

Role of Reference Group in Investing in The Stock Market: An Empirical Study

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Abstract

The use of reference groups is crucial while trading on the stock market. A framework for social comparison is provided by reference groups, which has an impact on people's attitudes, behaviours, and perceptions of risk. They provide investors with useful sources of knowledge and guidance as they traverse the complexity of the stock market and make educated selections. As people look to their peers for acceptance and conformity, reference groups can influence how people perceive danger. Positive results seen within the reference group might lower perceived risk and boost investor confidence. Additionally, during times of market turbulence, reference groups provide emotional support, which affects the choices and results of investors. However, use caution to prevent succumbing to a herd mentality that might result in subpar financial outcomes.

Keywords – Reference group, Stock market, market turbulence, passive income, risk tolerance

Tob Regul Sci.™ 2021;7(5-1): 4562-4568

DOI: <https://doi.org/10.52783/trs.v7i5-1.1404>

Introduction

Everyone in India as well as the world today is entering stock market. As people want to increase their wealth and ensure their financial future, investing in the stock market has grown in popularity. People cannot simply earn and save a portion of their salaries due to the increase in inflation. Investments become crucial to coping with inflation-related price rises. Due to various advantages of investing in stocks, the stock market is one of the oldest and most well-liked financial channels. Apart from this over the long run, stocks have the potential to offer large capital growth. Investors can gain from price appreciation because of firms' growth and increased profitability as reflected in the value of their stocks (Van et.al, 2011). Investors may contribute to the expansion of prosperous firms and perhaps generate sizable returns on their capital by making investments in high-performing enterprises. To reward shareholders, many businesses pay dividends out of their profits. Dividend-paying stocks may offer a steady flow of income, which can be particularly alluring for income-oriented investors like retirees. Dividends can complement an investor's total investment returns and help one create a passive income source (Karpavičius & Yu, 2018) Lastly, People may diversify their financial portfolios by investing in equities. Spreading investments over several asset classes, sectors, industries, and geographical

locations is known as diversification. Investors might possibly offset losses and lower the risk of keeping a single investment by diversifying their portfolios. Stocks provide investors access to a variety of businesses operating in numerous industries, allowing them to diversify their portfolios and profit from diverse market segments (Guiso et.al, 2008). Hence, because of all these reasons, people nowadays prefer to invest in stocks. But in addition to one's own financial objectives and risk tolerance, societal variables also play a role in determining whether or not to invest in stocks. The reference group, a set of people who operate as a standard for social comparison and have an impact on others' behaviour and attitudes, is one such powerful element. Based on a collection of people who have specific characteristics, an organization employs reference groups to improve its business strategy. Peer group members can be identified by a trait that sets them apart from other societal members.

Literature Review

Reference groups can be extremely important for an individual to make the right decisions in stock markets. Reference groups offer a context for social comparison, enabling people to evaluate their attitude, behaviors, and beliefs considering those of others. Reference groups may significantly influence investor decisions when it comes to stock market trading by offering advice and information. People frequently use people who have success and expertise in investing as a point of reference for good investments. Investors may learn a lot about market trends, investment opportunities, and portfolio management tactics by looking at how their reference group members invest in stocks and other ventures. Reference groups may serve as informational resources for stock market performance and possible investment opportunities. Members of a reference group may have talks, share investing advice, or trade market developments information with each other. By facilitating the information flow, these contacts let investors choose their investments with more knowledge and insight (Mol & Birkinshaw, 2009). Investors can lessen information asymmetry and improve their capacity to negotiate the complexity of the stock market by drawing on the collective wisdom and experiences of their reference group.

Reference groups can really be useful for an individual in making smart business and stock market decisions. The sense of risk that a person has while investing is significantly influenced by reference group of that individual. People frequently rely their assessment of danger on the actions and attitudes of the people in their reference group. If the members of the reference group have conservative investment styles, the individual could view trading stocks as a dangerous venture. The person could be more motivated to take on more risk in their own investing selections, however, if the reference group has a high-risk tolerance and actively invests in speculative ventures (Amaldoss & Jain, 2008). Here, the basic idea is that individuals frequently seek approval and comfort from others when making decisions, especially when there is risk and uncertainty involved. When individuals see members of their reference group making profitable investments, they tend to view investing as a more favorable and low-risk activity. Their perception of risk is reduced and their belief in the likelihood of successful outcomes rises

when they observe that members of their reference group have successfully navigated the stock market (Kaustia & Knüpfer, 2012). The psychological demand for social approval and conformity has its roots in the effect of reference groups on risk perceptions. Being social creatures, humans frequently try to conform their actions and choices to those of their reference groups. Individuals depend on the activities and results of others as a standard for their own decision-making because they want to fit in with society. Their views of risk are strongly influenced by the perceived acceptability and success of the other members of their reference group, which also influences whether or not they choose to invest in the stock market. It is crucial to remember that the influence of reference groups on risk perceptions can vary depending on the degree of social ties within the group, the degree of credibility and trust that individuals accord to the members of their reference groups, and the level of financial literacy and investment knowledge that the individual themselves possesses (Hartatin & Simanjuntak, 2016). However reference groups have a major impact on how people perceive and react to investment risks due to the potent social proof process.

