

Framing and Investment Advisers

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Abstract: *Framing is defined as an effect, according to which the presentation of an event or prospect affects people's decisions about the specific event or prospect. In the context of stock market decision making and investment choices, it is a heuristic rule which suggests that investors make investing decisions depending on how information and investment choices were presented to them through a stock market process. The present research, investigating the attitudes of 81 Greek registered investment executives towards framing in investing decision making, demonstrated that the way the problem was presented caused a change in the advisors' decision making. Overall, when investment advisors, whose role is critical to affecting investing decisions, employ frames in decision making, rational thinking is prevented and stock market investment operations are threatened.*

Keywords: *Behavioral Finance, Framing, Psychology, Investment Advisers, Stock Market*

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I. Introduction

Behavioural Finance has come to fill the gaps in the standard finance theory by examining the psychological considerations, biases, heuristic rules and cognitive and emotional errors of individuals, and especially, investors. It derived from the weaknesses of the mainstream theory, which holds that those involved in investment processes always act rationally and also that money and stock markets are always efficient and predictable.

Framing is an effect, a heuristic rule, which has been extensively studied in the framework of behavioural theory. Frames involve individuals'/investors' decisions which are shaped on the basis of how events, processes or perspective are presented, and suggest that irrational decisions and choices are very likely to be made.

The present paper attempts an analysis of the framing effect both in individuals' and also investors' decisions during investment processes. It includes a survey to explore whether investment advisors are framed and whether their rational thinking, role and decisions are also shaped by framing.

II. Framing

The effect of framing suggests that the presentation of an event or prospect affects people's decision making about this event or prospect. Individuals make decisions depending on how dilemmas or situations will be presented and react differently to different descriptions, even though each may carry the same information.

The term "frame" implies that "the way people behave depends on the way that their decision problems are framed" (Shefrin, 2000). According to Goffman, frames are "interpretational frameworks", which allow individuals and groups to "locate, perceive, identify and label" events, thus giving meaning, organizing experiences and guiding actions. Through frames some aspects of a perceived reality are selected and made more salient in order to promote a particular causal interpretation of a problem (Entman, 1993).

Frames can be identified in at least three areas: (1) among journalists, newsrooms or media systems, (2) among recipients of media messages or society, and (3) among political, economic, cultural etc. actors, groups, or organizations (Scheufele, 2006).

According to Druckman (2001), framing is distinguished in: framing in communication and framing in thought. The former involves the presentation of an event, the way in which information is communicated and the latter the psychological manipulation, the method of assessing and managing situations.

Framing implies misleading public opinion, making wrong decisions, and preventing rational thinking and choices with a view to serving vested interests and specific situations.

III. Framing and Investors

In the context of stock market decision making and investment choices, framing is the heuristic rule which suggests that investors make investing decisions depending on how information and investment choices are presented in stock market processes. Investors do not act rationally and become victims of misleading information provided by those who employ framing of thought and communication.

In the context of the stock market, Shefrin considers that framing is produced by: a) loss aversion; b) concurrent decisions; c) hedonic editing.

In the first case, wrong investment choices inhibit rationality. Fear and aversion to new losses make investors more conservative and cautious even towards pleasant optimistic information. On the other hand, when they are called upon to make concurrent decisions, they adopt wrong attitudes towards complex situations and are unable to make suitable correlations.

Hedonic editing, in addition, which involves investment pleasure and satisfaction derived from processes rather than final outcomes (which involve always profit making), causes investors to reject unfavourable information and other investors who tend to keep them away from their utopian illusions by emphasizing the tough reality of the investment world.

Investing decision making is likely to produce the effect of narrow framing, which, in effect, is a short-sighted approach to portfolio management. More specifically, investors tend to make investing decisions overlooking their portfolios as a whole. Those who are affected by the specific bias usually focus on specific, superficially attractive investment choices, and tend to ignore the full range of choices they are offered.

Narrow framing is directly related to time horizon. Any effort to frame investment choices in the short term is an irrational decision producing loss. The time horizon of profit-making choices, or the time horizon over which investments are left to grow are unlikely to be temporary or short-term.

In addition, framing is directly related to anchoring, which involves making comparisons of market and financial information in specific periods of time. There will always be a time point which is used to frame data and, thus, produce positive or negative outcomes (Carlson, 2014).

Individuals use irrelevant information as a reference point to judge and evaluate different information or prices. They use facts, situations and values to make judgements, even if these are irrelevant to the actual fact or value, and they tend to base their judgements on an initial price to make a final decision. To resolve problems, an initial value or starting point may be suggested, or this may be the result of inconsistencies; in any case, any adjustment is usually inadequate (Slovic and Lichtenstein, 1971).

Information manipulation, promotion of specific companies, non-disclosure of information, and corrupt information are constraints to rational investing decisions resulting in wrong destructive outcomes produced by profit-making investing choices, which are made by those who create frames and take advantage of the framing effect.

Significantly, when framing is employed by stock market stakeholders and those involved in advisory and guidance processes, a number of complications arise and stock market processes tend to become rather unbalanced.

IV. The Research

The research investigates framing on the basis of a questionnaire delivered from 6 February to 19 March 2015 to Capital Market Commission registered executives working in stock market companies in Athens.

Sampling distribution and representativeness are sufficient:

- 23 companies participated in the research (43% - out of 53 companies)
- Representativeness: the participants are responsible for managing ~ 75% of the total value of transactions, (ASE, ATHEX - March 2015).

The corpus of data is comprised of 81 questionnaires including questions on a nine-item scale. It is worth noting the participating advisors were also able to answer (apart from choosing one of the two programs) that they do not accept either of the two programs described in the survey or show no preference (rational answer).

