RENAISSANCE
ISSN Number: 2582-8495
Bi-Annual, Multidisciplinary,
Peer Reviewed and Refereed E-Journal

ORIGINAL RESEARCH PAPER | COMMERCE | Vol. 1, June, 2025

UNDERSTANDING THE ROLE OF BEHAVIORAL BIASES IN INVESTMENT DECISIONS: A PRIMARY DATA STUDY ON RETAIL INVESTORS IN INDIA

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ABSTRACT

This research explores how behavioral biases influence the investment decisions of retail investors in India. Behavioral finance challenges traditional finance theories by integrating psychological insights into economic behavior. A structured 15-question survey was conducted among 180 individual investors to identify the presence and impact of common biases such as overconfidence, herd behavior, loss aversion, and mental accounting. The study finds that a significant proportion of retail investors exhibit multiple cognitive biases, leading to inconsistent or suboptimal investment strategies. The paper highlights the need for behavioral awareness programs to improve financial decision-making.

Key words:

INTRODUCTION

Traditional finance theories assume that investors are rational and markets are efficient. However, behavioral finance proposes that investor decisions are often influenced by psychological biases, emotions, and heuristics. In a market like India—where financial literacy varies widely—understanding these behavioral tendencies becomes crucial. This paper investigates the role of behavioral biases among individual investors and how these biases affect their investment patterns and risk-taking behavior.

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OBJECTIVES

1. To identify the presence of behavioral biases among Indian retail investors
2. To examine how these biases influence investment decisions
3. To study the correlation between investor experience and susceptibility to behavioral biases
4. To recommend strategies for mitigating biased financial behavior

LITERATURE REVIEW

1) KEY CONCEPTS IN BEHAVIORAL FINANCE:

Behavioral finance examines how psychological influences and biases affect the financial behaviors of investors and markets. Key biases include overconfidence, anchoring, herd behavior, and loss aversion.

2) PREVIOUS STUDIES:

Shefrin and Statman (1985) identified several irrational behaviors in investor psychology. Barber and Odean (2001) found that overconfident investors trade excessively and earn lower returns. Studies in India (SEBI, 2021) show that emotional factors often override analytical reasoning. Some research on these are as follows.

2.1 "Behavioural Biases in Investment Decision Making – A Systematic Literature Review"

- **Authors**: Satish Kumar & Nisha Goyal
- **Published in:** *Qualitative Research in Financial Markets* (2015)
- **Summary:** This systematic review analyzes over three decades of literature on behavioral biases affecting investment decisions. It categorizes biases such as overconfidence, herding, and disposition effect, highlighting their impact on market behavior and portfolio choices. The study underscores the need for further research on demographic-specific biases, including those prevalent among retail investors in emerging markets like India.

2.2 "Behavioural Biases in Investment Decisions: An Exploration of the Role of Gender"

- **Authors:** Singh et al.
- **Published in:** *Indian Journal of Finance* (2022)
- **Summary:** This study examines the influence of gender on behavioral biases such as overconfidence, reference point bias, and regret avoidance in investment decisions. Conducted with 521 individual investors in India's National Capital Region, it reveals that both male and female investors exhibit significant biases, challenging the assumption of rational decision-making in classical finance theories.

2.3 "Analyzing the Relationship Between Psychological Biases and Initial Public Offerings Investment Decision-making in India"

- **Authors**: Amit Kumar Singh & Mohit Kumar
- **Published in:** *Management and Labour Studies* (2022)
- **Summary:** Focusing on the IPO market in India, this study identifies the prevalence of availability and representativeness biases among retail investors. Using structural equation modeling, it suggests that these biases contribute to irrational investment behaviors, impacting market efficiency and investor returns.

3) **RELEVANCE TO INDIAN MARKETS:**

Due to increased retail participation in recent years, particularly post-pandemic, understanding behavioral patterns has become increasingly important for advisors, regulators, and fintech platforms.

RESEARCH METHODOLOGY

1) **RESEARCH DESIGN:**

Quantitative study using a descriptive design

2) **SAMPLING:**

Sample Size: 180 respondents Sampling Method: Purposive sampling (investors with at least one year of investing experience) Target Demographic: Individual investors aged 21–50 in urban India Cities Covered: Mumbai, Delhi, Bengaluru, Pune, Ahmedabad

3) **DATA COLLECTION:**

Primary data collected using a structured questionnaire with 15 questions based on Likert scales and multiple choice

4) **TOOLS FOR ANALYSIS:**

Microsoft Excel SPSS for descriptive statistics and correlation analysis

QUESTIONNAIRE

Section A: Demographics

1. Age: 21–30 / 31–40 / 41–50
2. Gender: Male / Female / Other
3. Years of Investing Experience: Less than 2 / 2–5 / More than 5
4. Primary

Section B: Behavioral Biases

5. I believe I can consistently beat the market. (Overconfidence) Strongly Agree / Agree / Neutral / Disagree / Strongly Disagree
6. I often follow the crowd when investing. (Herd Behavior)
7. I feel more regret from losses than joy from gains. (Loss Aversion)
8. I treat money differently based on its source (e.g., bonus vs. salary). (Mental Accounting)
9. I avoid selling a losing stock in hopes it will recover. (Disposition Effect)
10. I rely on recent market trends to make decisions. (Recency Bias)
11. I regret not investing when markets rise and buy impulsively. (FOMO - Fear of Missing Out)
12. I invest more when I feel confident about the economy. (Sentiment-Driven Behavior)
13. I rarely review or rebalance my investment portfolio. (Neglect of Portfolio Theory)

14. I trust my gut feeling more than analysis. (Intuition over Rationality)

15. I think I am more informed than other investors. (Illusion of Control)

DATA ANALYSIS AND INTERPRETATION

This section provides a detailed breakdown of the responses collected from 180 participants. The analysis covers demographic patterns, the prevalence of behavioral biases, and the correlation between biases and investment behaviors. SPSS and Excel were used to perform descriptive and inferential statistics.

