



INTERNATIONAL JOURNAL OF TRENDS IN EMERGING RESEARCH AND DEVELOPMENT

INTERNATIONAL JOURNAL OF TRENDS IN EMERGING RESEARCH AND DEVELOPMENT

Volume 3; Issue 1; 2025; Page No. 185-189

Received: 15-11-2024
Accepted: 24-12-2024

Behavioural Biases Exhibited by Investors Based on Their Demographic Profiles in The Indian Stock Market

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DOI: <https://doi.org/10.5281/zenodo.17589486>

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Abstract

The stock market has experienced significant investment expenditure in recent years, driven by the proliferation of internet trading platforms and the need for financial literacy among the workforce. Factors such as market trends, company results, economic statistics, and personal financial goals influence individual investors' decisions to buy or sell stocks. Media coverage, online discussion, and expert opinions also play a role in a retail investor's decision to buy or sell stocks. Investment choices are influenced by personality traits, such as risk tolerance, mental stability, patience, and discipline. Demographic, socioeconomic, and other social factors also significantly impact an investor's risk tolerance, investing goals, and investment approach. Cultures that value stability and security may encourage investors to play it safe, while those that value innovation and risk-taking may encourage them to take risks with more unknowns. Factors such as age, income, and education level can also impact an individual's risk tolerance and investing decisions.

Keywords: Stock Market, Behavioral Biases Exhibited, Investors, Investment

1. Introduction

Behavioral finance is the study of market reactions to financial experts' and traders' psychological biases. According to behavioral finance, some financial events may be described by models where certain investors are completely rational, meaning that they make investment choices only considering risk and reward. One of the best-known theories was put out by Harry. What occurs in markets when certain investors display human limits and complexities is investigated by behavioral finance, which is a mix of psychological and financial aspects. Psychology may offer us vital information about human differences since it systematically explores human judgment, conduct, and well-being (Rabin, 1996) [6]. Consequently, the stock market is a place where investors rely on notions from psychological decision-making to understand why they buy and sell stocks. By "a fast-emerging topic that deals with the effect of psychology on the conduct of financial practitioners," Shefrin (1999) [7] characterized behavioural finance. Behavioral finance seeks to elucidate and enhance

understanding of investors' thought processes, including the behavioral components and the extent to which they influence decision-making (Ricciardi and Simon, 2000) [8]. When someone is overconfident in their assessments and overestimates their capacity to do a task, this is known as overconfidence bias. People who feel they are reasonably well-developed are said to be overconfident. Exaggerating one's ability to predict and the correctness of information is a sign of overconfidence, which is simply a belief in one's own judgment, cognitive ability, logical thinking, and intellectuality. In times of financial market boom, overconfident investors are inclined to anticipate bigger returns, and they credit their successes to their knowledge while attributing failures to "poor luck." While a less confident investor would concentrate on low-risk assets like bonds, a more confident investor would often invest in high-risk assets like stocks and real estate. Research in psychology and behavior has examined overconfidence. Another significant predictor of overconfidence is trading frequency, which will be measured using this data as a

stand-in.

In addition to neglecting data that are readily accessible to the public, decision-makers often overestimate their expertise and information. Investors with an overconfidence bias tend to overlook them because they believe they are better than models and facts. People may not always know better, thus by rejecting early warning signals of likely harm, they can end up doing more harm than good. Overconfidence is defined as a sort of strong self-confidence in which one's superior analytical abilities allow one to utilize the knowledge one has effectively. That is really just a believing illusion brought on by a lack of experience and a poor ability to describe the facts as they stand.

In a word, overconfidence is the conviction that one has an exceptionally high degree of self-evaluation and that one's skills are better than the average of other investors. According to Frischhoff *et al.* (1977) ^[9], investors tend to overestimate their own talents in such an unpredictable financial environment. Some people, particularly those who are overconfident, have a tendency to believe that they are superior to or smarter than others around them. The general market reaction is never rational when a significant portion of the participants are overconfident.

