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Original Article

A Study on Behavioral Finance: Impact of Investor Psychology on Stock Investment Decision

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ABSTRACT: *This study focuses on the impact of investor psychology on stock investment decisions under the domain of behavioral finance. Behavioral finance explains how psychological factors, emotions, and cognitive biases influence investors while making financial decisions. The study aims to analyze how emotions such as fear and greed, along with behavioral biases like overconfidence, herd behavior, loss aversion, and anchoring, affect investors' decision-making and risk-taking behavior in stock market investments. The research adopted a descriptive research design, and primary data were collected through a structured questionnaire from 150 respondents. Statistical tools such as percentage analysis, mean analysis, correlation analysis, and chi-square test were used to analyze the collected data. The findings revealed that most respondents were young and moderately experienced investors. The study also found that emotional and behavioral factors had only a weak influence on investment decisions among respondents. The correlation analysis indicated no significant relationship between emotional influence and risk-taking behavior, as well as between planned investment strategy and diversification decisions. Similarly, the chi-square analysis showed no significant association between investment experience and market fluctuations. The study concludes that investors generally rely more on rational judgment and financial awareness rather than emotional influences while making investment decisions. The research suggests that improving financial knowledge, proper planning, diversification, and consulting financial experts can help investors make better and more rational investment decisions.*

KEYWORDS: *Behavioral Finance, Investor Psychology, Decision-Making, Risk-taking Behavior, Stock Investment.*

1. INTRODUCTION

Behavioural finance has been a vital area of research in recent years, challenging the conventional wisdom of classical finance, which holds that markets are efficient and investors behave rationally. By combining psychological knowledge with financial analysis, behavioural finance explains why investors frequently act irrationally, creating inefficiencies in the market. This multidisciplinary approach aims to comprehend the psychological, emotional, and cognitive biases that affect investors' decisions, frequently leading to more severe than ideal financial outcomes.

A fundamental aspect of behavioral finance is the psychology of investing, which focuses on the thought processes and emotional reactions that influence investor behavior, especially during stressful or uncertain times. Researchers and practitioners can gain a better understanding of the irrational behaviors that contribute to events like market bubbles, crashes, and anomalies by examining how psychological characteristics like overconfidence, loss aversion, and herding influence decisions. The purpose of this study is to investigate the connection between investor psychology and behavioral finance, elucidating the ways in which psychological biases and emotions influence financial decision-making and the overall market environment.

The limitations of conventional financial models, which frequently presume that investors behave rationally and are constantly looking to maximize utility, led to the development of behavioral finance. These traditional models have proven insufficient in describing actual occurrences like stock market bubbles, panic selling, or investor overreaction to news, although they have been helpful in comprehending broad market trends. The foundation of behavioral finance was established by economists such as Amos Tversky and Daniel Kahneman, who focused on cognitive psychology and developed Prospect Theory. Their findings demonstrated that people are prone to systematic errors in judgment as a result of cognitive biases and do not always act in their best financial interests.

Behavioral finance is an interdisciplinary field that blends psychology with traditional economic and financial theory to understand how human emotions and cognitive biases impact financial decisions. Unlike conventional finance, which assumes that investors are entirely rational and markets are efficient, behavioral finance acknowledges that real-world investors often

deviate from rationality due to emotional influences and mental shortcuts. These deviations can lead to suboptimal financial outcomes and create anomalies in the market.

Investors are not always driven solely by logic or data; emotions such as fear, greed, and overconfidence play a critical role in shaping their decisions. For instance, fear can lead to panic-selling during market downturns, while greed may push investors toward risky assets during bull markets. Similarly, biases such as loss aversion, where individuals fear losses more than they value gains, and overconfidence, where investors overestimate their ability to predict market movements, are common examples of how emotions influence decision-making.

Behavioral finance seeks to explore these tendencies by identifying patterns of irrational behavior and their impact on market outcomes. It highlights how heuristics, or mental shortcuts, are often used to simplify complex financial decisions, can lead to errors in judgment. Additionally, social influences, such as herd behavior, where investors follow the crowd without critically analyzing their decisions, further demonstrate how psychological factors shape financial behavior.

By understanding the emotional and psychological aspects of decision-making, behavioral finance provides valuable insights into investor behavior. It equips financial professionals and individual investors with tools to recognize and mitigate biases, helping them make more informed and balanced investment decisions. This knowledge not only enhances individual financial outcomes but also contributes to a more comprehensive understanding of market dynamics. In this context, behavioral finance underscores the importance of integrating psychology with financial strategies, as it offers a more realistic portrayal of how people interact with markets, ultimately bridging the gap between theoretical finance and real-world investing behavior.

