

Report Type

Mid Term Award Report

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Faculty/Department

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Project Title

Financial Decisions: The role of information through social networks

Project Abstract

We design, field and exploit novel survey data, from a representative sample of the French population in December 2014 and May 2015, that provide insights regarding two channels via which social interactions may generally affect financial decisions. The first is a pure information effect, which arises solely from communicating and disseminating information to and from friends and acquaintances. The second is an endorsement or imitation effect, broadly understood as comprising of social norm effects, complementarities, fads, etc. We find that both effects are positive, sizeable and significant. The more (and better) informed about the stock market members of respondents' social circles are, the higher the share of respondents' financial wealth that is invested in the stock market (information), in accordance with theoretical predictions. The same effect is found for more members of respondents' circles participating in the stock market (imitation). In the latter case however, we only find evidence of selective imitation (observational learning), by identifying a positive and significant effect coming only from a subset of respondents' social circle with whom respondents interact regarding financial matters. These findings indicate that informative social interactions are important for stock market financial behavior and may help in overcoming financial literacy limitations.

Activities and Achievement

What are the social processes underlying investment behaviour? Recent history has been punctuated by systemically serious investment events. One example was the fast spread of stock market participation in the 1990s that led to the burst of the dot-com bubble. Another was the spread of excessive borrowing against home equity, leading to the 2008 global financial crisis. It is natural to ask what the role of social interactions and peer effects is in the spread of financial behaviour. This research projects looks at how the social circle of people influences their decisions in the stock market. We distinguished two ways by which social interactions may affect investment decisions. The first is purely through the information that is exchanged with friends and acquaintances. The second way is through the imitation of peers, reflecting social norms in preferences and opinions. Our data were gathered with an innovative survey which provided measures of stock market participation and social connectedness, but which also derived measures of beliefs and perceptions of stock market returns using probabilistic elicitation techniques. It was conducted in two stages in late 2014 and mid 2015, on a sample of individuals who were representative in terms of standard demographics of the population of France. The analysis suggests that there is an information effect that runs directly from respondents' social interactions to how much they invest in the stock market. Having a social circle that is perceived to be better informed about the stock market is associated with both higher expected returns and a higher share of the respondent's financial wealth being invested in stocks. The same is true for perceived participation in the stock market by

the respondent's social circle, indicating that some pure imitation may also be going on. We then identify the subset of the respondent's social circle – their financial circle - with whom they interact on financial matters. It is assumed that they are considered more knowledgeable and that the respondent trusts their views. By asking them to provide information about all these people, it is possible to get measures relating to their financial circle on the one hand, and the outer circle of people with whom they do not discuss financial matters on the other. Analysis using the financial circles of respondents reinforces the main conclusions, i.e. that there is a pure information effect present. There is a strong and significant relationship between the share of financial wealth that individuals invest in the stock market and the proportion of their financial circle that is perceived to follow the stock market. The relationship with the outer, non-financial circle is statistically insignificant: in other words, information about the stock market does not pass from the outer circle to the respondents because the respondents apparently do not discuss financial matters with them. It is useful to distinguish between two types of imitation. One is 'mindless' imitation, when respondents might simply copy what others do, responding to peer pressure or fads. But there is also 'selective' imitation, by which investors might take the actions of the knowledgeable members of their circles as informative signals. It was possible to explore the influence of these different sorts of imitation by regressing the share of financial wealth invested by respondents in the stock market on two proxy measures: the proportion that are perceived to invest in the stock market of, first, the respondents' financial circle for 'selective' imitation and, second, their non-financial circle for 'mindless' imitation. The effect of their financial circle was again sizeable and significant, while the effect of the non-financial circle was statistically insignificant. It appears that investors decisions are indeed influenced by their social networks, but not blindly so. Investors use their social interactions selectively and they act on the indirect information thus provided.

Dissemination

Preliminary results from the research project were presented at (i) the Macroeconomics Workshop at the Faculty of Economics, Cambridge (May 2016), (ii) the 3rd CERF Cavalcade (May 2016) (iii) the BCAM Workshop 2016 (May 2016), (iv) the Keynes Fund research day (June 2016) and (v) the SED annual meeting (June 2016). A first paper should be ready to submit for publication in the next few months.

Outputs

None yet.

Major Difficulties and Any Other Issues

None.

Web Links

None.

Additional Information

Declaration

This award has not yet produced any relevant outputs, but details of any future publications will be submitted to the CERF database as soon as they become available.

Signature - Main Award Holder