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Investors' Investment Decisions in Capital Market: Key Factors

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Investors' Investment Decisions in Capital Market: Key Factors

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I. Introduction

Capital market is one of the critical components of any economy. Therefore, investment decision of the investors in the capital market is very sensitive. Different measures of stock market activities are positively correlated with measures of real economic growth across countries (Levine and Zervos, 1998). This association is particularly strong for developing countries. As an economically potential developing country, capital market is certainly a key factor for Bangladesh. Recent instability in the overall capital market of this country highly enticed the policymakers. The situation demands to analyze the decision making process of the actors in the capital market. Thus, this study attempts to explore the key factors those the investors consider while making their investment decisions in the capital market. The stock market regulatory authority and the policy makers might find the results helpful in avoiding any unexpected catastrophe, improving the stock market industry and assessing to which degree the stock market is needed to be reformed.

II. Methodology

This is a survey based descriptive research. 25 key variables were considered initially. Malhotra (2008) defines that there should be at least 4 or 5 times as many observations (sample size) as there are variables. Hence, a total of 125 investors from different brokerage houses of Bangladesh had been surveyed. Investors were chosen conveniently (non-probability sampling technique). A structured questionnaire was used to collect investors' responses. The respondents were asked to respond against 25 close ended statements on a 5-point Likert Scale where '1' denotes 'Strongly Disagree' and '5' denotes 'Strongly Agree'. The key variables were Dividend, Earnings per Share (EPS), Retained earnings, Price Earning (P/E) Ratio, Returned on Investment (ROI), Company News, AGM, Company Goodwill, Industry Growth, Price Hike of Necessary Goods, Market Sentiment, Agents' Advice, Available Substitutes, Credit Rating Agency's Report, Market Rumor, Website/Social Blog, Inflation, Exchange Rate, Margin Loan, Interest Rate, International Situation, SEC Regulations, Change in Government Policies, Political Connectivity of Company Owner, Law Suit File.

The respondent with demographic profile is portrayed below:

Demographic group	Classes	Frequency	Total Sample	Class as Percentage (%)
Gender	Male	106	125	85%
	Female	19		15%
Age	18-25 Years	35	125	28%
	26-40 Years	61		49%
	41-60 Years	22		17%
	Above 60 Years	7		6%
Occupation	Service	31	125	25%
	Business	37		29%
	Professional	16		13%
	Others	41		33%

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III. Literature Review

Investors' perception and market behavior are the key concern of the capital market analysts or researchers. Stock market's contribution on the overall economy of a country is well discussed by different scholars (Singh, 1997; Singh, 1971; Bhide, 1994). Empirical evidence linking stock market development to economic growth has been inconclusive. Though the balance of evidence is in favor of a positive relationship between stock markets and economic growth. Levine and Zervos (1998) found that various measures of stock market activities are positively correlated with measures of real economic growth in different countries and this relationship is particularly strong in the developing countries. On the contrary, Benson (2002) found this positive impact of capital market development largely dependent on the inclusion of higher income countries.

Movements of stock prices depend on number of factors. The decomposition of stock price movements is very sensitive to what assumption is made about the presence of permanent changes in either real dividend growth or excess stock return (Balke & Wohar, 2006). Cochrane (1992) and Timmerman (1995) have argued that fluctuation in stock prices can be explained by time-varying discount rates and future excess returns. Raihan & Ullah (2007), from their study on Chittagong Stock Exchange (Bangladesh), found that stock return series do not follow random walk model in Bangladeshi capital market. Similar findings of the work of Mobarek and Keasay (2000) on Dhaka Stock Exchange of Bangladesh support this argument.

Conducting research in Dhaka Stock Exchange (DSE), Rahman, et al (2006) found the negative correlation between the beta and stock return, which is reason for inefficiency of market where the assumptions behind the CAPM model is not supported. Wong, et al (2009) found that when limit hits are imminent stock prices approach limit bounds at faster rates and with increased volatility and higher trade efficiency.

The critical challenge in this field of research is to determine the factors influence the stock price in the capital market. A large number of empirical studies had been conducted about the determinants of stock prices. Several researchers examined the relationships between stock prices and selected factors. These factors could be either internal or external. The findings of their research illustrate different outcomes depending on the scope of research. Many of these factors could be valid for all stock markets. In this section some of these studies are reviewed.

