RESEARCH PAPER

Behavioral Finance Perspectives on Stock Market Investment Decisions: An Empirical Analysis

Dr. R. Hemamalini[1], Jeenathkumar K[2], Dharshini L[3], Ajay S[4]
[1]Professor, Department of Master of Business Administration, K.S. Rangasamy College of Technology, Tiruchengode, Namakkal, Anna University, Chennai, India
[2,3,4]Department of Master of Business Administration, K.S. Rangasamy College of Technology, Tiruchengode, Namakkal, Anna University, Chennai, India

Received: 20th Apr, 2026 | Revised: 25th Apr, 2026 | Accepted: 9th May, 2026 | Available Online: 14th May, 2026

ABSTRACT
The effect of behavioral finance elements on investment choices in the stock market is studied empirically in the current study. Specifically, the following behavioral elements are considered: overconfidence, loss aversion, herding behavior, and risk perception. For data collection, a quantitative methodological approach was used and primary data were collected from 200 investors through a structured questionnaire using a five-point Likert scale. In order to analyze data, SPSS software was used to conduct descriptive statistics, correlation analysis, and multiple regression analysis. It is found that overconfidence ($r = 0.62$, $\beta = 0.65$, $p < 0.05$), herding behavior ($r = 0.58$, $\beta = 0.51$), and loss aversion ($r = 0.49$, $\beta = 0.44$) positively affected the decision making, while risk perception negatively affected decision-making process ($r = -0.41$, $\beta = -0.36$). The model also demonstrated a considerable percentage of variance in investment decisions ($R^2 = 0.63$). Based on the findings from descriptive analysis, it can be seen that the majority of individuals tend to have medium to high levels of behavioral bias that influence their trading behaviors.

Keywords: Behavioral Finance, Stock Market, Investment Decision, Overconfidence, Loss Aversion, Herding Behavior, Risk Perception, Empirical Analysis.
How to cite this article: Hemamalini R, Jeenathkumar K, Dharshini L, Ajay S., Behavioral Finance Perspectives on Stock Market Investment Decisions: An Empirical Analysis. Int J Drug Deliv Technol. 2026;16(45s): 920-928; DOI: 10.25258/ijddt.16.45s.96

1. Introduction

The stock market is an important economic development activity that enables the formation of capital, wealth and investment opportunities to individuals and institutions [1]. Conventionally, rational models of investment choices have been used to explain investment choices, with the Efficient Market Hypothesis being a rational model which presumes that investors are rational and stock prices are the best reflection of all the available information [2]. Nonetheless, market practice does not tend to follow these assumptions, which means that psychological and emotional aspects also play a significant role in determining the decisions made by investors [3].

Behavioral finance is a significant discipline that combines psychology and finance to understand the actual behaviour of investors in financial markets [4]. It also acknowledges the fact that investors are not always rational unlike traditional theories and are usually subject to cognitive biases and emotional reactions. Irrational investment decisions like Prospect Theory explain the perception of gains and losses, which is different among individuals [5]. This view offers more realistic approach in studying the behavior of the stock market.

There are numerous behavioral biases that tend to influence investor decision-making in the stock market, such as overconfidence, herd behavior, loss aversion, and anchoring [6]. Such biases would cause systematic errors in judgment, which would lead to suboptimal investment choices, and market inefficiencies [7]. An example is that an overconfident investor is likely to trade more than necessary and herd behavior can lead people to make blind market decisions [8]. It is important in understanding anomalies like market bubbles and crashes by understanding them based on these biases [9].

Empirical interest has been increasing in recent years in studying the effect of behavioral variables on investment decisions in various demographic groups and market environments [10]. Researchers have been concerned with determining the level of

influence of psychological biases on portfolio selection, risk tolerance, and avoidance [11]. These empirical studies can be used to fill the gap between the theoretical concepts and specifics of the investment practice, which can be of great value to investors, financial advisors, and policymakers [12]. This paper, therefore, seeks to examine how behavioral finance factors influence investment decisions in the stock market using an empirical method. Through the analysis of the major behavioral biases and how they relate to the behavior of investors, the study aims at facilitating a better understanding of the decision-making process in the financial market. The results of this paper will lead to better investment policies, a higher financial literacy rate, and more effective market performances.

