International Journal of Research Publication and Reviews

Journal homepage: www.ijrpr.com ISSN 2582-7421

A STUDY ON PSYCHOLOGICAL INFLUENCES AND BIASES THAT AFFECT FINANCIAL BEHAVIOURS OF INVESTORS

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ABSTRACT:

This research paper explores the impact of psychological factors on investment decisions, highlighting cognitive biases like representativeness and overconfidence, emotional influences such as fear and greed, and personality characteristics like risk tolerance. It emphasizes the role of financial literacy in mitigating biases and improving decision-making. By understanding and managing these factors, investors can make more informed choices, avoid common pitfalls, and enhance their investment outcomes in volatile financial markets.

Keywords: Psychological influences, biases, financial behaviors, investors

1.1. Rationale for the Study and Motivation

This research delves into the impact of psychological factors on financial decision-making, revealing how cognitive biases, emotional influences, and personality traits often lead investors to make irrational choices. By exploring these elements, researchers aim to enhance investment strategies and market efficiency. This study contributes to advancing the field of behavioural finance, offering valuable insights for investors and financial institutions to optimize portfolios and improve financial outcomes.

1.2. Statement of the Research Problem

This study investigates the intricate psychological influences and biases impacting investors' financial decisions, aiming to bridge gaps in understanding within the burgeoning field of behavioural finance. Despite the complexities arising from diverse human psychology and constantly evolving financial markets, research reveals various biases like loss aversion and overconfidence, yet much remains to be understood. By elucidating these influences and their implications, this research seeks to enhance decision-making models and promote more informed investment strategies, crucial for fostering market efficiency and stability.

1.3 Review of Literature

Various studies explore the impact of psychological biases on investment decision-making. For instance, research in Indonesia and Pakistan delves into cognitive and emotional biases, employing methods like surveys and structural equation modelling. Similarly, studies in Tanzania and India investigate the influence of psychological traits on investment decisions among individual investors, highlighting the importance of understanding behavioural finance. These findings contribute to enhancing our comprehension of investor behaviour and the role of psychological factors in financial decision-making.

2.1 Research Objectives

To analyze the psychological variables and biases that affect investor decision-making.

To investigate the efficacy of interventions in reducing psychological biases and improving investor decision-making.

To contribute to the field of behavioral finance by enhancing our understanding of the psychological factors influencing investor decision-making.

2.2 Research Design

This study employs a mixed-methods approach, combining quantitative surveys, qualitative interviews, and analysis of secondary sources like financial reports. Surveys gather quantitative data on cognitive biases, emotions, and personality traits, enabling statistical analysis.

Interviews provide qualitative insights into participants' experiences and decision-making processes. Additionally, secondary sources offer contextual insights into market dynamics and investment behavior. By triangulating these diverse data sources, researchers gain a comprehensive understanding of the psychological factors influencing financial behaviors.

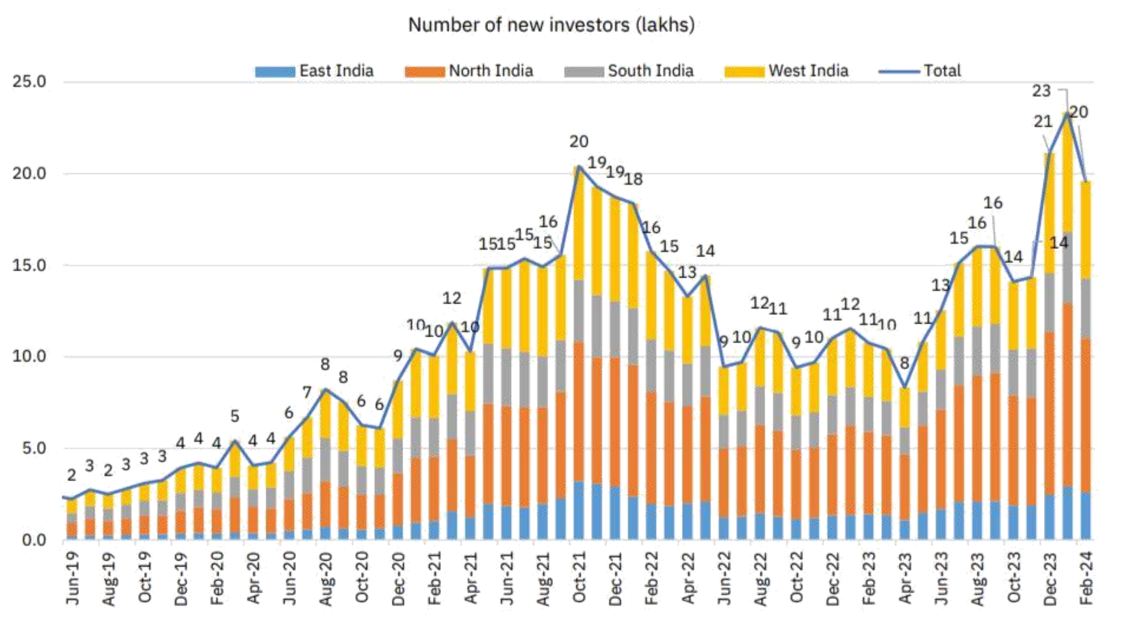
2.5 Methods for Data Collection & Variables of the study