2. REVIEW OF LITERATURE

- Sharma, Anute & Ingale (2021) identified that the stock market is one of the important elements of the Indian economy, which determines the economic growth of India and the financial state of the country. In today's world, there are millions of people are connected to the internet, and the internet has had a significant impact on people's perception of investment in the stock market
- Decisions on investments are always made in an uncertain environment. Alternative frameworks are required in these situations since conventional utility-based models are unable to adequately represent the complexity of human behavior. Prospect theory, which was created by Daniel Kahneman and Amos Tversky, is among the most significant models in behavioral finance. Prospect theory proposes that people assess benefits and losses in relation to a reference point rather than in absolute terms, in contrast to expected utility theory (Tran HT, Le HT,2021).
- Investor choices are often influenced by emotional and cognitive biases that diverge from sound reasoning. Overconfidence, which causes people to overestimate their knowledge, predicting skills, or control over results, is one of the most common. Investors that are overconfident frequently trade excessively, undervalue risk, and disregard contradicting evidence, which results in worse than ideal portfolio performance (Mulili BM,2020)
- Additionally, risk preferences vary depending on the situation. Behavioral studies demonstrate that risk preferences are dynamic and context-dependent, in contrast to classical finance's assumption of constant risk aversion. In times of economic stability, an investor may be risk-averse, but in times of crisis or FOMO, they may become risk-seeking. These changes are brought about by mood, social cues, and recent events; this is known as recency bias (Adegbesan, B.O., Ogunlabi, O.O., Olawale, O.O., Edema, A.A., Onasanya, O.O,2020).
- When investors place an excessive amount of weight on early bits of information like past stock prices or arbitrary benchmarks, even when they are no longer relevant, this is known as anchoring. For example, despite shifts in the fundamentals, an investor may become fixated on a stock's previous high and refuse to sell at that price (Hendriks S,2019). This may skew the value and postpone essential portfolio modifications. These prejudices frequently interact and support one another; they are not isolated. For instance, mental accounting may be impacted by loss aversion, whereas overconfidence may strengthen anchoring. Both individual investors and financial advisors looking to reduce irrational behavior and encourage disciplined investment methods must be aware of these trends. Therefore, behavioral finance offers a methodical framework for recognizing, evaluating, and combating the psychological inclinations that frequently thwart sound investment choices, particularly in erratic markets.
- Another fundamental bias that stems from prospect theory is loss aversion. It implies that people experience the anguish of losses more keenly than they do the joy of comparable gains. The disposition effect is a phenomenon that can lead to actions like holding onto losing stocks for an extended period of time or selling winning equities too soon in order to "lock in" gains (Lal T,2018).
- Davalbhakt et al. (2016) conducted a study focusing on the investment behavior of individual investors in India. Using a qualitative research design involving in-depth interviews, they uncovered the role of emotions, particularly fear and greed, in driving investment decisions. The research shed light on the intricate interplay between emotional factors and risk perceptions, offering insights into the psychological underpinnings of Indian investors' behaviors.
- Mankad and Bhate (2016) explored investment psychology among individuals from Indian backgrounds. Employing a survey-based approach, they analyzed the impact of framing effects on investor perceptions of financial products.

The findings highlighted the susceptibility of Indian investors to framing manipulations, showcasing how the presentation of information influences decision-making.

