IMPACT OF GLOBAL FINANCIAL CRISIS ON INVESTORS' PSYCHOLOGY: AN ANALYSIS

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ABSTRACT

Nearly Thirteen month ago, panic shown by the bankruptcy of Lehman Brothers had pushed financial markets close to collapse. The worldwide economic slowdown of the advanced countries which started around mid-2007, as a result of sub-prime crisis in USA, led to the spread of economic crisis across the globe. Many hegemonic financial institutions like Lehman Brothers or Washington Mutual or General Motors collapsed and several became bankrupt in this crisis. During this economic meltdown lots of talks have been seen on the investor's psychology particularly investing in the financial market. The investing world has changed their attitude towards the financial market and has become more conservative. The present paper is an attempt to deal with various dimensions of global liquidity crunch and analyze the behavior of investor during this period.

Key Words: *Global Recession, Impact on Investors 'psychology, Indian Economy, GDP, Interest Rate, Risk and Uncertainty*

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Introduction:

The financial markets world wide was on a roller coaster over the last two years which made it difficult to predict road ahead. The Lehman collapse in 2008 and the credit crunch thereafter created an air of uncertainty and investors shied away from risk. Financial melt down in recent period has affected whole gamut of economies around the world. The crisis has surged across the public-private boundary, as the hit to private firms' balance sheets has now imposed heavy new demands on the public sector's finances. It has surged across national borders within the developed world, as the people of Iceland know all too well. And now there are reasons to fear that the crisis will swamp emerging markets and other developing countries, cutting into the considerable economic progress of recent years. The investing world has changed their attitude towards the financial market and has become more conservative. The present paper is an attempt to analyze the behavior of investor during this period.

Concept of Recession:

Recession can be defined as a period of general economic slowdown; typically defined as a decline in Gross Domestic Product for two or more consecutive quarters. A recession is typically accompanied by a fall in the securities market, an increase in unemployment, and a decline in the housing market. A recession is generally considered less severe than a depression, and if a recession continues long enough it is often then classified as a depression. There is no one obvious cause of a recession, although overall blame generally falls on the financial regulation and administration. Followings are the main feature of recession:

- A Recession is a contraction phase of the business cycle.
- National Bureau of Economic Research (NBER) is the official agency in charge of declaring that the economy is in a state of recession.

- Recession is significant decline in economic activity lasting more than a few months, which is normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales.
- For this reason, the official designation of recession may not come until after we are in a recession for six months or longer.

Causes of Recession:

- An economy typically expands for 6-10 years and tends to go into a recession for about six months to 2 years.
- A recession normally takes place when consumers loose confidence in the growth of the economy and spend less.
- This leads to a decreased demand for goods and services, which in turn leads to a decrease in production, lay-offs and a sharp rise in unemployment.
- Investors spend less as they fear stocks values will fall and thus stock markets fall on negative sentiment.

Objective of the Study: Following objectives study tries to achieve:

- To study the impact of financial crisis on investors' psychology of the basis of analysis of survey output.
- To study the cause of global recession and impact on Indian Economy.
- To study the investors attitude while framing their investment strategy
- To study the act of financial institution to attract the investors.
- To study the most attractive financial avenue where people invest during recession.

Research Methodology

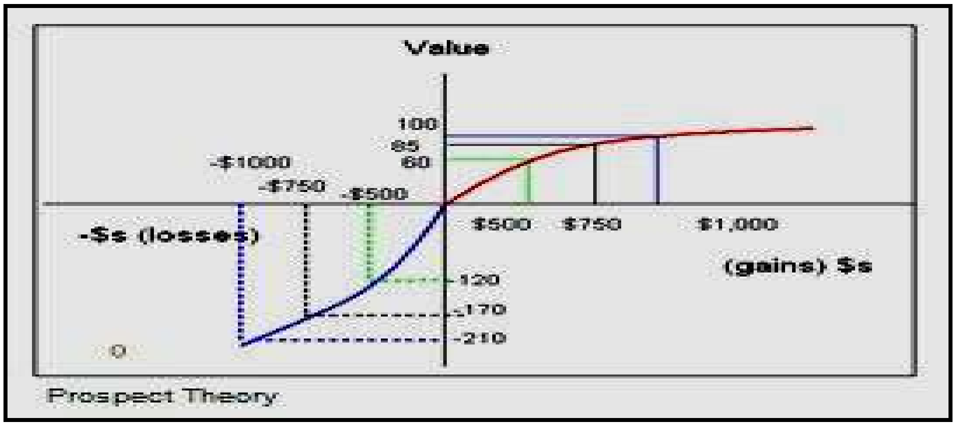
- **Type of Research**: Research in common parlance refers to the search of knowledge. Research has it significance in solving various operational and planning problems of business and industries. Present research work is descriptive of nature.

