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Behavioral Biases and Investment Decisions: An Empirical Study on Retail Investors in India

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Abstract **– The rapid growth of financial markets in India has led to a substantial increase in participation from retail investors. However, investment choices made by individuals frequently deviate from rational decision-making models, largely due to psychological and emotional influences. This study investigates the extent to which behavioral biases affect the investment decisions of retail investors in India. It specifically explores the impact of overconfidence, herd behaviour, loss aversion, anchoring, and mental accounting on investment preferences, risk perception, and portfolio selection. Primary data was collected through a structured questionnaire administered to retail investors across major metropolitan cities such as Hyderabad, Bengaluru, Mumbai, and Delhi, using a convenience sampling method. The dataset was analyzed using descriptive statistics, correlation analysis, and regression modelling to examine the strength of the relationships between identified behavioural biases and investment decisions. The results indicate that overconfidence and herd behaviour significantly influence speculative and short-term trading tendencies, while loss aversion plays a critical role in determining risk appetite and investment safety choices. Anchoring bias was identified as a key factor affecting timing decisions regarding stock entry and exit. The findings underscore the importance of promoting financial literacy, behavioural awareness, and transparent advisory practices to encourage rational and disciplined investment behaviour. The study offers meaningful insights for regulators, policy makers, investment advisors, and financial institutions aiming to enhance investor protection and improve the efficiency of capital markets. Overall, the research emphasizes that recognizing and addressing behavioural biases is essential for strengthening retail investor decision-making and ensuring sustained and responsible participation in India's financial markets.**

Keywords **– Behavioral Finance, Behavioral Biases, Investment Decisions. Retail Investors, Overconfidence Bias, Herd Behaviour, Anchoring Bias, Risk Perception and Portfolio Management.**

I. INTRODUCTION

The financial markets in India have witnessed remarkable growth over the past decade, driven by technological advancements, expanding financial inclusion, and increased awareness of wealth-building opportunities. A significant rise in retail participation is visible through a surge in Demat account openings, mutual fund SIP enrolments, and online trading activities. Despite the availability of comprehensive financial information and advanced analytical tools, investors do not always act rationally. Their decisions are often shaped by emotions, personal beliefs, and psychological biases rather than objective assessment of risk and return.

Behavioral finance provides a framework for understanding why individual investors deviate from traditional finance assumptions, which presume rationality and efficient market behaviour. Retail investors frequently make decisions influenced by heuristics, perceptions, and irrational thinking patterns, which may lead to suboptimal investment outcomes. Biases such as overconfidence, herd behaviour, loss aversion, anchoring, and mental accounting can distort judgment, influence risk preferences, and shape trading strategies.

In the context of India, where financial literacy levels differ across demographic groups and investment culture is still evolving, understanding behavioural biases becomes crucial. Investors may follow market rumours, trade impulsively, or react emotionally to market fluctuations rather than relying on strategic planning. Therefore, an empirical study examining how behavioural biases influence the investment decisions of retail investors is essential to support policymakers, advisors, and financial institutions in designing effective investor education strategies.

II. REVIEW OF LITERATURE

Shefrin & Statman (1985) highlighted that psychological factor significantly impact investment choices, leading investors to behave irrationally during market volatility. Kahneman & Tversky's Prospect Theory (1979) demonstrated that individuals value gains and losses differently, resulting in loss aversion and risk misjudgment. Barber & Odean (2001) found that overconfident investors trade more frequently and often experiences lower returns due to excessive optimism about market predictions.

Nofsinger (2005) emphasized that herd behaviour causes investors to imitate others' decisions instead of performing their own analysis, particularly during market uncertainty. According to Pompian (2006), anchoring bias makes investors depend excessively on reference points such as purchase price or market rumours, which affects entry and exit strategies.

In the Indian context, Chandra & Kumar (2012) observed that emotional influences are strongly present among retail investors, leading to speculative behaviour. Kumari & Sar (2017) identified that loss aversion significantly affects portfolio diversification decisions. Jaiswal & Kamil (2020)

found herd behaviour to be a dominant factor affecting new investors during market volatility.

Despite extensive research, limited empirical evidence exists on how multiple behavioural biases collectively affect investment decisions of retail investors in major metropolitan Indian cities. This study attempts to fill that gap.

