Behavioural Finance and Investment Decisions: Understanding the Psychology of Retail Investors

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ABSTRACT

Traditional financial theories assume that investors are rational individuals who make investment decisions based on available information, expected returns and associated risks, in practical situations, investment decisions are not always rational. Investors are frequently influenced by psychological and emotional factors such as fear, greed, overconfidence, loss aversion, herd mentality and market sentiment. The objectives of this research paper are (i) to analyse the influence of demographic factors such as gender, age group, educational level, amount of investment and years of experience in investment, (ii) to find the influence of independent variables and mediating variable in Investment decision making and (iii) to suggest suitable measures for improving rational investment decisions among retail investors. The present study conducted in Coimbatore District only, questionnaire designed with the help of previous study results. Google forms used for data collection, so convenient sampling method adopted, the Google form link may share to all state of India, so to restrict the samples in Coimbatore District, and respondents are asked whether they are in Coimbatore district only to fill the questionnaire. The researcher planned 300 samples, time restricted for data collection. The Google form link share in the month of August 2026, from 1.8.2026 to 18.8.2026 the responds reached 300, immediately the entries closed and analysis started. The researched used percentage analysis and Structural Equation Model. The data were taken in MS excel, then transferred to SPSS – 19 and AMOS-20 for analysis. Percentage analysis used to present the socio economic factors and multiple regression analysis has been adopted. The study concluded that Retail investors should focus on long-term financial objectives, diversify their investment portfolios and seek professional financial guidance whenever necessary. Financial institutions and regulatory authorities should also promote investor education and awareness programmes to minimise behavioural errors. Understanding the psychology of retail investors and integrating behavioural finance principles into investment planning can encourage informed, disciplined and rational investment decisions, thereby contributing to improved financial well-being and long-term wealth creation.

Keywords : Behavioural finance, retail investors, Financial literacy, Financial confidence, Risk tolerance and Financial self efficacy.

INTRODUCTION

Traditional financial theories assume that investors are rational individuals who make investment decisions based on available information, expected returns and associated risks, in practical situations, investment decisions are not always rational. Investors are frequently influenced by psychological and emotional factors such as fear, greed, overconfidence, loss aversion, herd mentality and market sentiment. These factors can influence their investment preferences, risk-taking behaviour and financial decisions. Behavioural finance is an emerging area of financial research that combines psychological principles with financial theories to

explain how individuals make investment decisions. It challenges the assumption of complete investor rationality and highlights the influence of cognitive errors and emotional responses. In India, the increasing participation of retail investors in equity markets, mutual funds and digital investment platforms makes it important to understand the psychological factors influencing their investment decisions. This study aims to examine the relationship between behavioural biases and investment decision-making among retail investors.

REVIEW OF LITERATURE

There were plenty of study conducted is the past 3 decades, the sample reviews were presented here.

Arjun Goud K, et. al., [1] (2024), A study on Behavioural Finance and its impact on Decision Making of an Investment, This study delves into the foundational ideas of behavioural finance, illuminating the ways in which emotions, cognitive biases, and shortcuts influence the actions of investors. The research delves into certain biases including herding, anchoring, overconfidence, and loss aversion that impact investing decisions. This study delves at the ways in which fear and greed influence financial decisions. Investors' impulsive actions, fuelled by these emotions, have the potential to cause market fluctuations. Investors may improve their risk management and strategy development by understanding the psychological aspects that play a role in decision-making. These initiatives may aid lawmakers, financial advisers, and investors in making better decisions in the financial markets by encouraging educated and reasonable decision-making.

Abdul Kerim, et. al., [2] (2025), conducted study entitled Behavioural Finance and Investors Decision Making: A Review of the Nigeria Stock Exchange. This research explores the impact of behavioral finance on investors' decision-making within the Nigerian Stock Exchange, focusing on overconfidence, herding, and blue-chip stock preferences as key behavioral variables. The study concluded that overconfidence was evaluated to understand its effect on trading volume and stock selection. Herding behavior was analyzed to explore investors' propensity to follow the crowd, potentially leading to market inefficiencies. The preference for blue-chip stocks was examined to determine its impact on portfolio diversification and risk management. The findings of this study aim to provide insights into the psychological drivers of investor behavior in emerging markets, with implications for financial education and policy-making to enhance informed decision-making processes. The study recommends that both institutional and individual investors be educated about the various Behavioral factors, such as overconfidence and herding, that can influence their investment decision-making processes.

