

A REVIEW ON EMOTIONAL INTELLIGENCE AND INVESTMENT BEHAVIOR

Sashikala V.

Research Scholar, Avinashilingam School of Management Technology, Coimbatore

Dr.P.Chitramani

Professor and Head, Avinashilingam School of Management Technology, Coimbatore

ABSTRACT

Investors are bound to be emotional while taking investment decisions. Conventional literature has proved that investors become more emotional while choosing their portfolio. Investment decision making process also has evolved with the impact of psychology wherein emotions play an important role. Emotional stability is thus an influencing factor in investment decision making process which is identified by Emotional Intelligence (EI). There are various EI theories serving this purpose but all such theories are common EI theories and not specific to EI related to financial decision making process. Assessing an investor's behavior is a major task that should be carried out by the financial sectors in order to help investors take better decisions. Financial Institutions could introduce better products for investors knowing the behavior of investors. This study focuses on identifying the constructs necessary to identify the EI of investors through an extensive review stating the role that emotional intelligence plays in investment behavior of the investor. A conceptual model has been derived that states that Emotional Intelligence of an investor influences Investment Behavior.

Key Words: Emotional Intelligence, Investment Behavior, Decision Making, Biases, Review.

Cite this Article: Sashikala V. and Dr.P.Chitramani A Review on Emotional Intelligence and Investment Behavior. *International Journal of Management*, 8 (3), 2017, pp. 32–41.

<http://www.iaeme.com/IJM/issues.asp?JType=IJM&VType=8&IType=3>

1. INTRODUCTION

Financial decision making follows models derived from economic theory, which postulate that people are rational economic actors. The Tversky- Kahneman heuristics approach is dominating, but it needs to be complemented with emotional and personality factors, since cognitive limitations do not provide exhaustive explanations of the psychology of decision making. It is important to identify how investors think and how investors feel. It has been

believed that investors usually behave rationally and hence cognitive and emotional weakness that affects an investors behavior were ignored (Statman, 1995).

This paper is an attempt to develop a model that brings about the relationship between Investment behavior and Emotional Intelligence (EI). There has been very few Reviews for EI in relation to Investment behavior. Those who have found EI in relation to Investment behavior have used a generic approach and not a specific approach. The paper is constructed in such a way that it first part of the paper describes facts on investment behavior, emotional intelligence and personality of investors. Following this is an extensive review stating the role that emotional intelligence plays in investment behavior as well as its relation with personality of the investor. A conceptual model has been derived that states that Emotional Intelligence of an investor influences investment behavior.

2. INVESTMENT BEHAVIOR

Investment Behavior is a cross functional discipline, borrowing heavily from economics, finance, investment, psychology, and other allied disciplines (Naela Jamal rushdi, 2015). The behavior of investors towards investment is usually identified by the factors that determine such investment decision. For a smart investor to capture the essence of behavioral finance, all he/she would have to do is reflect on his/her own investment decisions. Maximising wealth is what an investor would aim at but they are still bound by certain behavioral anomalies.

Robert J.Shiller (2000) stated that investment behavior is determined by structural factors, cultural factors and psychological factors. Baker et. al (2002) state that by understanding the psychological bias for investors errors and taking appropriate action of correcting them will reduce their effects on investment outcome. Nik (2009) found that the most common behavior that most investors do when making investment decision are (1) Investors often do not participate in all asset and security categories, (2) Individual investors exhibit loss-averse behavior, (3) Investors use past performance as an indicator of future performance in stock purchase decisions, (4) Investors trade too aggressively, (5) Investors behave on status quo, (6) Investors do not always form efficient portfolios, (7) Investors behave parallel to each other, and (8) Investors are influenced by historical high or low trading stocks.

