

THE ROLE OF BEHAVIOURAL BIASES IN INVESTMENT DECISION-MAKING: A THEORETICAL PERSPECTIVE

Anish Kumar Saini

MBA Student
Vivekananda Global University, Jaipur

Prem Shankar Saini

MBA Student
Vivekananda Global University, Jaipur

Shivam Kumar

MBA Student
Vivekananda Global University, Jaipur

Deepak Gangwar

Assistant Professor
Vivekananda Global University, Jaipur

ABSTRACT

Investment decision-making has traditionally been explained through rationality, expected utility maximization, market efficiency, and objective information processing. However, behavioural finance demonstrates that investors often depart from these assumptions because decisions are shaped by cognitive limitations, emotions, social influences, experience, and contextual conditions. Biases including overconfidence, anchoring, representativeness, availability, confirmation, herding, loss aversion, disposition effect, regret aversion, and mental accounting can affect information interpretation, risk perception, expectations, and investment choices. The growing participation of households in securities markets, expansion of mutual funds, digital investment platforms, and increased access to financial information have further strengthened the relevance of behavioural perspectives. This paper theoretically examines behavioural biases in investment decision-making by integrating behavioural finance, prospect theory, bounded rationality, investor psychology, financial literacy, and technology-enabled investment environments. Official evidence from Indian institutions, including SEBI and RBI, provides contemporary contextual grounding without transforming the study into an empirical investigation. The paper proposes that behavioural biases operate primarily through information processing and risk perception, while financial literacy, investment experience, investor characteristics, social influence, and technology act as important contextual mechanisms. An integrated theoretical framework and propositions are developed, highlighting the multidimensional nature of investment behaviour.

Keywords: Behavioural Finance, Behavioural Biases, Investment Decision-Making, Overconfidence, Loss Aversion

INTRODUCTION

Investment decision-making represents one of the most important areas of financial economics because the allocation of financial resources affects individual wealth accumulation, household financial security, corporate financing, capital-market development,

and broader economic growth. Conventional financial theory has traditionally conceptualized investors as rational economic agents who evaluate available information, assess expected returns and associated risks, and select investment alternatives that maximize expected utility. The development of portfolio theory, expected utility theory, and the efficient market hypothesis established an influential intellectual foundation for understanding financial markets through the assumptions of rationality and information efficiency Alhenawi et al. (2022). Within this framework, investors are expected to process information systematically, maintain relatively stable preferences, and respond to market information in ways that promote efficient allocation of capital. Nevertheless, the actual behaviour of investors frequently demonstrates patterns that are difficult to reconcile completely with these assumptions. Investors may trade excessively, hold losing securities for extended periods, respond disproportionately to negative information, follow other investors, rely excessively on historical prices, or become excessively confident in their own forecasting ability. These recurring patterns have contributed to the emergence and development of behavioural finance as an important theoretical perspective within modern financial research.

Behavioural finance challenges the proposition that financial decision-making can be adequately understood through mathematical optimization alone. Instead, it incorporates psychological insights to explain how individuals make decisions when confronted with uncertainty, incomplete information, limited attention, and complex financial alternatives. The central premise is not necessarily that investors are irrational in every circumstance, but that human decision-making is subject to systematic limitations and predictable tendencies. Investors may use mental shortcuts to simplify complex decisions, rely on reference points when evaluating gains and losses, give disproportionate attention to salient information, or allow emotions to influence financial choices. These mechanisms can produce systematic departures from the behaviour predicted by traditional financial models. Corzo et al. (2024) demonstrate the breadth of behavioural finance as a field by mapping its conceptual development across a wide range of financial themes, reflecting the increasing recognition that psychological mechanisms are relevant to multiple dimensions of finance.

The relevance of behavioural biases has become particularly important because the investment environment has changed substantially. The expansion of financial markets, mutual funds, online brokerage platforms, mobile applications, social media, financial influencers, algorithmic recommendations, and artificial intelligence has significantly altered how investors obtain and respond to information. Investors now have access to financial information at a speed and scale that was difficult to imagine in traditional investment environments. However, increased information availability does not automatically result in improved investment decisions. On the contrary, information abundance can increase attention constraints and make investors more dependent upon heuristics and socially transmitted signals. The speed of digital investment platforms may also reduce the time available for reflection before an investment decision is executed Alhenawi et al. (2022). Thus, technological development has created an environment in which some behavioural biases may be reduced through automation while others may be strengthened through increased accessibility, immediacy, and social influence.

