

## BEHAVIOURAL BIASES AND INVESTMENT DECISIONS OF RETAIL INVESTORS

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### Abstract

Behavioural finance has emerged as a significant field explaining deviations from rational investment decision-making. Retail investors, particularly in Indian urban markets, often exhibit behavioural biases that influence their investment patterns. This study examines how behavioural biases such as overconfidence, herd behaviour, anchoring, and familiarity bias affect investment decisions among retail investors, with a focus on Indian cities like Mumbai. The paper also explores how investors display preference towards blue-chip companies and how market sentiments shape their choices. Based on secondary data and literature, the study finds that emotional and psychological factors significantly override rational analysis, leading to suboptimal investment outcomes. Understanding these biases is crucial for improving investor awareness and financial decision-making.

**Keywords:** Behavioural Finance, Retail Investors, Investment Decisions, Biases, Blue-chip Stocks, Market Sentiment, India.

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### 1.0 Introduction

Traditional financial theories assume that investors act rationally and make decisions based on complete information. However, real-world observations suggest that retail investors often deviate from rationality due to psychological and emotional influences. Behavioural finance seeks to explain such deviations by incorporating insights from psychology into financial decision-making. In India, particularly in metropolitan cities like Mumbai, the growth of retail participation in stock markets has been substantial. With increased access to trading platforms, social media influence, and financial news, retail investors are more active than ever. However, their decisions are often shaped by biases such as overconfidence, herd mentality, and preference for familiar or reputed companies.

Blue-chip stocks—well-established and financially stable companies—tend to attract retail investors due to perceived safety. Market sentiments, driven by news, speculation, and peer influence, further impact investment behaviour. This study examines how behavioural biases influence retail investors' decisions and how these biases affect their inclination towards certain stocks and overall portfolio performance.

### 2.0 Objectives of the Study

1. To identify major behavioural biases influencing investment decisions of retail investors.
2. To analyze how biases affect preference towards blue-chip companies.

3. To examine the role of market sentiment in shaping retail investment behaviour in Indian urban contexts.

### **3.0 Conceptual Framework: Behavioural Biases in Investment**

Behavioural biases are systematic patterns of deviation from rationality in judgment and decision-making. In investment contexts, these biases can significantly influence portfolio choices.

#### **Common Behavioural Biases:**

- **Overconfidence Bias:** Investors overestimate their knowledge and predictive ability.
- **Herd Behaviour:** Investors follow the actions of the majority rather than independent analysis.
- **Anchoring Bias:** Decisions are based on initial reference points (e.g., past stock prices).
- **Familiarity Bias:** Preference for investing in well-known or frequently discussed companies.
- **Loss Aversion:** Tendency to avoid losses rather than maximize gains.

Retail investors often rely on heuristics (mental shortcuts), leading to biased decisions, especially under uncertainty.

### **4.0 Review of Literature**

#### **4.1 Kahneman and Tversky (1979): Prospect Theory**

Prospect Theory explains how individuals evaluate gains and losses asymmetrically. Investors tend to fear losses more than they value gains, leading to irrational decisions such as holding losing stocks too long.

#### **4.2 Barber and Odean (2001): Overconfidence in Investors**

The study found that overconfident investors trade excessively, often reducing their overall returns due to higher transaction costs and poor timing.

#### **4.3 Shiller (2000): Market Sentiment and Irrational Exuberance**

Shiller emphasized the role of investor sentiment and speculative bubbles, showing that psychological factors can drive markets away from fundamental values.

#### **4.4 Shefrin (2007): Behavioural Corporate Finance**

Shefrin highlighted how biases such as overreaction and herd behaviour influence investor decisions, often leading to mispricing in markets.

#### **4.5 Gupta and Ahmed (2020): Behavioural Biases in Indian Retail Investors**

This study observed that Indian retail investors exhibit strong herd behaviour and familiarity bias, often investing in popular blue-chip stocks without adequate analysis.

### **5.0 Research Methodology**

This study is descriptive and analytical, based on secondary data.

#### **Sources of Data:**

- Academic journals on behavioural finance
- Reports from SEBI and stock exchanges
- Financial news and investor surveys
- Observational insights from urban investment patterns

#### **Method:**

The study interprets existing data to analyze patterns of behavioural biases and their impact on investment decisions.

### 6.0 Secondary Data Analysis: Retail Investors in Urban India (Mumbai Context)

Mumbai, being India's financial capital, has a high concentration of retail investors actively participating in stock markets.

#### 6.1 Growth of Retail Participation

Recent trends indicate a surge in retail investors in India, with millions of new demat accounts opened in recent years. Urban centers like Mumbai contribute significantly to this growth.

#### 6.2 Preference for Blue-Chip Stocks

Retail investors in Mumbai show strong preference for well-known companies such as those in banking, IT, and FMCG sectors.