Deepak Kumar Baser and Dr Parul Dashora [3] (2023), were conducted study titled, "A Study of Behavioral Finance in Investment Decisions". Behavioral finance is a broad field that incorporates the exploration of psychology, sociology, and finance. It delves into the intricate behaviors and biases of investors on a micro level, while also addressing anomalies within the efficient market on a macro scale. In today's context, behavioral finance is a well established concept, as the influence of behavioral biases on investor actions and human decision-making is substantial. In this paper, we will critically examine a range of studies in this domain to gain a comprehensive insight into the realm of behavioral finance and its importance in shaping the financial choices made by investors.

Statement of the Problem

Investment decisions are generally expected to be based on financial knowledge, market information, risk assessment and expected returns. However, many retail investors make investment decisions under the influence of psychological factors rather than rational financial analysis. Overconfidence may encourage investors to trade excessively, while herd behaviour may lead them to follow the investment decisions of friends, relatives or market participants. Similarly, loss aversion may prevent investors from selling poorly

[1] Arjun Goud K, Satya Kumar KVR, and Chakradhar. P (2024), A study on Behavioural Finance and its impact on Decision Making of an Investment, International Journal of Economics, Business and Management Studies (EBMS), 11(3), 2024, 104 – 115.
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performing investments, whereas fear and greed may influence their investment timing. The increasing availability of online trading applications, social media investment advice and real-time market information has further changed the way retail investors make financial decisions. Despite the availability of financial information and investment opportunities, investors continue to experience difficulties in making rational investment decisions. This study attempts to identify the major behavioural biases influencing retail investors and analyse their relationship with investment decision-making.

Objectives of the Study

The following objectives of this research paper.

1. To analyse the influence of demographic factors such as gender, age group, educational level, amount of investment and years of experience in investment.

2. To find the influence of independent variables and mediating variable in Investment decision making.

3. To suggest suitable measures for improving rational investment decisions among retail investors.

Explanation of Psychological Factors

1. Overconfidence Bias

Overconfidence occurs when investors overestimate their financial knowledge, analytical abilities and capacity to predict market movements. Such investors may trade frequently and take excessive risks.

2. Herd Behaviour

Herd behaviour refers to the tendency of investors to follow the investment decisions of others rather than conducting independent financial analysis. Social media recommendations and market trends may influence this behaviour.

3. Loss Aversion

Loss aversion explains why investors experience greater emotional discomfort from financial losses than satisfaction from equivalent financial gains. It may result in holding loss-making investments for longer periods.

4. Anchoring Bias

Anchoring occurs when investors depend excessively on previously observed information, such as the original purchase price, historical share prices or market predictions, while making investment decisions.

Research gap

There were many studies conducted world wild about behavioural finance, the investors are need of more returns for their investment, the educated people analysing well about the investment avenue and start investment. The dimensions which taken for this study were not used in the previous studies, and similar type of studies not yet conducted in Coimbatore District. The researcher taken this two concepts as research gap and conducted the present study.

Sampling Design

The present study conducted in Coimbatore District only, questionnaire designed with the help of previous study results. The behaviour finance study is fully focused the investors those are investing in shares and future and options, they are expecting daily returns from their investment. Google forms used for data collection, so convenient sampling method adopted, the google form link shared various whats app groups, so the Google form link may reach to all state of India, so to restrict the samples in Coimbatore District, and respondents are asked whether they are in Coimbatore district only to fill the questionnaire. The researcher

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planned 300 samples, the Google form link share in the month of August 2026, the required data reached on 18.8.2026, immediately the entries closed and analysis started.