The Indian financial market provides an especially relevant context for examining this theoretical issue. Household participation in securities markets has expanded alongside the growth of mutual funds and other investment products. The Association of Mutual Funds in India reports that mutual fund assets under management reached ₹65.74 lakh crore in March 2024, compared with ₹53.40 lakh crore in March 2024, while the industry experienced substantial growth in investor folios. ([AMFI India](https://www.amfiindia.com)) Such expansion indicates that investment

decision-making is increasingly relevant to a broad population rather than being restricted to specialized financial institutions. As participation expands, investors with different levels of financial knowledge, investment experience, risk tolerance, and psychological characteristics interact with financial markets. This creates an important theoretical setting in which behavioural biases can influence investment decisions in different ways. The role of household financial behaviour is also evident in official national saving statistics. RBI data based on NSO estimates indicate that household gross financial saving represented 10.9 percent of gross national disposable income in both 2021–22 and 2022–23, while net financial saving declined from 7.2 percent to 5.2 percent over the same period. The same data show that household financial assets include deposits, shares and debentures, claims on government, insurance funds, and provident and pension funds. These figures are not evidence that investors behave irrationally; rather, they demonstrate the breadth of financial choices available to households and provide an important contextual basis for understanding why investment decision-making deserves consideration from both conventional and behavioural perspectives.

Investor education has also become increasingly important as participation in financial markets expands. SEBI's Investor Survey 2024 reports that participation in investor education programmes remains below one percent nationally, although 91 percent of those who attended such programmes considered them useful. The survey further identifies social media, mobile applications, and television/digital advertising as important channels through which investors prefer to receive financial education. These findings have theoretical significance because they highlight the relationship between information access, investor education, digital communication, and behavioural decision-making. Financial literacy may improve the capacity to evaluate information, but the presence of financial knowledge does not necessarily eliminate psychological biases. The importance of behavioural finance is further reinforced by recent regulatory research concerning individual participation in equity derivatives. SEBI published studies in August 2026 specifically examining the trading behaviour and profitability of individual traders in the equity derivatives segment for FY2023–24. The existence of such regulatory research demonstrates that investor behaviour has become an important policy and market-development issue. However, the present paper does not reproduce these studies as empirical evidence of behavioural biases. Instead, they are used to demonstrate the contemporary relevance of investor behaviour as an area of financial inquiry.

Against this background, this paper theoretically examines the role of behavioural biases in investment decision-making Ambler et al. (2023). The study focuses on the mechanisms through which cognitive and emotional biases influence information processing, risk perception, expectations, and investment behaviour. It further considers the potential moderating and contextual roles of financial literacy, investment experience, investor characteristics, social influence, and technology. The central argument developed in the paper is that investment decisions should be understood as outcomes of an interaction between financial information and psychological processes rather than as purely rational responses to objective market information.

THEORETICAL FOUNDATIONS OF INVESTMENT DECISION-MAKING

Traditional Finance and the Rational Investor

Traditional financial theory provides the intellectual foundation against which behavioural finance has developed. The rational investor is assumed to possess the ability to evaluate relevant information, estimate expected outcomes, understand risk, and make decisions that

maximize utility. Within portfolio theory, investors are expected to construct portfolios according to their preferences for risk and return, while efficient-market reasoning suggests that market prices incorporate available information. The rational framework has been highly influential because it provides a systematic basis for explaining asset prices, portfolio selection, and resource allocation Ambler et al. (2023). Nevertheless, its assumptions become increasingly difficult to maintain when investors operate under conditions characterized by uncertainty, information overload, limited attention, emotional responses, and social influence.

The rational model also implicitly assumes that investors can process available information without systematic distortion. In reality, investors may have access to the same information but interpret it differently. One investor may view a market decline as an opportunity to purchase undervalued securities, whereas another may interpret the same decline as evidence of increasing risk and withdraw from the market. Such differences cannot be fully explained by differences in objective information. They may instead reflect differences in experience, beliefs, reference points, financial knowledge, and psychological characteristics. The emergence of behavioural finance therefore does not necessarily imply that traditional finance is irrelevant. Rather, behavioural finance extends traditional financial analysis by examining the psychological mechanisms that operate between the availability of information and the final investment decision. This distinction is important because the objective characteristics of an investment and the subjective perception of that investment may differ substantially. Behavioural finance seeks to explain this gap.