Individual investors are not always rational (Barber and Odean; 2011). They exhibit a lot of behavioral biases. Investors usually tend to look at investments that would give them good returns. The factor risk affects investor's behavior to a greater extent. The risk taking behavior varies from investor to investor. Likewise a model presented by Barberis, Shleifer and Visny(1998) shows that investors do underreact to stock prices depending on the information the investor receives which is known as Assymetric Information that helps investors take better investment decisions (Barber and Odean, 2000; Barber et al., 2009; Gao, 2002). Whereas (Daniel, Hishleifer and Subrahmanyam, 1998; Odean, 1999; Camere & Lovallo, 1999; Moore and Healy, 2008; Benos, 1998; Caballe and Sakovics, 2003; Gervais and Odean, 2001; Hong, Scheinkman, and Xiong, 2006; Kyle and Wang, 1997; Peng and Xiong, 2006; Scheinkman and Xiong, 2003; and Wang, 2001; Kyle, 1985; Grossman and Stiglitz, 1980; Diamond and Varcchia, 1981) and few others have stated that Investors tend to be overconfident while investing.

Others state that Herding (Wermers, 1999), Mental Accounting (Thaler, 1999), Simple Heuristics (Gigerenzer & Todd, 1999), Risk Aversion (Rabin& Thaler, 2001), Familiarity (Massa and Simonov, 2006; Ivkovic and Weisbenner, 2005; Seasholes and Zhu, 2010; Døskeland and Hvide, 2011) ,Status Quo Bias (Yaari, 1987), Loss Aversion (Trev & Kahneman, 1991), Sensation Seeking (Dorn and Sengmueller,2009; Barber et al.,2009; Gao and Lin,2011; Kumar, 2009b; Mitton and Vorkink,2007) Judgement and Uncertainty (Trev & Kahneman, 1991) are some other determinants or biases that investors exhibit while making

investments or taking investment decisions. Finally, Finucane et.al (2000) stated that it is due to heuristics that people tend to derive both risk and benefit evaluation from a common source. Thus these evidences prove that investment behavior could be best determined by the bias that is exhibited by investors.

3. EMOTIONAL INTELLIGENCE

Emotions are a result of conditioning process (Frank 1988; LeDoux 1996). Emotional Intelligence (EI) is a psychological state that modifies individual beliefs towards a specific action (Elster 1998). Arnold (1960) has stated that an individual's emotional state is an intuitive action which hurts or rewards depending on situations.

Zeidner, Roberts, & Matthews, 2009 defines Emotional intelligence as “a set of aptitudes, competencies, and skills for managing emotion and emotive encounters”. Emotional intelligence (Salovey & Mayer, 1989; Mayer & Salovey, 1993; Caruso et al., 2002) plays an important role in investment decisions and is hence considered as a personal characteristic. According to Goleman (2006), investors make better decision making strategies with high emotional intelligence.

The relation between EI and life outcomes suggests that EI informs the understanding of emotions, and their interventions in human behavior. As an emotion emerges, it results in changes in physiology, behavior, cognition, and subjective experience (Izard 1993; Parrott 2002; Simon 1982).

Emotional intelligence is involved in the capacity to perceive emotions, assimilate emotion-related feelings, understand the information of those emotions, and manage them (Mayer&Salovey, 1997; Salovey&Mayer, 1990). Emotional intelligence is a combination of competencies. These skills contribute to a person's ability to manage and monitor his or her own emotions, to correctly gauge the emotional state of others and to influence opinions (Caudron, 1999; Goleman, 1998).

Samuel E. Bliss state that EI theories, although specifying accurate reasoning about emotions, generally are agnostic as to the emotions a person might feel at a given time. Some researchers have placed intensively emphasis on this construct and provided evidence on its effects. Rosete and Ciarrochi (2005) revealed that emotional intelligence explained variance which was not explained by intellectual intelligence or personality (i.e. big five). Lopes et al. (2003) detected significant modest relations between emotional intelligence and personality and verbal intelligence. But they found that even big five and verbal intelligence controlled, EQ strongly explained the dependent variable (i.e., satisfaction with social relations).

Selim Aren and Sibel Dinc Aydemir (2014) suggest that for researchers, it is better to take personality and/or cognitive intelligence when deciding on studying emotional intelligence in order to see its incremental value above other two. While comparing emotional intelligence studies, any researcher can have some difficulty.

4. MEASURES OF EI

Various experts have developed various scales to measure EI. Some of the frequently used EI measures as mentioned by Annu. Rev., 2008. Specific-Ability approach examines relatively discrete mental abilities that process emotional information and Integrative-Model approaches describe frameworks of mental abilities that combine skills from multiple EI areas.

