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Antecedents and Precedents of Governance on Retail Investors' Sentiments in Indian Perspective

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Abstract:
Investor sentiment is seen as an approach to measure market sentiment. Investor sentiment can be defined as the feeling or tone of a market while Governance is the action or manner of governing a state. Investors Sentiments are affected by various governance factors *viz.* political stability, governance orientation, regulatory framework, price-sensitive information content (media), and investors' confidence. In recent times there have been instances where investors' sentiments seem to be driven by governance. Thus, it is important that government keeps a strong focus on driving investors' sentiments. Financial planning of investors is affected by sentiments which are driven by governance.

Keywords*: Investors' Sentiments, Governance, Price Sensitive Informaion.*

1. Investor Sentiments:

Sentiment refers to psychological traits viz. opinion or emotions of the individual and market sentiments refer to the sum of such emotions or opinions of participants in market altogether. To assess and evaluate market sentiments, it is imperative to assess the investor sentiments. Investors' sentiments are assumed to be closely associated with the anticipated price changes. This paradigm of sentiments comprises of various fundamental and technical factors which includes previous price and return trends, published economic information and various national and global events taking place which may eventually affect the investors' sentiments (Eichengreen and Mody, 1998; Dow, 2011).

Delong, Shleifer, Summers and Waldmann (1990) coined the term and explain the notion investors are subject to sentiments. Investor sentiment can be defined as the feeling or tone of a market. It is the overall attitude of investors toward a particular security or financial market. Sentiment defines the thoughts, feelings or beliefs of all market participants and market sentiment sums up certain perceptions for the whole market (Thorp, 2004). Any person who

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owns stock, directly or indirectly, could be described as a retail investor (O'Hare, 2007)

Price expectation remains the basic tenet affecting the market sentiments. The sentiment is said to be bullish Investors are expecting upward movement in stock market prices. On the contrary, when the market sentiment is bearish, most investors expect downward movement in prices. Market sentiment is generally seen as a predictor of the contrary: what most people expect is a good thing to bet against. Market sentiment is employed as a decent predictor of market moves, particularly once it's a lot of extreme. Market may exhibit terribly pessimistic sentiment as it is sometimes followed by the market moving rapidly more than normal, and the other way around (Simon and Wiggins, 2001; Galariotis, 2014).

Investor sentiment, broadly speaking, underlines a belief, about the expected cash flows as well as perceived investment risks in the coming time horizon, which may not be justified by existing and available facts. However, the second assumption is that going against sentimental investors may prove expensive and eventually cost risky to investors. That is the basic reason that even arbitrageurs don’t aggressively follow the fundamentals as per standard model because the sentiments put together may drag the market away from fundamentals. However, Zhou (2018) underlines that investor sentiment indicates how far an asset value deviates from its economic fundamentals. There is enough evidence that investor sentiments can be used to explain returns on stocks which may be difficult to value and costly to arbitrage.

There is a different branch of behavioral finance which is meant to examine the impact of investors’ sentiment within the securities market (Fama, 1998;Ricciardi and Simon. 2000; Shiller. 2003). There have been a range of sentiment surveys which display fascinating investor attitudes over the years. The decisions of investors tend to be more sentiment driven rather than what fundamental suggests. Investors may expect reversal of price and return trends ignoring the current fundamental indicators. Extraordinarily optimistic levels of sentiment typically come back once sturdy market run-ups when investors are absolutely invested within the market. Market tends to move in opposite direction to highest levels of bullish and bearish sentiments (Thorp 2004). Experts have also underlined the investor sentiments as a contrarian indicator for the general market in bound specific situations.

When market is characterized with extreme level of bullish sentiment, a downturn may be expected. Similar situation may occur in extreme prevalence of bearish sentiments. Thus sentiments may be used to understand resistance and support levels of a market.When it comes to assessment of investor sentiments and its effect on stock prices, it remains a difficult proposition (Barberis. Shleifer. and Vishny, 1998). However, scholars have advocated the ‘bottom up’ approach for studying the individual investor behaviour studying their psychological traits such as overconfidence, conservatism and representativeness to understand the impact of behavioural finance on investors decision making and to understand how individual investors under-react or over-react to past returns or fundamentals.

2. Literature Review

Warren Buffet (2004), a world renowned investment expert, in Annual report of Berkshire Hathaway Inc., mentioned that investor should always keep in mind that excitement and expenses are the negative forces which an investor should always be wary of. It is advisable to be on contrarian side of market sentiments i.e. to stay greedy when other market participants are fearful and try to be fearful when other participants turn to be greedy.