2. Literature Review

Rahul Kumar and Prof (Dr.) Nagendra Kumar Jha (2024) ^[1] - The current research aims to validate the scope of behavioral biases related to individual investors who engage in the Indian stock market, including overconfidence, the herding effect, loss aversion, and investment choices. The current research evaluates how the aforementioned behavioral biases affect individual investors' investing choices. The research is based on a questionnaire inquiry that used a simple sampling strategy to include individual Indian stock market investors who reside in Bihar, India. Individual investors were sent 500 hundred questionnaires, and 428 of the replies were taken into account for this research. SPSS was used to do multiple regression analysis on the gathered data. The current research showed that overconfidence biases significantly impact individual investors' investment choices and that the scale utilized to quantify behavioral biases and investor decisions was valid. On the other hand, loss aversion and the herding effect have little influence on an individual investor's choice of investments. Individual investors exhibit behavioral bias while making financial choices, according to the current research. Individual investors who invest in the Indian stock market and behavioral characteristics are the subjects of the current research. The current research aids in comprehending the idea of behavioral biases among individual stock market participants in India.

Abigail Alves de Sousa Barbosa, *et al.* (2024) ^[2] - The goal of this study is to examine two biases-the endowment effect and conservatism-and then develop a tool that can measure both. The development of behavioral finance research has led to the conclusion that people use personal references to assess their earnings and losses. As a result, their decision-making perspective is subjective and unique to each person. A questionnaire was administered to a sample of 150 managers after the key traits of both biases were gathered based on a study of the literature. The Cronbach reliability

test and exploratory factor analysis were performed on the information gathered from the questionnaire responses. Three elements of the conservative bias were identified by the research's results. These elements include conservatism in finance choices, conservatism in investing choices, and conservatism in security. A component of the endowment effect was found and given the same name as the effect. Managers are linked to knowledge and prior circumstances, which makes them uneasy when faced with novel situations, according to the indications of the factor conservatism in investment decisions. The preference for safer investments was indicated by the indicators of conservatism and security as well as conservatism in financing choices. Despite having weaker endowment effect indicators, they were nonetheless able to draw attention to the indirect impact on the sample's managers. The nature of the assets that managers oversee, when established ownership is not recognized, may be the source of this issue. In order to facilitate a conversation on the subject, this research adds to the body of literature by creating a tool that can detect and quantify managers' conservatism and endowment effect biases.

Umar Sadeeq and Khursheed a Butt (2024) ^[3] - In the context of investment decision making, the purpose of this research is to evaluate the influence of heuristic driven availability bias as a candidate for prediction. The data for this research came from investors in the Delhi-National Capital area (NCR) area of India. As a result of the results, the hypothesis that availability bias has a positive link with investment decision making is supported by empirical data. This means that investors who are affected by this prejudice are making illogical decisions about their investments. This study is in line with the heuristic and biases hypothesis, which suggests that investors are not rational beings as is often believed in the field of finance. Instead, investors have a limit to their rationality and are subject to a multitude of heuristics and biases, which have an effect on the decisions they make about their investments. The research makes a contribution to the existing body of evidence concerning heuristic-driven biases and the influence that these biases have on investment decision making.

Mr. Pradeep Kumar and Dr. Anurag Kumar (2024) ^[4] - In this study, an investigation is conducted on the impact that overconfidence bias has on the processes and outcomes of investment decision-making situations. Overconfidence is a cognitive bias in which individuals overestimate their knowledge, talents, or prospects of success. According to this cognitive bias, the performance of personal investments and the financial markets may be significantly impacted by confidence. By conducting a comprehensive literature review and conducting empirical analysis, this study investigates the ways in which overconfidence manifests itself in several aspects of investing behaviour. These aspects include excessive trading, risk perception, and portfolio diversification all of which are investigated. The research used a mixed-methods approach, which combines qualitative insights gleaned from semi-structured interviews with fifty professional fund managers with quantitative analysis of trading data gathered from a sample of five hundred retail investors over the course of three years. According to the findings, investors who are overconfident engage in more frequent trading, have portfolios that are less diversified, and undervalue the risks associated with