- **Sample Size:** Sample size refers to the number to be selected for conducting a survey. Here it has been kept 200.
- **Type of data and collection method:** This survey has been done through primary data collection. For primary data collection questionnaire method has been adopted. The questionnaire was closed ended structured questionnaire.
- **Universe:** The universe is the entire group of items the researcher wants to study and generalize. The universe of the present study is regarded as whole investing community of Varanasi District
- **Sample techniques:** As the universe is quite large so a relatively small group of individual are selected is able to present the whole universe. In this survey convenience sampling has been used.
- **Data Presentation and analysis Techniques:** The data analysis techniques used was quantitative in nature and the data analysis instruments used for conducting the research are tabulation, bar chart and pie chart.

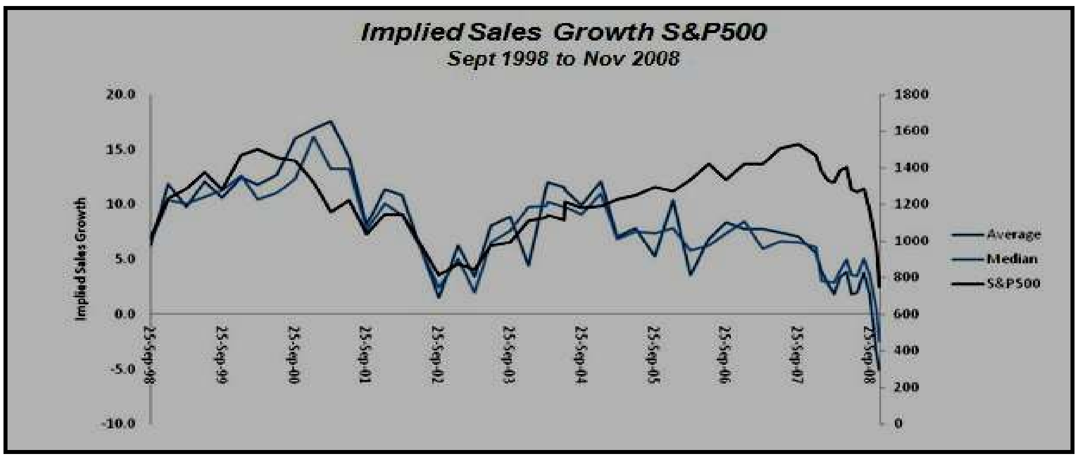
Behavioral Finance: Since present study is based on the assumption of behavioral finance it will be better to go through concept of behavioral finance:

• **Cognitive Bias (Winner Loser Effect):** De Bondt and Thaler (1985) argued that investors overreact to both bad news and good news. Therefore, overreaction leads past losers to become underpriced and past winners to become overpriced." De Bondt and Thaler propose a strategy of buying recent losers and selling recent winners. Investors become too pessimistic about past losers and overly optimistic about past winners.

• **Representative ness Heuristic:** Barberis, Shlieifer and Vishny (1998) argued that investors find patterns in data too readily, tend to over react to information and conservatism (clings to prior beliefs, under reacts to information).

