Why Common Investors stay away from the Foreign Exchange Market

Swati Satheendran
Amrita School of Business, Coimbatore
Amrita VishwaVidyapeetham
Amrita University
India

Dr. Sanjay Banerji
Amrita School of Business, Coimbatore
Amrita Vishwa Vidyapeetham
Amrita University
India

***Abstract*—The world has become financially integrated which provides our nation better opportunities to directly invest in international markets and earn increased profits. These opportunities have increased the significance of foreign exchange market in every country. A better understanding of the functioning of the FOREX market is required for the development of a global economy. However, the participation of common investors in the FOREX market stays low when compared to their participation in many other investment avenues. This study attempts to determine the various factors which make individual investors stay away from the foreign exchange market. It is observed that there are certain attributes such as Experience of Investing in the FOREX market, Financial Literacy, Risk tolerance, Perception about risk and Perception about returns generated in FOREX market which influences the participation level of common investors in the FOREX market. For this study, data is collected using a structured questionnaire with a sample size of 90 respondents surveyed both online. It is evident from the analysis of these responses that many of these factors are significant as to why common investors stay away from the FOREX market.**

Keywords – Foreign Exchange Market; Experience; Financial Literacy; Risk Tolerance; Perception.

I. INTRODUCTION

The Foreign exchange market in India implements its powers to control the foreign exchange transactions in the nation. This market was earlier regulated by the Reserve Bank of India but since 1999, it is being regulated as per The Foreign Exchange Management Act. Foreign exchange market in India has grown over the years as a preferred area of investment by institutional investors. Presently the Indian Forex market is the 16th largest Forex market in the world in terms of daily turnover as per the BIS Triennial Survey report. According to the RBI Report, the daily average turnover increased from US $5 billion in 1997-98 to US $18 billion in 2005-06.

According to UNCTAD's World Investment Prospects Survey 2012–14, India is the third-most attractive destination for FDI (after China and the US) in the world. Foreign exchange market in India is regulated by the government of India and there is intervention from the Reserve Bank of India. RBI has responded to exchange rate volatility by ensuring net purchase of foreign currency in the market [1].

Ever since liberalization, trading volume witnessed in foreign exchange markets have grown exponentially. The Indian exchange rate policy has helped the Indian foreign exchange reserves to reach over 100 billion dollars. As such, the government has considered using a portion of these reserves to finance various infrastructure investments in the country [2].While the Indian Foreign Exchange Market has been a market where institutional investors have actively participated, it is only recently that individual investors have come to the forefront to participate in this market. However there are certain factors why common investors still keep away from participating in this financial market. The present paper tries to analyse these factors such as experience of investment in the foreign exchange market, financial literacy, perception about risk and return associated with the foreign exchange market and risk tolerance of people and its relationship, if any, with common investors' tendency to stay away from the foreign exchange market.

II. LITERATURE REVIEWAND HYPOTHESIS DEVELOPMENT

According to [3], FOREX is the main financial market where operations are carried out speculative and the success of investment depends on the preparation and understanding of each investor. There are certain risks associated with the foreign exchange market and certain risk and return perceptions associated with it. [4] investigated the nature of risk in the context of the Indian Foreign Exchange Market in terms of the deviations from the uncovered interest parity conditions during 1997-2006 and found the presence of a systematic risk associated with investments in India compared to those in the US.

The present study tries to analyse the impact of different factors relevant to investment behaviour on the likeliness

to participate in the foreign exchange market thus leading to gaining insights as to why common individual investors stay away from this investment avenue. The factors being considered for the study are Financial Literacy, Experience of investment, Risk Tolerance, Perception about risk associated with the foreign exchange market and Perception about return associated with the foreign exchange market.

[5] studied the financial literacy of college students and its impact on students' opinions and decisions about different investments and found that college students are not knowledgeable about personal finance and required education and training especially about the more complex and risky investment avenues. [6] found that investors used accounting information derived obtained from financial statements while making investment decisions and as far as recommendations were considered, those by stock brokers were taken into consideration whereas those by family and friends were not considered.Thus our study hypothesizes (null) that:

H1 : Financial Literacy has no significant impact on investors' likeliness to participate in the foreign exchange market.

[7] studied the impact of former experiences on portfolio choice and found that workers who had faced negative impacts were less likely to invest in comparatively riskier assets and this pattern was observed also in case of individuals whose neighbours and family members suffered adverse experiences as well. [8] found that those investors who used stop losses had less experience and when stop losses were not used, these investors were more reluctant to realise losses as compared to other investors.Thus our study hypothesizes (null) that:

H2 : Experience of investment has no significant impact on investors' likeliness to participate in the foreign exchange market.

[9]identified five factors as the ones which influence the investors' decision-making process and they were herding attitude, representativeness, anchoring, loss aversion and mental accounting. [10] found that there were five underlying psychological factors which drive the investment behaviour and they were prudence and precautious attitude, conservatism, under-confidence, information asymmetry and financial addiction. Thus our study hypothesizes (null) that:

H3 : Risk tolerance has no significant impact on investors' likeliness to participate in the foreign exchange market.