This study employs a mixed-methods approach, utilizing surveys, interviews, and analysis of secondary sources like financial reports and market data. Surveys gather quantitative data on cognitive biases, emotions, and personality traits, while interviews provide qualitative insights into participants' experiences. Additionally, analysis of secondary sources offers contextual insights into market dynamics and investment behavior. By triangulating these diverse data sources, researchers gain a comprehensive understanding of the psychological factors influencing financial behaviors.

3.1 Techniques for Data Analysis

In February 2024, new investor registrations saw a 16% decrease compared to January, totaling 19.6 lakh registrations. This decline, observed across all regions of India, could be influenced by various factors such as market volatility and shifts in investor sentiment. Despite the reduction, the overall investor base surpassed 9 crore by the end of February. The regional differences in registration trends suggest varying economic conditions or market perceptions across different parts of the country. Despite these fluctuations, the overall increase in total investor registrations over the first 11 months of FY24 indicates sustained interest in investing opportunities and growth, consistent with patterns seen in behavioural finance where investors' choices are influenced by perceived risks, rewards, and market trends.

Fig1: Region-wise distribution of new investors registered each month



In February 2024, individual investor turnover in the cash market saw a 3.4% decline compared to the previous month, totaling Rs 17.6 lakh crore, with decreases across all regions. The Eastern region experienced the largest drop in turnover at 6% MoM, followed by the Southern region at 4% MoM. Despite this, there was an increase in the number of active investors in all regions, indicating resilient investor behavior and sustained interest in market participation.

Fig 2: Region-wise distribution of monthly individual investor's turnover in the cash market