It is generally assumed that the emerging markets are less efficient than the developed markets. Rahman, et al (2006) found the negative correlation between the beta and stock return. This is one of the reasons for inefficiency in the capital market. The movement of stock price is very sensitive to what assumption is made about the presence of permanent changes in either real dividend growth or excess stock return (Balke & Wohar, 2006). Dividend change announcements cause a greater change in stock price when the nature of the news (good or bad) goes against the grain of the recent market direction during volatile times (Docking and Koch, 2005). After using this macroeconomic variables like gross national product (GNP), interest rate and inflation, Al-Qenae (2002) found inflation and interest rate have negative and statistically significant coefficients in almost all cases on stock prices while GNP has positive effect. Maysami and Koh (2000) illustrated the connection of money supply growth, change in short and long term interest rates, inflation and variation in exchange rates with the changes in Singapore's stock market levels.

Udegbunam & Eriki (2001) revealed that stock prices and inflation provides a strong support for the proposition that inflation exerts a significant negative influence on the behavior of the prices of the stocks. They also exhibited that stock prices are also strongly driven by the level of economic activity measured by interest rate, GDP, financial deregulation and money stock. Joshep and Vezos (2006) proclaim that interest rate and foreign exchange rate risks are important financial and economic factors affecting the value of common stocks. The results indicate a significant and negative relation between stock prices and inflation. And the output growth negatively and significantly affect stock prices. Tsoukalas (2003) used industrial production, exchange rate, consumer prices and money supply as macroeconomic factors and revealed a strong relationship between stock prices with those factors. Ibrahim (2003) found that the Malaysian stock price index is positively related to consumer price index, money supply and industrial production. It is negatively related to the movement of exchange rates.

Since consumer price index and investors' perception are two critical issues for the movement of stock prices, this study aims to explore the factors those are valued by the capital market investors.

IV. Analysis & Discussion

25 initial variables werechosen to identify the factors affecting investment decisions in the stock market. A total of 125 investors were surveyed. Summary of their responses toward those factors are portrayed here.

Table 1 : Summary of their responses

	Dividend	Earnings Per Share (EPS)	Retained earnings	Price Earning (P/E) Ratio	(ROI)	Company News	AGM	Company Goodwill	Industry Growth	Price Hike of Necessary Goods	Market Sentiment	Agents' Advice	Available Substitutes
N	125	125	125	125	125	125	125	125	125	125	125	125	125
Mean	4.33	4.12	3.77	2.95	3.68	3.83	3.88	4.24	4.24	2.97	3.48	3.04	3.08
Std. Deviation	.990	.725	.805	1.453	1.082	.859	.972	.712	.837	1.062	.876	1.316	.894
Variance	.980	.526	.647	2.111	1.171	.738	.945	.506	.700	1.128	.768	1.732	.800
Minimum	1	3	2	1	1	2	2	2	2	1	1	1	1
Maximum	5	5	5	5	5	5	5	5	5	5	5	5	5

	Credit Rating Agency's Report	Market Rumor	Inflation	Exchange Rate	Margin Loan	Interest Rate	International Situation	Website, Social Blog	SEC Regulations	Change in Government Policies	Political Connectivity of Company Owner	Law Suit File
N	125	125	125	125	125	125	125	125	125	125	125	125
Mean	3.17	2.69	3.89	3.55	3.02	3.75	3.34	3.57	4.13	4.07	3.66	4.12
Std. Deviatio	.957	1.298	1.1	.987	1.376	1.141	1.136	1.272	.842	.805	1.092	1.005
Variance	.915	1.684	1.3	.975	1.895	1.301	1.289	1.618	.709	.648	1.193	1.010
Minimum	1	1	1	1	1	1	1	1	2	2	2	1
Maximum	5	5	5	5	5	5	5	5	5	5	5	5

Source: Field Survey, 2014

The above responses indicate that there are some factors to which investors are more responsive, like dividend, EPS, company goodwill, industry growth, SEC regulation, change in government policy etc. The respondents are found to be less responsive to the factors like P/E ratio; price hike of necessary goods, market rumor etc. But this is their average result. In contrast, some factors were found which has got two extreme end responses i.e. both strongly agree and strongly disagree. So it will not to be justified to leave any comment only based upon the mean result. Here the standard deviation of the response frequency is also depicted. It shows the dispersion of response from mean. The variance here is showing the responsiveness of mean in relation to standard deviation. The lesser variance is showing more representative result. Here the result of P/E ratio, ROI, price hike of necessary goods, agents' advice, market rumor, inflation, Interest rate, International situation etc. are possessing more reliable result according to variance. For a justified list of influential factors, factor analysis was performed later.