Under these approaches the commonly used tests and scales are:

4.1. Specific Ability Approach

- a) Diagnostic Analysis of Nonverbal Accuracy: The test has three versions: Adult Facial Expressions (Nowicki & Carton 1993), Adult Paralanguage (e.g., auditory) (Baum & Nowicki 1998) and Posture Test (Pitterman & Nowicki 2004)
- b) Japanese and Caucasian Brief Affect Recognition Test (Matsumoto et al. 2000)
- c) Levels of Emotional Awareness Scale (Lane et al. 1990)

4.2. Integrative model approach

1. Emotion Knowledge Test (Izard et al. 2001, Mostow et al. 2002, Trentacosta & Izard 2007)
2. Mayer-Salovey-Caruso Emotional Intelligence Scale (Mayer et al. 2002a, Mayer et al. 2003)
3. Multibranch Emotional Intelligence Scale (Mayer et al. 1999)

The two approaches were not used in isolate and this paved way to a mixed model.

4.3. Mixed model approach

1. Emotional Quotient Inventory (Bar-On 1997)
2. Self-Report Emotional Intelligence Test (Schutte et al. 1998)
3. Multidimensional Emotional Intelligence Assessment (Tett et al. 2005, 2006)

The different test that are used to measure EI give different results to different samples they are tested on (Andrew M. Lane et. al., 2009). Many other measures of EI are also available. Thus all these measures have been used to measure EI considering various factors and constructs according to the different samples. Major constructs that have been identified as determinants of Goleman (1998) is a model with five dimensions in which each area has its own set of behavioral attributes. The areas identified are Self-awareness, Self-management or self-regulation, Self Motivation, Empathy and Social skills. Competencies specified from MSCEIT are perceiving emotions, using emotions, understanding emotions and managing emotions.

4.4. EI and IB

George (2000) stated that feelings are intricately bound up in the ways that people think, behave, and make decisions. Emotional intelligence refers to the ability to be aware of one's own feelings and to use the information to guide one's thinking and behavior (Salovey and Mayer, 1990). Goleman's (1998) presented a five dimensions model of emotional intelligence such as 1) Self-Awareness, 2) Self-Regulation 3) Motivation 4) Empathy and 5) Social Skills and argued that these skills in emotional intelligence are essential for successful leadership.

Goleman (2005) argued that emotional intelligence is the strongest indicator of human success. Our emotions play a much greater role in thought, decision-making and individual success. Prior research in behavioral finance suggests that investors are often driven by their emotions to make choices that are not optimal for their financial well-being. This may be in part because investors are rarely in a position to predict the future performance of a stock. (Micheal Ann, 2012)

Ameriks, Wranik, and Salovey (2009) found that investors with a high degree of emotional intelligence are more likely to invest wisely by trading less frequently and using low-cost fund options. When an investor becomes risk averse, he/she is more likely to use his/her emotional intelligence (Reza Pirayesh, 2013).

Participants with higher Trait EI (Petridis& Furnham, 2001) are consistently more likely to invest compared with participants with lower Trait EI. These results suggest that investing

behavior is influenced by individual differences in perceiving and managing emotions (Enrico Rubaltelli et al, 2015)

Kuhnen and Knutson (2011) found that subjects unknowingly made less risky investment decisions after viewing a picture associated with negative affect versus those viewing neutral pictures. These and similar cognitive lapses allow algorithmic traders to take advantage of the predictable emotional responses of others. Experiments have demonstrated that people put in certain complex situations are able to make superior decisions by using their intuitive gut feelings rather than deliberate thinking (Dijksterhuis, Bos, Nordgren, and Van Baaren, 2006; Persaud, McLeod, and Cowey, 2007; Mikels, Maglio, Reed and Kaplowitz, 2011). Baba Shiv George, et al, state that Lack of emotional reactions lead to more advantageous decision and thus have proven that Risky decision making and investment choice is influenced by the role of emotions. A.Charles and R.Kasilingam state that indecisiveness emotional state investors are not individualistic and so they should be risk averse and intuitive.