III. CONCEPTUAL FRAMEWORK

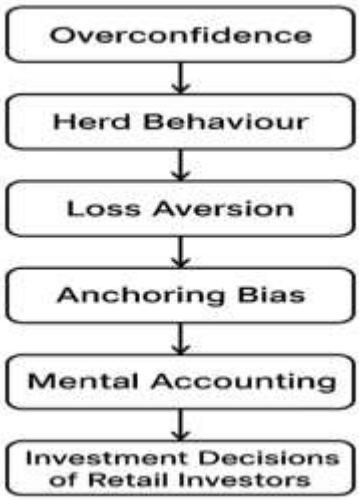
Conceptual Background

Behavioural Finance emphasizes that investors are not always rational; instead, they are influenced by emotional, psychological, and cognitive biases, which cause deviations from logical financial decisions. This study examines five major psychological biases—Overconfidence, Herd Behaviour, Loss Aversion, Anchoring Bias, and Mental Accounting—and their collective influence on the investment decisions of retail investors in India.

Conceptual Model Description

The model proposes that each behavioural bias independently affects how investors select investment options, evaluate risk, and construct portfolios. Investors under the influence of such biases may make decisions that differ from rational models such as EMH (Efficient Market Hypothesis) and utility theory.

Proposed Research Model



IV. RESEARCH GAP

Although several studies have explored behavioural finance dimensions, very few have examined the combined impact of major behavioural biases on retail investors across India. Further, limited research has evaluated the practical implications of these biases on portfolio construction, risk perception, and trading choices. This study addresses this gap by analyzing real investor behaviour using empirical data collected from major metropolitan regions.

V. OBJECTIVES OF THE STUDY

1. To examine the influence of behavioural biases on investment decisions of retail investors in India.
2. To assess the impact of overconfidence, herd behaviour, loss aversion, anchoring, and mental accounting on investment choices.
3. To analyze the relationship between behavioural biases and risk perception.
4. To identify implications for financial advisors, regulators, and policy makers.

VI. HYPOTHESES DEVELOPMENT

H1: Overconfidence bias significantly affects investment decision-making among retail investors.
H2: Herd behaviour has a positive influence on speculative investment decisions.
H3: Loss aversion negatively affects risk-taking ability.
H4: Anchoring bias significantly impacts investment timing decisions.
H5: Mental accounting influences investment preference and portfolio structure.

VII. RESEARCH METHODOLOGY

This is an empirical study based on primary data collected from 400 retail investors in Hyderabad, Bengaluru, Mumbai, and Delhi using structured questionnaires. Convenience sampling technique was adopted. The collected data was analyzed using descriptive statistics, correlation analysis, and regression modelling to determine the influence of behavioural biases on investment decision-making.

VIII. DATA ANALYSIS & INTERPRETATION

The primary data collected from 400 retail investors from Hyderabad, Bengaluru, Mumbai, and Delhi was analyzed using descriptive statistics, correlation analysis, and multiple regression to understand the influence of behavioural biases on investment decisions. The demographic distribution shows that 62% of respondents were male and 38% were female, with the majority belonging to the age group of 25–40 years. Nearly 71% of the respondents actively participate in stock market trading, either through equity, mutual funds, or derivatives.

Variable	Category	Percentage
Gender	Male	62%
	Female	38%
Age Group	Below 25 years	12%
	25–40 years	56%
	Above 40 years	32%
Investment Experience	Less than 1 year	21%
	1–5 years	47%
	Above 5 years	32%

Interpretation:

Most participants are young and middle-aged professionals with moderate experience in financial markets, indicating increasing participation of educated investors.

Analysis Between Behavioural Biases & Investment Decisions

Behavioural Bias	Correlation Coefficient (r)	Relationship Strength
Overconfidence	0.61	Strong positive
Herd Behaviour	0.58	Strong positive
Loss Aversion	-0.49	Moderate negative
Anchoring Bias	0.52	Moderate positive
Mental Accounting	0.45	Moderate positive

Interpretation:

Overconfidence and herd behaviour demonstrated strong positive correlations, indicating that investors with higher confidence levels and those who tend to follow market crowds are more likely to make speculative investment decisions. Loss aversion showed a negative relationship, meaning highly loss-averse individuals often prefer low–risk investments.

Regression Model Summary

Model Variables	Coefficient (β)	p-value	Significance
Overconfidence	0.378	0.001	Significant
Herd Behaviour	0.342	0.003	Significant
Loss Aversion	-0.297	0.018	Significant
Anchoring Bias	0.214	0.026	Significant
Mental Accounting	0.186	0.047	Significant

Interpretation:

The regression results indicate that overconfidence and herd behaviour have the highest effect on investment decisions, followed by anchoring and mental accounting. Loss aversion negatively influences risk-taking ability.

Reliability Test (Cronbach's Alpha)

To ensure the accuracy and stability of the questionnaire measurements, a reliability test was conducted using Cronbach's Alpha, one of the most widely accepted psychometric measures. The test evaluated the internal consistency of the scale across items related to the behavioural biases and investment decision variables.

