



UNDERSTANDING BEHAVIOURAL BIASES IN INVESTMENT DECISION-MAKING OF A STOCK MARKET INVESTOR

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ABSTRACT

Investment decisions in the stock market are often assumed to be rational and based purely on logical evaluation of information. However, real-world behaviour shows that investors are frequently influenced by psychological factors that shape their financial choices. This study explores how behavioural biases such as overconfidence, loss aversion, herding behaviour, and anchoring affect the decision-making process of retail investors. Primary data were collected through a structured questionnaire, and the responses were analysed using descriptive and regression techniques to understand the strength of these influences. The findings suggest that investors do not always act rationally. Many participants displayed overconfidence in their abilities, followed market trends without independent analysis, or hesitated to sell underperforming investments due to fear of losses. The statistical results indicate that these behavioural tendencies play a meaningful role in shaping investment outcomes. The study highlights the importance of recognizing psychological influences in financial decision-making and encourages investors to adopt more disciplined and analytical approaches. By increasing awareness of behavioural biases, investors can improve their long-term strategies and make more balanced investment decisions.

Keywords: Behavioral Finance, Retail Investors, Investment Decision-Making, Cognitive Biases (or Psychological Factors), Loss Aversion, Overconfidence Bias.

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I. INTRODUCTION

Financial markets have traditionally been studied under the assumption that investors behave rationally and make decisions aimed at maximizing their expected returns. Classical financial theories, such as the Efficient Market Hypothesis, suggest that market participants process all available information objectively and make logical choices based on risk–return analysis. According to this perspective, prices in the stock market fully reflect relevant information, and investors act in their best economic interest. However, real-world market behaviour frequently contradicts this assumption. Stock price bubbles, sudden crashes, excessive trading, and panic selling demonstrate that investment decisions are not always guided purely by logic and calculation [6,7]. In the context of stock market investments, behavioral biases play a crucial role in shaping decision-making

patterns. Investors are frequently influenced by emotions such as fear, greed, regret, and overconfidence. These emotional and cognitive influences may lead them to deviate from rational strategies [7,8]. For example, overconfidence bias may cause investors to overestimate their knowledge or predictive abilities, leading to excessive trading or underestimation of risks [9]. Loss aversion may result in investors holding onto declining stocks to avoid realizing losses, even when selling would be financially prudent [5]. Herding behaviour can push individuals to follow market trends or imitate the actions of others without conducting independent analysis [4]. Anchoring bias may lead investors to rely heavily on past prices or initial information when making current investment decisions [6].

The primary objective of this research is to identify major behavioural biases affecting retail investors and to measure their impact on investment decision-making. By applying statistical techniques to survey data, the study aims to determine whether these biases significantly explain variations in investor behaviour. Ultimately, the findings are expected to contribute to the broader literature on behavioral finance and provide practical insights that can help investors make more disciplined and informed financial decisions [6,7].

2. OBJECTIVES OF THE STUDY

- To identify the major behavioural biases such as overconfidence, loss aversion, herding behaviour, and anchoring that commonly affect individual investors.
- To examine the influence of behavioural biases on the investment decision-making process of retail stock market investors.

3. LITERATURE REVIEW

Behavioural finance has emerged as a significant field of study that challenges the traditional assumptions of rationality in financial decision-making. Classical financial theories, including the Efficient Market Hypothesis and Modern Portfolio Theory, are grounded in the belief that investors act rationally, process information efficiently, and aim to maximize expected utility. However, numerous empirical observations—such as speculative bubbles, excessive volatility, and market crashes—suggest that investor behaviour often deviates from rational models. This gap between theory and actual market behaviour has led to the development of behavioural finance, which integrates insights from psychology and economics to explain financial decision-making [6,7].

Overconfidence bias is another extensively studied behavioural phenomenon. Research indicates that investors frequently overestimate their knowledge, predictive abilities, and control over market outcomes. Overconfident investors tend to trade more frequently, underestimate risks, and ignore contradictory information. Studies show that excessive trading, often driven by overconfidence, can significantly reduce net returns due to higher transaction costs and poor timing decisions [8]. Overconfidence not only affects individual performance but can also increase overall market volatility [9].

Herding behaviour represents another critical bias influencing investment decisions. Herding occurs when investors mimic the actions of others rather than relying on independent analysis. This tendency is particularly strong during periods of uncertainty or market stress. Research explains how informational cascades can develop when individuals assume that others possess superior information and therefore follow their behaviour rather than conducting independent evaluation [10].