Stock market investing may be emotionally taxing, particularly during times of market turbulence or downturns. In those circumstances, reference groups can offer emotional support and aid to investors in navigating their anxieties and doubts through tough times. Members of reference groups can aid in easing investor concern and boosting confidence by sharing their experiences, offering encouragement, and offering proper guidance. All this can be crucial for uplifting the individual's confidence. During volatile market situations, an investor's decision-making may be significantly influenced by the emotional support of a reference group. Individual investors may be persuaded to stick with their plans in the face of difficulty if the reference group maintains composure and exhibits confidence in their investing choices. On the other hand, if the reference group sells its investments in a panic during a market downturn, it may increase anxiety and cause rash decisions among its members. By influencing people's investment behaviour, reference groups can affect the results of investments. If members of the reference group frequently outperform the market, it may inspire others to adopt similar tactics and judgements. However, this can also result in a herding effect, when people heedlessly copy the behaviours of the reference group without carefully considering their actions or comprehending the underlying logic (Lee et.al, 2018). In addition, the reference group's makeup itself affects how investments perform. Diverse reference groups with a range of investing preferences, risk tolerances, and financial objectives can offer a deeper understanding of the stock market. Investors may avoid group thinking and make more well-rounded financial selections by being exposed to a variety of perspectives and methods. It's vital to remember that reference groups might not necessarily represent a person's interests (Hoonsopon & Puriwat, 2016). Peer pressure among a group of peers may result in uniformity and a herd mentality, which may influence people to stray from their initial investing strategies or take on unnecessary risks. Such actions may lead to poor investment results and financial losses. It's important to keep in mind that reference groups may not always accurately reflect a person's interests. Peer pressure may cause

conformity and a herd mentality within a group of peers, which can lead people to deviate from their original investing plans or take unwarranted risks. Such behaviours may result in unsuccessful investments and financial losses.

Objective:

To Measure the Role of Reference Group in Investing in the Stock Market

Research Methodology:

The nature of the study is empirical. 170 respondents were targeted to share their viewpoints on the role of reference group in investing in the stock market. After the data collection it was examined through frequency distribution technique and therefore pie charts were used to present the data.

Data Analysis and Interpretation:

Table 1 Provide Investors with Useful Sources Of Knowledge

Particulars	Agree	Disagree	Can't Say	Total
No of Respondents	148	18	4	170
% age	87.0	11.0	2.0	100

Table 1 shows the data of the statement **provide investors with useful sources of knowledge**, and 87.0% of total respondents comply with the statement.

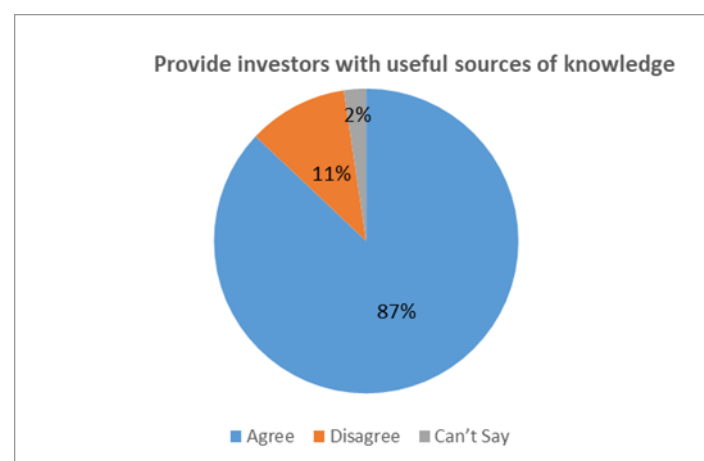


Figure 1 Provide investors with useful sources of knowledge

Table 2 Reference groups can influence how people perceive danger

Particulars	Agree	Disagree	Can't Say	Total
No of Respondents	153	12	5	170
% age	90.0	7.0	3.0	100

Table 2 shows the data of the statement reference groups can influence how people perceive danger, and 90.0% of total respondents comply with the statement.

