A study of the factors influencing the behavior of individual investors in the Chinese stock market

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Abstract: Participants in China's stock market include institutional investors and individual investors. For now, the number of individual investors involved in stock market investment is increasing, and their investment behavior is influenced by many factors. To this end, this paper examines the factors that influence the behavior of individual investors in the Chinese stock market. First, we introduce the definition of individual investors, and then we explain the behavior of individual investors in the stock market and the subjective and objective factors that affect their investment behavior. Finally, we propose suggestions from three aspects: government, enterprises, and individuals.

1. Introduction

In recent years, the proportion of individual investors in the Chinese stock market has increased significantly, and more and more individual investors are involved in stock trading. Therefore, the irrational behavior of individual investors can make Chinese stocks too unstable, which affects the healthy development of the Chinese stock market. This paper uses theoretical analysis to investigate the factors influencing the behavior of individual investors in the Chinese stock market. The analysis results are for the reference of government, enterprises, and investors. As far as the national level is concerned, scientific and reasonable measures should be taken to capitalize the market, stabilize the stock market, and increase confidence for individual investors. For enterprises, they can take the initiative to disclose business information so that individual investors can make rational judgments before investing. Individual investors are familiar with financial knowledge before investing and rational analysis can all contribute to the healthy development of China's stock market.

2. General explanation of individual investors' behavior

2.1 Definition of individual investors

Investors in China are divided into two categories, which are institutional investors and individual investors. Institutional investors are legal institutions engaged in securities investment in the financial market, mainly insurance companies, securities companies, and banks. It often obtains a large number of funds from investors, and after analysis and research by professionals, invests the funds in different fields, and the profits obtained are then given to investors in a certain proportion.

Individual investors, i.e. retail investors, are individuals who invest their money on their behalf. Usually, compared with institutional investors, individual investors invest relatively small amounts of money and have a narrower investment scope. And according to the data, participation in China's stock investment structure, still dominated by individual investors, the number of individual accounts accounted for the vast majority.

2.2 Individual investor behavior

Among individual investors, some investors follow the concept of value investment and have sufficient financial knowledge, they carefully analyze the trend of enterprises and do not follow the clouds, and firmly establish their ideas and gain from them.

However, most individual investors often enter the stock market with a speculative mentality. In particular, they are eager to get huge returns by paying fewer time costs. They tend to analyze the market demand based on what they see and hear, in addition to the impact of policies on the stock market trend is also taken into account. And individual judgments are susceptible to the influence of others to change in the direction of agreement with the majority, and thus the agreement with the dominant ideas and ways of behavior in a particular or temporary situation. The individual follows what the majority agrees with, dismisses his or her judgment by default, and does not think rationally about the rightness of doing so. This is what we call the herd effect. Herd mentality can easily lead to blind obedience, and blind obedience will often lead them to deception or failure.

3. Influencing Factors

3.1 Objective Influencing Factors

(1) Investment information

Investment information, including macroeconomic information and information directly related to listed companies, is an important objective factor influencing the behavior of individual investors. Specifically, the following factors of investment information affect the behavior of individual investors.

1) Comprehensibility of investment information

If individual investors are unable to understand investment information, such information may be ignored or misunderstood by individual investors. Individual investors usually do not have professional investment knowledge and have limited ability to understand the information of the invested company, especially the complex financial data, and the important company information contained in some financial data is ignored or misunderstood, which may lead individual investors to make a wrong judgment on the listed company. The Information Disclosure Quality Survey of Listed Companies (2002) (hereinafter referred to as "Information Disclosure Quality Survey of Listed Companies (2002)") jointly organized by Shanghai Stock Exchange, Securities Times, China Securities Journal, and Shanghai Securities News found that the individual investors can only understand or partially understand the information disclosed by listed companies, and the proportion of those who fully understand is very low, and some investors basically cannot or completely cannot understand.

2) Credibility of investment information

Only when individual investors consider the information credible, they will refer to the information when making investment decisions. The survey of information disclosure quality of listed companies (2002) shows that individual investors have little confidence in the financial data disclosed by listed companies. Compared with institutional investors, a higher percentage of individual investors think the data is basically or completely untrustworthy. It shows that the distortion of financial data in investors' minds has reached a very serious level at present.

3) Amount of investment information

The human ability to process information is limited, and the limited processing ability leads to the selectivity of the information processing process, i.e., people will filter out part of the information. Therefore, when individual investors receive too much information about the company, some important information may be wrongly filtered out, and prone to information confusion and mutual interference. Investment information is too detailed, too many branches, but may lead to individual investors can not independently make a correct judgment of the company. And when there is too little information, it is difficult for individual investors to make judgments. A high degree of uncertainty about investment prospects can trigger speculative behavior. Investment information should be sufficient to enable individual investors to make objective judgments about the company as a whole, but should not be overly detailed. The current overload of the information reported by listed companies affects the judgment of individual investors.