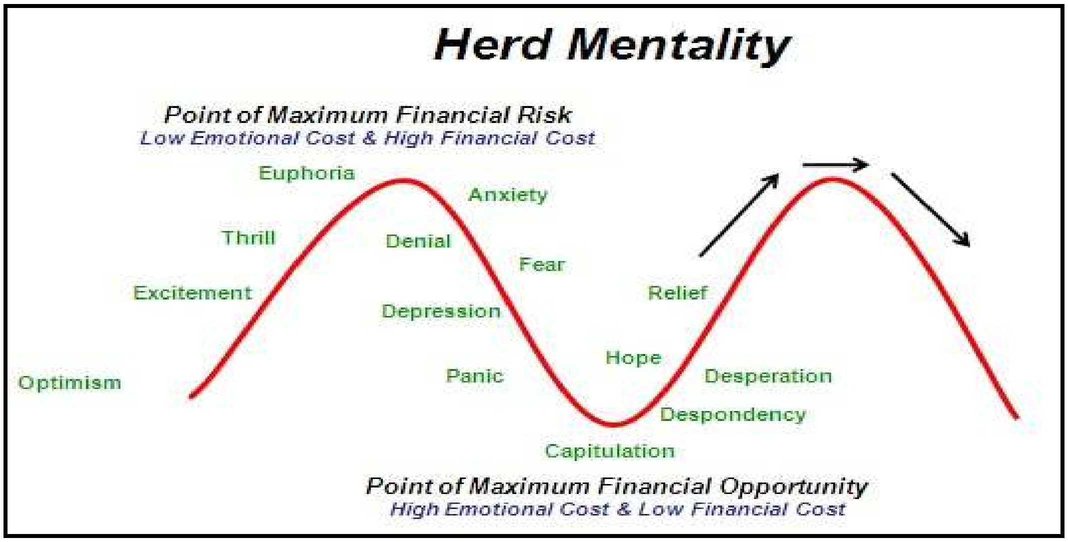


<u>Then & Now</u>



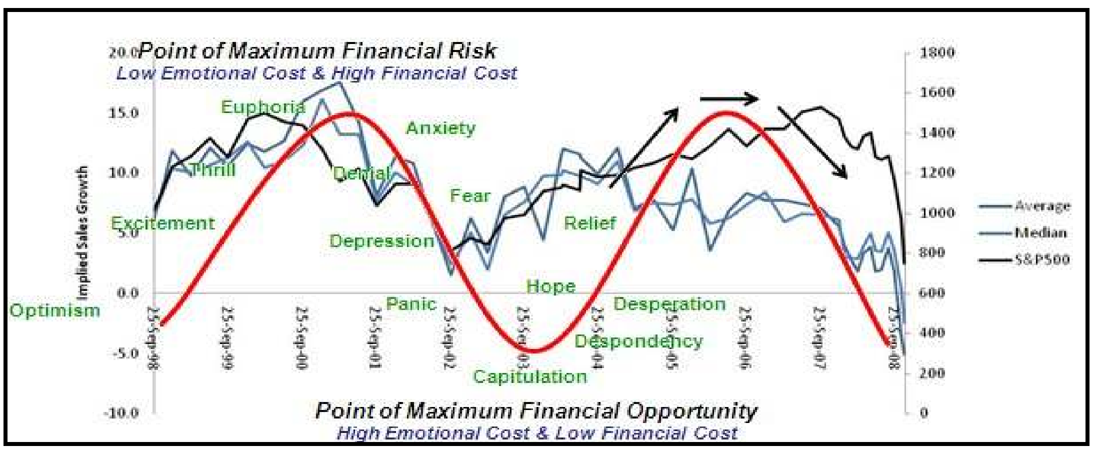
Source: S& P website

At the end of year 2008: The Median Company in the S&P500 has -2.5% Sales Growth priced in for each of the next 5 years. The Average Company in the S&P500 has -5.0% Sales Growth priced in for each of the next 5 years.Assumes 5 Year Median EBITDA & Asset Turnover for each individual company in the S&P500 (monthly).



Because investors value gains and losses differently, markets tend to over react. This creates extraordinary opportunities!

Overlay: VE Analysis and Market Psychology



Impact of Financial Recession on Indian Financial Market:

The impact of the financial crisis has been deeper in India than what was estimated by our policy makers though it is less severe than in other emerging market economies. The extent of impact has been restricted due to several reasons such as-

- Indian financial sector particularly our banks have no direct exposure to non performing assets and its off-balance sheet activities have been limited. The credit derivatives market is in an embryonic stage and there are restrictions on investments by residents in such products issued abroad.