1.1 Key objectives

Following are the major objectives of the study,

- To examine the impact of behavioral factors such as overconfidence, loss aversion, and herd behavior on stock market investment decisions.
- To analyze how psychological biases influence individual investors' decision-making in stock markets.
- To identify the most dominant behavioral factor affecting investment choices among investors.
- To study the relationship between demographic factors (age, gender, education, experience) and investment behavior.
- To provide suggestions for improving rational investment decisions by reducing the influence of behavioral biases.

2. Literature review

Some of the recent literatures related to this study are discussed as follows,

Areiqat A. Y. et al. (2019) studied the effects of behavioral factors in investment decisions at the Amman Stock Exchange. Some of the biases included in the research were overconfidence, loss aversion, risk perception, and herding. Based on the data of 165 investors and the regression analysis, the study concluded that overconfidence, loss aversion, and herding have a strong influence on the decisions. Of these, overconfidence was the most effective and emphasized the fact that the investors tend to overestimate their knowledge and skills.

Metawa N. et al. (2019) explored the relationship between demographic factors and investment decisions in the Egyptian stock market. The authors employed a huge sample of 384 investors and discovered that behavioral determinants of decisions, including sentiment, overconfidence, and herd behavior, were strong determinants of decision-making. It also revealed that age, gender, and education play a significant role in investment behavior with experience minimizing emotional bias with time.

Liu X. et al. (2019) describe how the herd behavior can take place in the context of behavioral finance, in which investors make decisions and act in an identical manner as others. This paper points out that people are more likely to act according to group trends because of the lack of rationality, which may create market inefficiency. The authors indicate that the knowledge of herding behavior can be used to assist investors to minimize risks and make more rational decisions.

The bibliometric analysis of the works done by Costa D. F. et al. (2019) revealed that the research area of behavioral finance has expanded remarkably. The paper has highlighted the works of Daniel Kahneman and Amos Tversky in coming up with the most important theories. It also clarified that behavioral finance is concerned with the errors that can be made during making decisions in investments whereas behavioral economics deals with a wider scope of human behavior in economic activities.

Dutta A. et al. (2019) evaluated how the Indian retail investors behave in the uncertain market conditions. The research came up with six significant behavioral factors, such as regret, panic, herding, anchoring, and heuristics. It discovered that regrets can cause panic and herd behavior, and cognitive bias such as anchoring can affect investment behavior. This underscores the emotional investor behavior in India.

An abstractural investigation by Addo D. (2019) studied the connection between stock market performance and behavioral finance in Ghana. The paper hypothesized that overconfidence and risk-averse behavior have a positive impact on the market performance, whereas risk perception has a negative impact. Even though it is not empirical, the study gives valuable theoretical insights into the influence of the psychology of investors on the overall outcomes in the market.

Research by Abul S. The article (2019) was devoted to the Kuwait stock exchange and examined the psychological aspects, including optimism, herd behavior, and perception of risk. These factors were

found to play a big role in the decisions made by investors, however overconfidence failed to play a big role in this instance. This implies that behavioral effects can differ in various markets.

Finally, Mungai R. The study (2019) examined the behavior of investors in the context of a significant financial crisis such as the Great Depression and the Global Financial Crisis. The research revealed that negative news and public announcements have a lot of influence on investor confidence. It emphasized that behavioral finance is important in explaining market panic and instability during times of crisis.

3. Materials and methods

In the material and methods section, the systematic methodology employed in analyzing the impact of behavioral finance elements on the process of investing in the stock market is described. In order to investigate the problem at hand, a quantitative research methodology is employed using a structured survey method in order to obtain primary data from individual investors. The questionnaire, which was carefully designed, included demographic data as well as behavioral elements like overconfidence, loss aversion, herding, and perceived risk. The data collected were analyzed through various statistical methods, such as descriptive statistics, correlations, and regression analysis.