Table 1: Common Blue-Chip Preference Trends

Sector	Typical Investor Preference
Banking	Large private and PSU banks
IT	Established technology firms
FMCG	Well-known consumer brands
Energy	Major oil and energy companies

#### Observations:

- Investors perceive blue-chip stocks as “safe investments”
- Brand familiarity influences decision-making
- Media coverage strengthens bias toward these stocks

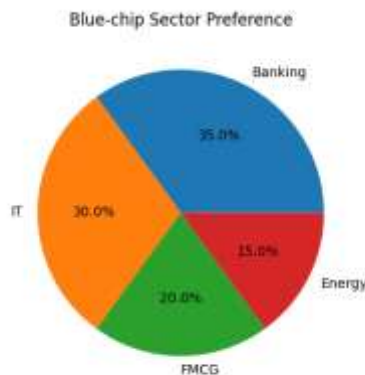


Chart 1: Blue-chip Preference

#### 6.3 Influence of Market Sentiment

Retail investors are highly sensitive to market sentiment, influenced by:

- News channels
- Social media platforms
- Peer discussions
- Market rumors

#### Impact:

- Sudden buying during bullish trends
- Panic selling during market downturns
- Lack of long-term strategy

## 7.0 Behavioural Biases Observed in Retail Investors

### 7.1 Overconfidence Bias

Retail investors often believe they can “time the market,” leading to excessive trading and risk-taking.

### 7.2 Herd Behaviour

Investors follow trends without independent analysis, especially during IPOs or market rallies.

### 7.3 Familiarity Bias

Preference for blue-chip companies arises from brand recognition rather than financial evaluation.

### 7.4 Anchoring Bias

Investors rely on past stock prices as reference points, affecting buying and selling decisions.

### 7.5 Loss Aversion

Investors hold onto losing stocks, hoping for recovery, instead of cutting losses.

## 8.0 Relationship between Biases and Investment Decisions

Table 2: Behavioural Bias and Investment Outcome

Bias	Impact on Decision
Overconfidence	Excessive trading
Herd Behaviour	Trend-following investments
Familiarity Bias	Concentration in blue-chip stocks
Anchoring	Delayed decision-making
Loss Aversion	Holding losing investments

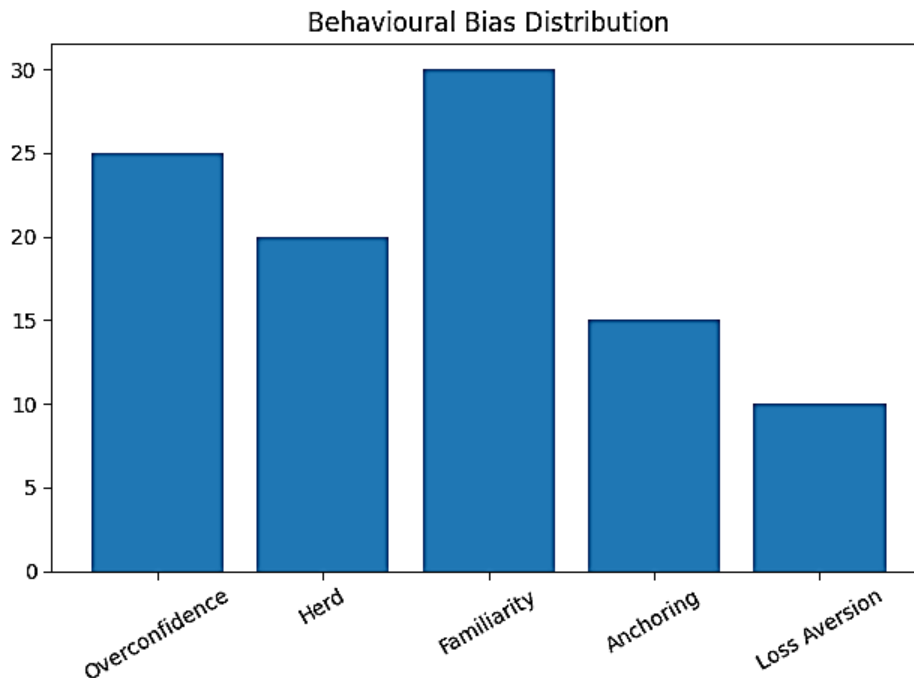


Chart 2: Behavioural Bias Distribution

### **9.0 Findings and Observations**

1. Retail investors in urban India are significantly influenced by behavioural biases.
2. Blue-chip companies attract disproportionate investment due to familiarity and perceived safety.
3. Market sentiment plays a dominant role in short-term investment decisions.
4. Overconfidence leads to frequent trading and reduced returns.
5. Herd behaviour results in market volatility and irrational investment patterns.
6. Investors lack diversification due to concentration in well-known stocks.
7. Emotional decision-making often overrides rational financial analysis.

### **10.0 Suggestions and Recommendations**

#### **1. Investor Education Programs**

Financial literacy initiatives should focus on behavioural awareness.

#### **2. Promotion of Rational Investment Strategies**

Encourage long-term, diversified investment approaches.

#### **3. Regulatory Awareness Campaigns**

Authorities should educate investors about risks of herd behaviour.

#### **4. Use of Financial Advisors**

Professional guidance can reduce bias-driven decisions.

#### **5. Digital Tools and Analytics**

Encourage use of data-driven platforms for informed decision-making.

### **11.0 Conclusion**

Behavioural biases play a significant role in shaping the investment decisions of retail investors. In Indian urban markets such as Mumbai, investors exhibit strong preferences for blue-chip stocks due to familiarity and perceived safety, often influenced by market sentiment and social factors. These biases lead to irrational investment patterns, including overtrading, lack of diversification, and emotional decision-making.

Understanding behavioural biases is essential for improving investment outcomes and market efficiency. Policymakers, financial institutions, and educators must work together to enhance investor awareness and promote rational decision-making practices. Ultimately, minimizing behavioural biases can lead to more stable financial markets and better wealth creation for retail investors.

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