- India’s growth process has been largely domestic demand driven and its reliance on foreign savings has remained around 1.5 per cent in recent period.
- India’s comfortable foreign exchange reserves provide confidence in our ability to manage our balance of payments notwithstanding lower export demand and dampened capital flows.
- Headline inflation, as measured by the wholesale price index (WPI), has declined sharply. Consumer price inflation too has begun to moderate.
- Rural demand continues to be robust due to mandated agricultural lending and social safety-net programmes.
- India’s merchandise exports are around 15 per cent of GDP, which is relatively modest.

Today, India is certainly more integrated market economy into the world economy than ten years ago at the time of the Asian crisis as the ratio of total external transactions (gross current account flows plus gross capital flows) to GDP has increased from 46.8 per cent in 1997-98 to 117.4 per cent in 2007-08. Although Indian banks have very limited exposure to the US mortgage market, directly or through derivatives, and to the failed and stressed financial institutions yet Indian economy is experiencing the knock-on effects of the global crisis, through the monetary, financial and real channels – all of which are coming on top of the already expected cyclical moderation in growth.

Securities Market:

The world economy affairs and the stock market movement are closely related as the buoyancy of the economy gets reflected in the stock market. Due to the impact of global economic recession, Indian stock market came down sharply from the high of 20000 to a low of around 8000 points. Corporate profitability also exhibited negative growth during the recession period. Indian stock market has tumbled down mainly because of 'the substitution effect' of:

- Drying up of overseas financing for Indian banks and Indian corporates;
- Constraints in raising funds in a bearish domestic capital market; and
- Decline in the internal accruals of the corporates.

Thus, the combined effect of the reversal of portfolio equity flows, the reduced availability of international capital both debt and equity and the perceived increase in the price of equity with lower equity valuations has led to the bearish influence on stock market.

Anatomy of the economic depression in India

➢ **Share Market**

- More people have sold the shares in the Indian share market than they bought in the recent weeks. This has added to the fall of Sensex to lower points.
- Foreign investors have pulled out from stock markets leading to heavy losses in stocks and mutual funds
- Stock broking houses are laying-off people
- Because of such uncertainty many people have started saving money in banks rather than investing

➢ **IT and Real Estate Sector**

- The key challenges faced by the industry now are inflation and the psychological impact of the US crisis, leading the companies to hit the panic button.
- Bonuses, perks, lavish parties, and many other benefits are missing as companies look to cut cost.
- India's IT export growth is also slowering down
- One of the casualties this time are real estate, where building projects are half-done all over the country and in this tight liquidity situation developers find it difficult to raise finances.

➢ **Layoffs and Unemployment**

- Hundreds of workers have lost jobs in diamond jewellery, textiles and leather industry.
- Companies in IT industry have stopped hiring and projected lower manpower need.

- Firms attached to the capital market are laying off people and large companies are putting their future expansion plans on hold.

➢ Industrial sector

- Government and other private companies are reluctant in starting new ventures and starting new projects.
- Projects that are halfway to completion, or companies that are stuck with cash flow issues on businesses that are yet to reach break even, will run out of cash.
- Car, bike & truck sales down
- Steel plants are cutting production
- Hospitality and airlines are hit by poor demand

Corrective Steps to Check Recession

- RBI needs to neutralize the outflow of FII money by unwinding the market stabilization securities that it had used to sterilize the inflows when they happened.
- This will mean drawing down the dollar reserves which is important at this hour.
- In the IT sector, there should be correction in salary offerings rather than job cutting
- Public should spend wisely and save more
- Taxes including excise duty and custom duty should be reduced to lighten the adverse effect of economic crunch on various industries
- In real estate the builders should drop prices, so as to bring buyers back into the market.
- Also, the government should try and improve liquidity, while CRR and SLR must be cut further
- Indian Companies have to adopt a multi-pronged strategy, which includes diversification of the export markets, improving internal efficiencies to maintain cost competitiveness in a tight export market situation

Opportunities in India due to US recession:

- US recession may be a boon for Indian offshore software companies
- The impact of recession is higher to small and medium sized (SMEs) enterprises whose bottom lines get squeezed due to lack of spending by consumers
- SMEs in the US are under severe pressure to increase profitability and business margins to survive. This will force them to outsource and even have M&A arrangements with Indian firms.
- India is going to be a great beneficiary of this trend which will minimize the impact of the US recession on Indian industry
- By March 2008, India had received SME outsourcing deals worth $7 billion from the US as against $6.2 billion in the previous year.

