Friendship and Finance: Understanding the Social Dimensions of Individual Investor Choices

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This study investigates the intricate relationship between social networks, specifically friendships, and the decision-making processes of individual investors in financial markets. It examines the substantial yet often underestimated influence of social connections on investment behavior, risk management, and financial decision outcomes. Through a comprehensive analysis combining quantitative data and qualitative assessments, this research aims to uncover the nuanced ways in which social interactions shape individual investor choices. In order to collect data, a survey was administered to engage in stock market investment. The current study employed regression, correlation, and descriptive statistics as the analytical methods. The findings imply that cognitive predispositions can exert an influence on the evaluations made by individual investors in their investment decisions. This study substantiates the theoretical premise regarding the integration of social interactions in the investment decision-making process. The results illustrate that investors are augmenting their self-regulatory and analytical capacities when making investment decisions, alongside an elevated recognition of the emotional ramifications linked to their choices. The findings not only contribute to a deeper understanding of the social dimensions impacting financial decision-making but also offer implications for improving individual financial decision processes and enhancing overall market understanding.

Keywords: Stock Market Investment, Psychological Economics, Descriptive Statistics.

Introduction:

In the realm of financial decision-making, the role of social connections, particularly friendships, has garnered increasing attention in recent years. While traditional economic theories often emphasize rational decision-making based on individual preferences and information, the significance of social networks in shaping these decisions has emerged as a compelling area of exploration. This study delves into the intricate relationship between friendships and the choices made by individual investors in financial markets. Despite the prevalent assumption of investors as independent decision-makers, the influence of social ties on investment behavior has proven to be substantial. Within the context of friendships, a multitude of factors such as trust, information sharing, and behavioral cues can significantly impact investment strategies and outcomes. Understanding these dynamics is crucial for comprehending the complexities that underlie individual investor choices and, consequently, their financial well-being. Extensive research efforts have been dedicated to probing into the decision-making procedures adopted by investors. Notably, scholars have displayed a keen interest in dissecting the elements that shape investors' decision-making processes. Nevertheless, it is imperative to acknowledge that a substantial portion of these investigations has primarily focused on scrutinizing the influence of psychological components on investment decisions [1].

Individuals often exhibit illogical behavior when making investing decisions. In order to be effective in the stock market, investors must demonstrate appropriate, conventional, and rational behavioral habits. It is exceedingly rare, if not unattainable, to encounter a person who consistently makes decisions that yield advantageous outcomes for both themselves and their organization [2]. Investors have access to publicly available information, which, when combined with their individual knowledge, often leads to a phenomenon referred to as "information propagation". In the realm of economic platforms, a phenomenon known as information propagation occurs when investors opt to disregard their personal information and, instead, replicate the actions of their peers [3]. Extensive research has been conducted on the impact of interpersonal engagement activities on financial markets and other financial markets in industrialized nations. Individuals occasionally engage in behaviors without conscious consideration of their rationality or illogicality due to a multitude of factors. While it may appear that interpersonal engagement is unrelated to individual choice processes, it holds significant importance in shaping the culture and working environment of a company [4].

This essay explores the correlation between interpersonal engagement and investment choice processes. The significance of this matter lies in the scarcity of information available from developing countries such as Pakistan and India. Hameed and Ijaz (n.d.) assert that a predominant focus of contemporary research in Pakistan lies in the realm of survey-based investigations, specifically aimed at identifying cognitive predispositions that exert influence on choice processes [5]. To elucidate the influence of specific cognitive predispositions on financial markets, it is evident that the existing research findings are either inconclusive or lack substantial effectiveness. This study holds considerable importance as it expands the existing body of knowledge on the topic [6].

Diversity in investment holdings performance manifests in the context of adjustments to equity risk exposures, influenced either by colleagues' decisions in asset allocation (choice-driven interpersonal engagement) or by the performance of their equity holdings (results-oriented interpersonal engagement). Our empirical analysis indicates that modifications made in response to colleagues' "action" choices result in comparatively diminished abnormal returns on equity in the subsequent quarter. In contrast, adaptations prompted by colleagues' "outcome" choices, or those stemming from a combination of "action" and "outcome," engender positive abnormal returns in subsequent periods. These findings imply the existence of individuals prone to common investment errors, aligning with the insights of the researcher [7]. Nonetheless, our study also suggests the presence of individuals possessing a commendable proficiency in investment, who may serve as valuable sources of advice for colleagues, potentially leading to enhanced investment returns in the future.