Tools and Techniques

The researched used percentage analysis and Structural Equation Model. The data were taken in MS excel, then transferred to SPSS – 19 and AMOS-20 for analysis. Percentage analysis used to present the socio economic factors and multiple regression analysis has been adopted.

Percentage analysis

The socio economic profile of the respondents are presented in the following table with help of percentage analysis.

Table 1 : Gender of the sample respondents

Sl. No.	Gender	Number of sample respondents	Percentage
1	Male	208	69.33
2	Female	92	30.67
	Total	300	100

Source : Primary data

The above table shows the gender of the sample respondents, out of 300 sample respondents, 208 (69.33%) sample respondents are male and remaining 92 (30.67%) sample respondents are female. Majority (69.33%) of the sample respondents are male.

Table 2 : Age group of the sample respondents

Sl. No.	Age group	Number of sample respondents	Percentage
1	Less than 30 years	75	25
2	31 years to 45 years	128	42.67
3	Above 45 years	97	32.33
	Total	300	100

Source : Primary data

The above table shows the age group of the sample respondents, out of 300 sample respondents, 75 (25.00%) respondents are less than 30 years old. 128 (42.67%) sample respondents are 31 years to 45 years and remaining 97 (32.33%) sample respondents are above 45 years old. Majority (42.67%) of the sample respondents are between 31 years to 45 years old.

Table 3 : Educational level of the sample respondents

Sl. No.	Educational level	Number of sample respondents	Percentage
1	Under graduate	137	45.67
2	Post graduate	96	32
3	Others	67	22.33
	Total	300	100

Source : Primary data

The above table shows the educational qualification of the sample respondents, out of 300 sample respondents, 137 (45.67%) sample respondents are under graduates. 96 (32.00%) sample respondents are post graduates and remaining 67 (22.33%) sample respondents are others like diploma and other degree. Majority (45.67%) of the sample respondents are under graduates.

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Table 4 : Amount of Investment of the sample respondents

Sl. No.	Amount of Investment	Number of sample respondents	Percentage
1	Less than Rs. 50,000	74	24.67
2	Rs. 50,001 to Rs. 1,00,000	103	34.33
3	Above Rs. 1,00,000	123	41
	Total	300	100

Source : Primary data

The above table shows the amount of investment which they have invested for trading. Out of 300 sample respondents, 74 (24.67%) respondents are invested less than Rs. 50,000. 103 (34.33%) sample respondents are invested Rs. 50,001 to Rs. 1,00,000 and remaining 123 (41.00%) sample respondents are invested above Rs. 1,00,000. Majority (41.00%) of the sample respondents are invested above Rs. 1,00,000.

Table 5 : Years of experience in Investment of the sample respondents

Sl. No.	Years of experience in Investment	Number of sample respondents	Percentage
1	Less than 5 years	65	21.67
2	6 years to 10 years	102	34
3	Above 10 years	133	44.33
	Total	300	100

Source : Primary data

The above table shows the years of experience of the sample respondents, out of 300 sample respondents, 65 (21.67%) sample respondents are less than 5 years of investment experience. 102 (34.00%) sample respondents are having 6 years to 10 years of investment experience. Majority (44.33%) of the sample respondents are having above 10 years of investment experience.

Level of Investment Decision Making

Likert five point scale used to find the level of investment decision making of the sample respondents. The total score take to find the level and presented in the following table.

Table 6 : Level of Investment Decision Making (Psychological Factors)

Sl. No.	Level of investment decision making	Number of sample respondents	Percentage
1	Low	53	17.67
2	Medium	165	55
3	High	82	27.33
	Total	300	100

Source : Primary data

The above table shows the level of investment decision making of the sample respondents, out of 300 sample respondents, 53 (17.67%) sample respondents are felt low level of investment decision making. 165 (55.00%) sample respondents are felt medium level of investment decision making and remaining 82 (27.33%) sample respondents are felt high level of investment decision making. Majority (55.00%) of the sample respondents are felt medium level of investment decision making.

