

## **BENEFITS AND DRAWBACKS OF ONLINE TRADING VERSUS TRADITIONAL TRADING. EDUCATIONAL FACTORS IN ONLINE TRADING**

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**Abstract:** *In terms of marketing, online trading is a new distribution channel and trading platforms are products of Investment and Financial Services Companies. Internet shortens the connection between the investor and the products they wish to purchase (shares, futures, CFDs, government securities, bonds, etc.), and in some cases it no longer needs a security broker. Increasing use of the Internet and increasing competitiveness between Investment and Financial Services Companies do the latter, to seek new distribution channels to specific products. The purpose of this paper is to examine to what extent the investor education level affects the decision to move from traditional trading to online trading and the benefits and disadvantages of these types of transactions. To whom should the Investment and Financial Services Companies guide their marketing campaign to attract more investors for online platforms? The work presented is part of a larger project that will be part of author thesis, studying other factors that influence the decision to move from traditional to online trading: cost factor, time factor, psychological and social attributes of investors, yield portfolios and technological capacities of Investment and Financial Services Companies. Starting from the idea that with the increase of experience in stock investments the investors will want to make their own decisions, Investment and Financial Services Companies should provide new products. Compared to competitors, an Investment and Financial Services Company must innovate, and information technology currently offers the tools for innovation facilities. At the same time, the existence and development of the Internet has made the transaction without assistance or with minimal human intervention possible (Voss, 2000). The difference is in the knowledge about stock market, the speed the transaction orders arrive in the stock market, direct access to multiple markets, transaction costs and the level of interaction between the client and his stock broker. To analyze the extent to which the investor education level affects the decision to move from traditional to online trading trading, author started from the literature review, a questionnaire-based survey available on internet and personal experience. The study shows that investors will switch to online trading when they have a high level of knowledge in the stock market, higher education and knowledge of internet.*

**Keywords:** online trading; traditional trading; stock market; educational factor;

**JEL classification:** G24

### **Introduction**

Many analysts discuss the influence of the Internet development over the consumer behavior of financial services (Gordon, 1998) and the spread of online trading volatility and volume of transactions (Choi, 2000; D'Avolio et al., 2001; Barber and Odean, 2000 ; Oh et al., 2007; Davis et al., 1999). Online transactions are important in the development of financial markets (Barber and Odean, 2008) and it is surprising that there are very few studies about their impact on investors in Romania.

Information Technology (IT) plays an important role in attracting and retaining customers (Wayland and Cole, 1997) and has revolutionized the concept of distribution, redefining the way the companies relates with its customers (Jones and Sasser, 1995; Roth and Jakson, 1995; Prahalad and Krishnan, 1999).

C.J. George, in his work called "Taking Stock of Online Trading", argues that online transactions with IT can bring major benefits in increasing the speed of trading, market information transparency and low operating costs. Talking specifically, the development of Internet and IT made possible the distribution of products and services provided by Investment and Financial Services Companies with minimal or no human intervention (Voss, 2000), and provides a new communication channel with customers (Hoffman et al., 1997).

In Korea, for example, the country where most transactions are done online (Kang, 2003), increased interest in this type of investment is closely related to the low cost of fees and the fierce competition between Investment and Financial Services Companies (Oh et al., 2007). However, Jobman, Salcedo and Depilla (2003) demonstrate that the most important element is the efficiency and speed with which it executes and mentions that when the client decides to trade online, you must consider the capabilities of back- up and good trading systems. There are studies showing the existence of links between the investor's education and attitude toward risk (Donkers et al., 2001). Berhein and Garnett (1996) stated that a campaign to promote savings through education could have a tremendous impact on the financial behavior.

### **Advantages and disadvantages of online trading compared to traditional trading**

Following the literature and professional experience, we can highlight the strengths and drawbacks of online versus traditional trading.