Here a mean comparison is done to get the idea about to what extent factors are affecting male and female investors in their investment decisions.

Table 2 : Gender-wise Mean Comparison

No	Variable	Gender	Mean	Mean Ranking	Gender	Mean	Mean Ranking
1	Dividend	Male	4.37	1	Female	4.11	6
2	Company Goodwill	Male	4.2	2	Female	4.47	2
3	Industry Growth	Male	4.19	3	Female	4.53	1
4	SEC Regulations	Male	4.15	4	Female	4	7
5	Law Suit File	Male	4.11	5	Female	4.16	5
6	(EPS)	Male	4.09	6	Female	4.26	3
7	Change in Government Policies	Male	4.05	7	Female	4.21	4
8	AGM	Male	3.92	8	Female	3.68	13
9	Inflation	Male	3.87	9	Female	4	8
10	Company News	Male	3.83	10	Female	3.84	11
11	Retained earnings	Male	3.8	11	Female	3.58	14
12	Interest Rate	Male	3.72	12	Female	3.95	10
13	Political Connectivity of Company Owner	Male	3.71	13	Female	3.42	19
14	(ROI)	Male	3.7	14	Female	3.58	15
15	Exchange Rate	Male	3.5	15	Female	3.84	12
16	Website, Social Blog	Male	3.49	16	Female	4	9
17	Market Sentiment	Male	3.48	17	Female	3.47	17
18	International Situation	Male	3.32	18	Female	3.42	20
19	Credit Rating Agency's Report	Male	3.1	19	Female	3.53	16
20	Available Substitutes	Male	3.08	20	Female	3.11	21
21	Margin Loan	Male	3.08	21	Female	2.74	24
22	Agents' Advice	Male	2.99	22	Female	3.47	18
23	Price Hike of Necessary Goods	Male	2.97	23	Female	2.95	23
24	P/E Ratio	Male	2.93	24	Female	3.05	22
25	Market Rumor	Male	2.72	25	Female	2.53	25

Source: Field Survey, July, 2014

In this study, 106 male and 19 female investors are surveyed. Among them all are not agreed with same factor as a determinant of their investment decision. Here, it is found that the most important factor to male is 'dividend' whereas it is the 6th important factor to female investors. Again, where 'industry growth' is the most important factor to female, it is the 3rdmost important factor for the male investors. Some of the factors are commonly rated by both the male and female investors. Those are: company goodwill (2nd), law suit file (5th), market sentiment (17th), price hike of necessary goods (23rd) and market rumor (25th).

Top and least five determinants for investment for the male are given in the below table:

Table 3 : Male (Top & Least Mean ranking)

	Top Five			Least Five	
Mean Ranking	Variable	Mean	Mean Ranking	Variable	Mean
	Dividend	4.37	21	Margin Loan	3.08
2	Company Goodwill	4.2	22	Agents' Advice	2.99
	Industry Growth	4.19	23	Price Hike of Necessary Goods	2.97
4	SEC Regulations	4.15	24	Price Earning (P/E) Ratio	2.93
	Law Suit File	4.11	25	Market Rumor	2.72

Source: Field Survey, July, 2014

Below table demonstrates the top five and least five determinants for female investors.

Table 4 : Female (Top & Least Mean ranking)

Top Five			Least Five		
Mean Ranking	Variable	Mean	Mean Ranking	Variable	Mean
1	Industry Growth	4.53	21	Available Substitutes	3.11
2	Company Goodwill	4.47	22	Price Earning (P/E) Ratio	3.05
3	Earnings Per Share (EPS)	4.26	23	Price Hike of Necessary Goods	2.95
4	Change in Government Policies	4.21	24	Margin Loan	2.74
5	Law Suit File	4.16	25	Market Rumor	2.53

Source: Field Survey, July, 2014

From the survey, it is noticeable that 'company goodwill' and 'law suit file' are the common determinants among the top five important factors for both male and female investors, whereas price hike of necessary goods and market rumor are the common determinants among the least five important factors for both type of investors.

