

# A Study on Behavioural Biases and Their Impact on Investment Decision-Making

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## ABSTRACT

*Traditional financial theories assume that investors make rational decisions based on available information. However, in reality, investor behaviour is often influenced by psychological biases and emotional factors. This study examines the impact of behavioural biases on investment decision-making. The research is based on secondary data collected from academic journals, financial studies, and behavioural finance literature. The findings reveal that biases such as overconfidence, herd behaviour, loss aversion, and anchoring significantly influence investment decisions, often leading to irrational outcomes. These biases can result in excessive trading, poor portfolio diversification, and suboptimal investment strategies. The study concludes that understanding behavioural biases is essential for improving investment decisions and achieving better financial outcomes.*

**Keywords:** Behavioural Finance, Investment Decisions, Psychological Biases, Investor Behaviour, Market Psychology

## I. INTRODUCTION

The field of finance has traditionally been based on the assumption that investors are rational and markets are efficient. However, real-world observations suggest that investor behaviour often deviates from rationality due to psychological and emotional influences.

Behavioural finance is an emerging field that combines psychology and finance to understand how cognitive biases affect investment decisions. It challenges traditional theories by explaining why investors sometimes make irrational choices.

Investors are influenced by emotions such as fear, greed, and overconfidence, which can lead to poor decision-making. For example, during market booms, investors may become overly optimistic and invest aggressively, while during market downturns, fear may lead to panic selling. Understanding these behavioural biases is crucial for investors, financial advisors, and policymakers to design strategies that minimize irrational behaviour and improve financial outcomes.

## II. OBJECTIVES OF THE STUDY

- To understand the concept of behavioural finance
- To identify common behavioural biases in investors

- To examine the impact of these biases on investment decisions
- To suggest measures to reduce irrational investment behaviour

### III. LITERATURE REVIEW

Behavioural finance has gained significant attention in recent years. According to Kahneman and Tversky (1979), individuals often rely on heuristics, which can lead to systematic biases in decision-making.

A study by Barber and Odean (2001) highlights that overconfident investors tend to trade excessively, resulting in lower returns. Similarly, research by Shiller (2000) suggests that market bubbles and crashes are often driven by investor psychology rather than fundamentals.

Studies also indicate that herd behaviour leads investors to follow the crowd, ignoring their own analysis. Loss aversion, as explained in Prospect Theory, shows that investors fear losses more than they value gains.

In the Indian context, research indicates that retail investors are significantly influenced by market sentiment, peer behaviour, and media information.

### IV. RESEARCH METHODOLOGY

The study adopts a descriptive research design based on secondary data collected from academic journals, behavioural finance studies, and financial reports.

The analysis focuses on identifying common behavioural biases and their impact on investment decision-making.

#### Limitations:

- Lack of primary data
- Behavioural patterns may vary across individuals
- Dependence on secondary sources

### V. COMMON BEHAVIOURAL BIASES IN INVESTING

#### 1. Overconfidence Bias

Investors overestimate their knowledge and ability, leading to excessive trading and risk-taking.

#### 2. Herd Behaviour

Investors follow the actions of others, especially during market booms or crashes.

#### 3. Loss Aversion

Investors prefer avoiding losses rather than acquiring gains, leading to delayed decision-making.

#### 4. Anchoring Bias

Investors rely heavily on initial information or past prices while making decisions.

#### 5. Confirmation Bias

Investors seek information that supports their existing beliefs and ignore contradictory evidence.

### VI. IMPACT OF BEHAVIOURAL BIASES ON INVESTMENT DECISIONS

#### 1. Irrational Investment Choices

Biases lead to decisions that are not based on fundamental analysis.

## **2. Excessive Trading**

Overconfidence results in frequent buying and selling, reducing returns.

## **3. Poor Portfolio Diversification**

Investors may concentrate investments in familiar assets.

## **4. Market Volatility**

Herd behaviour contributes to market bubbles and crashes.

## **5. Emotional Decision-Making**

Fear and greed influence investment timing.

## **VII. FINDINGS AND ANALYSIS**

The study reveals that behavioural biases significantly influence investment decisions, often leading to suboptimal financial outcomes. Investors tend to rely on emotions and heuristics rather than rational analysis.

The analysis indicates that overconfidence and herd behaviour are the most common biases affecting retail investors. These biases result in excessive trading and speculative investments.

Loss aversion prevents investors from selling underperforming assets, leading to losses. Anchoring bias causes investors to rely on past price levels, ignoring current market conditions.

The study highlights the importance of financial education and awareness in reducing the impact of behavioural biases.

## **VIII. ADVANTAGES OF UNDERSTANDING BEHAVIOURAL FINANCE**

- Improves investment decision-making
- Reduces irrational behaviour
- Enhances portfolio management
- Promotes long-term investment strategies
- Helps in risk management

## **IX. CHALLENGES AND ISSUES**

- Difficulty in controlling emotions
- Lack of awareness about biases
- Influence of market sentiment
- Over-reliance on informal information
- Limited financial literacy

## **X. CONCLUSION**

Behavioural biases play a significant role in shaping investment decisions, often leading to irrational and suboptimal outcomes. The study highlights that understanding these biases is essential for improving financial decision-making.

Investors must adopt disciplined and informed approaches to minimize the impact of psychological factors. Financial education and awareness programs can help investors make rational decisions and achieve better financial outcomes.

## **IX. SUGGESTIONS**

- Promote financial literacy and awareness

- Encourage disciplined investment strategies
- Avoid emotional decision-making
- Seek professional financial advice
- Focus on long-term investment goals

#### **X. REFERENCES**

- Kahneman, D., & Tversky, A. (1979)
- Barber, B., & Odean, T. (2001)
- Shiller, R. J. (2000)
- Various behavioural finance journals and studies