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"Psychological Trap in the Decision Making of Retail Investors- An Analysis"

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Abstract

In olden days, we assume that investors act rationally. However, behavioural finance reveals that investment decisions are heavily influenced by deep-seated psychological and cognitive biases. This paper explores the different factors that influence the decision making of retail investors and influence of behaviour bias on decision making. This study focuses on individuals' behavioural biases in investment decision-making. the study concludes that psychological and emotional factors significantly influence investment decisions, sometimes leading to irrational behaviour. Therefore, improving financial awareness and promoting rational decision-making can help investors make better investment choices and enhance their investment performance.

Key words: behavioural bias, investment decisions, retail investor

In the ancient root itself there was an investment activity before the invention of money or stock market by selling seeds to farmers and the farmer paid them back with a portion of the harvest. From that time onwards people influenced by their own thoughts while investing. However, in1979 Tvesky and Kahneman discovered that human brains are not wired for purely rational risk assessment. In the 1980s, behavioural finance emerged as a new concept combining behavioural and psychological aspects in economic and financial decision-making. Behavioural finance challenges the efficient market perspective and helps to understand why investors behave in a particular manner while investing in financial assets. (Kahneman)**.** Behavioural biases are psychological patterns that cause investors to act irrationally. They make people rely on emotions or shortcuts instead of facts. These biases cause common mistakes like panic-selling during a dip or buying into a fad. There are so many behavioural biases are influenced by the investors. Some of them are given below.

1. Overconfidence bias: - It is a well-established and common bias that makes people too confident about their knowledge and skills and ignore the risk associated to investment Earlier.
2. Disposition bias: - Disposition effect is another important behavioural bias wherein investors are more prone to selling the winning stock and tend to hold on to the loss-making asset.
3. Herding bias: - Herding refers to the situation wherein rational people start behaving irrationally by imitating the judgements of others while making decisions.
4. Loss aversion bias: - It is a psychological concept where the pain of losing something is twice as powerful as the pleasure of gaining the exact same thing.

5. Anchoring bias: - It is triggered when investors give excessive importance to the first information they encounter, such as an initial stock price or the first investment tip.
6. Emotional and cognitive biases: - A wide range of emotional and cognitive distortions influences investment decisions. Emotions such as fear, greed, optimism, regret, and anxiety can override logical thinking, resulting in impulsive or irrational trading.

1. Literature review

Sathya, R Gayathiri (2024) Conducted study on the topic "Behavioral biases in investment decisions: An extensive literature review and pathways for future research ―provided an extensive review of behavioral biases in investment decisions, highlighting key biases such as overconfidence, loss aversion, anchoring, confirmation bias, herding, disposition effect, framing, and regret aversion. Their study emphasized how these biases distort investor judgment, create market inefficiencies, and increase volatility. They also stressed the importance of recognizing these biases for designing interventions and suggested pathways for future research bridging psychology and finance. The authors further noted that understanding these behavioral patterns can help investors make more rational financial choices. **Eetika Madaan, Sanjeet Singh (2019)** The study conducted on the topic ―Impact of Behavioural Biases on Investment Decisions: An Empirical Study.‖ The investors in the National Stock Exchange analyzed four behavioral biases—overconfidence, anchoring, disposition effect, and herding—and found that overconfidence and herding had a significant positive impact on investment decisions. The research concluded that individual investors often have limited knowledge and are prone to psychological errors, making them vulnerable to biased decision making.

Research problem

Investment choices are frequently shaped not just by financial data but also by psychological biases, including overconfidence, herd behaviour, loss aversion, anchoring, and regret aversion. Young investors in the Malappuram district may engage in less-than-optimal decision-making as a result of these cognitive and emotional influences. Additional factors such as gender, investment experience, and emotional states can further impact the decision-making process. Although there is an increasing interest in Behavioural finance, there is a scarcity of research examining how these biases affect investors in specific regions. This study seeks to investigate the effects of Behavioural biases on investment decisions, providing valuable insights for both investors and financial advisors.

Objectives of the study

1. To identify the factors influencing investment decisions of investors.
2. To examine the most influencing behavioural biases in investment decisions of young investors.

Research hypotheses

1. There is no association between investment experience and Overconfidence bias.
2. There is no association between Gender and Loss Aversion Bias.

2. Methodology used for the study

The present study is descriptive and exploratory and make use of both primary and secondary data. Primary data were collected through survey and secondary data were collected from various books, journals, websites, etc. Purposive sampling was adopted to select respondents who are engaged in various forms of investment. The sample size for the present study was 120 investors from Malappuram district. The statistical tools were used for analysis like percentage analysis, ranking, scaling, mean score, etc.

Data analysis and Discussion

To study the effect of behavioural bias in investment decision making, the following parameters used for the study.

Table 1. Socio Demographic Profile

Factors	Basis	Frequency	Percentage	Mode
Gender	Male	77	64	Male
	Female	43	36	
Age	Below 25	12	10	25-40
	25-40	82	68	
	40 and above	26	22	
Occupation	Private	41	34	Private
	Government	26	22	
	Business	24	20	
	Others	29	24	
Monthly income (in ₹)	Below 10000	17	14	10000- 25000
	10000-25000	51	43	
	25000-50000	28	23	
	50000-100000	16	13	
	Above 100000	08	7	

Investment Experience	Less than 1year	60	50	Less than 1 year
	1-3 years	39	33	
	3 – 5 years	16	13	
	More than 5 years	5	04	
Investment Instrument (Multi response)	Mutual fund	69	31	Mutual fund
	Stock	67	29	
	Gold	39	17	
	Bond	35	16	
	Others	15	7	

Source: Primary data

Among the respondents it is found that 64 per cent belongs to male, 68 per cent belong to the age category of 25-40 years old, 34 per cent respondents are occupied from private sector, 43 per cent of the respondents earn a monthly income of ₹ 10000-25000, investment experience of the investors are less than one year and most of the investors preferred mutual fund as investment instrument.