In summary, the literature clearly establishes that behavioural biases significantly affect financial decision-

making and challenge the assumptions of traditional finance theory. Concepts such as loss aversion, overconfidence, herding, anchoring, and mental accounting provide valuable insights into why investors deviate from rational behaviour [6,7,9]. Building upon these theoretical and empirical foundations, the present study seeks to further examine the impact of behavioural biases on retail investors' decision-making in the stock market context. In summary, the literature clearly establishes that behavioural biases significantly affect financial decision-making and challenge the assumptions of traditional finance theory. Concepts such as loss aversion, overconfidence, herding, anchoring, and mental accounting provide valuable insights into why investors deviate from rational behaviour. Building upon these theoretical and empirical foundations, the present study seeks to further examine the impact of behavioural biases on retail investors' decision-making in the stock market context.

4. RESEARCH METHODOLOGY

This study adopts a quantitative and descriptive research design to examine the influence of behavioural biases on the investment decision-making process of retail stock market investors. The research aims to identify the relationship between selected psychological biases and investment behaviour using empirical data.

Research Design

A descriptive research approach was employed to analyze patterns, relationships, and the degree of influence of behavioural biases such as overconfidence, loss aversion, herding behaviour, and anchoring on investment decisions.

Data Collection

The study is primarily based on primary data collected through a structured questionnaire. The questionnaire was distributed online using Google Forms to retail investors who actively participate in the stock market.

Sampling Technique and Sample Size

A convenience sampling method was used to gather responses from accessible retail investors. The final sample consisted of respondents who have prior experience in stock market investments, ensuring relevance and reliability of responses.

Data Analysis Tools

The collected data were analysed using statistical techniques including descriptive statistics, correlation analysis, and multiple regression analysis. Descriptive statistics were used to summarize demographic characteristics and behavioural patterns.

This methodological approach ensures systematic evaluation of behavioural influences on financial decision-making and enhances the empirical strength of the study.

5. RESULTS

Q8. Primary Investment Objective
56 responses

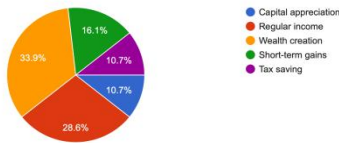


Figure 1. Primary Investment Objective

The pie chart indicates that wealth creation (33.9%) is the primary investment objective among respondents, followed by regular income (28.6%). Short-term gains account for 16.1%, while capital appreciation and tax saving each represent 10.7%. This suggests that most investors prioritize long-term financial growth and stable returns over short-term profits or tax benefits.

Q10. Sources Influencing Investment Decisions
56 responses

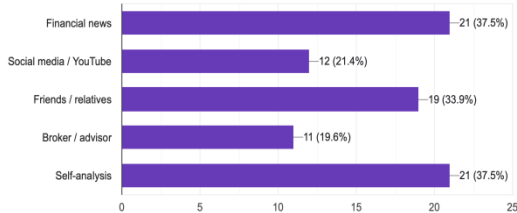


Figure 2. Different sources influencing investment objective

Financial news and self-analysis are the most influential sources, each accounting for 37.5% of responses, indicating strong reliance on personal evaluation and formal information. Friends and relatives also significantly influence decisions (33.9%), reflecting social impact. Social media and brokers have comparatively lower influence. Overall, investors prefer independent research but remain partially influenced by social connections and external inputs.

Overconfidence Bias

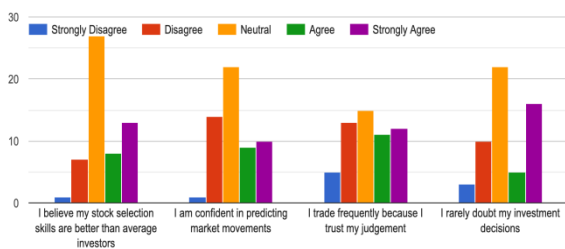


Figure 3. Overconfidence bias

The graph indicates that a significant proportion of respondents selected “Agree” and “Strongly Agree” for statements related to stock selection ability, prediction of market movements, trust in personal judgment, and quick investment decisions. This suggests that many investors believe their knowledge and skills are superior to average market participants. The dominance of neutral-to-positive responses highlights a noticeable

presence of overconfidence bias. Such behaviour may lead to excessive trading, underestimation of risks, and reliance on personal judgment over objective analysis.

Herding Bias

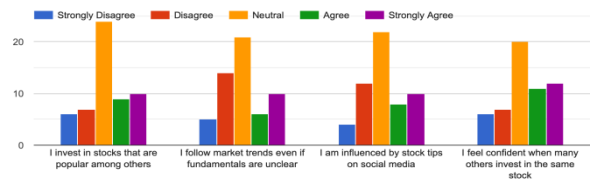


Figure 4. Herding Bias

The herding bias graph shows that many respondents agree they follow market trends, popular stocks, and social media tips, especially when fundamentals are unclear. A moderate to high number of “Agree” and “Strongly Agree” responses indicates that investors are influenced by collective market behaviour.