During the 1990s, Standard & Poor's identified three specific sub-styles: deep value, relative value and new value.

- ***Deep Value*** style uses the traditional Graham and Dodd approach whereby managers buy the cheapest stocks and hold them for long periods in anticipation of a market upswing.
- ***Relative Value*** money managers seek out stocks that are under-appreciated relative to the market, their peer group, and the company's earnings potential. Relative value stocks should also feature some sort of channel (such as a patent or pending FDA approval) that has the potential to unlock the stock's real value. A typical holding period is three to five years. Unlike traditional value managers, relative value managers pursue opportunities across all economic sectors and may not concentrate on the usual "value sectors".
- ***New value*** managers choose their investments from all securities categories, seeking any stock that holds prospect for significant appreciation.

Growth style managers typically focus on an issuer's future earnings potential. They try to identify stocks offering the potential for growing earnings at above-average rates. Where value managers look at current earnings and assets, growth managers look to the issuer's future earnings power. Growth is generally associated with greater upside potential relative to style investing and, of course, it has concomitant greater downside risk.

Traditional growth style investing has also spawned a few sub styles, specifically, disciplined growth or growth-at-a reasonable-price (GARP), and aggressive, or momentum, growth.

Disciplined growth style managers concentrate on companies that they believe can grow their earnings at a rate higher than the market average and that are selling for an appropriate price.

Aggressive growth styles tend not to rely on traditional valuation methods or fundamental analysis. They rely on technical analysis.

Sector Strategy: Look at a particular industry such as transportation. Because the holdings of this type of fund are in the same industry, there is an inherent lack of diversification associated with these funds. These funds tend to increase substantially in price when there is an increased demand for the product or service offering provided by the businesses in which the funds invest. On the other hand, if there is a downturn in the specific sector in which a sector fund invests, the fund will face heavy losses due to the lack of diversification in its holdings.

Index Strategy: Tends to track the index it follows by purchasing the same weights and types of securities in that index, such as an S&P fund. Investing in an index fund is a form of passive investing. The primary advantage to such a strategy is the lower management expense ratio on an index fund. Also, a majority of mutual funds fail to beat broad indexes such as the S&P 500.

Global Strategy : A global strategist builds a diversified portfolio of securities from any country throughout the globe (Not to be confused with an international strategy, which may include securities from every other country except the fund's home country.) Global money managers may further concentrate on a particular style or sector or they may choose to allocate investment capital in the same weightings as world market capitalization weights.

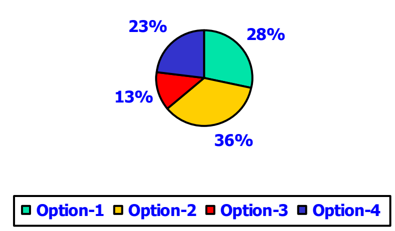
Stable Value Strategy : The stable value investment style is a conservative fixed income investment strategy. A stable value investment manager seeks short-term fixed income securities and guaranteed investment contracts issued by insurance companies. These funds are attractive to investors who want high current income and protection from price volatility caused by movements in interest rates.

Dollar-Cost Averaging : Dollar-cost averaging is a straightforward, traditional investing methodology. Dollar-cost averaging is implemented when an investor commits to investing a fixed dollar amount on a regular basis, usually monthly purchase of shares in a mutual fund. When the fund's price declines, the investor can buy a greater number of shares for the fixed investment amount, and a lesser number when the share price is moves up. This strategy results in lowering the average cost slightly, assuming the fund fluctuates up and down.

