# RESHAPING INVESTMENTS AMIDST 2020 PANDEMIC: A PROSPECT THEORY WAY

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**Abstract**

The unprecedented breakdown of COVID-19 pandemic has brought to core the colossal of transitions in the business and economy. Overall the Indian economy has witnessed loss of human lives and turmoil leading crisis situation and slow growth rate. Indian economy is diverse, the challenges and the contraction of growth region-wise is not same. The intensity of business closures, job cuts and unemployment has displaced the financial sector. Retail investments were greatly affected due to changing investor preferences. The paper attempts to analyse the burden of COVID-19 on the savings decisions of retail segment of investors for insurance products and gold. The research encompasses a comprehensive review of the articles published in secondary sources for understanding the trends in the insurance sector and in gold investments. The paper relates to apply the prospect theory to the changing uncertain investment environment. Several experiences of the retail investors have been ascertained based on the observations for 6 months from January to June 2020 time period. The findings indicate investor biases towards other asset classes to reduce risk and shift towards insurance products and online gold products. Theoretically, the paper contributes to the field of pandemic research and behavioural economics in terms of risk aversion in unprecedented times. Pandemic leaves a long-lasting impact on the economy; such instances time test the theories which serve as enablers for identifying the best practices in addressing uncertainty.

**Key words:** Pandemic, COVID-19, Uncertainty, Insurance, Gold

## Introduction

COVID-19 pandemic, has placed several challenges to citizens and governments across the globe. People not only had to adapt to the fast-paced developments in the midst of a crisis, but also have to comply with strict interventions from the governments of their countries. Many countries imposed stringent rules and boundaries on social life. Schools and colleges were shut, offices asked their employees to work from their homes, and people were asked to avoid gatherings and maintain social distancing. Various countries enforced a lockdown on public life, including India. People experienced strong negative emotions of fear and powerlessness.

In times of this global crisis, it is important to investigate sentiments of people towards their investment decisions and to understand how people have changed their investment portfolios during this pandemic.

Prospect theory propounded by Kahneman and Tversky (1979) explains the alternative investment options available to the individuals under risk and uncertainty environment.

The central element of this study is an attempt to capture the elements of Prospect Theory that underlie decision making in uncertain and risky circumstances. How the change in investors' behaviour towards their investments, insurance in particular, has taken place. COVID-19 pandemic looks difficult equally for the insurance industry, but there is also an opportunity in this challenge.

Analysis and results of this study are based on reports published by the big consulting houses such as PwC, KPMG during Pandemic; on the data relevant to Insurance companies in India and gold; and is based on the observations of the retail investor's behaviour made by the authors in the worst hit areas of Maharashtra (India).

The paper seeks to explore the pandemic effect on the retail investor's investment decisions and to analyse the critical drivers for such transition.

**Literature Review**

"Prospect theory is, first and foremost, a model of decision-making under risk. As such, the most obvious places to look for applications are areas such as finance and insurance where attitudes to risk play a central role. Prospect theory is also referred to as loss aversion theory was propounded by Kahneman and Tversky (1979). Investors exhibit different behaviour. They are much more concerned about prospective loses than they are happy about potential gains. "Investor considers the impact of a loss or possibility of a loss to be higher than that of a gain, though negative or positive impacts respectively" (Jordan & Miller, 2008; Baker & Nofsinger, 2010). "The theory indicates that investors have the tendency to be risk-averse when it comes to gains; but are risk-seekers when it comes to losses. Between the option of a sure gain and that of a gamble which could increase or decrease of sure gain, investors are more likely to choose sure gain. However, when they are faced with an option of a sure loss and that of that of a gamble which could increase or decrease of sure loss, investors are likely to opt for a gamble" (Musundi, 2014). According to Nicholas and Berberis, "People are much more sensitive to losses even small losses than to gains of the same magnitude." Kahneman and Tversky realized the fact that the expected utility theory model given by Morgenstern and Von Neuman (1953) did not fully describe the manner in which individuals make decisions in risky situations and that therefore, there were instances in which a decision-maker's choice could not be predicted. The central idea in prospect theory is that people derive utility from "gains" and "losses" measured relative to a reference point. But, in any given context, it is often unclear how to define precisely what a gain or loss is, not least because Kahneman and Tversky offered relatively little guidance on how the reference point is determined (Nicholas C. Berberis, 2012)".