The determinants of trading behavior among individual investors have become a focal point in the evolving field of finance referred to as "psychological finance." This field delves into the personal attributes, whether psychological or otherwise, that influence prevailing financial and investment practices [8]. Social factors and interactions with peers can lead investors to make irrational decisions. Under the influence of social pressures and the impact of media coverage, investors may collectively make errors in a herd-like fashion. The media, in this context, serves a dual role: it sets the stage for market movements and, at times, triggers these movements itself. Furthermore, the advent of the internet has transformed the way investors engage in trading. Online-based trading has been observed to heighten the trading frequency of individual investors [9].

The global financial crisis of 2007-2008 underscored the importance of investment decisions in our daily lives and the need to understand the factors that influence individual investors' choices [10]. Researchers have used various methods to study investor and investment manager behavior, leading to ongoing debate about the role of psychological elements and human behavior in investment decision-making. Future research should explore how

psychological factors and demographic characteristics affect investors, especially in decision-making contexts [11]. While the existing literature has produced diverse findings in fields like psychology and financial decision-making, research on the impact of social interaction on investor decision-making remains limited.

This study focuses on the influence of social interaction, particularly the social component, on investor decision-making. [12] examined the role of "anchors" in stock markets, highlighting the potential influence of key players within these markets [13]. These experts often guide investors in making informed financial decisions, and investors frequently depend on them to reach their final decisions. Social networks can help investors improve decision-making, particularly when they face uncertainty. The social network serves an informational role in this regard [14]. Ambiguity has grown due to limited information and other contributing factors, making social interaction a significant factor in shaping investment choices.

Investors often trust others more than themselves, even without a clear understanding of moral principles. Social interaction involves the phenomenon where investors imitate each other's investment decisions when entering or exiting specific shares. This behavior encompasses both individual and institutional investors [15]. A study on social interaction behavior within the Indonesian stock exchange did not find instances of such behavior [16]. Extensive research has explored various aspects of social interaction and its impact on investment behavior, shedding light on the dynamics at play.

The primary objective of this study is to gain a nuanced comprehension of the determinants that shape the trading conduct of individual investors. While substantial research has been devoted to studying individual investor behavior and the composition of investment portfolios, there has been a relatively limited exploration of behavioral models applied to the analysis of trading behavior. Early scholars, such as researchers [14] have emphasized the significance of concepts like social attitude, personality traits, and other behavioral dispositions in predicting and elucidating human behavior. Recently, individual investors have been increasingly involved in frequent trading, often to their detriment. While frequent trading can be profitable for brokerage firms, it frequently results in losses for most individual investors. Research indicates that the more actively investors trade, the lower their overall earnings [18].

Despite the burgeoning interest among researchers in the field of behavioral finance since the late 1980s, there remains a dearth of empirical research that identifies the foundational factors that influence the trading behavior of individual investors. Furthermore, research concentrating on the application of behavioral models to elucidate the trading conduct of individual investors is notably scarce. As a result, this study distinctly endeavors to investigate the social factors that impact the trading behavior of individual investors [19].

This study possesses a distinctive characteristic as it expands the pursuit of a decision-making framework for investments to encompass social interactions [20][21]. Despite the completion of studies in Pakistan, multiple variables are still jointly integrated. This study enables investors to ascertain the potential profitability associated with each of these distinct factors, facilitating informed financial decision-making through the integration of various variables. This research aims to bridge the gap between traditional economic models and the social realities that permeate investment decision-making. By examining the intricate interplay between friendships and financial choices, this study seeks to provide a comprehensive understanding of the social dimensions that influence individual investors. Insights garnered from this exploration not only contribute to refining economic models but also offer practical implications for improving individual financial decision processes and fostering a deeper understanding of market behavior [22]. Through a blend of empirical analysis and qualitative exploration, this study endeavors to shed light on the nuanced ways in which friendships shape investment decisions, ultimately enriching our comprehension of the broader social fabric that intertwines with financial markets.

Methodology:

Research Design:

The research methodology adopted for this study follows a causal approach, aiming to establish causal relationships among variables associated with individual investor behavior in the context of the Pakistan Stock Exchange (PSX).

Data Collection Instrument:

A survey instrument was developed, comprising a comprehensive questionnaire targeting demographic characteristics and investment-related factors. The questionnaire utilized a Likert scale for responses, enabling the evaluation of the interplay between variables influenced by individual investors.

Sample and Sampling Method:

The study involved 425 individual investors actively participating in the Pakistan Stock Exchange. To ensure representativeness, a targeted sampling method was employed, specifically focusing on individual traders operating within the PSX. Purposive sampling was utilized to select respondents based on specific criteria, in alignment with previous research findings [23][24].