(2) Influence of government behavior

China's stock market is characterized as a "policy market", and the government's behavior has a significant impact on investors' behavior. For example, policies have a significant impact on the frequency of investors' transactions, directly affecting the activity of investors' trading and their willingness to enter the market. When a positive policy is issued, the trading frequency of investors increases significantly and lasts for a long period, while when a negative policy is issued, the trading frequency of investors decreases to a greater extent and the downward trend lasts for a longer period. If the promulgation of policies and regulations is always opaque, there is bound to be a lag in investors' understanding and recognition, coupled with continuous revision and improvement, which will inevitably make it difficult for investors to clarify the long-term development prospects of the securities market, and will mostly generate short-term speculative psychology that only cares about immediate interests. As China's securities market mechanism is still not perfect, the policy-making process is not transparent, sometimes changing from time to time, which to a certain extent causes speculative behavior of individual investors, which is not conducive to the healthy development of the stock market.

(3) Influence of others' behavior

1) Influence of bankers

Individual investors of Chinese listed companies like to follow the dealer, the reason is that the dealer is usually an institutional investor. Compared with individual investors, institutional investors have a large amount of capital investment and a relatively low cost of information search and analysis. Institutional investors invest much more in information search and analysis than individual investors, and the degree of information mastery is also much higher. From this perspective, it is a reasonable decision for individual investors to follow the banker, but it also leads to the banker using the mentality of individual investors to follow the banker to manipulate the stock price, harm the interests of individual investors, and earn excessive profits.

2) Influence of major shareholders

Large shareholders have a great influence on individual investors. If individual investors have confidence in the majority shareholder, it will increase individual investors' confidence in the company. Conversely, if individual investors do not have confidence in the controlling shareholder, it will reduce individual investors' confidence in the company. Large shareholders can be divided into two categories: individual large shareholders and legal large shareholders. Individual controlling shareholders are also called core shareholders. The influence of core shareholders on individual investors depends on the following factors: (1) personal charisma. That is, the core shareholders are attractive, individual investors identify with them, respect and even worship the core shareholders, and are willing to follow the core shareholders. (2) Authority. That is, the core shareholder has a successful experience, rich experience, and expertise in certain areas. (3) Impartiality. That is, the core shareholder treats all shareholders fairly in the management of the company and does not engage in improper behavior that encroaches on the interests of other shareholders. Core shareholders with the above three conditions have a great influence on individual investors. If the core shareholder can effectively exert his influence and attract individual investors to follow him, it can effectively increase the attractiveness of the company's stock to individual investors. In addition to personal charisma, the influence of corporate controlling shareholders on individual investors is similar to that of core shareholders. The authority and impartiality of the corporate majority shareholder determine whether individual investors will follow the corporate majority shareholder. On the other hand, the behavior of large shareholders also hurts individual investors from time to time. The main reason for this is that the current legal system for the regulation of large shareholders is not perfect, and it happens that large shareholders encroach on the interests of individual investors, thus greatly reducing the attractiveness of the company's stock to individual investors.

3) Influence of management's behavior

The objectives of management and shareholders are not fully aligned. Managers may sometimes deviate from the interests of shareholders for their benefit. The deviation is reflected in both moral hazard and adverse selection. Shareholders need to prevent management from deviating from shareholders' goals through supervision and incentives. For individual investors, it is also necessary to prevent the management from joining hands with the major shareholders to encroach on the interests of individual investors. Currently, there is a widespread practice of "free-riding" by individual investors in the securities market. The purpose is to monitor the management through the major shareholders, but the interests of individual investors are also harmed as a result. The reason for individual investors' "free-rider" behavior is that individual investors' monitoring power is fragmented and cannot be effectively monitored, and the cost of monitoring is too high compared to the shares held. In addition, the personal charisma, authority, and fairness of the management may also affect the confidence of individual investors in the future of the company.

3.2 Subjective factors of individual investors

(1) Needs, motivations of individual investors

In addition to the need for survival, people as individuals need achievement, the need for power, and the need for affinity. Individual investors are no exception, and they also have these four needs. The survival needs of individual investors are the dominant needs in their investment behavior, and their main motivation for investing in stocks is to obtain economic benefits to meet their survival needs. However, individual investors' needs for achievement, power, and affinity should not be neglected, and if the company can provide incentives to meet the "three needs" of individual investors, it can increase the attractiveness of the company to individual investors. However, usually listed companies ignore the achievement needs, power needs, and affinity needs of individual investors, and focus only on material benefit incentives, thinking that dividends are the only means to attract individual investors. This is not the case in reality. Due to the lack of inducements, the three needs are in a latent state; once the inducements appear, these three needs will stimulate individual investors' investment motivation and influence individual investors' investment behavior.

(2) Laws of thinking and biases of individual investors

Individual investors rely more on heuristic thinking for investment decisions due to factors such as information, cost, and expertise. Heuristic thinking follows few rules of thinking and often leads to various cognitive biases. In turn, cognitive biases lead to poor investment decisions. The rules and biases of individual investors' thinking are generally divided into representative rules and biases, accessibility rules and biases, and anchoring and adjustment rules and biases.