Some of the *benefits* of trading online are:

- Costs related fees to online trading are lower than those in traditional trading. Whether we are talking in terms of the investment firm's, which remove the human factor from the equation placing market orders, or investor who pays a lower fee, online trading is winning (Voss, 2000). The amount of commissions on online trading is different from an intermediary to another, but the average is 16% lower than the fees charged in the same company on transactions by broker ([http://www.monitorulcj.ro/cms/site/m\\_cj/news/73174-comisioanele-mici-magnet-pentru-investitori#sthash.2XSvZGbW.dpbs](http://www.monitorulcj.ro/cms/site/m_cj/news/73174-comisioanele-mici-magnet-pentru-investitori#sthash.2XSvZGbW.dpbs)).
- Speed of response, in a stock market with high volatility is best for online trading (Jobman et al., 2003). The explanation comes from the fact that it is difficult for a broker, managing hundreds of accounts, to discuss and place orders coming from several investors in the same time.
- Transparency is promoted through the online trading platform and the users can see the market depth on certain symbols, the number of orders (bid and ask), volume traded in real time and other data relevant to trading. Madhavan (1996) indicates that the greater the transparency in the market, the price volatility is lower.
- Studies show that in some cases (see South Korea), market liquidity increased with the number of investors who trade online. Market liquidity and the existence of a large volume of market instruments is essential in discovering the real price of shares (Balling et al., 2003).
- Through online trading, the broker indiscretion is avoid.
- Brokers have not always acted in the interests of customers, resulting in increased fees for excess transactions (Bakos et al. 2005).

Some of the *disadvantages* of online trading are:

- The profits from the online portfolio administration is lower than when given by a broker (Barber and Odean, 2000; , 2002)
- Lack of information that a stock broker provides: "If you are an online investor, you have low fees, but there is just you, your computer and the tools we provide. You need to stay connected all the time, because nobody calls you..." says Rares Nilas, former manager at BT Securities SA ([http://www.monitorulcj.ro/cms/site/m\\_cj/news/73174-comisioanele-mici-magnet-pentru-investitori#sthash.2XSvZGbW.dpbs](http://www.monitorulcj.ro/cms/site/m_cj/news/73174-comisioanele-mici-magnet-pentru-investitori#sthash.2XSvZGbW.dpbs)).
- Increasing "information noise" due to discussion groups dominated by unskilled investors (Madhavan, 2000)
- Due to the facilities offered by the Internet and the comparison between fees, the investor can make the decision in choosing an Investment and Financial Services Company based on price only, neglecting other variables and creating the illusion of efficiency (Bakos et al. 2005).
- No operations can be done without money. In traditional trading you can buy or sell financial instruments without any money in the account as payments will be necessary within 2 working days.
- Brokers can discover hidden orders, that can change the overall picture of a symbol. For example, a large investor decides to liquidate a portfolio but placing a large order sale might scare some investors. There is the possibility of placing such "hidden order" which does not reveal the whole quantity to trade, but only a part (at least 20% of the total amount). Investors who trade online are unable to see these special orders.

### **Research Methodology**

Questionnaire based survey was posted on the internet at: [www.isondaje.ro/sondaj/339299588/](http://www.isondaje.ro/sondaj/339299588/) and related information were sent by e-mail to 280 contacts and were promoted on one social network. Brokers from different companies of Cluj-Napoca helped to promote the questionnaire. As the author lacked direct connection with most of those questioned, she could not control the number of respondents. Since the survey addressed to a particular category of stock investors, the number of respondents was small.

The method chosen to investigate the investor's decision to switch from traditional trading, assisted by a broker to online trading, was a survey sent non-randomly, based on accessibility and reasoning.

The sample of subjects who answered the questionnaire was 50. It is estimated from data from third parties, the number of people who trade online and were reached by the questionnaire was 2,500. As observed, the response rate was low, around 2%. It should be noted that the results are specific only to the sample of investors investigated.

The answers reflected the view of investors in stock market on the degree of importance of various factors in the decision to trade online, training and experience in the stock market, the confidence of investors in their own methods and information for decision making.

In Romania there are 32 Financial Investment Services Companies (BSE, <http://www.bvb.ro/Intermediaries/SSIFuri.aspx>) but only 20 offer the possibility to trade online.

## Results and Discussion

To track how education influences the investors who trade online, people were asked to answer questions related to level of education, knowledge of internet and knowledge of technical and fundamental analysis of financial instruments.

Our data shows that most investors who trade online have at least a university degree, and are more drawn to online trading on the stock market than those with no education.

Distribution of the sample investigated about the level of education, (Table 1) shows that half (50%) of investors are postgraduate, while a close share of 46% is made up of investors who graduated. Thus, 96% of those investigated are at least university graduates, and the remaining 4% of the 50 respondents are high school graduates.