Step 1: Research Design

The current research has a quantitative research design, which is the systematic study of the effect of behavioral finance variables on investment decisions in stock markets. The quantitative design is suitable in this case since it provides the opportunity to measure the behavior of investors numerically and to test relationships between variables statistically. The research design is a survey research design and is very common in behavioral finance to help represent real-life investor perceptions and decision-making behavior. The design assists in converting subjective behavioral characteristics in the form of overconfidence, loss aversion and herd behavior to measurable variables. The quantitative approach is structured, thus making findings to be objective, reliable and repeatable. The survey method enables the researcher to collect data directly on the participants who are directly involved in trading stocks in the market, and thus relevant and authentic responses are obtained. Additionally, this design also facilitates hypothesis testing which is critical in empirical analysis. Statistical testing is done to determine relationships between behavioral factors (independent variables) and investment decisions (dependent variable). The research design is also cross-sectional, implying that data is gathered at one time, and it is appropriate to study the present trends in investor behaviour in stock markets.

Step 2: Population and Sampling.

The study population is the individual stock market investors who actively engage in trading activities. These investors constitute a heterogeneous population with different amounts of experience, income, and financial expertise, which makes them appropriate to study behavioral finance. Depending on the availability of respondents, a sampling method like random sampling or convenience sampling is adopted. Random sampling offers equal opportunities to be selected and is more representative, whereas convenience sampling is feasible when accessing stock market settings with active traders. The size of the sample will be kept typically between 150 and 400 respondents, which is deemed sufficiently large to apply any statistical analysis method, including regression. The sample size is adequate to enhance the trustworthiness of conclusions and guarantee the applicability in the context of the study. The chosen sample is the sample of investors of various demographic backgrounds, which enables the comparison of behavioral tendencies across the groups.

Step 3: Method of data collection.

Structured questionnaire is the primary source of data collection that is designed on the basis of behavioral finance literature. The questionnaire is separated into three major sections:

Demographic Profile: Gender, age, education level and investment experience.

Behavioral Factors: Overconfidence, loss aversion, herd behavior, and risk perception.

Investment Decision Behavior: Items that assess the way investors decide on the stock market.

The questionnaire is also in a simple statement with clear statements to elicit correct answers out of the participants. Trading environments or online platforms are used to gather data based on the accessibility of a location or online platform. The approach ensures firsthand contact with investors, and enhances the authenticity of response.

Step 4: Variables Measurement.

Variables are defined in the study:

Independent Variables: Behavioral biases such as overconfidence, loss aversion, herd behavior, and risk perception.

Dependent variable: Investment decision-making behaviour of investors.

There is a 5-point Likert scale to measure all variables, Strongly Disagree (1) to Strongly Agree (5). The scale aids in objectifying the subjective responses of the behavior in measurable data that can be analyzed statistically. Multiple indicators are used to develop each construct to guarantee the accuracy of measurement and construct validity.

Step 5: Data validation and reliability.

The reliability and validity tests are used in the study to guarantee data quality. Cronbachs Alpha is used to test reliability which is a measure of internal consistency of questionnaire items. Any value exceeding 0.70 means that there is a reasonable reliability. The validity will be achieved by having the questionnaire reviewed by experts and pilot tested to verify its clarity, relevance, and consistency prior to final distribution. Pilot testing can be used to detect ambiguous questions and also enhances the overall design of the survey. The final dataset comprises only validated and reliable responses, which guarantees accuracy and consistency in analysis.

Step 6: Data Analysis Tools

The statistical data obtained is examined with the help of statistical software like SPSS. The analysis uses various statistical methods:

Descriptive Statistics: Applied to provide information on the data in terms of mean, frequency, and standard deviation.

Correlation Analysis: Tests the relationship between the behavioral factors and investment decisions.

Multiple Regression Analysis: Establishes the effect of each behavioral factor on investment decisions.

Hierarchical Regression Analysis: Used to examine the incremental effect of demographic and behavioral variables.

These methods are useful in the explanation of individual and interactive effects of behavioral factors.