1) Representative rule and bias

When processing information, people often put something into a category after understanding certain characteristics of it, and add the characteristics of such things in their minds to it, thinking that it also has various characteristics of such things. This is the law of representative thinking. According to the law of representative thinking, people tend to think that a sequence of events generated by a random process represents the basic characteristics of that random process.

In the securities market, individual investors can also make the mistake of representativeness bias. A survey of Chinese individual investors conducted by the China Securities Investor Behavior Study found that most investors are most bullish on blue-chip and technology stocks based on past performance and performance. In reality, past performance and results are not necessarily indicative of future growth. This representational cognitive bias makes many investors unable to identify the true nature of pseudo-performing and technology stocks, which leads to investment failure.

2) Availability rule and bias

In the process of information processing, people will pay attention to certain information because it is easy to obtain or make a strong impression, and ignore other information that needs to be dug deeper. This is the law of accessibility. The study of Chinese Securities Investor Behavior found that individual investors have "accessibility bias" when using information. The most important sources of information for individual investors are the newspapers, publications, and media disclosures on radio and TV designated by the Securities Regulatory Commission, which is relatively easy to obtain, while most individual investors do not pay attention to information that requires deeper exploration. Some non-compliant institutions and listed companies take advantage of this weakness of investors and use "blinders" on the neglected accounting data so that the rights of individual investors are violated. According to the above survey, as many as 65.76% of individual investors have experienced investment failure due to deception by false information.

3) Anchoring and Adjustment rule and bias

When solving complex problems, people often make a rough estimate of the problem - anchoring, and then slowly adjust the estimate based on new information to obtain a more accurate judgment. In real life, people often use the anchoring and adjustment rule. For example, in bargaining, a well-trained salesman often first offers a high price to the customer and then slowly lowers the price. His goal is to anchor the customer to the high price (ignoring the true value of the product) and eventually reach a higher price while making the customer feel like he is getting a good deal.

For example, if a listed company suddenly announces much higher than expected earnings, the individual investor often fails to adjust his expectations of the company's value immediately because the individual investor is still anchored on past earnings forecasts and assumes that these earnings are temporary and thus does not react adequately to the earnings news.

The study of Chinese securities investors' behavior examined the anchoring psychology of Chinese individual investors using psychometric tests, and the results of the tests confirmed the existence of significant anchoring psychology of Chinese individual investors.

4. Suggestions for countermeasures

4.1 Government level

If the macroeconomic situation is good, it will increase the confidence of individual investors in the stock market, so it is necessary to make the economy develop smoothly under the macroeconomic control of the government. Since many investors have the insufficient financial knowledge and are not sufficiently prepared for risks, and they have no investment experience, they need the government's help. The government should supervise the relevant financial institutions to examine the financial knowledge of registered individual investors and provide training to those who do not have such knowledge so that investors can be aware of the risks and analyze the stocks rationally when choosing stocks to avoid the same thing as others. Individual investors will judge whether or not to buy shares based on whether or not the business is in good condition, and in some cases, the low transparency of information about the company can cause investors to make wrong judgments. Therefore, the government should supervise the enterprises to ensure that investors have access to the real situation of the business operation so that individual investors can make the right judgment. Secondly, create a fair, open, transparent, healthy, and stable investment market for investors to make more individual investors actively participate in investment and make a reasonable allocation of idle capital.

4.2 Enterprise perspective

As far as enterprises are concerned, they can appropriately switch their development direction, adapt to market demand and pursue high-quality development. At the same time, improve the management of new technology, new products, and new business models, improve industrial technology policy and management system, innovation-driven development, is the enterprise itself more competitive. In addition, it is also necessary to take the initiative to publicize its operating conditions, not to exaggerate, not to make false. In this way, we can gain the trust of investors and make full use of the liquidity to strengthen the operation and management, so that we can gain the favor of many investors to obtain more funds for the company's operation.

4.3 Personal perspective

In terms of individual investors who are ready to enter the market, they should actively participate in the study of relevant financial knowledge before investing, understand market information, clear market demand and market development trends. Understand the operation of the industry and invest in areas or projects that you are more familiar with. Have a sense of risk, do not just pursue high returns, before determining that you can afford a high risk. Preliminary understanding of market psychology, to facilitate their analysis of market trends and the rise of stocks in a short period while reducing the occurrence of the irrational behavior of the clouds. Investors can only benefit from it if they are well prepared to enter the market again, not blindly, and analyze it rationally.

5. Conclusion

Individual investor behavior is influenced by complex factors and often tends to behave irrationally. Therefore, policymakers must have a full understanding of the factors influencing the behavior of individual investors, target and reasonably guide them, protect them against their psychological weaknesses, and improve the securities market. This will ensure the healthy development of the Chinese stock market.

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