



# A Study on the Impact of Behavioral Finance on Retail Investing

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## ABSTRACT

Behavioral finance explains how psychological biases and emotions influence retail investors' decisions, often leading to irrational behavior. Biases like overconfidence, herd mentality, and loss aversion can cause poor investment choices, such as excessive trading or holding losing assets. Understanding these factors helps investors make more rational decisions and improve their overall financial performance. The growing influence of social media, online trading apps, and easy access to market information has amplified these biases, making retail investors more reactive to trends and short-term market movements. Therefore, understanding behavioral finance not only helps in identifying these errors but also encourages better financial discipline, improved decision-making, and more stable long-term investment outcomes.

## KEYWORDS

Behavioral Finance ,Retail Investing ,Investor Psychology ,

Cognitive Biases ,Overconfidence ,Herd Behavior ,Loss Aversion



## 1. INTRODUCTION

Behavioral finance studies how psychological factors influence retail investors' decisions, often leading to irrational behavior. Despite the growth of easy access to trading platforms, investors are affected by biases like overconfidence, herd behavior, and loss aversion. Understanding these influences helps explain market behavior and improves investment decision-making. With the rapid growth of online trading platforms and easy access to financial information, more individuals are participating in stock markets. However, this increased participation has also made retail investors more vulnerable to emotional decision-making and market trends. As a result, they may make poor investment choices, such as overtrading or reacting impulsively to market fluctuations.

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### 1.1 Objectives of the Study

- To study how psychological biases affect retail investors' decisions
  - To identify common behavioral biases in investing
  - To analyze their impact on investment performance
  - To understand the role of emotions in decision-making
  - To suggest ways to improve investor behavior
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## 2. LITERATURE REVIEW

- Daniel Kahneman and Amos Tversky introduced the concept of cognitive biases and Prospect Theory, explaining how investors react more strongly to losses than gains.
  - Richard Thaler expanded behavioral finance by highlighting biases like overconfidence, mental accounting, and herd behavior in financial decisions.
  - Studies show that retail investors often exhibit overconfidence, leading to excessive trading and lower returns.
  - Herd behavior causes investors to follow market trends without proper analysis, contributing to market volatility.
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## 3. RESEARCH METHODOLOGY

**Research Design:** Descriptive and analytical research design to study investor behavior and biases.

**Research Approach:** Quantitative approach (can be supported with qualitative insights if needed).

**Data Type:** Primary data (collected from retail investors) and/or secondary data (journals, reports, articles).

**Data Collection Method:** Structured questionnaire or survey to gather responses from retail investors.

**Sampling Technique:** Convenience sampling or random sampling method.

**Sample Size:** Selected group of retail investors (e.g., 50–150 respondents depending on study scope).

**Variables Studied:** Behavioral biases (overconfidence, herd behavior, loss aversion, anchoring) and investment decisions/performance.

**Data Analysis Tools:** Statistical tools such as percentage analysis, mean, correlation, and regression analysis.



Research Instruments: Questionnaire with Likert scale (e.g., strongly agree to strongly disagree).

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#### 4. Overview

Behavioral finance is a field that combines psychology and finance to understand how individuals make investment decisions in real-world situations. Unlike traditional financial theories, which assume that investors act rationally and markets are efficient, behavioral finance recognizes that retail investors are often influenced by emotions, cognitive biases, and social factors.

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#### 5. THEORETICAL FRAMEWORK

Based on behavioral finance, which integrates psychology with investment decision-making.

Prospect Theory explains loss aversion and how investors react differently to gains and losses.

Heuristics theory highlights the use of mental shortcuts, leading to biases like anchoring and availability.

Overconfidence theory explains excessive trading and risk-taking by investors.

Herd behavior theory shows how investors follow others during market uncertainty.

Emphasizes that markets are not always efficient due to irrational investor behavior.

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#### 8. FINDING

- Influence of psychological biases on retail investors
  - Overconfidence leading to excessive trading
  - Herd behavior affecting investment choices
  - Loss aversion impacting buy/sell decisions
  - Anchoring bias influencing judgment
  - Emotional factors (fear and greed) driving decisions
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#### 9. CONCLUSION

Behavioral finance shows that retail investors are often influenced by psychological biases and emotions, leading to irrational investment decisions. These biases can negatively affect returns and increase risk. Understanding and managing these behaviors can help investors make more rational choices and achieve better long-term financial outcomes

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## 10. LIMITATIONS

- Small sample size may not represent all retail investors
  - Limited geographical area of study
  - Reliance on self-reported data (possible bias)
  - Time constraints affecting depth of analysis
  - Difficulty in measuring psychological factors accurately
  - Changing market conditions may influence results
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## 11. SUGGESTIONS

- Improve financial literacy among retail investors
  - Conduct awareness programs on behavioral biases
  - Encourage long-term investment strategies
  - Promote disciplined and goal-based investing
  - Avoid emotional and impulsive decision-making
  - Use proper research and analysis before investing
  - Diversify investment portfolios to reduce risk
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