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Delong et al. (1990) coined the term and explain the notion investors are subject to sentiments they also explained investors react to “irrelevant information” and the unexpected bust and boom in the financial market is mere reflection of noise trading rather than fundamentals (Baker and Wurgler, 2007).Investor sentiment can be defined as the “propensity to speculate” (Baker and Wurgler, 2006) it means group of investor’s attitude, opinions, views or emotions for the market as a whole. For example a rising prices or trends would indicate a bullish Investor’s sentiments and a falling would indicate bearish investor’s sentiments. Investor’s sentiment can be defined as beliefs about future cash flows or discount rates that are not supported by prevailing fundamentals (Lemmon and Portniaguina, 2006).

Any individual who owns stock by any means, direct or indirect, could be defined as a retail investor (O’Hare, 2007). Black et al. (2006) investigates that the different levels of investors’ sentiments get affected by governance mechanism. Many of the previous studies have also examined the significant difference between the governance mechanism and investors’ sentiments. Many of the papers have shown that good governance practices lead to higher stock returns which ultimately lead to positive investors’ sentiments. Firms with good governance exhibit higher return, higher firm’s value, higher growth in sales, more profitability (Gompers, Ishii and Metrick, 2003; McKinsey and Company, 2000, 2002) conducted an investor opinion survey and finds that institutional investors are willing to pay more premium to well-governed forms instead of poorly governed firms. Many of the studies also find the significance of governance on stock returns (Drobetz, Schillhofer and Zimmermann, 2004).

The presence of positive relationship between investor sentiment and governance mechanism indicate that positive sentiment will continue to persist if appropriate governing measures are adopted. Royster (1986) suggests the contents of news can be linked with investor sociology and psychology and there is a relationship between daily activity of stock market and content of media report. This paper also finds evidence that news media content can predict stock market movements. Cutler, Poterba, and Summers (1989) is also one of the empirical studies that explore the link between stock prices and media coverage. (Tetlock, 2007), finds that high level of media pessimism strongly predicts downward pressure on market prices followed by a reversion to fundamentals. It means when expert or media says something negative then investors react more. He also finds that low or high value of media pessimism forecast high market trading volume it means media pessimism is having impact on trading volume and low market return leads to high media pessimism.

Tetlock (2007) also talks about timing of media pessimism in his paper entitled as “Giving content to Investor Sentiment: The Role of media in the Stock market.” Tetlock (2008) further find out that the use of negative words in news stories will result in to prediction of earnings and stock returns. Fang and Peress (2009) investigates that there is an interaction between media coverage and expected stock returns. Stocks which are covered by media earn lesser return and those stocks which have no media coverage earn higher returns. Ormos and Vazsonyi (2011) also investigated that there is an interaction between nouns and objectives within business news sentences with negative and positive returns. Xie et al. (2013) for the analysis of the business news with respect to company performance and stock price movement he developed the semantic approach that gives significantly the better prediction of the price movements.

Investor confidence can be defined as the feeling that nothing can be wrong with an investment that the investor can sleep well because there is nothing to worry about (Shiller, 2000).With the sentiment of retail investors; confidence level of consumers also goes up or down. There is statistically significant increase in bullishness of individual investors with the increases in the level of consumer confidence. There is a positive and significant relationship between changes in consumer confidence and changes in the sentiment of individual investors (Fisher and Statman, 2002). Brown and Cliff (2004) also identify sentiments measures are of two types: Indirect and direct sentiment measures. Indirect sentiment measure are created from financial data and it can be categorized in to four groups according to Brown and Cliff: indicators based on recent market performance, indicators related to derivatives variables, related to particular type of trading activity and other sentiment proxies that do not fall within one of the above three categories.

3. Objective and Methodology

The objective of this study is to understand and explore relationship of governance and investor sentiments and implications of governance for investor sentiments to understand how does governance affects the investors' sentiments. A model has been developed after extensive literature review from academic research papers published in the respective domain.

4.1 Governance: An Eternal Buzz

Governance is term that is used to describe the process of governing which may be adopted by government. However, term governance has been extended to market, network, territory and formal as well as informal organization and even to family. Governance may be executed through the specified laws, a set of norms, power or language of an organized society (Rhodes, 1997).Governance is the most imperative component of any economic system as the governance is responsible for establishing norms and laws, building the system and ensuring lawful decisions to ensure the due protection of all stakeholders. This, governance also acts as a mechanism of fostering protection of stakeholders' interest (Kaufmann et al., 1999).