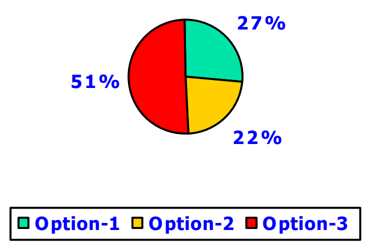
Value Averaging : This is a strategy in which an investor adjusts the amount invested, up or down, to meet a prescribed target. An example should clarify: Suppose you are going to invest $200 per month in a mutual fund. At the end of the first month, thanks to a decline in the fund's value, your initial $200 investment has declined to $190. In this case, you would contribute $210 the following month, bringing the value to $400 (2*$200). Similarly, if the fund is worth $430 at the end of the second month, you only put in $170 to bring it up to the $600 target. What happens is that compared to dollar cost averaging, you put in more when prices are down, and less when prices are up.

Analysis of Data:

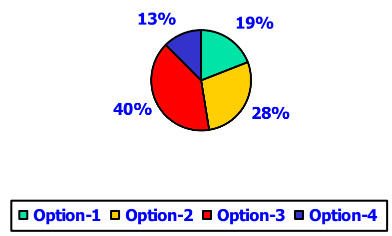
What are objectives of your investment decision? When this question was asked response was socking as most of investor viz. preferred for high return than safety as following chart shows. Safety, High return, Tax saving and Security



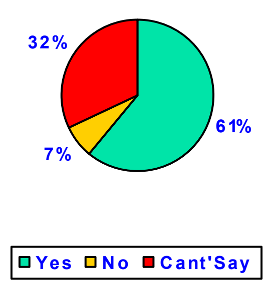
As per risk preference is concerned when the question was asked are you Risk seeker or Risk averter or Neutral most of investor were not ready to bear high risk and 52% said they are risk neutral means that risk has no relevance for them while 22% are found risk averter.



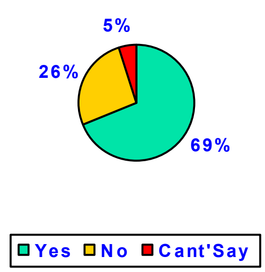
Today you invest mainly to: a)Earn interest/dividend income b)Save for your post retirement future, c)Save for your children's education/marriage/career and d)Deploy surplus earning. 40% of the respondent investors save their money for their future plans.



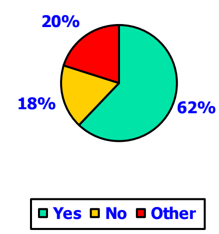
Do you think that in the recession period investment in bank is more reliable than other investing sector/mode? 61% of the investors think that banks are most reliable investing sector.



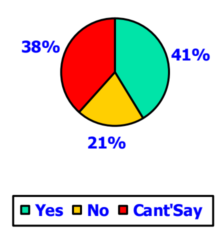
Is this recession/crisis affecting your income/future? 69% of the investors accept that this recession period affect their future.



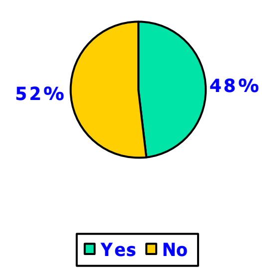
Do you think that is LIC right step to invest your money? 62% of the investors accept that LIC is the right place for their investment.



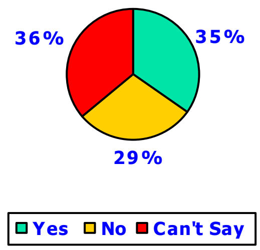
Do you satisfied/agree with steps of government which is helpful in cope-up with the crisis? 41% investors are satisfied with the step of government where as 38%investors are not.



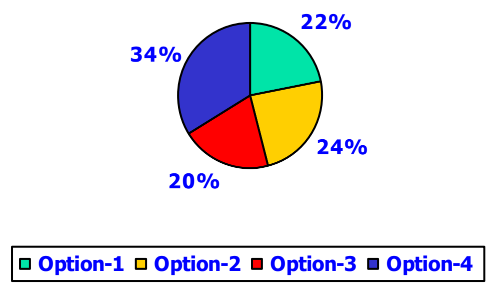
Do you have complete knowledge of different instrument of different institution? 52% of the investors have the complete knowledge of the different instrument of institution.