Data Collection and Analysis:

The questionnaire's reliability and internal consistency were evaluated using Cronbach's Alpha and Composite reliability measures. Convergent validity assessed the average variance among latent variables, while discriminant validity explored differences between these variables. Descriptive analysis techniques were applied to evaluate the collected data quality [7].

Statistical Analysis:

Logistic Regression Model served as the principal analytical approach for this study. Given the complexity of multiple variables involved in the survey data, SEM was chosen for its effectiveness in assessing and validating theoretical constructs' relationships and their observable indicators within the social and behavioral sciences domain. SEM allows for the efficient examination and validation of hypothetical relationships between constructs and their indicators, particularly with a sizable sample size (N).

Results:

The study employed Cronbach's alpha and composite reliability to assess the internal consistency of latent variables. Cronbach's alpha values for all latent variables ranged from 0.534 to 0.909, surpassing the recommended threshold of 0.48, indicating robust internal consistency. Similarly, composite reliability values ranged from 0.746 to 0.914, surpassing the 0.64 threshold, and affirming favorable internal consistency across all variables.

Composite Reliability (CR), our second criterion for evaluating internal consistency, appraises the consistency of variables by considering external loading. Unlike Cronbach's alpha, the calculation of the Average Variance Extracted (AVE) quantifies the proportion of variance attributable to the construct itself, rather than measurement error. Moreover, CR explicitly defines construct reliability, as outlined by Drawing from the work of a composite measure of reliability generated for each construct and subsequently assessed against a predetermined threshold of 0.5. The findings indicated that the composite reliability of the latent variable ranged from 0.746 to 0.914. In line with these results, it can be inferred that the latent variable exhibits a favorable level of internal consistency, with a composite reliability value surpassing the 0.64 threshold. Convergent validity pertains to the assessment of the relationship between each observed variable and a single latent variable. The evaluation of convergent validity, in this study, was carried out using the AVE method. It was found that the convergent validity of all latent variables fell within the range of 0.508 to 0.822. The researchers employed the AVE measure to assess convergent validity, employing a predefined threshold value of 0.50. All latent variables surpassed the 0.50 threshold, indicating satisfactory levels of convergent validity. This approach aligns with the study conducted by the researcher [25].

Discriminant validity, on the other hand, is instrumental in distinguishing between latent variables. To assess discriminant validity, the AVE values were compared to the square of the correlations between the constructs. The statistical analysis confirms that the variance extracted mean exceeds the square root of the correlations among the latent variables. The present study employs various statistical analysis techniques to rigorously scrutinize and interpret the collected data. Social engagement encompasses the active involvement and interaction of individuals within social contexts. It entails the process of individuals engaging with others, forging connections, and influencing each other's behaviors. The responses from 425 participants in the current study regarding the variable of social interaction exemplify how individuals emulating the actions and behaviors of others can make them susceptible to patterns of social engagement.

Responses from 425 participants regarding social interaction showcased varied sentiments across five dimensions. The responses illustrated levels of agreement, disagreement, and neutrality across the components. Mean values for these dimensions ranged from 2.45 to 2.67, indicating generally favorable responses across all facets of social interaction. All 425 respondents exhibited diverse responses across five items related to investment decision-making. Mean values for these components ranged from 2.82 to 3.20, suggesting a generally positive trend in investors' perceptions and decisions regarding investments.

Table 1. Internal Consistency Assessment

Latent Variables	Cronbach's Alpha	Composite Reliability
Variable 1	0.534	0.746
Variable 2	0.909	0.914
Variable 3	0.462	0.412

Furthermore, the data provides the means of the five items comprising the social interaction variable, reflecting the presence of positive or negative sentiments among the respondents. The mean values for the five components of social interaction are 2.46, 2.67, 2.62, 2.45, and 2.65, respectively. The positive values of the means indicate that investors have responded favorably to all five dimensions of social interaction.