Governance has been instrumental in laying down the rules or norms which ensures structured, sustainable, regulated and accountable course of actions. However, the degree of formality varies as per the internal rules as well as nature of the external stakeholders. The form of governance depends upon the motivation and each form may offer different outputs. For example, a small board of directors may govern non-profit organization to pursue specific aims while a government may operate as a democratic force where the public vote to decide the force who should govern and the purpose of governance here is the public goals (Kooiman, 2003)

Thus, Governance has a wide perspective and refers to a framework that provides a mechanism to regulate and provide for fair structure. In fact, good governance is considered to be the integral part of any regulatory mechanism. According to John Healey and Mark Robinson, "Good governance implies a high level of organizational effectiveness in relation to policy formulation and the policies actually pursued, especially in the conduct of economic policy and its contribution to growth, stability and popular welfare."Accountability, scope for participation, apt openness and most importantly transparency are the key attributes for good governance and good governance leads to lots of trust in the stakeholders and participants (Shearing, 2018). There has talk for various facet of governance to have a structured system and to ensure the protection of all stakeholders.

4.2 Governance and Investors' Sentiments

Stock market becomes centre of attraction and all time preferred investment avenue in the whole world among different investment avenues because of its fundamental nature of earning more and faster. But, making decisions in investment is a complex and

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mental activity. Many of the financial and economic theory depend on the belief that investors are rational while taking investment decision they are supposed to use all the available information to form any "rational expectations" they take decision on the basis of fundamental and technical analysis as the investment spectrum is driven by variety of attributes primarily revolving around risk and return optimization.

Any investor normally consider their goals, needs, objectives and constraints of their investment while taking decisions so that, they optimize their risk-return proposition but all the time it is not possible to take correct decision because in real world investment decisions are not guided by the tools like technical and fundamental analysis but by the qualitative factors like psychological bias viz. cognitive and emotional bias (Kahneman and Tversky, 1979) and sometimes this optimization is affected by numbers of environmental factors.

Investors' are subject to sentiments, they react to irrelevant information the question arises is the impact of investors' sentiments on stock prices is of foremost importance because investors' sentiment can lead to market bubbles (Brown and Cliff, 2004). There are various tenets of Investor sentiment in Indian context. One of them is Governance. This study will explore the tenets of governance on investors' sentiments as Governance has a direct impact on the investors' sentiments and ultimately affecting their investment decisions. This study will help us to find out how investors look at governance when it comes to investment decision making and how the investors' trust can be enhanced.

Investors Sentiments are affected by various factors of governance viz.

- Political Stability
- Governance Orientation
- Regulatory Framework
- Price Sensitive Information Content (Media)
- Investors Confidence
- Quality of Governance

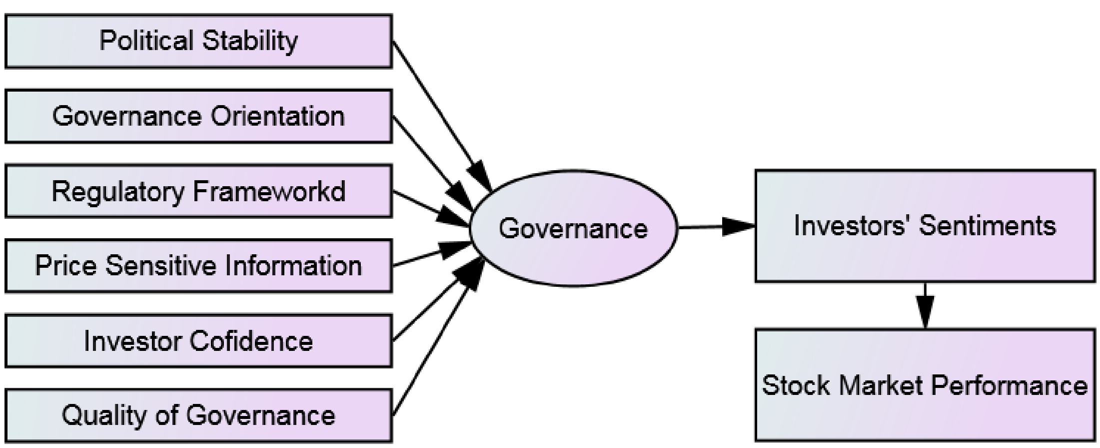

Figure: Proposed Model for Assessment of Impact of Governance on Investors' Sentiments

(Source: Author's Proposed Model)

This model provides for a set of relationships to be tested for understanding of implications of governance on investors' sentiments and eventually its relationship with stock market performance. First part of model mentions constructs of governance viz. Political Stability, Governance Orientation,

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Regulatory Framework, Price Sensitive Information Content (Media), Investors Confidence, and Quality of Governance. All these variables may be used to assess the perception of stakeholders about the governance.