investing. As a consequence, they generate earnings that are less than ideal in comparison to their colleagues who are less confident. At the conclusion of the study, the researchers discuss the implications of these findings for individual investors, financial advisors, and lawmakers. They also provide suggestions for how to mitigate the adverse effects of overconfidence bias in the process of making investment decisions.

Puneet Nandan, *et al.* (2024) [5] - As a consequence of the expansion of the financial markets, investments have been made in a diverse assortment of securities and investments in financial instruments. Consequently, the field of behavioural finance has shed light on the ways in which the cognitive processes and traits of investors influence their intentions and choices when it comes to making investments. In this study, we conducted a comprehensive examination of the most current research on the primary factors that influence people's behaviour and the choices they make about investments. The purpose of this research is to give a comprehensive technique for evaluating qualitative factors that influence the intents and behaviours of investors while they are making financial investments. This will be accomplished via the use of bibliometric analysis. This work contributes to the advancement of the field of behavioural finance by carrying out an investigation of the factors that influence the decisions made by individual investors, particularly in developing markets.

3. Behavioral Economics

The field of research known as behavioural economics focuses on the application of psychological principles to the process of economic decision-making in both people and organizations. This study pulls from the fields of psychology and economics to investigate the reasons behind why individuals occasionally make illogical choices, as well as the cognitive biases that lead to behaviour that deviates from economic models.

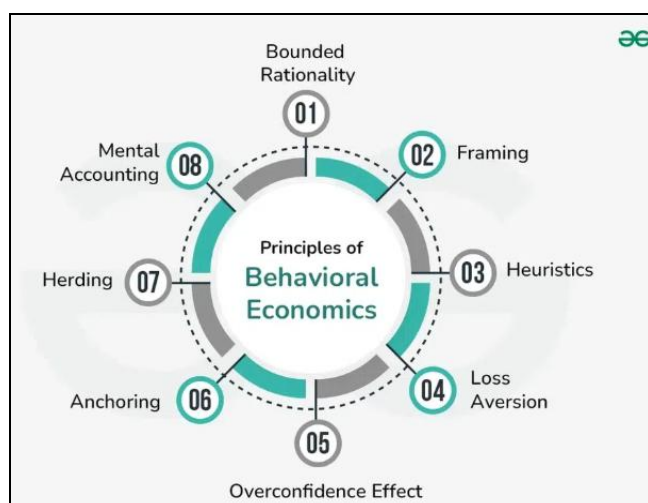


Fig 1: Principles of Behavioural Economics

Behavioural Economics examines how people and organizations make decisions influenced by emotions, cognition, and social context, rather than adhering only to conventional economic theory. It integrates concepts from psychology, neurology, and fundamental economic theory

to explain how humans make economic decisions and the factors that impact those choices. It examines how humans may not consistently make judgments in the most rational or foreseeable manner and investigates the underlying reasons for this phenomenon.

Behavioral economics is very valuable in marketing tactics for forecasting customer behaviour. Behavioral economics is often associated with normative economics.

4. Behavioural Biases

The economy, as well as the industrial sector, is now being impacted by the fast growth of technology. Due to the fact that there are so many products that can be purchased online, consumers may do so in a simple and speedy manner, eliminating the need to physically visit the business that offers those products. Consequently, the ceaseless needs and aspirations of human beings continue to rise. As a result of technological improvements, an individual's salary may no longer be sufficient to pay their expenses if their want level continues to increase. If individuals want to be successful in overcoming this obstacle, it is very necessary for them to manage their resources in a prudent manner. The efforts that may have been made include, among other things, the fulfillment of individual needs and goals, in addition to the maintenance of their financial stability via investment. It would seem that investment selection is a means of distributing money between high-risk assets such as gold, real estate, or stocks and low-risk assets such as deposits and savings.