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Chi Square Test

Table 7 : Chi square test : socio economic profile and level of investment decision making (Psychological Factors)

Sl. No.	Variables	Chi Square value	DF	P – value	Result
1	Gender	18.382	2	0.001	Significant
2	Age group	22.178	4	0.001	Significant
3	Educational level	20.381	4	0.001	Significant
4	Amount of investment	21.943	4	0.001	Significant
5	Years of experiences in investment	19.783	4	0.001	Significant

Source : Computed data

The gender (0.001), age group (0.001), educational level (0.001), amount of investment (0.001) and years of experience in investment (0.001) has influence the level of investment decision making at 5% significant level.

SEM

The following independent variables are taken, used five point likert scale to get the score.

Independent Variable

1. Financial literacy
2. Financial confidence
3. Risk tolerance
4. Financial self efficacy
5. Rational decision making

Mediating variable

The Financial Decision confidence is taken as mediating variable, used five point likert scale to get the score.

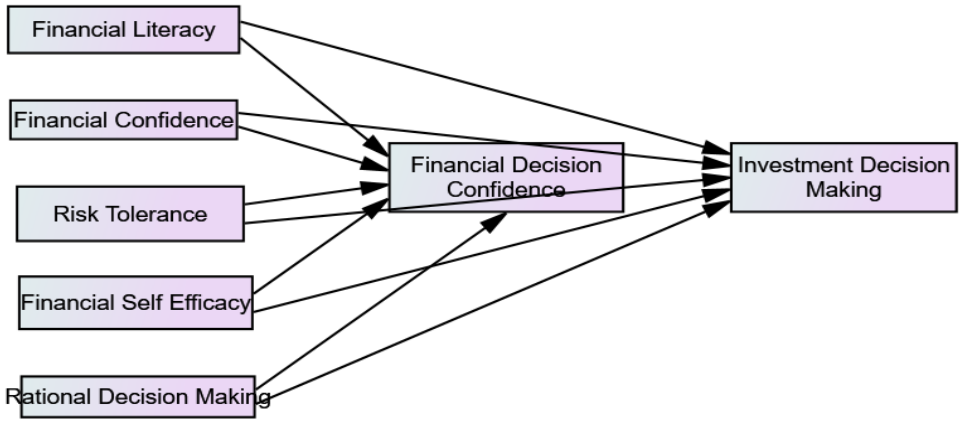
1. Financial Decision confidence

Dependent variable

The Investment decision making is taken as dependent variable, used five point likert scale to get the score.

1. Investment decision making

Figure 1 : SEM – Investment Decision Making



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SEM Model Structure

This Structural Equation Modeling (SEM) framework evaluates how cognitive traits, psychological confidence, and decision-making styles shape an individual's **Investment Decision Making**, both directly and through the mediating role of **Financial Decision Confidence**.

1. Variables in the Model

Independent Variables (Exogenous Constructs):

1. **Financial literacy :** Objective knowledge of financial concepts, interest rates, inflation, and investment instruments.
2. **Financial confidence :** General self-assuredness regarding one's handling of money matters.
3. **Risk tolerance :** Willingness to endure volatility, uncertainty, or potential loss in pursuit of returns.
4. **Financial self-efficacy :** Belief in one's capability to execute specific financial tasks and manage outcomes.
5. **Rational decision making :** Analytical, structured, and objective evaluation of choices rather than emotional or impulse-driven behavior.

Mediating Variable (Endogenous Mediator) :

1. **Financial Decision Confidence:** State-specific confidence experienced right at the moment of choosing an investment alternative. It acts as a bridge translating background traits/knowledge into active choice.

Dependent Variable (Endogenous Target Construct):

1. **Investment decision making:** The actual quality, frequency, portfolio choice, or execution of investment acts.

2. Path Relationships & Hypotheses

1. **Direct Paths to Mediator (IV → Financial Decision Confidence):**
    1. Higher financial literacy and financial self-efficacy directly build task-specific decision confidence.
    2. Rational decision making and risk tolerance provide the cognitive and emotional baseline needed to feel sure about a financial choice.