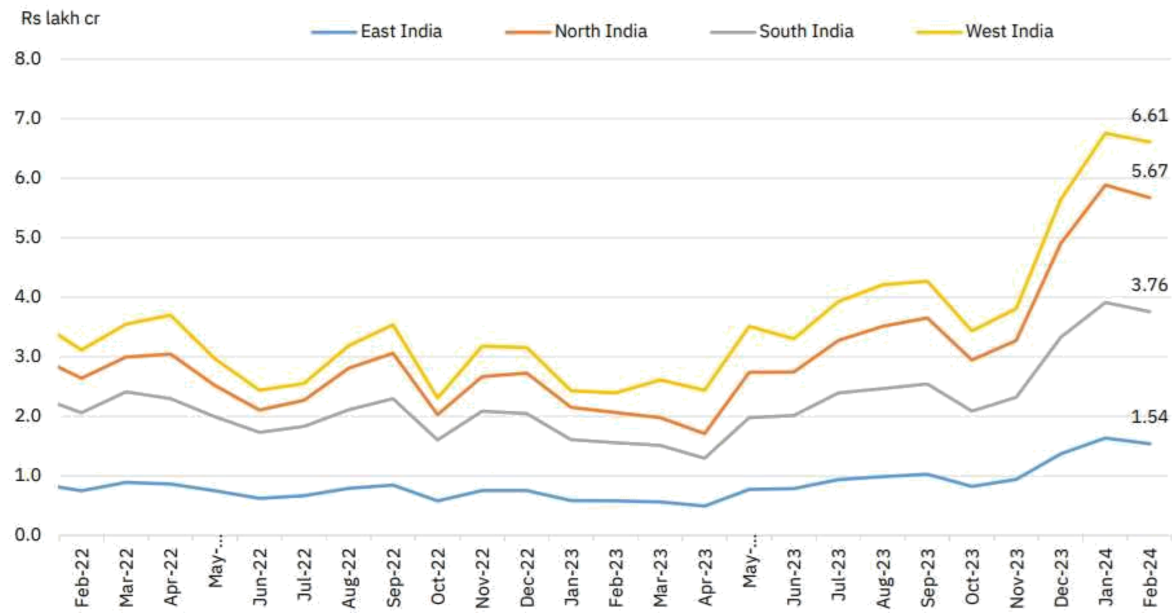
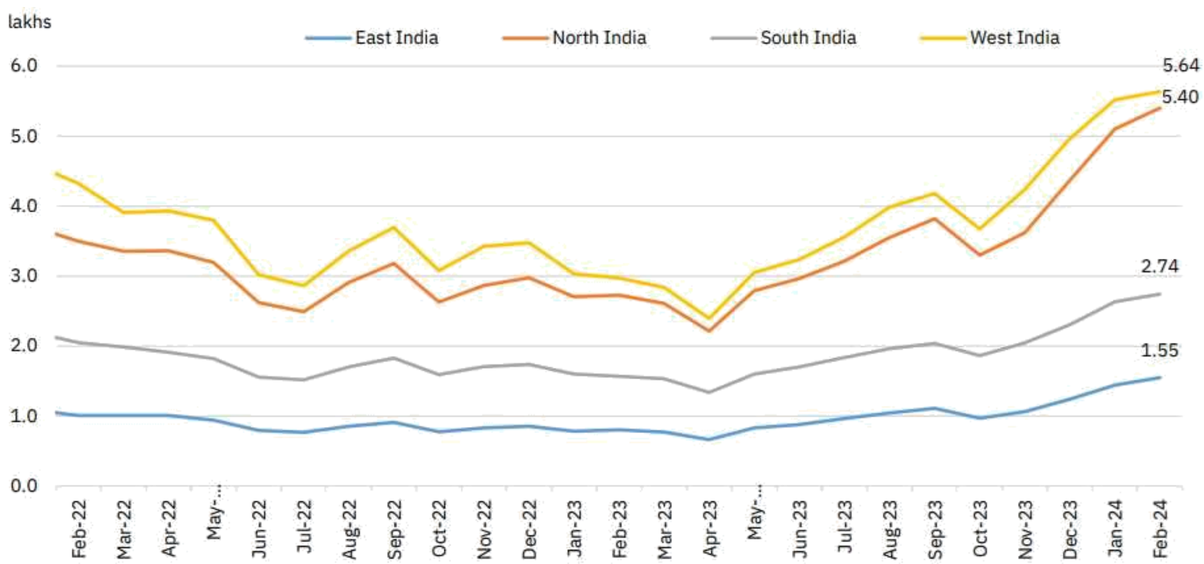


Fig 3: Region-wise distribution of Individual investors traded in the cash market



In February 2024, there was a noticeable shift in the distribution of individual investor turnover, with the Western and Northern regions seeing increased proportions while the shares of Southern and Eastern India slightly declined. This trend was also reflected in the distribution of active investors, with the Northern region's share increasing and the Western region's share decreasing slightly. These changes suggest investors' reactions to evolving market conditions, with growing confidence and interest in the Western and Northern regions possibly driven by perceived economic opportunities, while the declines in Southern and Eastern India could indicate a slowdown in investor activity in those areas. Overall, investors seem to be strategically positioning themselves in regions offering greater growth potential and investment opportunities.