Over the course of the last several decades, the practice of investing in financial markets has been subjected to a significant amount of scrutiny from a normative perspective. As a result, many theories have been developed concerning financial return and financial risk, with both of these concepts often being discussed simultaneously in the context of investment. Individuals are prone to making irrational assessments in everyday circumstances. There is little doubt that such erroneous judgments are made in the marketplace, where the fear of losing money may be great, leading to significant psychological and cognitive errors. The majority of these erroneous judgments are the consequence of human heuristic simplification in the face of potentially dangerous and unclear circumstances. For a number of years, conventional finance has operated on the assumption that investors make rational choices with regard to their stock holdings, with the goal of maximizing utility and minimizing risk-return trade-offs. Nevertheless, research in the field of behavioral finance has shown that people do not truly behave in a rational manner as economists assume they do. This is due to the fact that human judgments are occasionally impacted by their psychological moods.

Investors are prone to deviating from rationality and making irrational decisions, according to the theory of behavioural finance, which proposes that a number of cognitive biases impact the decision-making process about investments. (2014) According to Niehaus and Shrider. The current study takes a comprehensive look at the ways in which behavioral biases influence financial decision-making. (2017) According to Spence, Taffler, and Eshraghi. Recent developments have resulted in an increase in the prominence of this study issue, which now incorporates both

empirical and theoretical contributions. According to Goyal and Kumar (2015) ^[10], after conducting a review of the existing literature, it was found that there is a crucial need to conduct a single research study that incorporates a comprehensive analysis of the behavioral elements involved. For the purpose of this study, four significant behavioral features are being used as a foundation for the investigation of the effect that it has on the decision-making process of individual investors. It would seem that this paradigm is indicating a willingness to research a wide variety of behavioral biases via the prism of the study of financial economics.

5. Indian Stock Market

The Indian Stock Market has been there for as long as the history of Asia itself. Around two hundred years ago, it began with security deals in India that were considered to be insignificant and inconspicuous. During that time period, the East India Company was the most prominent institution for the purchase and sale of various types of financial assets. In the 1830s, Bombay became the center of activity for the trading of corporate stocks as well as shares in banks and cotton presses.

In spite of the fact that the trade list was more extensive in the year 1839, there were only a half dozen brokers that were recognized by merchants and banks between the years 1840 and 1850. Nevertheless, the year 1850 saw a significant expansion of commercial industry, and the brokerage business attracted a large number of individuals. By the year 1860, the number of brokers had expanded to sixty at that point. When the American Civil War broke out in 1860–1861, the supply of cotton from the United States to Europe was halted, and India saw the beginning of the Share Mania. There was an increase in the number of brokers to around 200 to 250.

At the conclusion of the American Civil War in 1874, the brokers who had been successful in the aftermath of the war discovered a location on a street (which we now refer to as Dalal Street) where they could easily congregate and conduct their business transactions. Native Share and Stock Brokers Association, sometimes referred to as "The Stock Exchange," was originally created in Bombay in the year 1887.

This association is also known by its alternate name. It was in 1899 that the Stock Exchange first opened its doors after having purchased a location on the same street in the year 1895. This resulted in the consolidation of the Bombay Stock Exchange (Bahng, 2003 as stated). When it comes to the financing of the Indian business sector, the Indian stock market has been given a significant role.