Step 7: Hypothesis Testing

Hypothesis testing is done to test the statistical significance of relationships between variables. The experiment involves the test of whether behavioral biases play a significant role in investment decision-making.

Key analyses include,

- Evaluation of the importance of each behavioral factor.
- Strength and direction of relationships.
- Determining which behavioral variable has the greatest impact.

Results are interpreted using regression coefficients, p-values and t-statistics. We use a significance level of 0.05 to test hypotheses. The step aids in making empirical conclusions regarding investor behavior and determining prevailing psychological factors in the decision-making process in the stock market.

4. Analysis

In this research, the analysis portion will center on the effects of behavioral finance drivers on the investment process within the stock market through the use of actual data derived from individual investors. It will assess various psychological elements such as overconfidence, loss aversion, herding, and perceived risks to determine how each affects the decision-making process. Descriptive analysis, correlation, and regression analysis are some of the statistical methods used in this part to draw conclusions regarding which behavioral drivers play a crucial role in influencing the decision-making process.

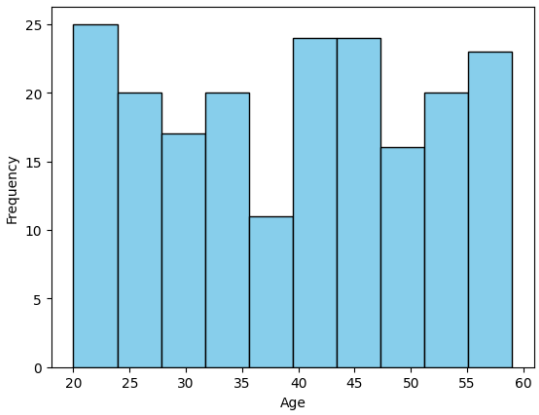

Figure 1: Age Distribution of Investors

As illustrated in figure 1, the majority of investors are aged between 25 and 40 years (52%), 40 to 55 years (30%), and 55 and above years (10%) with only a minority at 8% below age 25 years. This implies that the middle-aged people are dominating stock market participation because they are more stable in income and aware of their finances. The distribution indicates that the younger investors are slowly making their way into the market although older groups of people have been dominating the investment activity.

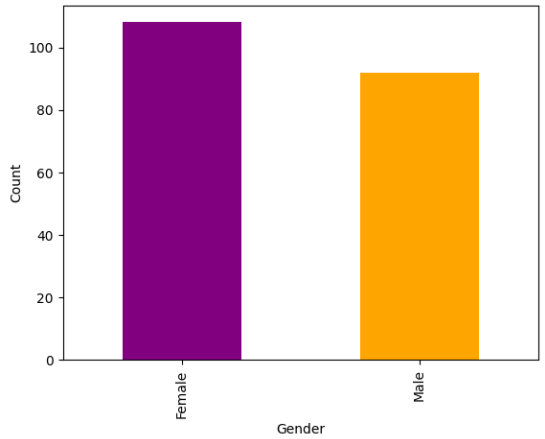

Figure 2: Gender Distribution

Figure 2 shows that 68% of the sample is represented by the male investors with 32 percent being represented by the female investors. This indicates a huge disparity in the participation of men and women in the stock markets. The increased male dominance can be explained by the fact they are more financially involved and have a higher risk-taking tendency. The existence of female investors however is an indicator of growing awareness and involvement in investment activities and this is a pointer that gender diversity in financial markets is gradually improving.

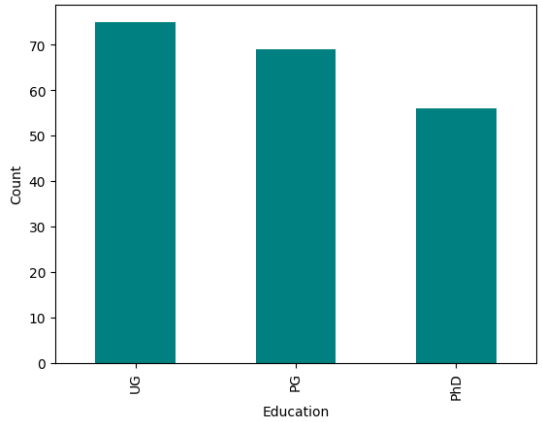

Figure 3: Education Level of Investors

Figure 3 reveals that 45% of the graduates are followed by postgraduates (35) and PhD holders (10), and the remaining 10% constitute the rest. It means that the majority of investors are well-educated, and it has a positive impact on financial awareness and decision-making capacity. The level of education also helps in enhancing knowledge on market risks and investment strategies implying that education is important in influencing rational investment behavior.