Bounded Rationality

The concept of bounded rationality provides an important theoretical foundation for understanding why investors may not always behave according to complete rationality. Individuals have limited cognitive resources and cannot evaluate every possible alternative under every possible future state. Financial markets further increase this difficulty because investors face uncertain outcomes, rapidly changing information, and complex financial products. Under these circumstances, individuals often rely on simplified decision rules or heuristics. Heuristics can be beneficial because they reduce cognitive effort and allow investors to make decisions efficiently Amoozad Mahdiraji et al. (2022). However, the same shortcuts can produce systematic errors when applied in situations for which they are inappropriate. Anchoring, representativeness, availability, and other cognitive biases can therefore be interpreted as consequences of the interaction between limited information-processing capacity and complex decision environments. Behavioural finance consequently provides a more realistic representation of decision-making by recognizing that investors may attempt to behave rationally while remaining subject to cognitive constraints.

Prospect Theory and Behavioural Investment Decision-Making

Prospect theory provides one of the most important theoretical foundations for understanding behavioural investment decisions because it challenges the assumption that individuals evaluate gains and losses symmetrically. Investors generally evaluate financial outcomes relative to a reference point rather than simply considering their absolute monetary value. This reference point may be the purchase price of a security, a previous market value, an expected return, or a personally established financial target. Consequently, identical financial outcomes may produce different psychological reactions depending upon the investor's reference position Amoozad Mahdiraji et al. (2022). Loss aversion is central to this theoretical perspective. Investors may experience the psychological impact of a loss more strongly than the satisfaction associated with an equivalent gain. This asymmetry can

influence investment behaviour by encouraging investors to avoid losses, delay selling losing assets, or accept additional risk in an attempt to recover previous losses. Such behaviour challenges conventional models that assume investors evaluate outcomes according to their objective expected utility.

Prospect theory also helps explain why risk preferences can vary across situations. Investors may become more conservative when protecting gains but more willing to accept risk when attempting to recover losses. Therefore, risk preference should not necessarily be regarded as completely stable. Instead, the investor's psychological position, reference point, and framing of the decision may influence the perceived attractiveness of alternative outcomes.

LITERATURE REVIEW

The literature on behavioural finance has developed from an initial challenge to rational-market assumptions into a broad interdisciplinary research field that incorporates psychology, economics, finance, technology, and investor education. Behavioural finance research increasingly recognizes that investment decisions are influenced by the manner in which investors acquire information, process uncertainty, evaluate financial outcomes, and respond to the actions of others. The development of the field therefore represents not simply a rejection of rational financial theory but an expansion of financial analysis toward a more realistic understanding of human behaviour Carè & Weber (2023). One major stream of research focuses on cognitive biases and their influence on investment decisions. Overconfidence is particularly important because investors may systematically overestimate their knowledge, forecasting ability, or control over financial outcomes. Such overconfidence can influence trading behaviour, portfolio concentration, risk-taking, and expectations regarding future returns. Anchoring provides another explanation for deviations from rational information processing because investors may remain influenced by an initial reference value even after receiving new information. Representativeness may cause investors to infer future performance from limited patterns, while availability may increase the influence of information that is particularly recent, dramatic, or easily recalled.

Confirmation bias represents another important cognitive mechanism. Investors who develop a strong investment belief may selectively seek information that confirms that belief and discount contradictory evidence. This process can make investment decisions increasingly resistant to revision. Theoretical significance arises because investors can possess substantial quantities of information and still process that information selectively Carè & Weber (2023). Thus, the behavioural problem is not simply an information deficit but an information-processing distortion. Social influences represent another important dimension of investment behaviour. Herding occurs when investors imitate the decisions or opinions of others rather than relying exclusively on their own analysis. Herding may occur because other investors are perceived as possessing superior information, because uncertainty makes independent decision-making psychologically difficult, or because social conformity reduces the perceived risk of making an independent decision. In contemporary markets, digital platforms and social media have substantially increased the visibility of other investors' opinions, potentially strengthening these mechanisms.