6. Individual Investors in the Indian Stock Market

Retail investors as they are commonly known are the major players in the Indian stock market. These are non-institutional investors who use their own savings to buy different financial assets in the form of shares, mutual funds, bonds, and derivatives. Individual investors do not trade with a different purpose like to accumulate personal wealth and financial security unlike institutional investors (mutual funds, insurance companies, or foreign portfolio investors). The retail investor or individual investor are non-professional participants in the market who purchase and

sell financial security in the form of stocks, bonds, mutual funds and other investment products with their own capital. Individual investors contrast with institutional investors such as banks, mutual funds or insurance companies because they are not trading with the same motivations or goals as institutional investors do and so their interests are primarily in wealth creation, retirement planning or saving, not institutions.

Personal choices are normally made by individual investors relying on personal research, financial recommendations or market forces. They might have a short and long period of investment. Individual investors in most economies particularly the emerging ones such as India contribute significantly in the capital market development as well as growth of the economy.

The Indian stock market which is dominated by the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE) has experienced a steep increase in the involvement of individual investors in the last ten years. The development of technology, financial literacy, the ready availability of online trading platforms, and increasing confidence by the retail investors in equity as an asset class has prompted more retail investors to invest in capital markets.

7. Effects of Behavioural Biases on Making Investment Decisions in the Indian Stock Exchange

The behavioural biases play a significant role in the process of making financial decisions by individual investors in the Indian stock market, which results in the lack of the use of the rational and optimal investment strategies. One of the most common biases in retail investors is overconfidence bias. Most of the Indian investors underestimate the level of their knowledge, ability to analyse and draw conclusions about the market trends and overtrade hence they underestimate risks and are concentrated in a small number of stocks. This complacency may give rise to temporary profitability in the case of some, but it frequently presents huge losses in the long-term term because of an incorrect evaluation of the situation in the market and inability to diversify portfolios in the most effective manner.

The bias of conservatism is also an important factor that influences the decision of investors. Investors that are subject to this bias will stick to their old beliefs and take long to absorb new information, despite a shift in the fundamentals in the market. In India, this has been reflected in the form of a perpetual investment in old blue-chip stocks or in sectors that are already being known whereas new opportunities in technology, renewable energy, or start-ups are not taken into consideration. Consequently, investors could fail to get hold of investment opportunities at the right time or to make portfolio changes according to how the market is reacting, which in effect impacts on returns.

Availability bias also has effects on the decision-making in that investors may utilize the information that is easily remembered or more recent than other information. Retail investors in India tend to be influenced by the news headlines, social media chatter or anecdotal tales of success and make hasty judgments based on limited facts. In the example given, the investors can herd when they are rushing to invest without looking at the fundamentals of that company upon hearing that the stock price of the company

is increasing rapidly in the news, which can lead to herding behavior, overvaluation, or speculative losses.

The effects are exacerbated by herding bias that causes investors to imitate the behaviours of others, instead of making their own informed decisions. The herd behaviour is prevalent in the Indian stock market when the market is on a bullish run and when the investors buy the trending stocks in large numbers or when there is a market crash and panic selling occurs at a wide rate. Such bias enhances market volatility, inspires asset prices in the speculative bubble and leads to irrational sell-offs in the correction.

All in all, these behavioural biases, overconfidence, conservatism, availability, and herding, are all intertwined to affect how Indian individual investors make their decisions. They may result in inefficient portfolio diversification, risk-taking, opportunities missed, and reactive and not strategic investments. Learning these biases and reducing them by financial literacy, advice services, and knowledge of psychological human behaviour is the key to improving the level of rational decision-making and long-term wealth generation in India among retail investors.

8. Conclusion

The purpose of the research was to investigate several biases exhibited by the investors in Indian stock market, specifically overconfidence bias, conservatism bias, availability bias, and herding bias special focus on investors. To find out the relationship between behavioural biases and investment decision-making, Structural Equation Modelling was used. The output indicates that behavioural biases such as overconfidence bias, availability bias, and conservatism bias have a major impact on investment decisions, however, herding bias has a low impact on investment decisions. It is also found that there is an association between demographic variables and investment decisions. There is also an association between investment alternatives, investment experience, and investment decisions.

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