Table 2 Factors influencing the investment decisions

Factors	**1**	**2**	**3**	**4**	**5**	**Total**
Family/friends	64	14	7	9	26	120
Social media influencers	11	57	13	31	8	120
Fear of loss	9	17	78	11	5	120
	13	25	17	58	7	120

Own Judgment and Confidence						
None of the above	23	7	5	11	74	120

Factors	Weighted score					Total	Mean score	Rank
	5	4	3	2	1			
Family/Friends	320	56	21	18	26	441	3.67	1
Social media influences	55	228	39	62	8	392	3.26	2
Fear of loss	45	68	239	22	5	374	3.11	3
Own judgement and confidence	65	100	51	116	7	339	2.82	4
None of the above	115	28	15	22	74	254	2.11	5

Source : Computed Data

The above analysis shows that family and friends are the most influential factor in investment decisions, followed by social media influencers. Fear of loss has a moderate impact, while own judgement and confidence is less preferred. None of the above is ranked last, indicating that most respondents are influenced by external factors. Overall, social and external influences dominate over personal judgement in investment decisions.

Table 3 Behavioural biases in investment decision

Factors	1	2	3	4	5	Total
Overconfidence bias	62	15	9	3	31	120

Herding bias	10	61	12	31	6	120
Anchoring bias	5	12	80	18	5	120
Loss aversion bias	14	19	13	60	14	120
Emotional and cognitive bias	29	13	6	8	64	120

Factors	**Weighted score**					**Total**	**Mean score**	**Rank**
	5	4	3	2	1			
Overconfidence bias	310	60	27	6	31	434	3.6	1
Herding bias	50	244	36	62	6	398	3.3	2
Anchoring bias	25	48	240	36	5	354	2.95	3
Loss aversion bias	70	76	39	120	14	319	2.65	4
Emotional and cognitive bias	145	52	18	16	64	295	2.45	5

Computed by researcher

The above table presents the ranking of behavioural biases among the investors likely based a five-point scale Likert Scale (Where 5 is the highest impact and 1 is the lowest). Over confidence bias is the most affected bias in investment decision with mean score of 3.6, it depicts that an investor over estimate their own knowledge or ability. This is followed by herding bias (mean score 3.3) and anchoring bias (mean score 2.95), it indicates that reliance on first information in investment decisions. Loss aversion bias (mean score 2.65) and emotional and cognitive bias (mean score 2.45) rank the lowest, suggesting that these two have minimal impact on the investment decisions.

Table 4. Hypothesis 1

Ho: There is no association between investment experience and Overconfidence bias.

Investment experience	Overconfidence bias					Total	Chi-square value	Table value
	Strongly Disagree	Disagree	Neutral	Agree	Strongly agree			
Less than 1 year	11	9	16	25	2	63	26.65	21.026
1-3 year	9	8	7	15	4	43		
3-5 year	1	2	0	4	4	11		
More than 5 years	0	0	0	1	2	3		
Total	21	19	23	45	12	120		

Computed data

Chi- Square test was conducted to examine the association between investment experience and overconfidence bias. Since the calculated value (26.65) is greater than table value (21.026), the null hypothesis is rejected. Rejecting the null hypothesis means there is a significant association between investment experience and overconfidence bias.

Table 5 Hypothesis 2

H0: There is no association between Gender and Loss Aversion Bias.

Gender	Loss aversion bias					Total	Chi square value	Table value
	Strongly disagree	Disagree	Neutral	Agree	Strongly Agree			
Male	14	19	11	24	9	77	4.54	9.488
Female	3	6	9	20	5	43		
Total	17	25	20	44	14	120		

Source: Calculated Manually

Chi- Square test was conducted to examine the association between gender and loss aversion bias. Since the calculated value (4.54) is less than table value (9.488), we fail to reject the null hypothesis. This indicates that there is no significant association between gender and loss aversion bias.

Findings of the study

- The findings related to the factors influencing investment decisions of investors are family and friends (3.67), followed by social media influencers (3.26). Fear of loss (3.11) has a moderate impact, while own judgement and confidence is less preferred.
- The most influencing behavioural biases in investment decision is over confidence bias with mean score of 3.6. This is followed by herding bias (mean score 3.3) and anchoring bias (mean score 2.95), it indicates that reliance on first information in investment decisions. Loss aversion bias

(mean score 2.65) and emotional and cognitive bias (mean score 2.45) rank the lowest, suggesting that these two have minimal impact on the investment decisions.

- From demographic profile it is found that 64 per cent belongs to male, 68 per cent belong to the age category of 25-40 years old, 34 per cent respondents are occupied from private sector, 43 per cent of the respondents earn a monthly income of ₹ 10000-25000, investment experience of the investors are less than one year and most of the investors preferred mutual fund as investment instrument.
- There is a significant association between investment experience and overconfidence bias.
- There is no significant association between gender and loss aversion bias.

3. Conclusion

The study reveals that behavioural biases play a significant role in influencing the investment behaviour of respondents. The findings indicate that most investors are beginners with limited investment experience and belong to low and middle-income groups. Mutual funds and stocks are the most preferred investment options among respondents. Overall, the study concludes that psychological and emotional factors significantly influence investment decisions, sometimes leading to irrational behaviour. Therefore, improving financial awareness and promoting rational decision-making can help investors make better investment choices and enhance their investment performance.

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