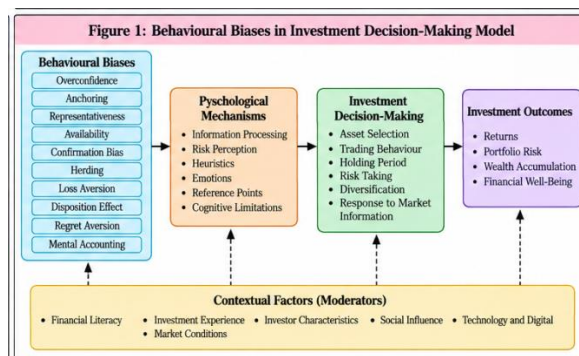


Figure 1: Conceptual Model

Emotional biases provide a complementary explanation. Loss aversion influences how investors respond to negative outcomes, while the disposition effect explains the tendency to treat winning and losing investments differently. Regret aversion can influence both investment action and inaction because investors may avoid decisions that could subsequently generate psychological regret Chenet et al. (2021). Mental accounting can cause investors to categorize money into separate psychological accounts rather than evaluating their overall wealth and portfolio risk systematically. Research also increasingly recognizes that behavioural biases may interact. An investor may initially become overconfident, develop an anchored expectation, selectively seek confirming information, and subsequently refuse to realize a loss because of loss aversion. In such a situation, the final investment decision reflects a combination of psychological mechanisms rather than one isolated bias. This supports an integrated theoretical approach.

Financial literacy represents an important contextual variable within this literature. Greater financial knowledge may improve investors' ability to evaluate investment products and recognize certain behavioural errors. Recent evidence from behavioural investment research has also considered financial literacy as a moderator of the relationship between behavioural biases and investment decisions. However, financial knowledge should not be interpreted as a complete solution because emotional responses can remain present even among highly knowledgeable investors. Investment experience presents a similar theoretical complexity. Experience may enhance learning, improve familiarity with market cycles, and strengthen understanding of financial instruments. However, successful previous investment outcomes may also strengthen overconfidence. Consequently, experience can simultaneously reduce some behavioural errors and intensify others.

The technological transformation of financial markets adds another layer to the literature. Shanmuganathan (2020) examines behavioural finance in the context of artificial intelligence and robo-advisors, illustrating how technology is becoming increasingly connected to investment decision-making Chenet et al. (2021). Automated systems may reduce certain human biases by applying systematic rules, but technology can also increase the speed and accessibility of trading. The behavioural consequences therefore depend on how investors interact with digital systems. Recent developments in decentralized finance and other technology-enabled financial systems further illustrate the need for behavioural perspectives. Bennett, Mekelburg and Williams (2023) connect behavioural finance with decentralized finance, indicating that psychological mechanisms remain relevant even as financial technologies evolve. Behavioural finance therefore needs to move beyond traditional stock-market settings and consider increasingly digital investment environments.

The literature ultimately suggests that investment behaviour emerges from the interaction of cognitive, emotional, social, financial, and technological factors. The theoretical challenge is consequently to develop models that explain not only whether biases exist but also how multiple biases interact, under what conditions they become stronger or weaker, and how investors' characteristics and environments influence their effects.

Table 1: Literature Synthesis on Behavioural Biases and Investment Decision-Making

Author(s) & Year	Focus of Study	Approach	Major Contribution	Relevance to Present Paper
Shanmuganathan (2020)	Behavioural finance and AI	Longitudinal case study	Examines behavioural finance in robo-advisory investment decisions	Establishes technology as a behavioural context
Castro et al. (2015)	Disposition effect	Investment behaviour research	Examines disposition-related investment behaviour	Supports emotional-bias perspective
Gendron & Smith-Lacroix (2015)	Finance and rationality	Critical theoretical analysis	Questions narrow disciplinary assumptions in finance	Supports broader conceptualization of finance
Bennett et al. (2023)	Behavioural finance and DeFi	Conceptual approach	Extends behavioural finance to decentralized finance	Demonstrates relevance in emerging financial systems
Corzo et al. (2024)	Behavioural finance literature	Conceptual synthesis	Maps behavioural finance across multiple themes	Supports interdisciplinary perspective
Abideen et al. (2023)	Behavioural biases and investment decisions	Empirical behavioural-finance research	Examines multiple biases and investment decisions	Supports relationship between biases and decisions
Mahmood et al. (2024)	Behavioural biases and financial literacy	Behavioural framework	Examines moderating role of financial literacy	Supports literacy as contextual mechanism
Hussain et al. (2023)	Cognitive biases and investment	Behavioural-risk framework	Highlights role of risk propensity	Supports risk perception mechanism
Duclos (2015)	Psychology of investment behaviour	Conceptual/experimental perspective	Explores debiasing financial decision-making	Supports psychological intervention perspective
SEBI (2026)	Individual derivatives trading	Regulatory research	Examines current trading behaviour of individuals	Establishes contemporary relevance of investor behaviour
RBI/NSO	Household financial saving	Official national statistics	Documents composition of household financial saving	Provides financial-market context