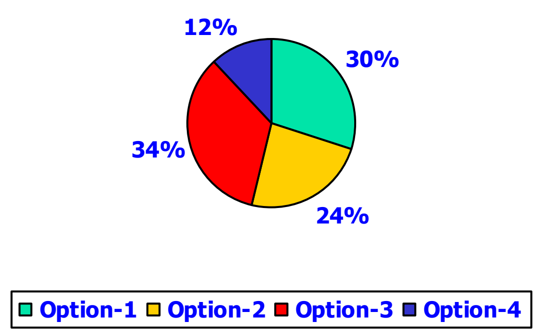
Is this period right for investing your money? According to the response on question most of the investors are in dilemma. As all categories of respondent found themselves pondering whether or not invest.



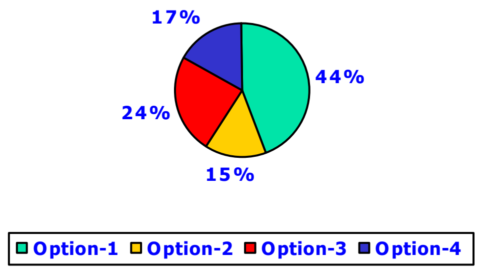
During the period of economic recession what is the role of insurance industry? A)They are capable to provide effective interest. B) They cannot provide effective interest.c) People don't have option other than insurance. d)Don't know. Most of the investors are not aware of the role of insurance industry.



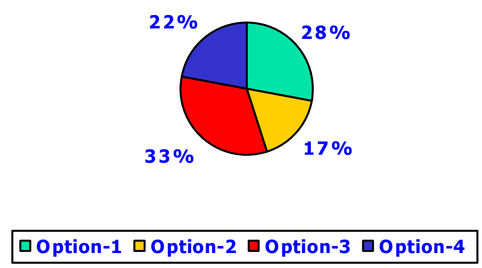
Which type of change have you seen in your expenditure pattern during global recession? A)Expenditure on consumption has been increase/decrease. B)Expenditure on capital goods has been increase/decrease. C)Savings in banks has been increased/decreased) Expenditure on services has been increased/decreased. 34% of the investors accept the change during recession.



What is your step to cope-up with the situation?a) Investing money in banks. B)Investing in shares. C) Investments in gold. D) Investments in mutual funds. 44% of the investors admit that investing their money in banks is the right step for cope-up with the situation.



What care you take while investing? A) Find out cost and benefits associated with the investments. B) Examine if fits with other investment you are considering or you have already made c) Deal only through an authorized intermediary and d) other. Most of the investors deal only with the authorized intermediary while investing their money. As 22% of respondent gives priority to cost benefit associated with investment, while 33% deals with authorized dealers.



Conclusion:

During an economic downturn, consumer spending continues. However, buyer attitudes and behavior patterns alter substantially in recession as consumers delay replacing serviceable products and focus on achieving value for money, seeking out deals and eliminating indulgences. This insight explores how consumers prioritize spending during a recession and provides implications and recommendations for action. In the recession period most of the investors like to invest their money in governmental securities and banks because they are the safest financial avenues for deploying their hard earned money. During this recession period several factors like high volatility of sensex, fluctuating interest rate, reduced economic growth rate, subprime crisis, issues of corporate governance etc have influenced investors' psychology negatively. It is the need of hour to identify basic intricacies of investor's psychology motivating them to invest and take corrective steps to ameliorate investment and capital generation activities in the country.

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Annexure:

Questionnaire for investor's survey (2008-2009)

Dear sir / madam,

Kindly fill the questionnaire containing your profile. This is meant for the study of "**survey on changing investor's psychology during post global financial crisis: A case study of Varanasi district**" under the minor project approved by SMS.It is assured that the information will be used only for the said purpose and will be kept confidential. Kindly give your response to the best of your knowledge, experience and belief.
Thanks

Tick [ ] wherever applicable……………………………………

PERSONAL DETAILS:

1. Name. ..…………………………………..
2. Address & Contact No.: ……………………………………
   …………………………………….
3. Age : Below 21 [ ] 21 to 35 [ ] 35 to 50 [ ] over 50 [ ]
4. Marital Status : Single [ ] Married [ ] Separated [ ] Divorced [ ] Widowed [ ]
5. Occupation : Unemployed [ ] Factory Worker/ Supervisor [ ] Office clerck/Excutive [ ] Sales Executive [ ] Middle/Top management [ ] Self Employed (Business) [ ] Self Employed (Professional) [ ] Student [ ] Retired [ ] other [ ]
6. Education : Non metric [ ] Std X/XII pass [ ] Graduate [ ] Post Graduate/ Professional [ ]

7. You live in : Flat/ Apartment[ ] Rented [ ] Owned by you[ ]

8. No. of persons in your family : ……………out of which earning members are: ………………………

Tick [ ] wherever applicable ………………………………….