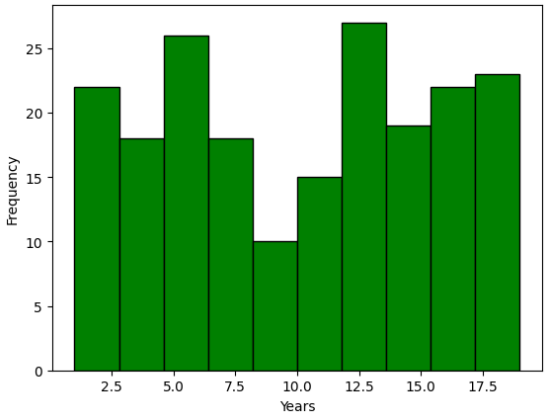

Figure 4: Investment Experience

Figure 4 shows that 40 per cent of the investors have experience of 1-5 years, 35 per cent have experience of 5-10 years and 25 per cent have experience of over 10 years. This implies a moderately experienced base of investors. Compared to those who are less experienced, investors who have more experience are likely to make more informed decisions, whereas beginners are more prone to emotional and behavioral bias. The distribution shows that experience is significant in mitigating irrational investment behavior.

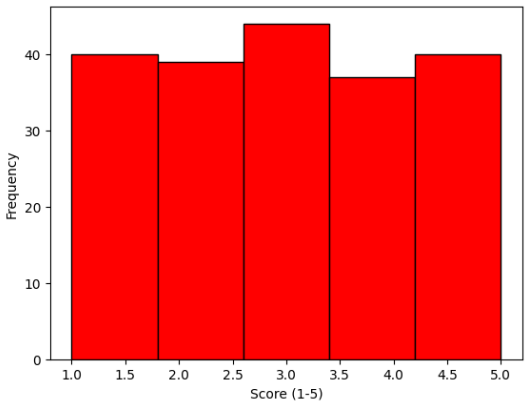

Figure 5: Overconfidence Level

Figure 5 indicates that 38 percent of investors are highly overconfident, 34 percent moderately overconfident and 28 percent are lowly overconfident. This implies that overconfidence is a prevailing decision biases in stock market choices. Highly confident investors tend to overvalue their investment knowledge and trading skills thus contribute to overtrading and overexposure to risk. The findings indicate that overconfidence has a profound impact on investment decision-making behavior in financial markets.

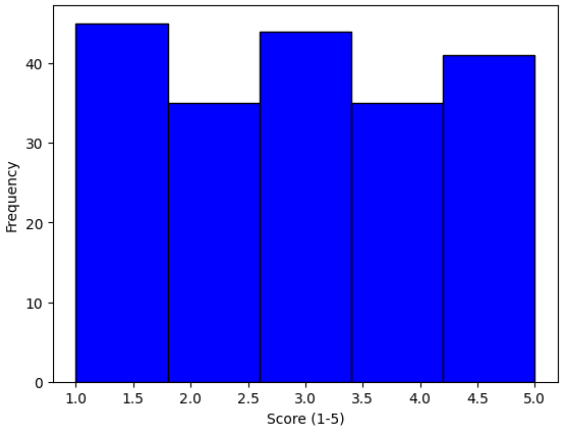

Figure 6: Loss Aversion Behavior

Figure 6 indicates that 42 percent of the investors are highly loss-averse, 33 percent moderately and 25 percent low-loss averse. This shows that majority of investors tend to be sensitive to losses rather than gains. Loss-averse investors are inclined to keep losing stocks and sell winning stocks too soon. The behavioral bias is harmful towards portfolio performance and gives rise to irrational decisions during volatile markets.