The overall Cronbach's Alpha coefficient obtained for the instrument was 0.87, which is above the accepted minimum threshold of 0.70 recommended by Nunnally (1978). This indicates that the research instrument is highly reliable and suitable for further statistical analysis such as correlation and regression.

Constructs	No. of Items	Cronbach's Alpha
Overconfidence	4	0.82
Herd Behaviour	4	0.85
Loss Aversion	4	0.88
Anchoring	4	0.86
Mental Accounting	4	0.83
Investment Decisions	5	0.89
Overall Scale	25	0.87

IX. FINDINGS OF THE STUDY

- Most retail investors rely strongly on personal confidence and informal market information rather than detailed analysis.
- Overconfidence leads investors to trade frequently, expecting higher returns, often resulting in impulsive decisions.
- Herd behaviour significantly affects new investors who tend to follow market trends or popular recommendations without independent evaluation.
- Loss aversion causes investors to hold loss–making stocks longer due to emotional attachment and fear of realizing losses.
- Anchoring bias influences decisions related to buying and selling based on reference prices or rumours.
- Mental accounting results in preference for multiple small investments, even when diversified portfolio options are available.
- Younger investors demonstrate higher risk appetite compared to older investors.
- Awareness about behavioral finance concepts remains limited among retail participants.
- Technology and mobile trading apps encourage speculative behaviour through instant information access.
- Behavioural biases have a measurable and statistically significant impact on investment decision-making.

X. SUGGESTIONS & RECOMMENDATIONS

- Investor education programmes should focus on financial literacy and behavioural awareness.
- Investment advisors need to integrate behavioural assessment tools before recommending portfolio strategies.
- Regulators like SEBI should promote transparent disclosures and protect small investors from misleading market signals.
- Training workshops on investor psychology can help reduce emotional decision-making.
- Advisory platforms must encourage disciplined and long-term investment instead of short-term speculation.
- Use of risk profiling and automated advisory systems (robo-advisors) can minimize bias-based decision errors.

- Investors should maintain written financial plans to avoid impulsive behaviour.
- Financial media must promote analytical content instead of sensational reporting.
- Investors should regularly discipline themselves through stop-loss strategies and balanced portfolio diversification.

XI. LIMITATIONS & SCOPE FOR FUTURE RESEARCH

Although this research offers useful insights into behavioural finance patterns among Indian retail investors, certain limitations should be acknowledged. First, the study is geographically limited to four metropolitan cities—Hyderabad, Bengaluru, Mumbai, and Delhi—restricting the generalizability of findings across diverse regional investor profiles. The sampling technique used was convenience sampling, which may include selection bias and restrict complete representativeness of the population.

Second, the study relied on self-reported responses, which may involve subjective judgment and social desirability bias. Third, the research focuses only on five behavioural constructs, though behavioural finance literature identifies several additional factors that influence investor decisions. Future studies may adopt broader sampling frameworks, such as stratified probability sampling, or analyze investors across multiple age groups, income brackets, and rural settings. Future research may also include additional variables such as Regret Aversion, Disposition Effect, Framing Effect, Confirmation Bias, Self-Control Bias, and consider longitudinal or experimental research methods to examine changes over time.

XII. PRACTICAL IMPLICATIONS

Practical Implications for Stakeholders

The results of the study hold significant practical implications. Policymakers, regulatory bodies such as SEBI, brokerage houses, financial advisors, and investor awareness organizations can employ the findings to design interventions that mitigate behavioural distortions in investment decision-making. Understanding how biases influence investor behaviour can help advisors deliver more personalized advisory services and guide investors toward rational investment strategies.

Educational institutions, investor education programs, and digital investment platforms may incorporate behavioural finance training modules and simulation-based learning to help investors identify and correct behavioural distortions. Digital trading platforms can integrate behavioural alerts to caution investors when making irrational or emotionally driven investment choices.

Overall, this study highlights the importance of promoting financial literacy, behavioural counselling, and transparent advisory systems, which will contribute to improved investment discipline and more efficient functioning of Indian financial markets.

XIII. CONCLUSION

The study concludes that behavioural biases significantly influence the investment decisions of retail investors in India. Overconfidence and herd behaviour are major contributors to speculative and frequent trading tendencies, whereas loss aversion reduces risk-taking ability and affects portfolio diversification. Anchoring and mental accounting biases shape decision-making patterns by creating psychological boundaries that influence timing and investment preferences.

The findings highlight the need to strengthen behavioural finance awareness, improve investor training, and develop advisory systems that assist retail investors in making informed and rational decisions. Understanding and managing these psychological biases is essential for improving investor welfare and enhancing market efficiency.

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