Table 85: Distribution of turnover by range in cash market for all investors

Turnover range	Dec-23		Jan-24		Feb-24			
	Total net turnover (Rs cr)	No. of unique investors	Total net turnover (Rs cr)	No. of unique investors	Total net turnover (Rs cr)	Share in turnover (%)	No. of unique investors	Share in investors (%)
<Rs 10,000	566.6	38,20,239	721.7	45,83,473	769.6	0.03	49,49,804	32.8
Rs 10,000-Rs 1 lakh	8,598.7	44,81,215	9,502.4	48,37,147	9,929.2	0.4	50,93,143	34
Rs 1 lakh - Rs 10 lakh	50,941.7	30,06,615	59,644.6	34,89,938	59,860.5	2.4	35,28,886	23.4
Rs 10 lakh - Rs 1 cr	1,63,767.9	10,74,248	1,93,320.4	12,69,404	1,86,106.8	7.6	12,31,949	8.2
Rs 1 cr – 10 cr	3,02,795.3	2,23,720	3,53,448.8	2,61,130	3,35,547.1	13.7	2,48,204	1.6
>Rs 10 cr	15,52,924.0	23,491	18,74,543.0	28,118	18,65,458.1	75.9	26,882	0.2
Total	**20,79,594.2**	**1,26,29,528**	**24,91,181**	**1,44,69,210**	**24,57,671**	**100**	**1,50,78,868**	**100**

In February, a majority of active investors in equity options trading conducted transactions below Rs 10 lakh, reflecting cautious trading behavior despite a 4% increase in active investors. The flat premium turnover alongside this rise suggests a preference for smaller investments, possibly driven by risk aversion or limited capital availability. Furthermore, while the majority of investors engaged in smaller trades, a minority contributed significantly to the total turnover, indicating a pattern of disproportionate impact. This behavior aligns with principles of behavioural finance, such as loss aversion, and reflects a "power law" distribution in market participation. Additionally, a survey conducted via Google Form with 129 responses aimed to gain insights into investor behavior, revealing diverse patterns, preferences, and techniques used by investors across demographics. This initiative underscores the importance of understanding investor behavior in navigating the dynamic financial landscape.

3.2 Hypotheses Testing and Methods

Chi-square Test

Contingency Tables

Contingency Tables

	Are you aware of the psychological biases that can influence investment decisions?				
What is your age?	**1**	**2**	**3**	**Are you aware of the psychological biases that can influence investment decisions?**	**Total**
1	0	4	0	0	4
2	8	24	4	0	36
3	214	12	20	0	246
4	4	8	0	0	12
5	192	8	0	0	200
96.6% of respondents indicated either a definite interest or a prospective interest based on the solutions that were presented. This indicate that the majority of respondents are interested in learning strategies to limit the influence of psychological biases on investment decisions. This highlights the necessity of knowing biases and trying to overcome them in order to make financial decisions that are more informed and logical.	18	0	0	0	18
What is your age?	0	0	0	3	3
Total	436	56	24	3	519

χ^2 Tests

	Value	df	p
χ^2	754	18	< .001
N	519		

Descriptive statistics

Descriptives

Descriptives

	Have you ever made investment decisions in financial markets?	How often do you consult financial advisors or experts before making investment decisions?	Are you aware of the psychological biases that can influence investment decisions?	How do you perceive the impact of psychological biases on investment decisions?	Do you believe that emotions play a role in investment decision-making?	Have you ever experienced any of the following biases in your investment decisions? (Select all that apply)
N	519	519	519	519	519	511
Missing	480	480	480	480	480	488
Mean						
Median						
Standard deviation						
Minimum						
Maximum						

Frequencies

Frequencies of Have you ever made investment decisions in financial markets?

Have you ever made investment decisions in financial markets?	Counts	% of Total	Cumulative %
1	456	87.9 %	87.9 %
2	60	11.6 %	99.4 %
Have you ever made investment decisions in financial markets?	3	0.6 %	100.0 %

Frequencies of How often do you consult financial advisors or experts before making investment decisions?

How often do you consult financial advisors or experts before making investment decisions?	Counts	% of Total	Cumulative %
1	40	7.7 %	7.7 %
2	44	8.5 %	16.2 %
3	416	80.2 %	96.3 %
4	12	2.3 %	98.7 %
5	4	0.8 %	99.4 %
How often do you consult financial advisors or experts before making investment decisions?	3	0.6 %	100.0 %

Frequencies of Are you aware of the psychological biases that can influence investment decisions?