Expenditure and Saving Pattern:

9 Average monthly income :

Less than Rs. 10000	[ ]	10000-20000	[ ]
20000-30000	[ ]	30000-40000	[ ]
40000-50000	[ ]	Above 50000	[ ]

10 Average monthly expenditure:

Less than 30% of income	[ ]
30%-50% of income	[ ]
50%-60% of income	[ ]
60%-70% of income	[ ]
70%-80% of income	[ ]
Above 80 % of income	[ ]

11 Do you meet all your basic needs? Yes [ ] No [ ]

12 Does inflation influence your monthly budget? Yes [ ] No [ ]

13 Do you have a bank account? Yes [ ] No [ ]

14 How do you utilize your earning? Idle saving [ ] Investment[ ]

15 Do you think that an investment is necessary for securing older age? Yes [ ] No [ ]

Investment behavior and experience:

16 In which mode would you like to invest your money?

Mutual funds [ ]	Bank deposit/ Account [ ]	Company deposit [ ]
Tax saving Bond [ ]	National Saving Certificate [ ]	PPF [ ]

PSU Bonds [ ] Shares [ ] Derivatives [ ]

Life insurance [ ] Medial/Accident/General Insurance [ ] Other [ ]

17 What are objectives of your investment decision?

Safety [ ] Liquidity [ ] High return [ ] Capital Appreciation[ ]

Tax saving [ ] Security [ ] other [ ]

18 What is your risk preference?

Risk seeker [ ] Risk averter [ ] Neutral [ ]

19 Today, you invest mainly to:

i-Earn interest/ dividend income and live of these earning [ ]

ii-Save for your post retirement future [ ]

iii-Save for your children's education/marriage/career [ ]

iv-Deploy surplus earning [ ]

20 Do you think that in this recession period investment in bank is more reliable than other investing sector/mode?

Yes [ ] No [ ] cannot say [ ]

21 Is this recession or crisis affecting your income/ future?

Yes [ ] No [ ]

22 Do you think that LIC is the right step to invest your money?

Yes [ ] No [ ] other [ ]

23 Do you satisfied/agree with step of government which is helpful in cope up with the crisis?

Yes [ ] No [ ] cannot say [ ]

24 Do you have complete knowledge of financial instrument of different institution?

Yes [ ] No [ ]

25 Is this period right for investing your money?

Yes [ ] No [ ] cannot say [ ]

26 During the period of economic recession, what is the role of insurance industry?

i-They are capable to provide effective interest [ ] ii-They cannot provide effective interest [ ]

iii-People don't have option other than insurance [ ]

iv-Don't know [ ]

27 Which type of change have you seen in your expenditure pattern during the global recession?

i-Expenditure on consumption has been increased/decreased [ ]

ii-Expenditure of capital goods increased/ decreased [ ]

iii-Saving in banks has been increased/ decreased [ ]

iv-Expenditure on services has been increased/decreased [ ]

28 What is your step to cope up with the situation?

i-Investing money in banks [ ]

ii-Investment in shares [ ]

iii-Investment in gold [ ]

iv-Investment in mutual fund [ ]

29 How do you see the Indian investing environment?

i-Investor friendly [ ]

ii-Intermediaries friendly [ ]

iii-Liberal for all [ ]

iv-Transparent [ ]

v-Vague to all [ ]

vi-Supportive for corporate [ ]

30 What care you take while investing?

i-Find out the cost and benefits associated with the investment [ ]

ii-Examine it fits with other investment you are considering or you have already made[ ]

iii-Deal only through an authorized intermediary [ ]

iv-Others [ ]

Thank You

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