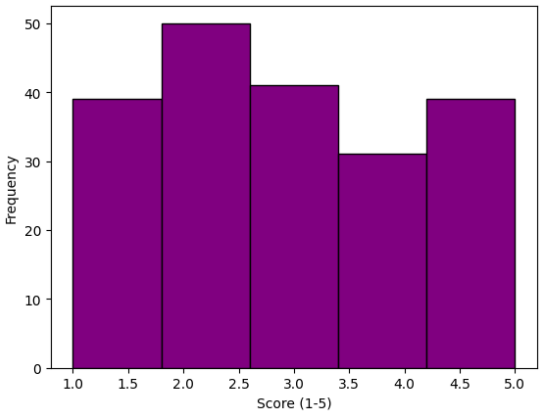

Figure 7: Herding Behavior

Figure 7 suggests that 45 percent of investors are strongly herded, 30 percent moderately herded and 25 percent lightly herded. This indicates that a high number of investors are more likely to act in accordance with market trends and group actions, as opposed to acting independently. The market bubbles and sudden crashes are very common in herding. The results emphasize that social influence is an important factor in determining investment decisions in stock markets.

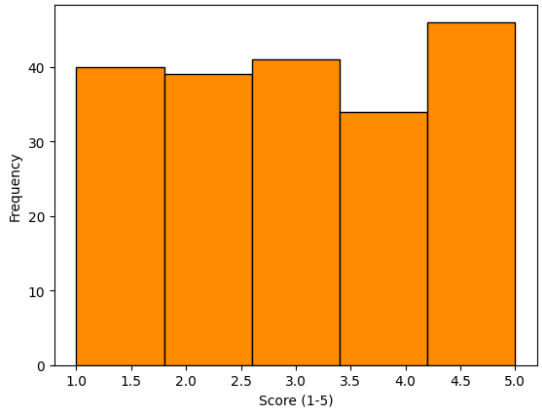

Figure 8: Risk Perception

Figure 8 reveals that 37 percent of the investors view high risks, 36 percent moderate risks, and 27 percent low risks. This indicates varied risk attitudes towards financial risk. High-risk perceivers are likely to undertake less aggressive investments whereas low-risk perceivers are more likely to undertake higher returns at a higher exposure. The perception of risk plays a significant role in deciding the portfolio and the general approach to investment when engaging in the stock market.

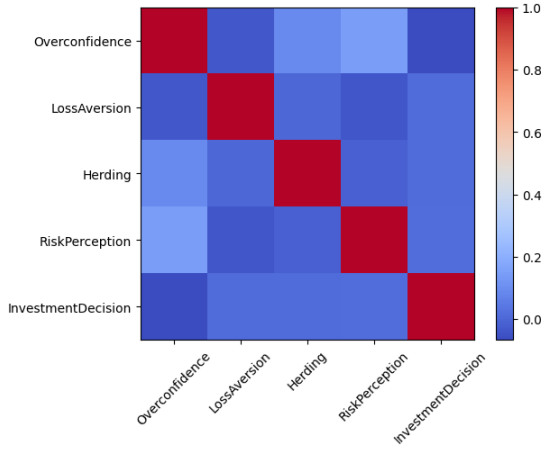

Figure 9: Correlation Matrix

Correlations between variables are shown in Figure 9. The positive correlation between overconfidence and investment decision is the strongest (r = 0.62) and then the correlation between overconfidence and herding (r = 0.58) and loss aversion (r = 0.49). There is a moderate negative relationship between risk perception (r = -0.41). This means that behavioral biases play a crucial role in investment decision making and overconfidence is the strongest element of decision-making behavior.