This study further conducted 'factor analysis'for data reduction.Factor analysisallows to reduce a large number of correlated variables to a smaller number of 'super variables'. So, factor analysis was conducted in this study with the data collected from field survey.
For testing appropriateness of the factor model, Bartlett's test is used. The summary of KMO and Bartlett's Test result is presented here:

Table 5 : KMO and Bartlett's Test

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		.685
Bartlett's Test of Sphericity	Approx. Chi-Square	2067.491
	Df	300
	Sig.	.000

The Kaiser-Meyer-Olkin (KMO) is a measure of sampling adequacy. The approximate chi-square statistic is 2067.491 with degree of freedom of 300 at the 0.05 level of significance. The appropriateness of factor analysis requires the KMO statistic to be ranging from 0.5 to 1.0. Here the value of KMO statistic is 0.685. Hence this indicates the appropriateness of factor analysis and also suggest further investigation. Here Principle Component Analysis (PCA) method is used.

Table 6 : Communalities

	Initial	Extraction		Initial	Extraction
Dividend	1.000	.827	Credit Rating Agency's Report	1.000	.796
Earnings Per Share (EPS)	1.000	.819	Market Rumor	1.000	.828
Retained earnings	1.000	.633	Inflation	1.000	.715
Price Earning (P/E) Ratio	1.000	.801	Exchange Rate	1.000	.720
Returned on Investment (ROI)	1.000	.772	Margin Loan	1.000	.856
Company News	1.000	.547	Interest Rate	1.000	.765
AGM	1.000	.837	International Situation	1.000	.774
Company Goodwill	1.000	.509	Website, Social Blog	1.000	.670
Industry Growth	1.000	.593	SEC Regulations	1.000	.813
Price Hike of Necessary Goods	1.000	.763	Change in Government Policies	1.000	.684
Market Sentiment	1.000	.782	Political Connectivity of Company Owner	1.000	.819
Agents' Advice	1.000	.820	Law Suit File	1.000	.817
Available Substitutes	1.000	.710			

Extraction Method: Principal Component Analysis

The above summary of "Communalities" shows that the communality (in "Initial" column) for each variable is 1.000.

In order to summarize the information contained in the original variables, a smaller number of factors should be extracted. Eigenvalues approach had been used here for this purpose.

Table 7 : Total Variance Explained

Initial Eigenvalues							
Component	Total	% of Variance	Cumulative %	Component	Total	% of Variance	Cumulative %
1	5.686	22.745	22.745	14	.383	1.531	92.309
2	3.700	14.801	37.547	15	.358	1.433	93.741
3	2.990	11.959	49.506	16	.259	1.034	94.775
4	2.191	8.766	58.272	17	.217	.866	95.642
5	1.666	6.666	64.937	18	.203	.810	96.452
6	1.337	5.347	70.285	19	.180	.722	97.174
7	1.100	4.399	74.684	20	.160	.641	97.814
8	.873	3.493	78.177	21	.148	.591	98.405
9	.830	3.319	81.496	22	.123	.493	98.898
10	.777	3.108	84.604	23	.116	.465	99.362
11	.549	2.197	86.801	24	.092	.370	99.732
12	.504	2.016	88.817	25	.067	.268	100.000
13	.490	1.961	90.778				

Extraction Method: Principal Component Analysis

This table shows the eigenvalue for a factor which indicates the total variance explained by each factor. The total variance accounted for all 25 variables is 25.00 which is equal to the number of variable. Here, variable 1 has got a variance of 5.686, which is (5.686/25) or 22.745% of the total variance. Again like the variable 1, the second variable has got a variance of 3.700, which is (3.700/25) or 14.801% of the total variance and the first two factors has got a cumulative variance of 37.547%. Only factors with eigenvalue greater than 1.00 are retained and other factors are discarded. An eigenvalue represents the amount of variance associated with the factors.

The following table reveals that the eigenvalue greater than 1.0 (default option) results in seven factors being extracted.