In 1992, Kahneman and Tversky published a revised version of their theory known as "cumulative prospect theory". This version is more often used in economic analysis.

**Research Questions:**

From the literature following research questions are formulated: How loss aversion can be explained as relative to a reference point which majorly depends upon the state of the economy? Does the individual investment decision change under the condition of uncertainty? Are the expectations of a retail investor investment outcome based on the probability of gain?

**Pandemic outbreak**

India had witnessed the outburst of coronavirus (COVID -19) in the month of January, 2020. The pandemic originated from the state of Kerala leading to a local contagion. Numerous cases were detected in different parts of India majorly linked with individuals having travel history to affected countries. India evidenced a rapid increase in the number of coronavirus cases and by June 2020 the fatality rate stood at 2.8%. The nationwide lockdown announced by the Indian government has led to an economic crisis. International Monetary Fund's estimation about the GDP to shrink by 4.5 per cent this year indicated the economy has headed towards the worst fall in more than four decades. Several studies highlight the impact of Coronavirus on the various sectors of the global economy prior and post crisis. COVID -19 surfaced as a black swan resulting into social isolation within countries, industries shut downs, loss of employment, job cuts, business losses and many adverse economic effects. Informal sector was the worst hit. COVID -19 has transformed the economic landscape resulting into change in the individual behavioural traits. Marcus Ranney (2020) article state the specific aspects of COVID -19 which indicates that individuals and places transmit an undetected threat. Shift in the individual decision-making process for relocations, work spaces, and investments will become less risk tolerable. Because of lesser confidence, trust will be more important than ever before. Mass migration to virtual mode has transformed the communication process across learning, transactions, consumption and work place. Self-awareness has emerged as a critical factor. Higher priority on individual long-term welfare during the pandemic has changed the psychological thought process. The magnitude of the pandemic was visible across many countries. The psychological, social and economic consequences of the pandemic were ahead of the experience in a generation. It was a transformative experience for individuals transversely across the globe in terms of stress, ambiguity and social isolation. Fear of contagion lead to panic and unrest among common persons leading to unconventional behaviour.

**Psychological biases during Pandemic**

The theory of prospects, loss-aversion bias was explored Kahneman and Tversky in the year 1979. The theory underlines that value of a gain and loss is not accepted in the same way by the investors. Due to the existence of biases, the investor decides to earn a gain rather a loss and want to avoid risk known as loss aversion. Investor's bias is due to the influence of purchase and sale of securities decisions. The prospect theory was a valuable resource during the course of COVID-19 for understanding the investment behaviour of individual investors. The turmoil in the financial sector due to pandemic outbreak has changed the normal behavioural characteristics of financial decisions of individual investor. Study by De Bondt and Thaler (1987) argues that "there exists an overreaction in the market due to the newly obtained information. Fuller (1998) defines one of them as representation bias that deceive the investors to judge they have already processed the information accurately right before they take a decision." The paper contemplates on the prospect theory and its applicability to the retail investor decision making during the pandemic of COVID-19. The research focuses on the significance of prospect theory on the investment behaviour of retail investors in the insurance and gold instruments during the pandemic.

**Objectives**

The objectives of this study are two-fold.

1) to analyse how the pandemic has pushed people to change the way they invest. Is it in accordance to the Prospective Theory?

2) to understand how businesses across insurance sector have changed the way they operate and how are they going to plan for the future.

