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Affect-based stock investment decision: The role of affective self-affinity

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ABSTRACT

This paper studies the role of affective self-affinity for a company in the stock investment decision by investigating the factors triggering it. Based on the social identity theory and the affect literature we hypothesize that three types of identifications, namely group related, company-people related and idea/ideal related, trigger affective self-affinity for a company which results in extra affect-based motivation to invest in the company's stock. The two ideas included in the idea/ideal related affective self-affinity are socially responsible investing and nationality related ideas. Based on the survey data of 133 active individual investors, we find that the more the investors perceive the company supports/represents a specific group or idea or employ a specific person, with which the investors identify themselves, the higher is the investors' affective self-affinity for the company. This results in higher extra affective motivation to invest in the company's stock over and beyond financial indicators. Thus, investors' identification with groups, people, or ideas such as socially responsible investing and nationality results in higher affect-based investment motivation through affective self-affinity aroused in the investors. Moreover, positive attitude towards the company is another factor that explains the affect-based extra investment motivation.

1. Introduction

Economic theorists have long held the rationality principle which suggests that the rational agents are simply preference maximizers given all available market constraints and information which is processed under strict Bayesian statistical principles (McFadden et al., 1999). Following this stream, the traditional finance literature assumes that while making investment choices, investors maximize their expected return for a given level of risk given all market information (Clark-Murphy and Soutar, 2004). However, this type of rational-agent model is challenged by the psychological views that individuals' behavior is influenced by the interactions of perceptions, motives, attitudes and affect. Hence their decision may deviate from the optimal decision suggested by the rational-agent model (Kahneman, 2003). As such, the field of behavioral finance has grown to attempt to understand the various influences that affect investor behavior beyond the fundamentals of a pure monetary incentive (Mokhtar, 2014).

Investors do not have all available information and have limited time to process it. So, they develop shortcuts and make their investment decisions based on heuristics and biases (Ackert and Deaves, 2009). The affect heuristic (a mental shortcut that allows people to make decisions and solve problems quickly and efficiently, in which emotions of fear, pleasure, surprise, etc. influences decisions) is one of those shortcuts, studied heavily in the literature. Affective heuristics research has suggested that affective reactions guide information processing and judgment (Zajonc, 1980), especially in uncertain and complex decisions (Loewenstein et al., 2001; Mellers, 2000). Damasio (1994) refers to emotions as "an integral component of the machinery of reason". He indicates that reason and emotions are in such a close interplay that when a potential outcome of an action is associated with positive (negative) feelings then it becomes a beacon of incentive (alarm) (Damasio, 1994). Affective heuristics play a significant role not only in the final decision but also in setting the alternatives to be considered. Among the thousands of stocks, investors often consider purchasing the stocks that were the first to attract their attention (Barber and Odean, 2008). Likewise, research has suggested that affect-laden imagery from word associations are predictive of preferences for investing in new companies on the stock market (MacGregor et al., 2000). Even though affect-based decisions are quicker, easier

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and more efficient in complex decisions, they can be faulty as they are subject to manipulation and inherent bias (Slovic et al., 2007).

Behavioral finance research proposes a stochastic discount factor based upon investors' sentiment relative to the fundamental value of the stock as the behavioral portion of the purchase decision is significant (Shefrin, 2008). Several recent studies underline the significance of the psychological affect in people's decision making mechanism (see Slovic et al., 2002, 2007; Finucane et al., 2000; MacGregor et al., 2000) suggesting that an investment is not an isolated mechanism and can also be influenced by factors other than financial returns and risk such as the affective evaluations concerning the company brands and corporate images (Statman et al., 2008; Ang et al., 2010; Freider and Subrahmanyam, 2005; Schoenbachler et al., 2004).

Our cross disciplinary research extends the behavioral finance research by exploring in particular how the affect heuristic may influence investors' decisions with a foundation in marketing, psychology and finance. Our theoretical foundation is social identity theory (SIT) (Tajfel, 1978, 1981; Tajfel and Turner, 1985; Turner, 1975, 1982, 1984, 1985) to explain how investors identify themselves with groups, people, and finally ideas/ideals and how these identifications may result in an increase in the affective investment motivation in the company's stock. The marketing research has a long history of customer-corporation identity/brand connection and social identity theory, suggesting that firms attract and retain customers who become loyal and repeat purchasers. When there is a connection between a customer's sense of self and a firm, a deep and mutual relationship develops (Bhattacharya and Sen, 2003) as customers use the symbolic properties of the relationship to communicate their identities (Press and Arnould, 2011). Firms in turn benefit from repeat purchase and price premiums (Lam, 2012). We examine the implications of investor identity to a firm and purchase intention.