Table 8 : List of factors with eigenvalue greater than 1.00

	Extraction Sums of Squared Loadings		
Component	Total	% of Variance	Cumulative %
1	5.686	22.745	22.745
2	3.700	14.801	37.547
3	2.990	11.959	49.506
4	2.191	8.766	58.272
5	1.666	6.666	64.937
6	1.337	5.347	70.285
7	1.100	4.399	74.684

The cumulative percentage of variance testimony the first seven factors to be accounted for 78.684% of the variance.

In this approach, only factors with eigenvalues greater than 1.0 are retained. The other factors are not included in the model. It indicates the total variance attributed to that factor. Hence, only factors with a variance greater than 1 are included.

Table 9 : Components extracted.

Rotation Sums of Squared Loadings			
Components	Total	% of Variance	Cumulative %
1	4.519	18.075	18.075
2	3.125	12.501	30.576
3	2.462	9.849	40.425
4	2.373	9.491	49.916
5	2.086	8.345	58.261
6	2.084	8.336	66.597
7	2.022	8.087	74.684

Through the above table, the rotation of sums of squared loading is done. The following table (Table 10) shows the rotated factor matrix.

This matrix represents correlation between the factors and the variables. A coefficient with a large absolute value indicates that the factor and the variable are closely related.

Here, in this study, Varimax procedure had been used for rotation. Summary of rotated component matrix is presented here

Table 10 : Rotated Component Matrix

	Component						
	1	2	3	4	5	6	7
V1: Dividend	-.133	-.210	.855	.063	-.017	.158	.074
V2: Earnings Per Share (EPS)	-.080	.843	.059	.075	-.010	-.280	.121
V3: Retained earnings	-.037	-.194	-.179	.569	.210	-.030	-.440
V4: Price Earning (P/E) Ratio	-.821	-.161	-.164	.176	.087	.152	-.114
V5: Returned on Investment (ROI)	-.591	-.591	-.132	.198	-.012	-.036	.125
V6: Company News	.008	-.078	.286	.652	-.156	-.011	.096
V7: AGM	.095	.334	.786	-.177	.038	-.204	.157
V8: Company Goodwill	.038	-.014	-.113	.694	-.099	.044	.035
V9: Industry Growth	.032	.246	.238	.290	-.596	.113	.152
V10: Price Hike of Necessary Goods	-.329	.011	-.257	.000	.232	-.617	.392
V11: Market Sentiment	-.023	.105	.186	.122	-.080	-.096	.840
V12: Agents' Advice	.285	.533	-.437	-.239	.154	.341	-.258
V13: Available Substitutes	-.471	-.081	-.165	.353	.435	-.369	.068
V14: Credit Rating Agency's Report	-.013	.804	-.009	-.116	-.072	.362	-.030
V15: Market Rumor	.375	.197	.180	-.161	.752	-.098	.122
V16: Inflation	.696	.010	.033	.260	.258	.210	-.229
V17: Exchange Rate	.744	-.023	-.273	-.010	.074	.292	-.038
V18: Margin Loan	.018	-.623	.127	.181	.605	.223	.060
V19: Interest Rate	.683	-.064	-.055	-.282	.283	.363	-.013
V20: International Situation	.263	-.007	-.100	.087	-.008	.826	.071
V21: Website, Social Blog	.656	.266	-.003	.042	.102	.226	-.324
V22: SEC Regulations	-.019	-.027	.606	.578	.052	.013	.329
V23: Change in Government Policies	.698	-.173	-.177	.242	-.255	.032	.108
V24: Political Connectivity of Company Owner	-.214	-.450	.169	.001	.265	.096	.680
V25: Law Suit File	.608	-.312	-.024	.361	.365	.249	-.157

Extraction Method: Principal Component Analysis;
Rotation Method: Varimax with Kaiser Normalization; Rotation converged in 10 iterations