**Methodology**

This study is review based and qualitative. Data has been consolidated from various secondary sources. The study is based on COVID – 19 which is considered as an event for testing the prospect theory. Study focuses on the retail investors and investments in insurance products and gold. The time period considered for the study was from January to June, 2020. The time period selection was based on multiple actions such as lockdown, increase in spread of disease and economic mayhem. To substantiate the secondary sources observational study was conducted on the retail investors from Pune during the specified time to validate the investment behaviour in the context of prospect theory. The observation was conducted at frequent interval of time to understand the behaviour and attitude of the individual investor.

**Discussion**

After the comprehensive review from the secondary sources, information is consolidated to understand the relevance of prospect theory for investment decisions under uncertainty. The observations from the review related to investment behaviour have been restricted to two financial instruments. The discussions of the review are categorized into two sub sections: Insurance and Gold.

**Insurance Sector:**

The pandemic has transformed the dealings of different sectors and compelled businesses to amend the way they operate and the insurance sector is not an exclusion. Insurance companies had leverage technology for sale of new policies and for settlement of claims during the lockdown. Report by KPMG on corona virus indicate that insurance sector is facing the brunt of a regressing economy and there is a need for customized products to suit the demand with COVID-19 specific policies. The section of the paper assesses the major findings related to the supply side (Insurance Company) and demand side (Retail Investors) for the insurance services during the pandemic. In India, Bancassurance, the efficient low-cost distribution channel account for over 90% insurers' new business premiums. Due to the lockdown limitations, sales through these channels have been severely diminished.

**Service provider perspective**

Mckinsey report (2020) depict the upsurge by 25 to 50 percent in the volume of business in the first few months of 2020. The conversion rates were on the higher side adding new sections of the retail customers who earlier were reluctant to avail insurance products. There has been a strong pull throughout in the term life insurance products as the demand has risen drastically. Similar pattern has extended to other product lines. Demand for disability insurance has increased. Also, interest in homeowners' insurance has surged high which was a reflection that people were more inclined to invest money on their insurance premiums. Insurance companies are leveraging technology for providing services to their customers, starting from provision of information about different policies up to payment of insurance premiums through digital payment methods. Some of the insurers have restructured their product offering to address the pandemic demand by increasing the sum assured for life insurance and healthcare policies. Some insurers have provided commissions in advance to their agents. This can help them monetarily in this indefinite time.

Insurers believe that people are hard-pressed to buy health insurance due to this difficult time period. "The report said inquiries about health insurance policies have increased by about 30-40%. Health insurance is expected to cushion the blow that this pandemic will deal. While being extremely relevant to society, using appropriate mitigation strategies, insurance companies may be able to support it further though product development activities and ensuring their reach is extensive (PwC's COVID-19 Impact on the Indian Insurance industry)".

"Amit Chhabra, health business head, Policybazaar.com, an online insurance marketplace, said the number of claims for COVID-19 is not really hurting insurers as much because the number of planned surgeries is down at the moment. For general insurers who have a mixed bag of products, motor claims are down due to the lockdown and social distancing which means their loss ratio is down too. Planned surgeries will happen eventually and claims could go up then. But it's also important to note that COVID-19 claims are not very high in number because the percentage of people covered under health insurance is quite low. As a percentage of the total number of cases, the claims filed are very less, said Chhabra".

"A report by professional services firm PwC says, a large proportion of this industry is dependent on industries and businesses such as automobile, travel, hotels and infrastructure. So, challenges in these sectors due to the lockdown could create additional issues. The automobile sector was witnessing a slowdown even before the pandemic set in. The over 70-day lockdown leading to job loss and pay cuts across most industries will put the purchase of new vehicles on the back burner, hurting the motor insurance space further. The two productive months for the insurance industry—March for life insurance and April for non-life corporate renewals—have been hit by around 30% and 15% respectively. The overall cost of testing and treating COVID-19 patients will have an extensive impact on life and health insurance providers that are already affected by the pandemic. As the insurance providers are struggling with shrinking market shares and profit levels there is a very high probability that the payable premiums will be increased in the next year to cover the losses incurred".

The instant outbreak of pandemic has compelled insurance sector to adopt transformative practices for addressing the new challenges and questions. For the products like health, which are renewable for the entire life time, additional consideration has to be paid given to those who are in the old age.