Loss aversion Bias

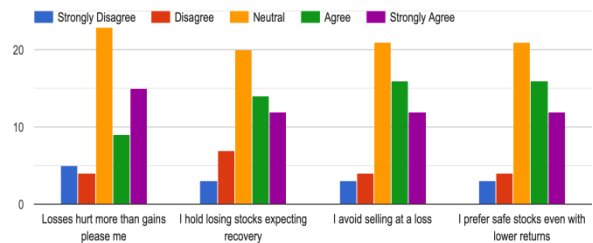


Figure 5. Loss Aversion Bias

The loss aversion graph indicates strong agreement with statements such as “Losses hurt more than gains please me” and reluctance to sell at a loss. Many respondents prefer holding losing stocks in anticipation of recovery. This confirms the presence of loss aversion bias among investors. Such behaviour may result in poor portfolio performance, as emotional attachment to losses can prevent rational decision-making and timely exit strategies.

Risk Tolerance & Decision Making

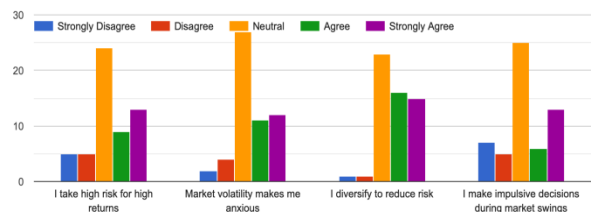


Figure 6. Risk Tolerance & Decision Making

The graph on Risk Tolerance and Decision Making indicates that investors display moderate willingness to take high risks for higher returns, though many responses remain neutral, reflecting cautious behaviour. A significant number agree that market volatility creates anxiety, suggesting emotional

sensitivity during uncertain market conditions. Strong agreement with diversification practices shows awareness of risk management principles.

6. LIMITATIONS

1. Limited Behavioral Scope

The research may focus only on selected biases (e.g., overconfidence, herd behavior, loss aversion), excluding other relevant psychological or emotional factors that influence decision-making.

2. Self-Reported Data Bias

Studies using questionnaires or surveys may suffer from:

- Social desirability bias
- Recall bias
- Inaccurate self-assessment
Respondents may not consciously recognize or admit their behavioural biases.

3. Market Volatility and External Factors

Macroeconomic events, political instability, or financial crises can influence investment decisions independently of behavioural biases, making it difficult to isolate psychological factors.

7. FINDINGS AND OUTCOMES

Behavioural factors influence investment decisions

The majority of respondents selected Neutral, Agree, or Strongly Agree when asked whether behavioural factors influence their investment decisions. Only a small proportion expressed disagreement. This indicates a general acknowledgment among investors that psychological biases affect their financial choices. The finding supports the core premise of behavioural finance that investor decisions are not entirely rational but influenced by cognitive and emotional factors.

Emotions affect buy and sell decisions

Responses show a high concentration in the Neutral category, followed by Agree and Strongly Agree. While some investors appear uncertain about the degree of emotional influence, a significant portion admits that emotions impact their trading decisions. This suggests that emotional reactions such as fear, greed, and anxiety play a meaningful role in buying and selling behaviour in the stock market.

8. FINANCIAL KNOWLEDGE CAN REDUCE BEHAVIOURAL BIAS

A strong majority of respondents selected Agree and Strongly Agree, with minimal disagreement. This demonstrates a clear belief that improved financial literacy and market knowledge can help investors manage and reduce behavioural biases. The outcome highlights the importance of financial education in promoting rational and disciplined investment decision-making.

9. CONCLUSION

- The graph clearly shows that behavioural and emotional factors influence investors.
- While some investors remain neutral (possibly due to lack of awareness), most acknowledge these effects.

There is a strong consensus that financial knowledge reduces biased decision-making. Better investment decisions then would be driven by data-driven analysis, clear-cut financial goals, and diverse opinions from people in your life. All things considered, managing and understanding behavioral biases will form the key to consistency in the right decisions toward long-term investment success and sound financial welfare.

10. ACKNOWLEDGEMENT

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11. CONFLICT OF INTEREST

Not declared

12. INFORMED CONSENT AND ETHICAL STATEMENT

Not applicable

13. AUTHOR CONTRIBUTIONS

Both are contributed equally.

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