Table 1: Sample of respondents structured by level of education

	Frequency	Percent	Valid Percent	Cumulative
High School	2	4.0	4.0	4.0
Valid Graduates	23	46.0	46.0	50.0
Postgraduates	25	50.0	50.0	100.0
Total	50	100.0	100.0	

Investors consider that is important (46% of all respondents) and very important (42%) to have Internet use knowledge of when shift from traditional to online trading is desired (Table 2). Altogether, only 12% of subjects assigned a medium or low importance knowledge to Internet related knowledge use in general. Given that online trading is primarily related to Internet use, it was logical that this idea is confirmed.

Table 2: Structure of the sample according to the importance attributed to personal knowledge related to Internet use in general

	Frequency	Percent	Valid Percent	Cumulative
Low	2	4.0	4.0	4.0
Neutral	4	8.0	8.0	12.0
Valid High	23	46.0	46.0	58.0
Very High	21	42.0	42.0	100.0
Total	50	100.0	100.0	

To make informed choices, the customer must be able to read and create their own analyses. More than half of respondents felt that it is very important (22%) and important (32%) to have knowledge of analyzing companies (Table 3). However, most of the respondents, representing about one third of the total investigated (34%) believe that having personal knowledge on technical and fundamental analysis of shares is only of average importance in online trading decision.

Table 3: Structure of the sample according to the importance attributed to personal knowledge related to technical and fundamental analysis of shares

	Frequency	Percent	Valid Percent	Cumulative
Very Low	2	4.0	4.0	4.0
Low	4	8.0	8.0	12.0
Valid Neutral	17	34.0	34.0	46.0
High	16	32.0	32.0	78.0
Very High	11	22.0	22.0	100.0
Total	50	100.0	100.0	

Distribution of respondents according to the importance given to their experience in stock transactions indicates that almost half (48%) of the investors investigated, attached great importance to this criterion when deciding to trade online, and another 36% of respondents assigned very high importance to personal experience in share market transactions. Other respondents, representing 14% of the total, have the opinion that this criterion is only of average importance in online trading decision.

Table 4: Structure of the sample according to the importance attributed to personal experience in share trading

	Frequency	Percent	Valid Percent	Cumulative
Low	1	2.0	2.0	2.0
Neutral	7	14.0	14.0	16.0
Valid High	24	48.0	48.0	64.0
Very High	18	36.0	36.0	100.0
Total	50	100.0	100.0	

It highlights that, according to the respondents (Table 5), the most important factor when deciding educational online trading lies in personal knowledge related to Internet use in general (88%), followed closely by personal experience in share transactions (84%). A less important educational factor appears to be the personal knowledge about technical and fundamental analysis (54%).

Table 5: Importance of educational factors in online trading

Educational Factors	Cumulative percentage of respondent who expressed a very high importance and high importance to educational factors
Personal knowledge of technical and fundamental analysis of shares	54%
Personal knowledge related to Internet use in general	88%
Personal experience in share transactions	84%

## Conclusions

As shown, investors will trade online when they have a high level of knowledge in the field of stock market and higher Internet knowledge.

Based on survey results, it appears that, according to the respondents, the most important educational factor when deciding to move to online trading, consists of personal knowledge related to Internet use in general, closely followed by personal experience in stock transactions; a less important educational factor appears to be the personal knowledge on technical and fundamental analysis.

Most investors who trade online have at least a university degree, so the logical conclusion is that if the Investment and Financial Services Companies want to attract more investors on this market place due to low costs, they should guide their marketing campaign to educated people.

### **Limitations and future research**

Due to legislation, limited resources and staff, the refusal of investors to cooperate, the small number of investors who trade online, the study experienced some difficulties.

Surprisingly, not even BSE (Bucharest Stock Exchange) employees are willing to give more information about online trading.

Although it was promoted through numerous channels, the number of respondents was very small. The author could not get access to any online investors database, because their identification data are confidential. The natural consequence is that the information in these questionnaires can not be proved.

Another drawback would be the lack of official information related to online trading of securities. If on the other stock markets (see the case of South Korea) there is a clear division of reporting online an traditional transactions.

A future research could show the position of Romanian online investors compared to those from European Union.

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