less cyclical and distrustful about the protection provided by the regulators. The traditional response to the finding was that experts and non experts had different perception and understanding about risk.

Veld and Veld-Merkoulova (2008) studied risk perception of individual investors by asking experimental questions to 2,226 members of a consumer panel. Their responses were analyzed in order to find which risk measure they implicitly used. They found that most investors implicitly use more than one risk measures. For those investors who systematically perceive risk according to the same risk measure, semi-variance return was most popular. The investors stated that they considered that the original investment was the most important benchmark followed by the risk free rate of return and market return. However, their choices in the experimental questionnaire study revealed that market return was the most important benchmark.

From the review of studies cited above, it is found that most of the studies were analyzed the risk perception of investors. The literature still lacks a comprehensive study establishing the influence of risk perception of mutual fund investors on their investment decisions. The present study is designed based on this background.

3. OBJECTIVE OF THE STUDY

To establish the influence of risk perception of individual investors on their investment decisions in mutual funds.

4. RESEARCH METHODOLOGY

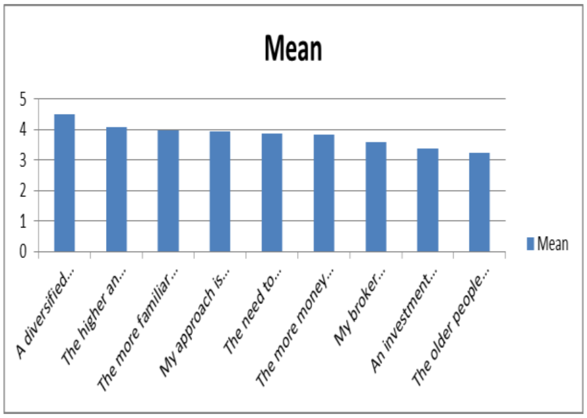
The present study is descriptive and explanatory in nature. Both secondary and primary data were collected and used for the study. The secondary data source of the study include books, journals, periodicals, publication of various mutual fund organizations, website of AMFI, website of SEBI, government publications and websites of various mutual fund companies.

5. DATA ANALYSIS AND DISCUSSIONS

Investment decision of individual investors in financial assets is usually affected by their risk perception. Hence, in the present study based on the review of literature and discussions with experts in the field a number of factors influencing the risk perception of investors were identified. These factors include unpredictability of returns, knowledge about the financial assets, chance for incurring loss, diversification of portfolios, and dependence on professional investment advice. The concept 'risk perception of individual investors' is operationally defined here as their beliefs, feelings, concerns, experiences and judgments about these factors. In order to measure the risk perception of individual investors, nine statements were developed based on these factors and the opinions of the respondents were measured on a five point rating scale. These statements include 'my approach is to be cautious and avoid all risky investment'; 'an investment that involves a great deal of risk is not really investments but it is gambling'; 'the more money one has, the more investment risk one can take'; 'my broker decides the best investment level for me'; 'the more familiar an investment, the less risky it is'; 'a diversified portfolio reduces risk'; 'the older people take lesser investment risk'; 'the need to liquidate quickly prohibits me from considering riskier products'; and 'the higher an investments' yield or rate of return, the greater is its associated risk'.

Risk Perception of Investors

Risk Perception	Mean	Standard Deviation	C. V.	Rank
A diversified portfolio reduces risk.	4.48	0.73	16.36	1
The higher an investments' yield or rate of return, the greater is its associated risk	4.08	0.97	23.84	2
The more familiar an investment, the less risky it is.	3.98	0.98	24.67	3
My approach is to be cautious and avoid all risky investment.	3.93	1.02	25.95	4
The need to liquidate quickly prohibits me from considering riskier products.	3.88	0.92	23.83	5
The more money one has, the more investment risk one can take.	3.82	0.9	23.46	6
My broker decides the best investment level for me.	3.58	1.22	34.04	7
An investment that involves a great deal of risk is not really investments but it is gambling	3.36	0.98	29.22	8
The older people take lesser investment risk.	3.23	1.26	39.16	9



Source: Field Survey

From the Table 1, it is clear that a diversified portfolio reduces risk is ranked first (Mean Value 4.48) followed by the higher an investments' yield or rate of return, the greater is its associated risk (Mean Value 4.08).

Investments in Mutual Funds

Investments in MFs (Percentage to Total Amount of Investments in Financial Assets)	Number of Investors	Percentage to Total
Less than 25%	166	18.4
25% - 50%	135	15.0
50% - 75%	133	14.8
75% - 100%	466	51.8
Total	900	100.0

Source: Field Survey

It is clear that, out of the 900 investors, 18.4 per cent of the respondents having less than 25 per cent investment, 15 per cent of the respondents are having 25-50 per cent investment, 14.8 per cent have invested between 50-75 per cent and 51.8 per cent have invested 75-100 per cent of their total financial investments in mutual funds. So, majority of the respondents 734 (81.56 per cent) covered in the study have invested more than 25 per cent of their total amount of financial investments in mutual funds.

6. CONCLUSION

From the forgoing analysis, it is clear that mutual fund investors are financial conservatives. They are aware about the principle higher the risk, higher will be the return and at the same time they understand that diversified portfolio will reduce the risk. So the investors should consider investing in a combination of schemes to achieve their specific goals. There is a need for Indian Mutual Funds to come out with innovative products that cater to the ever changing customer requirements. Diversified products will keep the present momentum going for the industry in a more competitive and efficient manner. The Asset Management Companies must consider the changing perceptions, especially risk perception of investors while launching new products. This will help the Mutual Funds to capture the market.

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