5. REVIEW OF LITERATURE CONSIDERED FOR THE MODEL

Authors	Outcomes
Michal Ann Strahilevitz, 2012	Reviewed over 700,000 actual stock purchases to identify the behavior of investors. Investors were significantly more likely to 1) repurchase stocks previously sold for a gain rather than stocks they previously sold for a loss and 2) repurchase stocks that have lost rather than gained value since a prior sale. Even when patterns had marginally negative effects on returns, investors traded more frequently which led to lower profits.
John Ameriks et.al., 2009	Investment behavior using three psychological tests namely Big Five Inventory, MSCEIT (Mayer Solovey Caruso Emotional Intelligence Test) and UPPS Impulsive Behavior Scale thus measuring personality, EI and Impulsiveness. The research establishes relations among EI(MSCEIT) and other psychological characteristics (Big Five Inventory and UPPS Impulsive Behavior Scale) and investment behavior. They state that (1) Women with high in impulsiveness or in EI tend to trade more than men. (2) Psychological variables have a strong effect on risk taking. (3) Identifying an investor’s personality type would reveal certain biases that affect the investment outcomes.
Enrico Rubaltelli et al., working paper series 2015	A more complex picture of the relation between emotions and behavior in the financial domain and provide first evidence about the possible link between individual differences in dealing with affective information and the profile of traders. People with high trait EI may engage in excessive trading and could be penalized by the high turnover of their portfolios. Again, these characteristics are consistent with the profile of traders, who are looking for short term speculative opportunities. Individual investors who change their portfolios more often tend to have lower net returns once costs are taken into account.

A Review on Emotional Intelligence and Investment Behavior

Authors	Outcomes
Jeremy A. Yip and Stéphane Côté, 2012	<p>On experimentation, if emotion-understanding ability facilitates decision making it was identified that Individuals with higher levels of emotion-understanding ability could (1) correctly identify which events caused their emotions and, in particular, whether their emotions stem from events that are unrelated to current decisions. (2) Incidental feelings of anxiety, which are unrelated to current decisions, would reduce risk taking more strongly among individuals with lower rather than higher levels of emotion-understanding ability.</p> <p>When the participants with lower emotional understanding ability were informed about the source of their anxiety the effect of Anxiety on risk taking was eliminated. This finding reveals that emotion-understanding ability guards against the biasing effects of incidental anxiety by helping individuals determine that such anxiety is irrelevant to current decisions.</p>
Reza Pirayesh	A positive and meaningful relationship between these two components. When investors become risk averse, they are more likely to use their emotional intelligence. The relationship between investment bias and interpersonal characteristics, stress management, consistency index and general personality was not significant.
A.Charles and R.Kasilingam, 2014	Investors who are influenced by indecisiveness emotions has shown negative relationship with individualistic and no relationship with methodical personality state. Frequency analysis of indecisiveness emotions suggest that only a smaller group of investors are influenced by emotions while majority of investors have shown neutral emotional state. Thus they state that there exists a structural relationship between investor's emotional state and investor's personality.
Eisenberg, Baron, and Seligman 1998)	Risk aversive behavior and anxiousness are closely associated with each other. They identified that Risk aversion was correlated with the tendency to believe that bad outcomes were both likely and particularly bad, and these beliefs were correlated with depressive symptoms and with pessimistic attributional style. All of these relations were confined to beliefs about the self: but disappeared when another person is involved.
Foo, (2011)	Emotions played significant role on entrepreneurial opportunity evaluation via risk perception. More clearly, fear as a negative emotion causes high risk perception while happiness leads to low risk perception.
Sjöberg and Engelberg (2009)	<p>Those who have a financial knowledge have (1) a positive attitude to economic risk taking and gambling behavior, a high level of sensation seeking and a low level of money concern. (2) The subgroup of participants planning a career in finance showed an even more pronounced interest in gambling. (3) It was found that women were lower than men in economic risk preferences, gambling and speculation, money concern, sensation seeking, success orientation, and deference to authority. (4) Women were also higher in emotional intelligence and expressed higher values of peace and protection of the environment.</p> <p>Attitudes to financial risk taking and gambling are related to sensation seeking, emotional intelligence and the perceived importance of money (money concern).</p>