- Herding Behavior in Indian Stock Markets • Rao & Sreejith (2014) analyzed herding behavior among Indian investors and found that investors blindly follow market trends, often leading to market bubbles and crashes. • Example: The cryptocurrency boom in India in 2021 saw massive investor participation, many without fundamental knowledge of the asset class
- Chaudhary (2013) studied how behavioral finance provides explanations for why investors make irrational financial decisions. The study demonstrates how emotions and cognitive errors influence investors in the decision-making process. The study shows that various causes that led to behavioral finance are anchoring, overconfidence, herd behavior, overreaction, underreaction, and loss aversion.
- (Waweru et al. 2008) mentioned with two major factors, namely Gambler's fallacy, and Overconfidence, which are drawn from heuristic theory. Prospect theory and expected utility theory are best suited to consider investment decision approaches from different investment avenues. Prospect theory focuses on subjective decision making, and expected utility theory focuses on investors' rational expectations (Filbeck, Hatfield & Horvath, 2005, p.170-171).
- Ranganathan (2006) examined Indian stock market investors and concluded that fear of losses results in excessive preference for fixed-income securities over high-return investments.
- Hong et al. (2005) argue that mutual fund managers are more likely to buy stocks that other managers in the same city are buying, suggesting that one factor impacting portfolio decisions is a word-of-mouth effect by way of social interaction between money managers. The authors also suggest that stock market participation is influenced by social interaction. For example, agents that are more social, in the sense of interacting more with peers at collective gatherings such as at church, are more likely to invest in the stock market.
- Meng Chen Gong et al. (2004) tested how investor experience influences investing behaviour and trading performance. The study shows that experienced investors are more inclined toward making trading mistakes and suffering from the representative bias. Chandra (2008) explored the impact of behavioral factors and investors' psychology on their decision-making. The research was based on secondary data. The study concluded that retail investors do not always make rational decisions. The decision of investment is influenced by many behavioral factors such as greed and fear, cognitive dissonance, mental accounting, heuristics, and anchoring. The study focuses on these behavioral factors that must be considered while making an investment decision.
- (Caparrelli et al., 2004) Herding investors act only with other investors' decisions because of a lack of knowledge and information on the surrounding environment, and always seek group advice and expert advice for their investment decisions. There are several elements involved in the herding behavior, such as overconfidence and the bulk of volume considered by the investors.

2.1. OBJECTIVE OF THE STUDY

- To analyze how psychological factors influence investors' decision-making in stock market investments.
- **To identify key behavioral biases** (such as overconfidence, herd behavior, loss aversion, and anchoring) affecting stock investors.
- **To examine the relationship between investor psychology and risk-taking behavior** in stock investments.

3. RESEARCH METHODOLOGY

1. Research Design

The study adopts a descriptive research design.

It focuses on analyzing the impact of investor psychology and behavioral biases on stock investment decisions using quantitative data collected through a structured questionnaire.

Descriptive: To identify and describe different psychological factors (such as overconfidence, herd behavior, risk perception, and loss aversion) affecting investors.

2. Data collection

Primary Data:

Primary data is collected directly from respondents using a structured questionnaire. The questionnaire includes questions on investor behavior and psychological biases, such as risk perception, overconfidence, herd behavior, and loss aversion.

3. Sampling Method

The study uses the Simple Random Sampling Technique.

- Every individual investor in the population has an equal chance of being selected.
- Respondents are selected randomly without bias

This method improves:

- Fairness
- Accuracy
- Generalizability of results

Sample Size

The sample size for the study is 150 respondents

4. Population of the Study

- Individual investors participating in stock market investments
- Includes students, salaried employees, and business people

5. Measurement Scale

5-point Likert Scale:

Strongly Agree to Strongly Disagree

Used for measuring:

- Psychology
- Biases
- Risk behavior
- Emotions

6. Statistical Tools Used

Descriptive Tools

Percentage Analysis:

Percentage analysis is one of the simplest statistical tools used to represent data in terms of percentages. It helps in understanding how respondents are distributed across different categories

Where you use it:

- **Demographic questions:**
  Age, Gender, Occupation
- **General behavior questions:**
  Investment experience
  Source of decision
  Reaction to market trends

$$\text{Percentage} = \frac{\text{No.of respondents}}{\text{Total respondents}} \times 100$$

Formula:

Example:

40 out of 100 respondents are aged 25–35
→ Percentage = 40%

Mean:

Mean is the average value of responses, used to measure the central tendency of data.

$$\text{Mean} = \frac{\sum X}{N}$$

Formula:

Correlation Analysis:

Correlation analysis measures the strength and direction of the relationship between two variables.

Purpose:

To measure the strength of the relationship between two variables

Where you use it:

- Psychological factors vs Investment decisions
- Emotional factors (fear/greed) vs Risktaking

- Biases vs Decision-making

Chi-Square Test:
Chi-square test is used to examine whether there is a significant association between two categorical variables.

Purpose:
- To test the association between two variables
- Where you use it:

Example:
- Age vs Risktaking behavior
- Gender vs Emotional decisions
- Occupation vs Investment strategy

Formula: $\text{Mean} = \frac{\sum (O-E)^2}{E}$

(O = Observed, E = Expected)

Hypothesis:
- H_0: No relationship
- H_1: There is a relationship

3.1. DATA ANALYSIS AND INTERPRETATION

3.1.1. .PERCENTAGE ANALYSIS

TABLE 1 Age Distribution of Survey Respondents

AGE		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Below 25	39	26.0	26.0	26.0
	25–35	67	44.7	44.7	70.7
	36–45	31	20.7	20.7	91.3
	Above 45	12	8.0	8.0	99.3
	5	1	.7	.7	100.0
	Total	150	100.0	100.0	

INFERENCE: The majority of the respondents (44.7%) belong to the age group of 25–35 years, indicating that young adults are more interested in stock investment activities.