V. Research results

The two questions, which are verbatim quotations from Kahneman and Tversky's (1984) work, "Choices, Values, and Frames" and investigate whether the effect of framing can have an impact on investment choices are:

-Imagine that the European Union is preparing for the outbreak of an unusual Asian disease, which is expected to kill 600 people. Two alternative programs to combat the disease have been proposed. Assume that the exact scientific estimates of the consequences of the programs are as follows: If Program A is adopted, 200 people will be saved. If Program B is adopted, there is a one-third probability (33.3%) that 600 people will be saved and a two-thirds probability (66.6%) that no people will be saved. Which of the two programs would you favor?

-Imagine that the European Union is preparing for the outbreak of a new unusual Asian disease, which is expected to kill 600 people. Two alternative programs to combat the disease have been proposed. Assume that the exact scientific estimates of the consequences of the programs are as follows: If Program C is adopted, 400 people will die. If Program D is adopted, there is a one-third probability (33.3%) that nobody will die and a two-thirds probability (66.6%) that 600 people will die. Which of the two programs would you favor?

The above questions demonstrate that the resulting "utility" from programs A and B is exactly the same. Implementation of either of the two programs (program A and program B), entails that 200 people will be saved, which is also true for programs C and D. If program C is implemented, 400 people will die (thus, 200 people will be saved); similarly, 400 people will die, if program D is implemented.

Despite the fact that the participants were also able to answer "Neither", 64% of them chose one of the two programs, and only 36% gave a neutral answer. The item "No answer" demonstrates rational thinking and neutral attitudes, and, thus, their own rational thinking, as suggested by Thaler (1999), who holds that in accounting systems proper decision-making is the result of collecting and reviewing a large amount of information. In an ideal world, in an efficient market, when investors are called to make decisions they are based only on statistical data to which they are definitely able to have access. According to Thaler, this is an impossible goal.

It is worth noting that 36% of the respondents demonstrate a neutral attitude and rational thinking. However, 64% of them exhibit a psychological and emotional rather than rational perspective.

The results also demonstrated that 43% of the sample who chose program A were significantly affected by the word "will be saved". From a psychological perspective, "saved" had a positive effect, whereas "no one will be saved", produced negative attitudes to a high percentage of subjects. Thus, irrespective of a wrong choice of programs, the way the answers were formulated affected specific decisions. The manner the problem was presented was critical to choosing one of the two programs.

The same question and the relevant answers demonstrated that the subjects are also risk averse. They do not want to risk to save all people, fearing that no one will survive. 43% of them made a safe choice, that 200 people will live.

In addition, a percentage of 45% of the investment advisors made no preference, similar to those who manage portfolios (46%). Master and PhD holders as well as Business School graduates did not choose a program (31% and 53%, respectively).

As regards the second question concerning framing, the executives chose between the two programs, C and D. 63% of the executives answered both programs, and 37% were neutral and, thus, rational. Neutral attitudes were 1% higher than in the previous answer.

Those who chose program C were only 28%. Aversion to the program was caused by the key phrase "they will die". Death as the highest probability encouraged them to choose program D. The probability of 66.6% that all people will die made them decide to risk, as the negative implication of the assumption that 400 people will die, had a significant and critical impact on their psychological and emotional state. By acting emotionally, they decided to take a risk (33.3%).

The item "Neither" of the specific question was chosen by 43% of the investment advisors and 54% of those managing portfolios. Business School graduates and Master or PhD holders chose rational thinking and thus, no program (53% and 31% respectively).

Examining a combination of the two problems, the conclusion to be drawn is that a different formulation producing, however, the same outcome has a strong impact on decision making processes. It is worth noting that those who chose program A of the first question did not choose Program C, which is exactly the same, but differently formulated.

In addition, it would be anticipated that 43% of the executives who chose program A would choose program C of the next question. However, only 28% of those who chose program A also chose program C. 14% of the executives chose program D, as the phrase "will not die" had a significant impact, and 1% made a rational choice.

On the other hand, the respondents who chose program B of the first question also chose program D which is matching; similarly, those who opted for the item "Neither" had a steady attitude. Although, as regards the first question, the item "200 people will be saved" resulted in risk aversion, the statement that 400 people will die (and thus 200 will be saved) of the second question prevented them from realizing that outcomes were entirely similar; thus, they made a risk-related decision.

VI. Conclusions

When individuals make decisions depending on how a dilemma or situation will be presented to them, they react differently to different descriptions, even if each of them carries the same information; thus, rational thinking and decisions are prevented.

When investors make decisions about their investments based on the manner the information or investment choice is presented in a stock market process, they do not act rationally and are victims of misleading information, which is communicated by those using frames of thought and communication.

When investment advisors make decisions and are affected by various types of framing, stock market order is disturbed and investment risk is most probable, as advisors, whose role is very influential, are likely to disturb market equilibrium.

The present research investigating the attitudes of Greek registered investment executives demonstrated that the way the problem was presented caused a change in the advisors' decision making. In a given situation, the participating executives made completely different choices, simply because the specific situation was framed in a different way. Thus, the participating executives appeared to be affected by the way events, situations and information are presented, and to adjust investment decisions to frames.

Overall, the executives of the sample at issue are greatly affected by the heuristic rule of framing. Their rational thinking and decisions are prevented and, thus, hamper the smooth operation of the stock market functions.

On the other hand, they can frame their own investment outcomes. They can present gains, enhancing any positive points and obscuring or underrating the negative ones. Thus, framing a problem affects a decision and generates irrationality.

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