Authors	Outcomes
Van der Zee et al., 2002	They investigated whether emotional intelligence relates to academic intelligence and big five personality factors and has incremental validity above them in estimating both academic and social success. Extraversion is more related to empathy and a combination of big five factors constituted emotional control. They performed stepwise regression in order to quest. The results showed that emotional intelligence has an incremental validity above other two constructs, meaning that it explained considerable part of variance in social success.
Lopes et al., 2003	Searching for linkages between personality and emotional intelligence, it was pointed out that emotional intelligence is related to big five factors. The highest linkage was identified with Agreeableness to managing emotions. They stated that MSCEIT (Mayer, Salovey, and Caruso Emotional Intelligence Test) did not overlap with personality. It was clear that emotional intelligence remains the significant predictor of social relationships even after controlling for personality.
(Van Rooy and Viswesvaran, 2004)	Combining various emotional intelligence studies a meta analysis demonstrated that emotional intelligence was a good performance estimator. The study also indicated that EI was closely correlated to personality (i.e., big five) factors.
Naser Ezadinea et al., 2011	Attempted to assess the effect of EI and its components on portfolio performance among Iranian shareholders. They hypothesized that developed EI would lead to increase in performance. In addition, effect of emotional intelligence on performance, return and risk were also examined with other demographic variables. The results obtained showed that there was (1) a positive effect of EI on portfolio performance (2) none of the components of emotional intelligence had an impact on portfolio performance and return. (3) Self-awareness and communication had an impact on portfolio risk (4) portfolio performance and returns were affected by investor's experience.
Monica Regina Rodrigues Baptista & H.A.Barnard, 2009	The relationship between personality preference groupings, as described by Jung's (1959) type theory, and emotional intelligence, as measured by Bar-On's emotional intelligence quotient among 1121 recruitment candidates of a South African investment bank revealed that there were statistically significant relationships between the preferences of Extroversion, Judgement, their combined preference grouping and emotional intelligence. The preferred Feeling preference type consistently scored the lowest in terms of emotional intelligence scores.
Roger Pearman, 2002	Pearman has used a measure of EI developed by Mayer, Salovey, and Caruso called the MESCEIT. Pearman found that the healthy use of emotion is related to effective use of all the mental functions rather than being uniquely associated with Feeling.
Elizabeth Murphy, 2006	The research highlights (1) Dominant Intuition and EI were to found to be correlated.(2) No relationship between EI and Feeling.(3) Some of the unexplainable EI relationship to Personality Type.
Henry Dick Thompson, 2006	Of the 5 personality types with the lowest overall EQ score, three were Feeling types and two were Thinking types. And surprisingly, the bottom two was Feeling types: ISFJ and INFP. No correlation between EQ and Feeling was found in this research. It appears that the EQ measures have a bias towards Extraversion.

Table 1: Review of Literature

Source: Consolidated from various sources

6. CONCEPTUAL MODEL FOR EI AND INVESTMENT BEHAVIOR

This theoretical model depicts the various qualitative and quantitative constructs and its likely relationship which may be empirically tested. The constructs and methods used to measure the parameters are wide and an attempt may be examined to standardize the methodology and the instrument to quantify and draw relationships among the constructs.