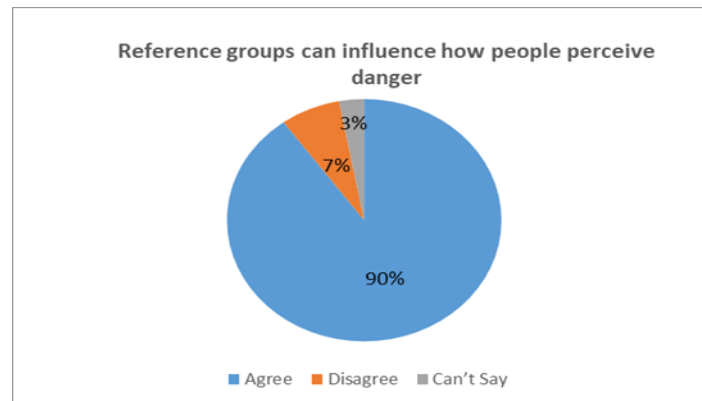


Figure 2 Reference groups can influence how people perceive danger

Table 3 Reference group might lower perceived risk

Particulars	Agree	Disagree	Can't Say	Total
No of Respondents	157	7	6	170
% age	92.0	4.0	4.0	100

Table 3 shows the data of the statement reference group might lower perceived risk, and 92.0% of total respondents comply with the statement.

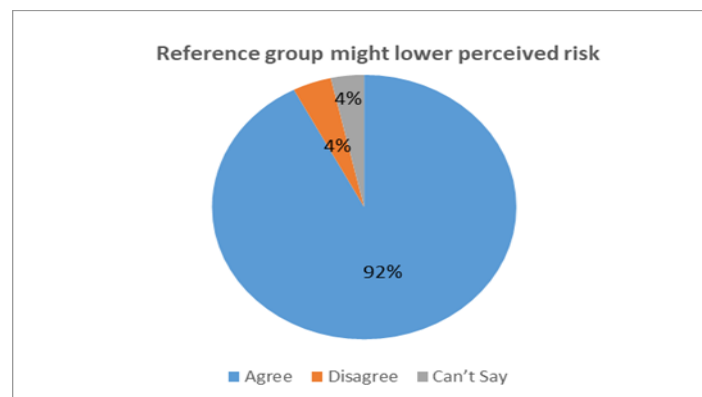


Figure 3 Reference group might lower perceived risk

Table 4 Boost investor confidence

Particulars	Agree	Disagree	Can't Say	Total
No of Respondents	161	7	2	170
% age	95.0	4.0	1.0	100

Table 4 shows the data of the statement **boost investor confidence**, and 95.0% of total respondents comply with the statement. Keeping in mind all the feedback of the statements, it was found that to a good percentage, the respondents have agreed that reference group play an important role in investing in the stock market.

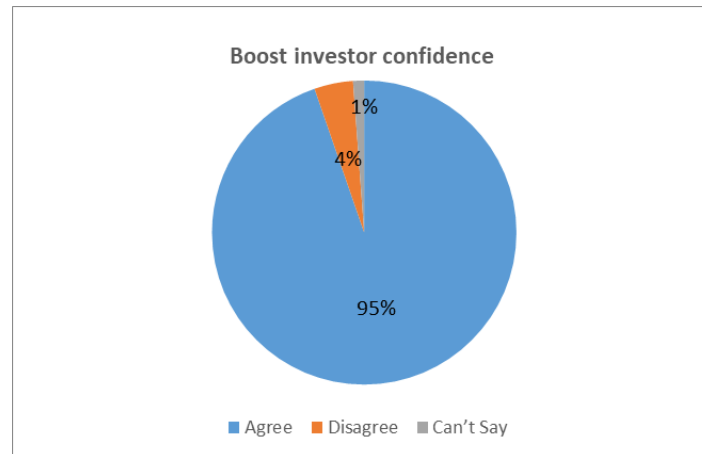


Figure 4 Boost investor confidence

Conclusion

Reference groups are important in stock market investment, to sum up. They give people useful knowledge, counsel, and direction so they can make wise choices in a complicated market. Reference groups have an impact on how people perceive risk because they frequently base their assessment of danger on the behaviours and attitudes of their peers. When members of the reference group exhibit investment success, people view investing as less hazardous and more advantageous. Additionally, during times of turbulence in the market, reference groups provide emotional support, which can have a big influence on investor confidence and decision-making. To avoid adopting a herd mentality and making ill-informed investing decisions, it is crucial to use prudence. Diverse reference groups with varying preferences and objectives can provide a broader understanding of the stock market and help investors avoid group thinking. By understanding the role of reference groups, investors can leverage their influence to enhance their investment outcomes while considering their own interests and risk tolerance.

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