Table 2. Mean Values for Components of Social Interaction

Variables	Mean Value
1	2.46
2	2.67
3	2.62
4	2.45
5	2.65

"Regarding participants' decisions related to investments, the responses varied across five different aspects among the 425 individuals surveyed. In the first aspect, 145 individuals strongly disagreed, 125 agreed, 58 strongly agreed, and 94 remained neutral. The second aspect received responses from 86 individuals strongly disagreeing, 83 disagreeing, 199 agreeing, 57 strongly agreeing, and 40 uncertain participants. For the third aspect, 74 participants remained neutral, 75 strongly agreed, 98 strongly disagreed, 152 agreed, and 52 very much agreed out of the total responses. The fourth aspect saw 40 strongly disagreeing, 80 moderately disagreeing, 157 agreeing, 69 strongly agreeing, and 110 remaining neutral. Regarding the fifth aspect, 116 expressed indifference, 153 agreed, 62 strongly agreed, 64 very strongly agreed, and 40 strongly disagreed among the 425 responses." This restates the details about the respondents' perspectives and decisions concerning investment-related aspects in a different manner.

Furthermore, the table showcases the average ratings attributed to each of the five elements comprising the Financial Decision variable. These mean scores recorded as 2.82, 3.20, 3.17, 3.03, and 3.16 for the different criteria, portray the collective sentiment expressed by

respondents. The gradual increase in these average values across the facets of investment decisions indicates an overall positive inclination observed among the surveyed investors towards these specific aspects of decision-making.

Table 3. Participant's Decision Regarding Investment

Components of Social Interaction	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
1	145	125	94	-	58
2	86	83	40	199	57
3	98	152	74	75	52
4	40	80	110	157	69
5	40	62	116	153	64

Table 4. Mean Values for Financial Decision Variables

Elements of Social Interaction	Mean Value
1	2.82
2	3.20
3	3.17
4	3.03

Discussion:

The present study seeks to explore the correlation between various factors and investment decision-making. It specifically investigates the relationship between social interaction and investment choices. The correlation matrix reveals a relatively weak connection between social engagement and financial decision-making. The latent variable termed social interaction in this study represents the exogenous factor of social interaction. It is defined as individuals or groups uncritically conforming to majority viewpoints rather than relying on their own knowledge or rational judgment. This social interaction assessment consists of five questions, and the mean score of these questions reflects the level of engagement in social interactions.

The structural model tested the hypothesis that social interaction negatively influences investment decisions. However, with a calculated p-value of 0.436, exceeding the significance level of 0.05, there's insufficient evidence to support this hypothesis, leading to its rejection. The findings highlight robust internal consistency, satisfactory convergent, and discriminant validity, as well as diversified responses across dimensions of social interaction and investment decision-making among the surveyed participants.

The findings suggest a lack of empirical support for the presence of significant social interaction within the Pakistan stock market over a ten-year period. This may be attributed to the dominance of institutional investors in the market, with individual investors playing a limited role. The study also contradicts the notion that social interaction negatively affects financial decision-making. Instead, it suggests that social interaction has a favorable influence on investment decisions in Pakistani society. The study highlights the importance of reevaluating the research process and considering alternative methodologies when hypotheses are not substantiated. It emphasizes that investors in Pakistan often rely on peer guidance and imitate the behaviors of others, particularly friends and family members.

In this study's conceptualization, social interaction refers to investors mimicking others' actions when entering or exiting the same stocks. The study recognizes the influence of emotions such as anger, fear, social contact, and stress on investors, with variations based on gender.

The model proposed in this study suggests that social interaction has a detrimental impact on investor judgment, with potential outcomes varying in nature. Further research is needed to explore the impacts of biases on investor behavior, as these misinterpretations can lead to significant financial consequences.

The trading activities of interconnected individual investors can influence asset prices. Outcome-based social interaction may serve as a mechanism, as investors often adjust their equity holdings in response to their colleagues' investment outcomes. An investor's efficacy depends on their ability to adapt to dynamic market conditions with efficient investment strategies. Stock exchanges offer educational sessions to enhance financial literacy and awareness among investors, aiming to improve investment outcomes. The findings also suggest that tailoring educational programs to individual students' experiences can motivate them to engage in studying, reducing susceptibility to behavioral biases in stock trading. This study underscores the need for further research to harness the positive impacts of psychological and social biases while mitigating the unfavorable ones.

Conclusion:

This study examined social interaction and investment decisions among 425 participants in the Pakistan Stock Exchange context. The data showed consistent and valid trends in both social engagement and investment choices. While social interactions exhibited positive inclinations, the influence of these interactions on investment decisions remained inconclusive. These findings offer insights into the complex relationship between social factors and financial choices, suggesting avenues for further investigation to better understand their interplay and implications.

Abbreviations

- Theory of Reasoned Action (TRA)
- Theory of Planned Behavior (TPB)
- Pakistan Stock Exchange (PSX)
- Composite Reliability (CR)
- Average Variance Extracted (AVE)

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