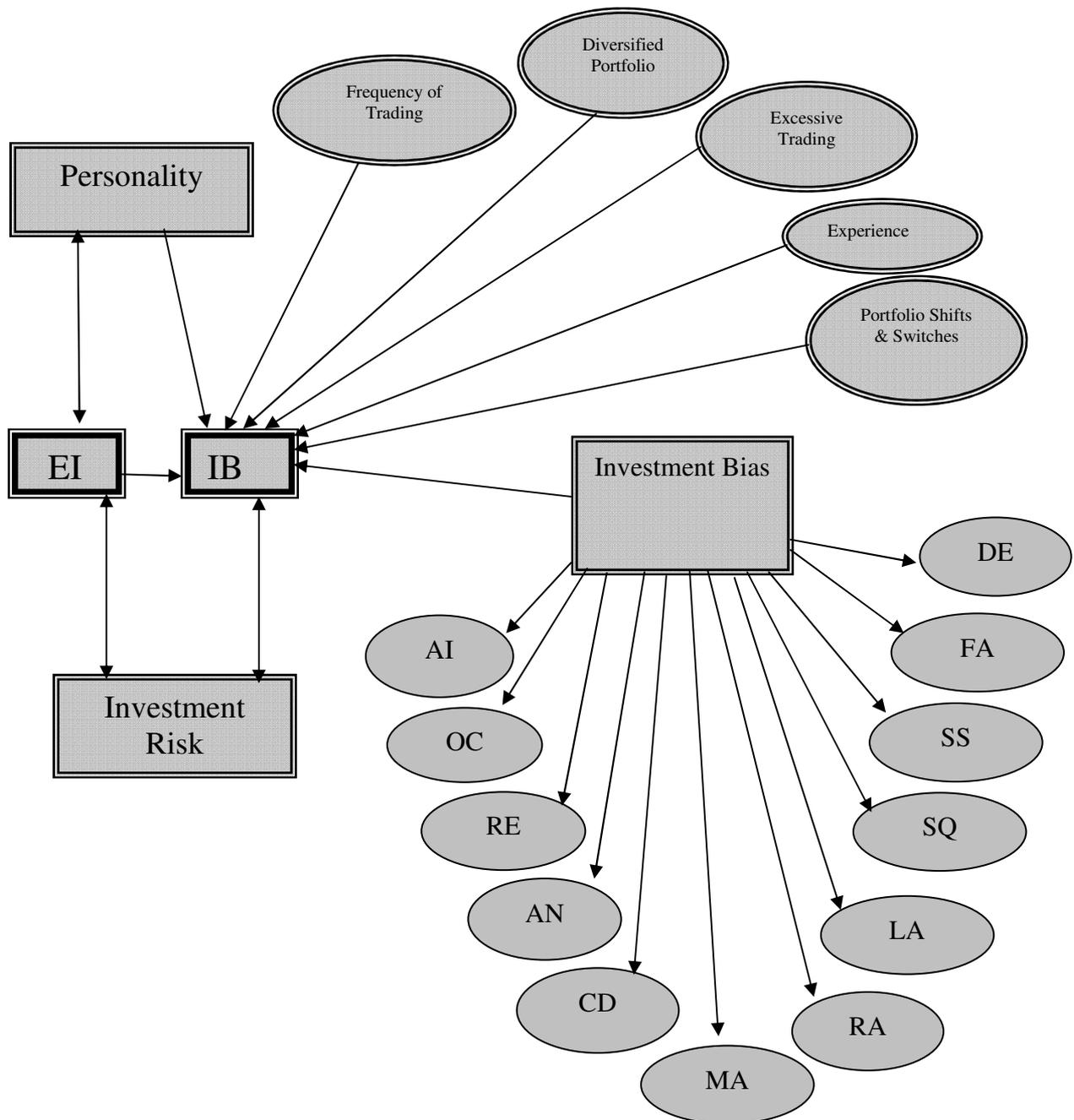


Figure 1 Conceptual Model developed through the study

Note: The model has been arrived at from reviews used in this study and has not yet been tested.

Asymmetric Information (AI) ;Overconfidence (OC); Representativeness (RE); Anchoring (AN)
Cognitive Dissonance (CD); Mental Accounting (MA); Risk Aversion (RA); Loss Aversion (LA); Status Quo Bias (SQ); Sensation Seeking (SS); Familiarity (FA); Disposition Effect (DE)

7. CONCLUSION

Though, Investors behave rationally, identifying how investors would behave is a challenge. Individuals have to clearly identify their behavior sooner to know the consequences of their investment decisions. And investment companies should also analyse the investor's behavior in order to guide the individuals in their investment decisions. Thus, Emotional Intelligence is closely related to the investment behavior of individuals. The model could be further tested with a proper sample of investors and proved.