Long-term insurance contracts especially for life and pension, the margins and assured returns are to be recalculated. Insurance companies will have to face daunting challenges ahead, even though it is well thought by the companies that it can overcome this pandemic time as well.

"Naval Goel, CEO and founder, PolicyX, an online insurance aggregator, said a fall in the sale of new vehicles directly impacts the growth of new premiums. Overall till June, the industry has seen de-growth in the motor segment by 11%. The slowdown will continue for the next one quarter and hopes are pinned on the festive season, he added."

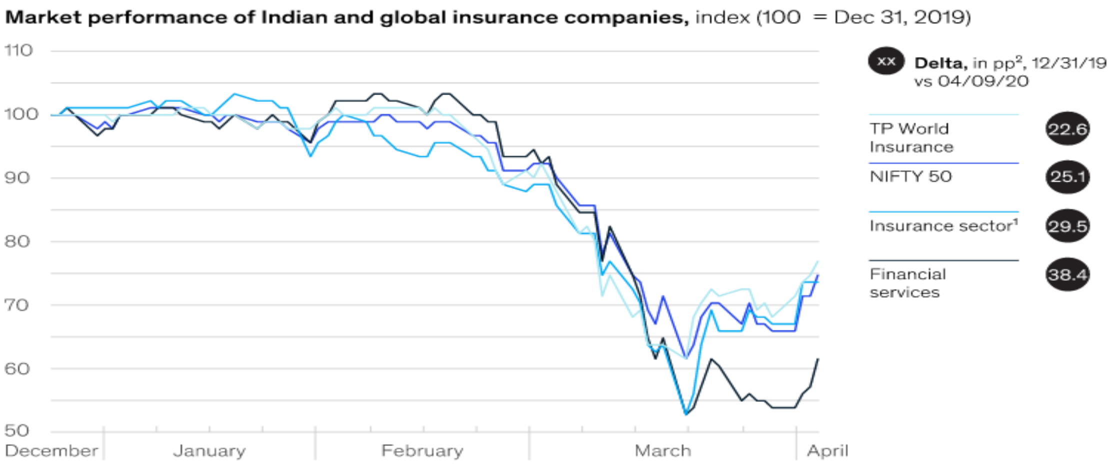
"Animesh Das, head of product strategy, Acko General Insurance, said for every insurer, the motor portfolio dipped in April-May because customers delayed renewals and the sale of new cars was minimal. It'll take two-three months for normalcy to return because the production of new vehicles is gradually getting back on track. For motor insurance, the number of claims has come down to less than 5% of the normal which led to some savings for insurers. On the personal accident front, too, low claims are expected due to lack of activity and movement, and also lower renewal of policies".

Digital architecture had been extensively used by insurance companies during the pandemic. Technology has accentuated the insurance sector during the pandemic time period. Insurers have introduced medical plans which have been extended to cover the treatment of coronavirus. Telemedicine and preventive healthcare were the key enablers for digital claim processing which indicated a remarkable rise. Deferred repayments and discounts have been offered by insurers to support the COVID-19 patients. Insurers have launched new products with COVID-19 coverage and have been successful in expediting the approval process. Turnaround time has been reduced through use of interactive voice response systems. Insurance companies are focusing on investment in new products or altering the product mix to mitigate the risk.

**Demand Side Perspective**

**According to Mckinsey Report (2020),** COVID-19 pandemic has caused persistent uncertainty and shifted the consumer focus with unparallel magnitude towards insurance products. Individuals are trying to understand their insurance coverage, free up their savings, reduce spending and address risks related to life and health. The investor sentiment towards insurance products have changed due to the pandemic, there is a shift in the investment practices of retail investors. There is sudden rise in the demand for insurance products which was evident from the highest levels of consumer search traffic ever for life insurance. The general insurance sector witnessed a tremendous downfall due to the lockdown and less movement of road and closure of businesses.