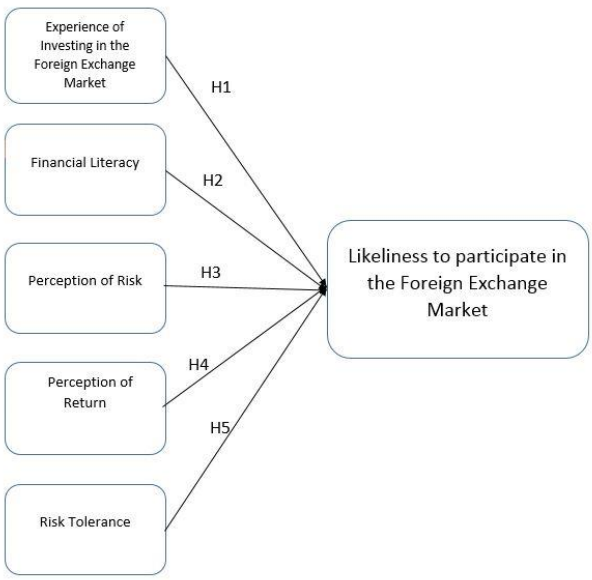
[11] examined the preferences among the major categories of financial assets such as direct shareholding and indirect investment through mutual funds etc. and found that investors' attitude towards various investment types and their perception about them are related to factors like age and income, portfolio diversification practices, market regulation etc. [12] found that there is significant gender differences when it comes to investment preferences for health insurance, fixed deposits and market investments among employees. [13] analysed the trading or investing of professionals in the age bracket of 25 years to 35 years and found that investment activities of young professionals are independent of gender but dependent on income and age. [14] analysed the preferred investors' behavior towards investments avenues in Indore city and found that different age groups have different perceptions and when it comes to investing in investment avenues with high returns and growth prospects.Thus our study hypothesizes (null) that:

H4 : Perception about risk has no significant impact on investors' likeliness to participate in the foreign exchange market.

H5 : Perception about return has no significant impact on investors' likeliness to participate in the foreign exchange market.

III. CONCEPTUAL MODEL

The conceptual model the study follows to understand the impact of source of information and other control variables on the choice of investment is shown below:



IV. RESEARCH METHODOLOGY

Data

The data required for the study were primary in nature. The data have been collected from a total of 90 respondents. Quota sampling was used to get a fair proportion of respondents. The sample was selected such that they were aware of the foreign exchange market even if they have never participated in it.

Questionnaire Development

An online questionnaires was used for this research study. There were questions on the likeliness to participate in the foreign exchange market so as to understand the reasons why people are likely to stay away from this investment avenue. There were also questions to measure financial literacy and experience of investment as well as questions to measure the risk tolerance of respondents and perception of risk and return associated with the foreign exchange market.

Measures

The likeliness to participate in the foreign exchange market was measure using a 5 point Likert Scale question ranging from 'Least Likely' to 'Most Likely'. Questions were asked to understand the respondents' experience in the foreign exchange market in terms of years, if any and also the level of exposure they had to financial education through different courses. Risk tolerance of the respondents were also measured using a 5 point scale question. Perception of risk and return about the foreign exchange market among the respondents were also measured using a 5 point Likert Scale question with options ranging from 'Very Low' to 'Very High'.

Data Description

Data was collected from a sample of 90 respondents. The respondents were spread across various age groups, gender, income levels and locations across India.

TABLE I SAMPLEDESCRIPTION ACROSSAGE GROUP& GENDER

Age Group	Female	Male
18 - 25	6	9
26 – 35	12	15
36 – 50	10	24
Above 50	5	9
Total	33	57

Empirical Model

The model which was used to test the hypothesis is given below:

$$LTP = ß_0 + ß_1EXP + ß_2FL + ß_3RISKPERC + ß_4RETPERC + ß_5RISK + U$$

Where,

LTP = Likeliness to Participate
EXP = Experience of Investment in Foreign Exchange Market
FL = Financial Literacy
RISKPERC = Perception of Risk
RETPERC = Perception of Return
RISK = Risk Tolerance
U = Error term

Ordered Logistic Regression was used to estimate the model. It was preferred as likeliness to participate was measured using a 5 point Likert Scale with options ranging from 'Least Likely' to 'Most Likely'. The results of Ordered Logistic Regression are given in Table II.

V. RESULTS AND DISCUSSION

TABLE II RESULTS OF THE FACTORS INFLUENCING PARTICIPATION

Independent Variable	Odds Ratio	Coefficient	P Value
Experience of Investment in Foreign Exchange Market	6.0025	4.05	0.000
Financial Literacy	0.5223	-0.91	0.363
Perception of Risk	0.8676	-0.73	0.464
Perception of Return	1.3649	1.81	0.070
Risk Tolerance	1.8113	2.52	0.012

From Table II, it is seen that people who have experience of investment in the foreign exchange market tend to be 6 times more likely to participate in the foreign exchange Market. It is also seen that people who have higher risk tolerance tend to be 1.8 times more likely to participate in the foreign exchange Market. Also at 10% level of significance, people who perceive return from the foreign exchange market tend to be 1.4 times more likely to participate in the foreign exchange market

The impact of having financial literacy and perception of risk associated with the foreign exchange market on the likeliness to participate in the foreign exchange market cannot be determined as the p value is found to be less greater than 0.1 thus making it not significant at 10% level of significance.

CONCLUSION

The study reveals that there are certain factors which influence the common investors to be more likely to participate in the foreign exchange factors which thus become the reasons why they stay away from the market as well. The positive impact of having experience of investment in the foreign exchange market on likeliness to participate in the foreign exchange market is shown which means that the lack of financial literacy is one major reason why common investors stay away from the foreign exchange market. Similarly, the study shows that risk tolerance has a positive impact on the likeliness to participate in the foreign exchange market which means that people who have less risk tolerant or risk averse are more likely to stay away from the foreign exchange market. The study also shows that perception of risk about the foreign exchange market has a positive impact on the likeliness to participate in the foreign exchange market which means that people who perceive that the returns from the foreign exchange market are low tend to stay away from the foreign exchange market.

The study shows that although foreign exchange market participation has increased over the years, especially in the recent years, there are still many factors which stop common investors from becoming frequent players in this market. Therefore it is essential to pay attention to these reasons and ensure that the controllable factors can be altered so as to bring it to the favour of increased participation in the foreign exchange market.

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