REFERENCES

- [1] Bar-On, R. (1997, 1998), BarOn Emotional Quotient Inventory: Facilitator's Resource Manual, Toronto: Multi-Health Systems.
- [2] Bar-On, R. (2002), BarOn Emotional Quotient Inventory Development Report, Toronto: Multi-Health Systems.
- [3] Eisenberg, A. E., Baron, J., & Seligman, M. E. P. (1998), Individual difference in risk aversion and anxiety, *Psychological Bulletin*, 87, 245–251.
- [4] Elizabeth Murphy (2006), Personality Type.
- [5] <http://www.personalitypathways.com/article/emotional-intelligence2.html>
- [6] Goleman, D. (1995), Emotional intelligence, New York: Bantam.
- [7] Henry “Dick” Thompson (2006), Bulletin for Psychological Type, Vol. 29, No.3, p. 18
- [8] Jeremy A. Yip¹ and Stéphane Côté² (2012), The Emotionally Intelligent Decision Maker: Emotion-Understanding Ability Reduces the Effect of Incidental Anxiety on Risk Taking, *Psychological Science*, December 6, 2012
- [9] Lopes, P. N., Salovey, P., & Straus, R. (2003), Emotional intelligence, personality and the perceived quality of social relationships, *Personality and Individual Differences*, 35(3), 641–658.
- [10] Mayer JD, Caruso DR, Salovey P. (1999), Emotional intelligence meets traditional standards for an intelligence, *Intelligence*, 27, 267–98
- [11] Mayer JD, DiPaolo MT, Salovey P. (1990), Perceiving affective content in ambiguous visual stimuli: a component of emotional intelligence, *J. Personal. Assess.*, 54, 772–81
- [12] Mayer JD, Salovey P, Caruso DR. (2002a), Mayer-Salovey-Caruso Emotional Intelligence Test (MSCEIT) Item Booklet, Toronto: MHS Publ.
- [13] Mayer JD, Salovey P. (1993), The intelligence of emotional intelligence, *Intelligence*, 17, 433–42
- [14] Myers, I., McCaulley, M. H., Quenk, N. L., & Hammer, A. L. (1998), *MBTI manual: A guide to the development and use of the Myers-Briggs Type Indicator* (3rd ed.), California: Consulting Psychologists Press.
- [15] Naela Jamal Rushdi (2015), Impact of Psychological Influences on Investment Behaviour of Salaried Investors in India, Dissertations.
- [16] <http://shodhganga.inflibnet.ac.in/handle/10603/44202>
- [17] Nik Maheran Nik Muhammad (2009), *Behavioral Finance Vs Traditional Finance*, Advances in Management, Vol 2(6).

- [18] Pearman, R. (2002), Introduction to Type and Emotional Intelligence, Mountain View, CA: CPP, Inc.
- [19] Rubaltelli E., Agnoli S., Rancan M., Pozzoli T. Emotional intelligence and risk taking in investment decision-making. CEFIN Working Papers No 53. <http://www.cefin.unimore.it/new/publications/emotional-intelligence-and-risk-taking-in-investment-decision-making/>
- [20] Salovey P, Mayer JD. 1990. Emotional intelligence. *Imagination Cogn. Personal.* 9:185–211
- [21] Salovey, P., & Mayer, J. D. (1990), Emotional intelligence, *Imagination, Cognition and Personality*, 9, 185–211.
- [22] Schutte NS, Malouff JM, Hall LE, Haggerty DJ, Cooper JT, et al. (1998), Development and validation of a measure of emotional intelligence, *Personality and Individual Differences*, 25(2), 167-177
- [23] Schutte, N. S., Malouff, J. M., Hall, L. E., Haggerty, D. J., Cooper, J. T., Golden, C. J., & Dornheim, L.(1998). Development and validation of a measure of emotional intelligence. *Personality and Individual Differences*, 25, 167–177.
- [24] Selim Aren and Sibel Dinc Aydemir (2014), Some Considerations on Emotional Intelligence, *Journal of Global Strategic Management*, 15, 2014, June
- [25] Van Rooy, D. L., & Viswesvaran, C. (2004), Emotional intelligence: A metaanalytic investigation of predictive validity and nomological net, *Journal of Vocational Behavior*, 65(1), 71–95.
- [26] Zeidner, M., Roberts, R. D., & Matthews, G. (2009), *What we know about emotional intelligence: How it affects learning, work, relationships and our mental health*, Cambridge, MA: MIT Press.
- [27] B.Asha and Dr. Jayasree Krishnan. An Examination of Emotional Intelligence (EI) Factors on Work-Related Outcome among Employees of Automobile Industry. *International Journal of Management*, 7(3), 2016, pp. 293–297.