**India's financial sector has faltered because of the COVID-19 pandemic.**



*Source: https://www.mckinsey.com/industries/financial-services/our-insights/how-indian-insurance-companies-can-respond-to-coronavirus*

Life insurance is a prominent investment tool amongst the retail investors. Household's investment in life insurance is driven by the objective of providing security to the dependents. Life insurance shields the livelihood of individuals and has a significant connection with the earnings of the individual. COVID- 19 has hit many of the sectors of Indian economy. Interdependencies between the sectors had witnessed a cascading effect of the pandemic to all the allied sectors and individuals. The sharp decline in the insurance sector has been largely due to the working challenges posed by the disaster. Further, the low level of awareness and penetration of insurance in India has increased the challenges.

Crisis and panic lead to rush for insurance products to increase the sum assured. However, the other side salary cuts and unemployment has resulted into shaky cash flows for the retail investors. Lower cash flows prompted for unwillingness towards new investment avenues and higher cover on insurance policies. Cumbersome health check-up procedures was another factor which discouraged retail customers for health insurance products. These psychological drivers have resulted into the downfall of insurance sales during the pandemic.

"We have seen two key areas of impact—primarily, we see greater awareness of being protected and protecting loved ones from unforeseen risks. In line with this, consumers are more inclined towards pure protection covers leading to an increased demand for term plans, said Rushabh Gandhi, deputy CEO, IndiaFirst Life Insurance Co Ltd. He added that the overall uncertainty in the environment, the market volatility and the falling interest rates have made an average consumer more cautious. If cases of COVID-19 increase significantly, a spike in health insurance claims will likely follow".

**Gold: Smart investors are buying gold**

Retail investors are acquiring gold recognising it to be a store of value during times of insecurity. Demand for jewellery and physical gold has declined over time, other avenues of gold products were on rise. Gold as an asset holds the potential to provide adequate returns and liquidity. Lockdown has declined the gold jewellery consumption with low volume which hit the investment in physical gold hard. The purchase intent and behaviour of retail investors purports the prospect theory in the pandemic state. High investments in the non traditional gold products such as Gold Exchange traded funds and sovereign gold bonds witnessed strong cash inflows (Money Control: "India's gold nosedive", 2020 August).

The long-term uptrend displayed by gold signifies the importance of holding gold as an asset in the portfolio with a longer investment horizon. Gold will continue to play its role as an effective portfolio diversifier and a store of value during economic uncertainty.

Economies are witnessing contraction in the global output and recession is anticipated. Deficiency of returns in other asset classes leads to an opportunity for gold to emerge as a safe stake for investors across the globe. The demand for physical gold has declined due to the current restrictions and lockdowns, people continue to buy or invest in gold digitally. (Financial express; "5 best options to invest in gold in times of Covid-19, 2020 July3)"

According to (The Economic times: "Online gold market to see growth amid COVID-19", 2020 July 16) depict the online gold market in India accounts for 1-2% of overall gold sales by value. Due to the COVID-19 outbreak, gold market is witnessing an immense thrust from both digital players who consider it as an opportunity and for large jewellers an additional channel to their brick and mortar model. Pandemic has disrupted the gold retail market; transition from traditional model to digital mode has enhanced the purchase options for the investors. Integration of online and offline mode has changed the transactional marketplace. Effective online investor experience will enable long term engagement. In the phase of high uncertainty due to pandemic, investors portfolio performance has undergone its impact on the portfolio performance. The shift in the investment towards gold as valuable asset for risk diversification supplements the prospect theory. The change in the investor sentiment for risk diversification to enhance risk adjusted returns is clearly visible.