The purpose of this study is, hence, to explore the relationship between an investor's affective self-affinity (ASA hereafter) for a company, its antecedents and their purchase intention of a stock. We have found very little research that explored this relationship. ASA is an investor's perception of the congruence between the company and their own personal identity (an identity which may be associated with people, groups of people or ideas and ideals, etc.) (Aspara et al., 2008). Past research has shown that an investor's identification with a company has a positive effect on their determination to invest over similar firms that have relatively similar return (Aspara and Tikkanen, 2011b). Further research by Aspara and Tikkanen (2011a) has indicated ASA and positive attitude may explain the affect-based extra investment motivation. Our research, furthers this stream by suggesting that three dimensions of identification, specifically; group related, company-people related and idea/ideal related, may create extra affective investment motivation by increasing ASA towards a company. Hence, we identify three antecedents which influence ASA aroused in the investor. By treating ASA as a mediator, we study the effects of the antecedents of ASA on the affect-based extra investment motivation. We choose two dimensions, namely socially-responsible investing (SRI hereafter) related ideas and nationality related ideas, as representatives of idea/ideal related ASA since past research shows that they influence individuals' consumption and investment decisions significantly (Statman, 2004; see the extant literature in Section 2.2). Thus, our study contributes to the existing literature by connecting the heavily studied literatures of "Affect", "Social Identity Theory", "Socially Responsible Investing", and "Nationalism and Home Bias".

Our results indicate that as positive attitude towards the investee company increases, the affect-based extra investment motivation increases. Our major contribution that adds to the emerging stream of literature; group-related ASA, company-people related ASA and idea/ideal related ASA are all significantly and positively mediated by ASA and have significant effects on affect-based extra investment motivation both directly and indirectly. In summary, if firms can develop ASA, then investors will tend to hold their shareholdings and invest more into their firm.

2. Literature review and hypotheses development

2.1. Affective self-affinity & positive attitude

Past research has focused on ASA and its influence on decision making (e.g. Slovic et al., 2002, 2007; Finucane et al., 2000). Researchers in the finance field investigated the influence of ASA in the stock investment decision due to the paradoxical return and risk evaluations (high expected return-low risk) of stocks of companies by investors which are associated with strong positive affect (Statman et al., 2008). In a similar manner, a study by Ang et al. (2010) demonstrated how ASA for "class A" shares results in higher valuation by investors compared to "class B" shares of the same companies.

There is a dearth of research that studies the specific relationship between the extra investment motivation to invest in companies and affective/attitudinal evaluations. However recent behavioral finance research focused on the impact of ASA towards companies' brands and corporate images on the willingness to invest in those companies (Aspara and Tikkanen, 2008, 2010a, 2010b; Frieder and Subrahmanyam, 2005; Schoenbachler et al., 2004), and examined the relationship between the affect-based extra investment motivation and two explanatory variables; positive attitude towards the company and ASA (Aspara and Tikkanen, 2011a). The results from this research indicate that a positive attitude towards a company and ASA for a company causes investors to have extra motivation to invest in a company's stock after controlling for several demographic and investor characteristics. As such, we follow the foundation of the literature and first test their hypothesis concerning the attitudinal evaluation and then we further the stream of research and develop hypotheses regarding affective evaluation and the antecedents of ASA.

The first hypothesis concerns the relationship between the positive attitude towards the company and the affect-based extra investment motivation. As suggested by the literature positive attitude always involves affect beside cognitive associations (Eagly et al., 1994; Eagly and Chaiken,1993; Zanna and Rempel, 1998; Breckler and Wiggins,1989a, b). Hence, we assume that an overall affective evaluation towards a company manifests as overall attitude, indicating how much a person likes/dislikes the object (Ajzen and Fishbein, 1980). Individuals may use those overall feelings to guide judgments (Damasio, 1994; Slovic et al., 2002; Zajonc, 1980), particularly in complex decisions where it is difficult to judge pros and cons of various alternatives such as the investment alternatives (Statman et al., 2008). That is why we hypothesize that as positive attitude towards the company increases, the affect-based extra investment motivation gets stronger.

H1: As positive attitude of an individual towards a company increases, his/her affect-based extra investment motivation to invest in the company's stock, over and beyond its expected return and risk, increases.

2.2. Social identity theory, affective self-affinity and its antecedents

Affect may also manifest as identification, especially at the higher levels. Our theoretical foundation is social identity theory (SIT) which helps explain the relationship of ASA aroused in people and its antecedents (Tajfel, 1978, 1981; Tajfel and Turner, 1985; Turner, 1975, 1982, 1984, 1985; Aspara et al., 2008). According to