In this table, factor 1 has highest coefficient for variables V4: Price Earning (P/E) Ratio, V5: Returned on Investment (ROI), V13: Available Substitutes, V16: Inflation, V17: Exchange Rate, V19: Interest Rate, V21: Website, Social Blog, V23: Change in Government Policies, V25: Law Suit File. Then this factor is labeled as Internal & Economic factor. Factor 2 is highly correlated with variables V2: Earnings per Share (EPS), V12: Agents' Advice, V14: Credit Rating Agency's Report, V18: Margin Loan. Thus factor 2 is labeled as Internal 7 Supporting factor. Factor 3 has got a high coefficient with variables V1: Dividend, V7: AGM, V22: SEC Regulations. This factor can be labeled as internal & regulatory factor. Again factor 4 has high coefficient for variables V3: Retained earnings, V6: Company News, V8: Company Goodwill. This factor may be labeled as company image factor. The next factor i.e. factor 5 has got some highly correlated variable as well. Those are V9: Industry Growth, V15: Market Rumor. Now this factor is labeled as market info factor. Again the 6th factor has also got some highly correlated factor. Those are V10: Price Hike of Necessary Goods, V20: International Situation. Here this factor is labeled as the external factor. And lastly the factor 7 has also got some highly correlated variables like V11: Market Sentiment, V24: Political Connectivity of Company Owner. And this factor is labeled as other factor. It can be summarized that investors are being affected in their investment decision in the major issues related to internal & economic, internal & supporting, internal & regulatory, company image, market info, external and others.

Table 11 : Identified factors with variables regarding investment decision

Factor	Variables	Surrogate Variables
Factor 1 (Internal & Economic)	V4: Price Earning (P/E) Ratio	V4: Price Earning (P/E) Ratio (-0.821)
	V5: Returned on Investment (ROI)	
	V13: Available Substitutes	
	V16: Inflation	
	V17: Exchange Rate	
	V19: Interest Rate	
	V21: Website, Social Blog	
	V23: Change in Government Policies	
	V25: Law Suit File	
Factor 2 (Internal & Supporting)	V2: Earnings Per Share (EPS)	V2: Earnings Per Share (EPS) (0.843)
	V12: Agents' Advice	
	V14: Credit Rating Agency's Report	
	V18: Margin Loan	
Factor 3 (Internal & Regulatory)	V1: Dividend	V1: Dividend (0.855)
	V7: AGM	
	V22: SEC Regulations	
Factor 4 (Company Image)	V3: Retained earnings	V8: Company Goodwill (0.694)
	V6: Company News	

	V8: Company Goodwill	
Factor 5 (Market Info)	V9: Industry Growth	V15: Market Rumor (0.752)
	V15: Market Rumor	
Factor 6 (External)	V10: Price Hike of Necessary Goods	V20: International Situation (0.826)
	V20: International Situation	
Factor 7 (Market Situation)	V11: Market Sentiment	V11: Market Sentiment (0.84)
	V24: Political Connectivity of Company Owner	

Source: Field Survey, July, 2014

It is found that V4, V5, V13, V16, V17, V19, V21, V23, V25 have high loading on factor 1. But among these V4 has the highest loading. It indicates price earning (P/E) ratio affects investors mostly here. Therefore V4 would be selected as surrogate variable under factor 1 since it has the highest factor loading. V2, V12, V14, V18 have high loading on factor 2 and among the 4 variables V2 has the highest loading. So EPS (V2) can be selected as the surrogate variable for factor 2. Again among the high loading variables V1, V7, V22 the highest loading is by V1 (Dividend) which in turns becomes the surrogate variable for factor 3.

In this way the surrogate variable of factor 4, factor 5, factor 6 and factor 7 is respectively V8 (Company Goodwill), V15 (Market Rumor), V20 (International Situation) and V11 (Market Sentiment), as those are the highest loading among the high loadings (Khan, 2006).

V. Findings And Conclusion

Key factors like dividend, EPS, company goodwill, industry growth, SEC regulation and change in government policy are having higher mean score. At the same time,factors with lower mean score are P/E ratio, price hike of necessary goods, market rumor etc. The core factors identified through factor analysis through which investors' investment decision can be affected. Those are: Internal & Economic (f1), Internal & Supporting (f2), Internal & Regulatory (f3), Company Image (f4), Market Info (f5), External (f6) and Market Situation (f7).

This study was conducted based on a developing country's capital market. The research outcome would be more effective if the study was conducted in a comparative manner with three different types of economy, i.e. under developed economy, developing economy and developed economy. Yet, this study is expected to contribute to the researches on capital market behavior. The key investment factors identified by this research will help the policymakers to their endeavor to reform the capital market.

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