The disruption in the economic activities and geopolitical uncertainties lead to global slump in economic growth drifting investors from risky asset classes and increasing the safe haven appeal for gold which substantiates the prospect theory of risk aversion. Liquidity crisis has prompted individual investors to prefer gold as investment and collateral. For many, gold loans kept the businesses afloat during the pandemic. Not only businesses but farmers are also moving towards the yellow metal for fulfilling their financial requirements. Ease and accessibility are the added features that makes gold loans demandable option. According to WGC, 2020 April 20, "retail investors in India who had never bought gold are now considering it. India's gold market is one of the largest and well-established markets in the world, augmented by the country's traditional affinity with gold. Around 29 per cent of retail investors who have never bought gold in the past are open to buying the precious metal in the future following several government-led financial inclusion programmes. Gold currently has a deeper penetration among urban investors as 76 per cent of this group have invested in gold in the past while 21 per cent are open to buying in the future never previously invested. Nearly 37 per cent of rural investors would consider buying gold in the future despite never having done so before".

**Observation based evidences supporting prospect theory**

A sample size of 55 retail investors in the age group of 30 to 55 years from Pune vicinity constituted the part of observation study. The observation was administered over the 6 months' time period from January to June, 2020 at frequent interval of the specified time period. The observation was undertaken to substantiate the prospect theory with the secondary source of information to map the changing retail investment patterns. The observation yielded the following outcomes:

i) Social isolation and lockdown have created panic with the individuals, dependency on the media for seeking information increased, leading to information asymmetry and self-perceived assumptions for their investment portfolios.

ii) Fear of contagion lead to increasing the insurance cover on the life insurance policies. Preferences for short term COVID-19 health policies were visible and evident.

iii) Savings were majorly diverted towards gold and insurance products for ensuring security and liquidity. Individual limited their risk discounting on returns.

iv) There was a positive relationship between rise in the number of COVID cases and the risk aversion amongst the retail investors this advocates the prospect theory. Investors change their preferences towards the risk depending on the environment and market conditions.

v) Uncertainties will persist in the pandemic situation however diversifying asset classes would enable investor to build flexible portfolio depending on the market conditions and to take advantage of the prospect theory.

**Managerial Implications and steps to be taken**

Immediate tasks that COVID-19 presents are with respect to employees, customers, and other stakeholders. Indian insurers can take actions of managing people's well-being and supporting them in all respects.

**Communication,** both internal and external, now will matter more than ever. The way company responds to a stressful event can shape public attitude and will be a defining aspect for the success. One may face reputational or litigation risks if a company is seen as neglecting policyholder concerns. Speed, flexibility and technical expertise will have to be demonstrated. Content and timely updates will be crucial for communicating with all stakeholders.

**Cybersecurity** will also be a key part of this crisis management. A significantly higher levels of remote access will have to be provided to the workforce and management could be more inclined towards influencing attitudes and behaviours in the midst of this tempest. Rising cyber-attacks will aim at exploiting this crisis. Rapid, secure and remote work models will have to be adapted as quickly as possible.

**Reaching out to the Regulators** for problems and risks and taking steps proactive steps for regulatory guidance will be required.

**Conclusion**

How would companies respond to this crisis? Agreed that this crisis has disrupted everything, at the same time it has also offered a time to think more deeply about innovation, improving customer experiences, differentiating cost structures, and an upskilling and re-skilling of employees.

COVID-19 as a ‘black swan’ event has provided an unmatched opportunity for evolving every facet of risk management. It needs to be realigned to enable businesses to be more agile and nimble. When the restrictions ease, insurance companies should change in their way of working- remote working and use of technology. Now onwards, they should start considering that contagions, fluctuations in environment and related risks are going to be part of their functioning.

Automation has immensely gain momentum due to sophisticated IT infrastructure outpaces human resources. The pandemic has weakened the trust in financial instruments and markets. Retail investors anticipated low profitability event and were more concerned with counterparty risk due to prevailing uncertainty. The retail investor behaviour based on the observations provides conclusive evidence that investor is concerned for gain and are inclined to high risk aversion towards risky financial investments. Retail investors focus has changed due to uncertainty related to life and medical expenses, most savings were diverted towards insurance products unlike other traditional investments. Gold was an alternate investment which provided adequate liquidity during crisis. Digital gold for investment was preferred against traditional purchases on occasions and festivals. Service delivery channels effectiveness and flexibility are the key determinants which would render stable investment environment.

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