3.1.2. DESCRIPTIVE STATISTICS

TABLE 2 Descriptive Statistics of Behavioral Factors Influencing Investment Decisions

	N	Minimum	Maximum	Mean	Std. Deviation
PERSONAL JUDGMENT RATHER THAN EMOTION	150	1	5	2.02	1.058
MY MOOD OR FEELINGS	150	1	5	2.36	.936
CONFIDENT WHILE INVESTMENT	150	1	5	2.36	1.005
BETTER THAN OTHER OVERCONFIDENCE	150	1	5	2.06	.957
I FOLLOW OTHER (HERD BEHAVIOR)	150	1	5	2.33	.974
LOSING STOCKS (LOSS AVERSION)	150	1	5	2.25	1.049
ANCHORING	150	1	5	2.31	.990
HIGH RISKS FOR HIGHER RETURNS	150	1	5	2.23	1.148
SAFE INVESTMENT OVER RISKY	150	1	5	2.30	1.913
RISKTAKING BASED ON MARKET CONDITIONS	150	1	5	2.32	.972
PANIC DURING MARKET DOWN(FEAR)	150	1	5	2.17	.923
GREED	150	1	5	2.42	1.012
INFLUENCED BY MARKET NEWS	150	1	5	2.43	1.228
PIANNED STRATEGY	149	1	5	2.06	.946
DIVERSIFY INVESTMENT	149	1	5	2.21	1.030
CONSULT FINANCIAL EXPERTS	150	1	5	2.41	1.100
MISTAKES TO IMPROVE DECISIONS	150	1	5	2.11	1.063
Valid N (listwise)	148				

3.1.3. CORRELATIONS TABLE

TABLE 3 Correlation between Mood and Feelings with Preference for High-Risk Higher-Return Investments

		MY MOOD OR FEELINGS	HIGH RISKS FOR HIGHER RETURNS
MY MOOD OR FEELINGS	Pearson Correlation	1	.105
	Sig. (2-tailed)		.202
	N	150	150
HIGH RISKS FOR HIGHER RETURNS	Pearson Correlation	.105	1
	Sig. (2-tailed)	.202	
	N	150	150

RESULT AND INTERPRETATION

- The correlation analysis was conducted between "My Mood or Feelings" and "High Risks for Higher Returns." The Pearson correlation value is 0.105, which indicates a weak positive relationship between the variables.
- The significance value (p-value) is 0.202, which is greater than 0.05. Therefore, the relationship between emotional influence and risk-taking behavior is not statistically significant.
- Hence, the null hypothesis is accepted, and the alternative hypothesis is rejected.

3.1.4. CHI-SQUARE TESTS

TABLE 4 Chi-Square Test Results for Association between Study Variables

	Value	df	Asymptotic Significance (2-sided)
Pearson Chi-Square	14.876[a]	16	.534
Likelihood Ratio	18.124	16	.317
Linear-by-Linear Association	2.404	1	.121
N of Valid Cases	150		
a. 14 cells (56.0%) have expected count less than 5. The minimum expected count is .07.			

RESULT INTERPRETATION:

- The Chi-square analysis indicates that the association between investment experience and market fluctuations is not statistically significant. The Pearson Chi-square value is 14.878 with a significance level of 0.534, which is greater than the accepted threshold of 0.05.
- This shows that there is no meaningful relationship between the two variables. Therefore, changes in market fluctuations are not significantly associated with investment experience among the respondents.
- Hence, the null hypothesis is accepted and the alternative hypothesis is rejected

4. CONCLUSION

- This study examined the factors influencing investor behavior in stock market investment decisions. The analysis shows that demographic factors and investment experience play an important role in shaping investment preferences.
- The statistical results revealed that there is no significant relationship between emotional influence and risktaking behavior, planned strategy and diversification decisions, and investment experience with market fluctuations.
- This indicates that investors generally make decisions based on rational judgment rather than being strongly influenced by emotional or behavioral factors. Therefore, the study concludes that informed decision-making, proper planning, and financial awareness are essential for effective investment management.

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