Direct Paths to Dependent Variable (IV → Investment Decision Making):

1. Literacy and risk tolerance also exert direct influences on what and how people invest (e.g., high risk tolerance directly shifts capital toward equities).

Mediated Path (Financial Decision Confidence → Investment Decision Making)

1. Financial decision confidence translates psychological preparedness and knowledge into action. Instead of freezing or second-guessing, an investor with high decision confidence acts on their literacy and risk profile.

FINDINGS

1. Majority (69.33%) of the sample respondents are male.
2. Majority (42.67%) of the sample respondents are between 31 years to 45 years old.
3. Majority (45.67%) of the sample respondents are under graduates.
4. Majority (41.00%) of the sample respondents are invested above Rs. 1,00,000.

5. Majority (44.33%) of the sample respondents are having above 10 years of investment experience.
6. Majority (55.00%) of the sample respondents are felt medium level of investment decision making.
7. The gender (0.001), age group (0.001), educational level (0.001), amount of investment (0.001) and years of experience in investment (0.001) has influence the level of investment decision making at 5% significant level.
8. SEM presented that all five independent variables are influencing the mediating variable and finally influencing the Investment decision making.

SUGGESTIONS

The following are the suggestions of the study.

1. Retail investors should improve their financial knowledge and understanding of investment products, market conditions, risk and returns. Financial education programmes should be conducted to help investors make informed and rational investment decisions.

2. Investors should avoid making investment decisions based on emotions such as fear, greed, anxiety and excitement. They should develop emotional stability and discipline to minimise impulsive investment behaviour.

3. Investors should not over estimate their investment knowledge, experience or ability to predict market movements. They should seek expert advice and consider reliable financial information before making investment decisions.

4. Retail investors should not blindly follow friends, relatives, social media influencers or market trends while selecting investment options. Independent analysis and personal financial objectives should guide their investment choices.

5. Investors should develop a clear understanding of different types of investment risks, including market risk, credit risk, liquidity risk and inflation risk. Proper risk assessment will help them select investments according to their financial capacity and risk tolerance.

6. Investors should focus on long-term financial goals rather than short-term market fluctuations. Systematic investment planning and disciplined investment practices can help reduce unnecessary trading and emotional reactions.

7. Investors should become aware of psychological biases such as anchoring, loss aversion, confirmation bias and availability bias. Understanding these behavioural tendencies can improve the quality of investment decisions.

8. Retail investors should diversify their investments across different financial instruments and asset classes rather than concentrating their funds in a single investment. Diversification helps manage risk and provides greater financial stability.

9. Investors should develop confidence in their financial knowledge and decision-making abilities through continuous learning, practical investment experience and professional guidance. Financial self-efficacy can encourage independent and responsible investment decisions.

10. Investors should consult qualified financial advisors whenever they face difficulties in selecting investment alternatives or evaluating market risks. Professional guidance, combined with individual financial goals and behavioural awareness, can contribute to better investment decisions.

CONCLUSION

Behavioural Finance plays a significant role in understanding the investment decisions of retail investors, as their financial choices are influenced not only by economic factors but also by psychological, emotional and

behavioural factors. Investors' attitudes, perceptions, beliefs, financial literacy, risk tolerance and confidence considerably influence their investment preferences and decision-making processes. Behavioural biases such as overconfidence, loss aversion, herding behaviour, anchoring and emotional decision-making may lead to irrational investment choices and affect investment performance. Therefore, developing financial awareness, emotional stability, rational thinking and risk-management skills is essential for improving investment decisions. Retail investors should focus on long-term financial objectives, diversify their investment portfolios and seek professional financial guidance whenever necessary. Financial institutions and regulatory authorities should also promote investor education and awareness programmes to minimise behavioural errors. Understanding the psychology of retail investors and integrating behavioural finance principles into investment planning can encourage informed, disciplined and rational investment decisions, thereby contributing to improved financial well-being and long-term wealth creation.

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