Second set of model is intended to study the impact of governance on investors' sentiments. There are various direct and indirect measures and proxies to measure investors' sentiments. The third set of model intends to study the inter-dependence of stock market performance and investors' sentiments. Investors' sentiments may affect the stock market performance, however, a likely proposition prevails that stock market performance may affect the sentiments

4.3. Implications of Governance for Investors' Sentiments:

There is always a buzz about the impact of governance on investors' sentiments. A very good example can be traced from the change in political regime in 2014 when Mr. Narendra Modi became prime minister of India there was a positive wave among the market participants just in anticipation of projected governance. However sentiments, being the cognitive component, keep fluctuating from time to time as it may be affected by number of factors altogether. When government imposed long term capital gain tax it directly affected sentiments of market participants, negatively to a larger extent. On the contrary when government announced relaxation in corporate tax rates, this affected sentiments in a positive way. However, there was an interesting debate as to whether such relaxation leads to positive market sentiments or weak market sentiments forced government to come with such governance change.

There are various reasons due to which sentiments of investors' may turn pessimistic and spook the market in India or Abroad. Some of them are local factors (India based factors) and some of them are international like LTCG tax, Fiscal deficit, tax on income from Equity Mutual Funds, Global market, Technical triggers etc.

Another reason of negative investors' sentiments may be that investors have fear; they are worried about inflation, bond market and interest rates as there is a chance that Federal Reserve will increase interest rates. To fulfill the position of deficit government used to do borrowings, issue bonds due to which inflation increases, as at higher interest rate government borrow money. So, inflation increases and due to which overall economy get affected. Investors are worried, treasury bills will increased up to the level that makes stocks less attractive and ultimately that force the Federal Reserve to raise the interest rate to fight the inflation.

Rises in bond yield essentially increases the opportunity cost of money and so money flies out of bonds and from equity in to other assets and it also erodes the purchasing power of whatever the individuals make on investments. Wall Street predicted that more spending of government will compel the treasury department to borrow more money by selling more bonds..

Another interesting aspect of governance attracted attention of investors which had nothing to do with governance framework directly. But as stability of governance is seen as essential in coming times, when poll expectations of state assembly elections of Gujarat were popping out and initially a downfall of current ruling party was anticipated in presumption that lead to a market correction. However, when this was proven wrong and results ensured the continuity of current governance, there was a positive reaction of market about the same. This story itself implies that governance has taken a bigger role in affecting investors' sentiments. Even polls predictions have a saying in market performance numbers.

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Financial planning is another dimension that investors focus. Financial planning has been a buzz among investors. Investors have various traits and preferences regarding investor sentiments (Baker and Ricciardi, 2014). Especially in a country like India, where most of investors are biased towards traditional investments and investment preferences of retail investors towards equity based investments are yet emerging, the effect of sentiments is more visible on financial planning. Investors tend to react to market information and governance issues which ultimately is reflected in their financial planning. Sentiments of market participants are affected by numerous factors including governance. Thus, there is strong relationship among governance, investor sentiments and financial planning of retail investors.

There are various instances where governance seems to have an impact on stock market performance. RBI policy reportedly is keenly watched, assessed and reacted by investors. Recent efforts of Indian government to boost Indian economy have acted as a magnet for investments. Even global credit rating agency Moody's Investors Service's decision to upgrade India's sovereign rating for the first time in almost a decade has got thumbs up by investors. Similarly, Morgan Stanley's estimation of increase in India's GDP growth rate has been reacted positively among investors.

5. Concluding Remarks:

Thus, it is important that government keeps a strong focus on driving investors' sentiments. Current government is taking a number of initiatives to keep up the investors' sentiments. The results have been encouraging so far. The participation of retail investors have increased. The dependency on FIIs has lowered progressively which is a fairly healthy sign for Indian economy. Among emerging economies, India's consumer confidence is reportedly highest among emerging markets. Mutual fund industry has been seeing an upsurge in Assets under Management like never before.

But this is not all positive, there are times when negative side of governance comes in portrait and which is eventually inevitable in economy like India. Like recently there were reports about expected fiscal deficit, which obviously was a factor that lead to a bearish sentiments and this is bound to happen. When it comes to investors sentiments, negativity has a faster pace at any point of economic spectrum. There is a stronger reaction to even a smaller piece of negativity. Thus, this is an emerging implied challenge for governance that government needs to ensure that they can maintain a positive sentiments environment.

6. Future Scope of Research

There is a lot of scope for research in the domain. Further researches can be carried to test the validity and fitness of model in various economic setups. Even a comparative study of developed and developing nations can be made and the impact of governance on investors' sentiments can be studied in details and reasons for differences can be explored. Governance ideology remains an imperative antecedent for market sentiments and dynamics of governance is changing rapidly. Even the studies can be extended to e-governance and its impact of market sentiments.

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