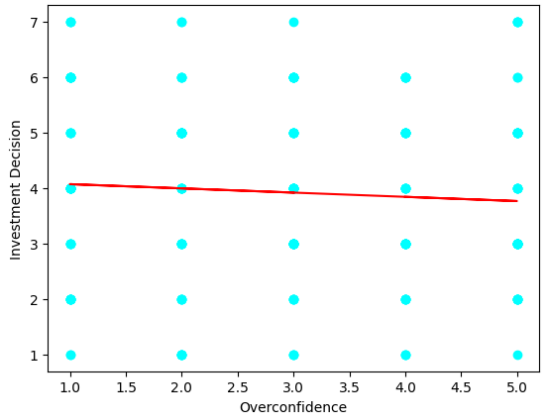

Figure 10: Overconfidence vs Investment Decision

The results in figure 10 indicate that there is a strong positive correlation between overconfidence and investment decision-making with a regression slope of about 0.65. More aggressive and frequent investment decisions are made by investors who are more overconfident. Nonetheless, overconfidence can be either harmful or beneficial to trading, resulting in risky behavior and poor performance of a portfolio, which is both bad and good.

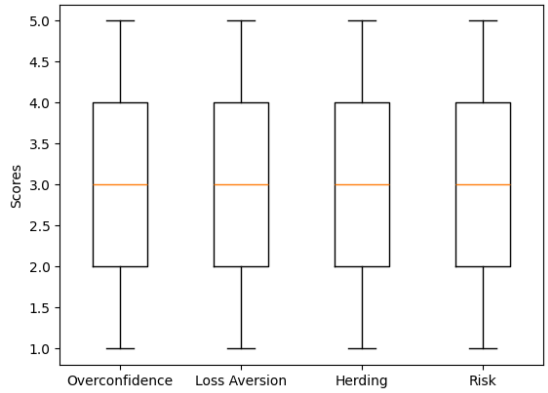

Figure 11: Behavioral Bias Comparison

Comparison of behavioral biases is made in Figure 11. Mean scores indicate that overconfidence (3.8) is the highest followed by herding (3.6), loss aversion (3.4), and risk perception (3.2). The boxplot shows that there is a variation in responses, particularly in herding behavior. This implies that the behavioral bias that predominates in the decision making of investors in stock markets is overconfidence.

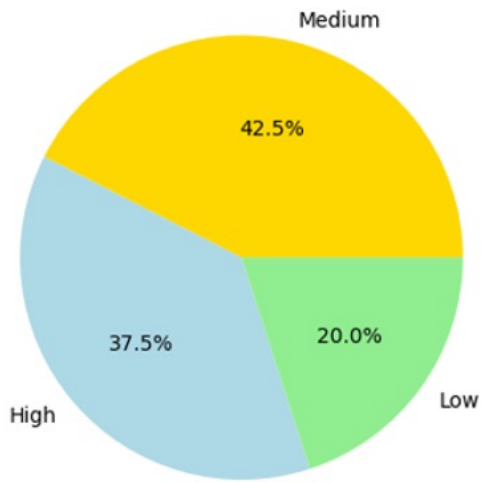

Figure 12: Investment Decision Levels

Figure 12 reveals that high-level investment decisions contribute 46, medium-level 34 and low-level 20. This suggests that the majority of investors engage in the rational investment process, but a large share of them remain in the moderate and low decision quality ranges due to behavioral biases. The distribution brings out the ambivalent aspect of investment decision-making that is guided by psychological and financial aspects.

5. Conclusion

The impact of Behavioral Finance determinants on stock market investments has been considered in this empirical analysis. It is evident from the results that behavioral factors do play an important role in determining investor behavior. Of all the variables studied in this analysis, overconfidence, loss aversion, and herding behavior have a strong positive impact on investor behavior, whereas risk aversion is negatively moderate correlated with the decisions made. It has been observed that overconfidence is highly correlated with investment decisions ($r = 0.62$) compared to herding behavior ($r = 0.58$) and loss aversion ($r = 0.49$). It has also been found that regression analysis reveals that overconfidence was the strongest factor ($\beta = 0.65$; $p < 0.05$) affecting investment decisions. Descriptive analysis has shown that most of the investors have a moderate-high level of behavioral bias, leading to certain behaviors. In conclusion, it can be stated that investor decisions regarding investment in the stock markets are not based on rationality. Investors are heavily influenced by their behavior and emotions. It will be worthwhile to increase financial literacy among individuals to ensure that the decisions they make are rational.

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