

Report Type

Mid Term Award Report

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Faculty/Department

Economics

Project Title

Financial Decisions: The role of information through social networks

Project Abstract

We examine how social interactions and peer effects affect individuals' decisions to invest in the stock market. 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: (i) information peer effects, which arise solely from communicating and disseminating information to and from friends and acquaintances and (ii) endorsement peer effects, broadly understood as comprising of social norm effects in preferences, imitation, complementarities, opinion transmission, etc. We find that respondents with larger social circles invest a higher proportion of their wealth in the stock market, in accordance to theoretical predictions. We also find that both information and endorsement effects are significant, and that perceptions about peers behaviour and information have only an indirect effect on expectations of returns, and mainly through respondents' information set.

Activities and Achievement

In this project, we focus on how social interactions and peer effects affect individuals' decisions to invest in the stock market. Recent literature broadly identifies two channels via which social interactions may generally affect financial decisions such as investing in the stock market: (i) information peer effects, also referred to as social learning, which arise solely from communicating and disseminating information to and from friends and acquaintances and (ii) endorsement peer effects, also referred to as social utility motive, broadly understood as comprising of social norm effects in preferences, imitation, complementarities, opinion transmission, etc. A key theoretical prediction is that individuals with higher 'connectedness', i.e. with more and/or more intense social interactions, trade in risky assets more aggressively. This is because well-connected individuals pool more privately received signals by individuals they are acquainted with, increasing the precision of their conditional stock market return expectations and thus the share of their wealth that is invested in risky assets. With this prediction in mind, we design, field and exploit novel survey data that provide a variety of measures of stock market participation (relative to individuals' wealth), connectedness, but also beliefs and perceptions of stock market returns via probabilistic elicitation techniques. Our empirical analysis exploits cross-sectional variation for a representative sample by age and wealth of the population of France, collected in two stages, in December 2014 and May 2015. In addition to subjective beliefs and perceptions of realized returns, the questionnaire contains a rich set of covariates for socioeconomic and demographic controls, preferences, constraints and access and frequency of consultation of information sources. Crucially, it also contains specific questions designed to obtain quantitative proxies of network characteristics that enable identification of information network effects on financial decisions from individual answers. Our preliminary findings can be summarised as

follows. We find that respondents with larger social circles invest a higher proportion of their wealth in the stock market: increasing the average number of social connections by 1 (from 38 to 39, representing a 2.6% increase) corresponds to an increase of the share of wealth invested in risky assets by 3% amongst stockholders, and by 0.7% unconditionally, controlling for individual risk preferences, expectations and perceptions of returns, as well as for socio-economic and demographic characteristics. Moreover, according to theory not only the number of social connections matters, but also how informed one's neighbours are: We then find that a 10% increase in the perceived proportion of one's social circle that follows the stock market (information effect) is associated with a 6% higher share of wealth invested in the stock market. Conditional on being an investor, this number changes to 24% higher share of wealth. In order to examine whether the identified information effect is not masking an endorsement effect, we empirically identify the two distinct channels of influence on individuals' stock holdings by including the perceived stock market participation rate of peers separately from the proportion of them that follow the stock market. We find that both effects are quantitatively significant. In particular, we now have that a 10% increase in the perceived stock market participation rate within one's social circle (endorsement effect) is associated with an increase in the share of wealth invested in the stock market by 6%, and conditional on being an investor, the increase is by 29%.

Dissemination

The project has so far generated one almost completed working paper, which has been accepted for presentation in three international academic conferences this summer.

We are expecting at least one more paper to be generated from this project, addressing similar questions, but for the housing market.

Outputs

Not available yet.

Major Difficulties and Any Other Issues

The project has been delayed substantially due to some administrative delays (relating to the collaboration between Cambridge and PSE). Due to the delays the survey had to be fielded in two stages, December 2014 and May 2015. Despite the delays, we believe that we will be able to deliver the final outputs in good time, at the end of the grant holding period.

Web Links

Not available.

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

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