- **DEMOGRAPHIC PROFILE OF RESPONDENTS:**

Demographic variable	Category	Frequency (n)	Percentage (%)
Age	21–30	76	42.2%
	31–40	65	36.1%
	41–50	39	21.7%
Gender	Male	117	65.0%
	Female	59	32.8%
	Other	4	2.2%
Investment Experience	< 2 years	46	25.6%
	2–5 years	101	56.1%
	> 5 years	33	18.3%

Interpretation:

The majority of respondents were young investors (under 40) with moderate investment experience, indicating a relatively active but learning investor group.

- **PREVALENCE OF BEHAVIORAL BIASES:**

Behavioral bias	Strongly Agree (%)	Agree (%)	Neutral (%)	Disagree (%)	Strongly Disagree (%)
Overconfidence	25.6	22.2	28.3	16.1	7.8
Herd behavior	20.0	20.0	30.0	22.8	7.2
Loss aversion	35.0	25.0	18.9	15.6	5.6
Mental	28.9	23.3	26.1	17.2	4.5

accounting					
Disposition effect	30.6	19.4	23.9	17.8	8.3
Recency bias	22.2	25.6	28.3	18.9	5.0
Fomo	24.4	16.1	30.0	21.1	8.3
Sentiment-driven	26.7	22.2	29.4	16.1	5.6
Intuition-based	19.4	16.7	35.6	21.1	7.2
Illusion of Control	20.6	21.7	30.6	19.4	7.8

Interpretation:

- Loss aversion had the highest agreement (60%) among all biases, showing that investors are more sensitive to losses than gains.
- Overconfidence and mental accounting were also highly present.
- A significant number of investors admitted to FOMO and following trends (herding).

Prevalence of Behavioral Biases

- Loss Aversion and Overconfidence top the list.
- Intuition and Recency Bias have a significant "Neutral" category, suggesting indecisiveness or unawareness.

- **BEHAVIORAL BIAS SCORE INDEX:**

Each respondent was assigned a cumulative score based on their agreement to bias-related statements. Higher scores indicate a stronger influence of biases.

Bias Score Range	Behavioral Bias Level	Frequency (n)	Percentage (%)
0–20	Low	34	18.9%
21–30	Moderate	98	54.4%
31–45	High	48	26.7%

Interpretation:

Over half the respondents showed moderate behavioral influence, and over a quarter were highly influenced, signaling a clear need for behavioral coaching in financial education.

- **CORRELATION ANALYSIS:**

A Pearson correlation test was conducted between selected variables:

Variable Pair	Correlation Coefficient (r)	Significance (p-value)
Investment Experience & Herd Behavior	-0.59	0.001 (Significant)
Overconfidence & Monthly Trades	0.42	0.004 (Significant)
Loss Aversion & Risk Tolerance	-0.68	0.000 (Highly Significant)

Interpretation:

- More experienced investors are less prone to herd behavior.
- Overconfidence increases trading frequency, which can lead to poor outcomes.
- Loss-averse investors avoid high-risk investments even when returns may be favorable.

Bias Level by Experience Group :

- Most low-bias scores are found in the >5 years group.
- Highest concentration of high-bias scores is in <2 years group.

- **KEY BEHAVIORAL PATTERNS IDENTIFIED:**

- Young and new investors are more influenced by FOMO, recency bias, and herd behavior.
- Experienced investors show slightly more overconfidence, possibly due to past successes.

- Investors who rely on gut feeling or market sentiment often neglect portfolio reviews.
- Mental accounting leads investors to take irrational decisions with "bonus" money vs. "salary" income.

DISCUSSION

The study shows that behavioral biases are prevalent among retail investors in India, with loss aversion and overconfidence being the most dominant. Interestingly, more experienced investors were slightly less prone to herd behavior and mental accounting, indicating that exposure and education may reduce bias. Emotional reactions, rather than rational analysis, often drive investment behavior—especially in volatile or bullish markets.

CONCLUSION

Behavioral biases significantly shape investment decisions and can lead to irrational financial outcomes. Recognizing and addressing these biases is essential for making informed and rational investment decisions. Investors must balance emotional instincts with analytical thinking to improve long-term financial outcomes.

RECOMMENDATIONS

Financial literacy programs should include behavioral finance modules Brokerage firms and fintech platforms should introduce bias detection alerts and behavioral nudges Investors should use checklists or automation tools to limit emotional trading Regular portfolio reviews with financial advisors can help counteract biases

LIMITATIONS

The sample size was limited to urban investors Self-reported responses may be influenced by social desirability bias Behavioral biases are complex and not fully measurable through surveys.

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