

The color red influences investor behavior, financial research reveals

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The phrase "to see red" means to become angry. But for investors, seeing red takes on a whole different meaning.

That's the premise behind a new article by William Bazley, assistant professor of finance at the University of Kansas.

"Visual Finance: The Pervasive Effects of Red on Investor Behavior" reveals that using the color red to represent financial data influences individuals' risk preferences, expectations of future stock returns and trading decisions. The effects are not present in people who are colorblind, and they're muted in China, where red represents prosperity. Other colors do not generate the same outcomes.

The article appears in the current issue of *Management Science*.

"Our findings suggest the use of color deserves careful consideration when it's to be used on financial platforms, such as brokerage websites or by retirement service providers," Bazley said. "For instance, the use of color could lead to investors avoiding the platform or delaying important financial decisions, which could have deleterious long-term consequences."

Co-written by Henrik Cronqvist at the University of Miami and Milica Mormann at Southern Methodist University, the article demonstrates how evolutionary biology and social learning are what creates this color-coded behavior. With regards to Western culture, it's possible that social learning has reinforced biological underpinnings. Specifically, the physical and psychological context in which color is perceived influences its meaning and human responses to it.

"In Western cultures, conditioning of red color and experiences start in early schooling as students receive feedback regarding academic errors in red," Bazley said.

Red is associated with alarms and stop signs that convey danger and command enhanced attention. Other examples include when California issues a "Red Flag Warning" that signals imminent danger of extreme fire or when the American Heart Association uses red in its guidelines to indicate hypertensive crisis (a blood pressure reading higher than

180/120) that necessitates medical care. Over time, repeated pairings of a color with negative stimuli can influence subsequent behavior.

In regard to finance, Bazley was most surprised to find how red color appears to prolong pessimistic expectations in relation to negative stock returns, while viewing the same information in black or blue leads to reversal beliefs.

He said, "This suggests the use of color may have broad implications for stock market liquidity during times of crisis and the momentum anomaly."

Their research also drew on other examples outside the financial community where colors influence choice. An emerging field called color psychology analyzes how this affects human behavior. Bazley cites a 2005 study in the publication *Nature* that argued the color of sportswear may influence outcomes in the Olympics.

"Much like our everyday choices, our financial decisions are likely to be shaped by factors which are not specific to the decision at hand. This can be due to a variety of reasons, such as limits to our attention. Ultimately, it suggests that incorporating aspects of psychology when studying financial decision-making is likely to yield insights," said Bazley, whose "Pervasive Effects" research is based on eight experiments with a total of 1,451 individuals.

He emphasized this particular project originated in a neuroscience course during graduate school. The research also benefited from the varied expertise of Mormann, who is a visual scientist, and Cronqvist, a behavioral finance expert.

Bazley's interest in color effects relates to his overall study in the dynamics of financial decision-making.

"Our everyday choices are shaped by a multitude of factors," said Bazley, whose expertise incorporates behavioral and social influences and fintech.

"A similar process plays out when we make our financial choices. We are still at the early stages of understanding these dynamics, but learning about them has the potential to yield insights that could ultimately improve the outcomes individuals realize from their decisions," he said.

So what is Bazley's favorite financial term involving the color red?

"I appreciate the phrase 'red herring,'" he said.

"In finance, it refers to a preliminary prospectus that a company uses when issuing securities to the public. It is an important document for potential investors, but it tends to omit key pieces of information; hence, it usually has a red disclaimer on the front. I also find fish to be delicious."

More information: William J. Bazley et al. Visual Finance: The Pervasive Effects of Red on Investor Behavior, *Management Science* (2021). [DOI: 10.1287/mnsc.2020.3747](https://doi.org/10.1287/mnsc.2020.3747)

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