Are you aware of the psychological biases that can influence investment decisions?	Counts	% of Total	Cumulative %
1	436	84.0 %	84.0 %
2	56	10.8 %	94.8 %
3	24	4.6 %	99.4 %
Are you aware of the psychological biases that can influence investment decisions?	3	0.6 %	100.0 %

Frequencies of How do you perceive the impact of psychological biases on investment decisions?

How do you perceive the impact of psychological biases on investment decisions?	Counts	% of Total	Cumulative %
1	28	5.4 %	5.4 %
2	8	1.5 %	6.9 %
3	480	92.5 %	99.4 %
How do you perceive the impact of psychological biases on investment decisions?	3	0.6 %	100.0 %

Frequencies of Do you believe that emotions play a role in investment decision-making?

Do you believe that emotions play a role in investment decision-making?	Counts	% of Total	Cumulative %
1	440	84.8 %	84.8 %
2	60	11.6 %	96.3 %
3	12	2.3 %	98.7 %
4	4	0.8 %	99.4 %
Do you believe that emotions play a role in investment decision-making?	3	0.6 %	100.0 %

3.3 Data Interpretation

Chi-square:

The chi-square test with 18 degrees of freedom and a p-value below 0.001 yielded a test statistic of 754, indicating a significant correlation between an individual's awareness of psychological biases and their age. This finding rejects the null hypothesis and confirms an association between the two variables. However, the test does not elucidate the nature or direction of this correlation. The data table demonstrates that respondents in age group 3 exhibit the highest awareness of psychological biases, with 214 out of 246 individuals acknowledging them. While the association between age and awareness is evident, it remains unclear whether awareness increases or decreases with age. Nonetheless, the statistical evidence underscores a substantial correlation between age and knowledge of psychological biases, though the specific dynamics remain unknown.

Descriptive statistics:

A large majority of respondents, 87.9%, reported having experience in making investment decisions, while 7.7% seek advice from financial consultants. Regarding psychological biases, 84% of respondents were aware of their influence on investment decisions, with age group 3 showing the highest awareness. Additionally, 84.8% of respondents believed that emotions play a role in financial decision-making. The chi-square test, though specific statistics are not provided, indicates a significant association between awareness of psychological biases and belief in the influence of emotions on investment decisions, likely with a p-value below 0.001. Overall, the study reveals that many respondents recognize psychological biases and consider emotions significant in investment choices.

4.1 Research Outcome and Findings

This study delves into investor psychology to understand how cognitive biases and emotional influences impact financial decisions. Employing surveys, questionnaires, and advanced statistical modeling, it explores phenomena like loss aversion, overconfidence, herd behavior, and emotional biases. By recognizing these biases, investors can make more informed decisions, avoiding impulsive actions driven by fear or greed. Emphasizing emotional stability and financial literacy, the study underscores the importance of objective analysis to mitigate the negative effects of biases and enhance decision-making in both individual and institutional investors.

4.2 Theoretical Implication

The study challenges traditional economic models by highlighting the role of psychological factors in investor decision-making, emphasizing cognitive biases and emotions. By integrating insights from behavioral finance and psychology, it introduces a more comprehensive theoretical framework that acknowledges the limitations of rationality. This shift offers practical implications for improving market efficiency and developing personalized investment strategies tailored to individual investors' behavioral patterns and risk tolerance. Overall, the study underscores the importance of considering human psychology in economic models to enhance our understanding of investor behavior and market dynamics.

Conclusions

The thesis explores how psychological factors influence investors' financial decisions, focusing on cognitive biases, emotional influences, and personality traits. It challenges traditional economic models by revealing the limitations of rationality in decision-making and advocates for integrating psychological insights into economic theories. By emphasizing the importance of understanding investors' behavioral patterns, the study offers practical implications for improving market efficiency and developing personalized investment strategies. Overall, it contributes to the field of behavioral finance by providing valuable insights that can reshape financial decision-making paradigms in complex and unpredictable markets.

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