The literature synthesis indicates that behavioural investment research has evolved from the examination of individual psychological biases toward increasingly integrated perspectives involving financial literacy, risk propensity, technology, social influence, and investor education. This evolution supports the present paper's central proposition that behavioural biases should be examined as interconnected components of investment decision-making rather than isolated psychological abnormalities.

INDIAN FINANCIAL INVESTMENT CONTEXT

The contemporary Indian financial environment provides an important contextual foundation for examining behavioural investment decision-making. Household financial savings are distributed across several categories, including deposits, shares and debentures, claims on government, insurance funds, and provident and pension funds. RBI data based on NSO estimates show that gross financial saving remained at 10.9 percent of gross national disposable income in 2021–22 and 2022–23, while net financial saving declined to 5.2 percent in 2022–23 from 7.2 percent in 2021–22. (System Health) These figures are contextual rather than behavioural measures, but they demonstrate the variety of financial decisions faced by households. Investors must choose among instruments with different liquidity, risk, return, maturity, and familiarity characteristics, creating conditions under which psychological preferences can influence financial choices.

Table 2: Household Financial Saving in India

Component	2019–20	2020–21	2021–22	2022–23
Gross Financial Saving	11.4	15.2	10.9	10.9
Currency	1.4	1.9	1.1	0.9
Deposits	4.3	6.2	3.5	4.0
Shares & Debentures	0.5	0.5	0.9	0.8
Claims on Government	1.3	1.3	1.1	0.9
Insurance Funds	1.7	2.8	2.0	2.0
Provident & Pension Funds	2.2	2.5	2.3	2.3
Financial Liabilities	3.8	3.7	3.8	5.7
Net Financial Saving	7.6	11.6	7.2	5.2

Note: Figures are percentages of GNDI. Figures may not add because of rounding. Source: RBI/NSO.

The composition of household financial saving is theoretically relevant because investors do not evaluate all financial instruments through identical psychological mechanisms. Deposits may benefit from familiarity and perceived safety, whereas market-linked investments may be associated with greater uncertainty and therefore stronger emotional responses. Investors may also evaluate financial products relative to previous experiences and social norms. The existence of several financial alternatives therefore provides a setting in which biases such as familiarity, loss aversion, anchoring, and risk perception can potentially influence asset allocation. The table should not be interpreted as evidence that any particular bias caused the observed saving pattern; rather, it demonstrates the financial environment in which behavioural decision-making takes place.

GROWTH OF MUTUAL FUND PARTICIPATION

The expansion of mutual funds represents another important development in India's investment environment. AMFI reports that mutual fund assets under management reached ₹65.74 lakh crore in March 2024, compared with ₹53.40 lakh crore in March 2024, while the number of folios also increased substantially. The industry reported average monthly SIP contributions of ₹24,113 crore during FY2024–25, compared with ₹16,602 crore during FY2023–24.

The growth of mutual fund participation is theoretically significant because investment decisions are increasingly being made by households and individual investors who may possess different levels of financial knowledge and investment experience. Systematic investment mechanisms may encourage disciplined investment behaviour, but investors can still be influenced by market sentiment, recent returns, social information, and emotional

reactions. For example, strong recent performance may encourage representativeness and recency-based expectations, whereas market corrections may trigger loss aversion. Consequently, the expansion of mutual funds provides an important context for examining how behavioural mechanisms operate within increasingly accessible investment products.

INVESTOR EDUCATION AND BEHAVIOURAL DECISION-MAKING

Investor education represents an important potential mechanism for improving financial decision-making. SEBI's Investor Survey 2024 reports that participation in investor education programmes remains below one percent nationally, while 91 percent of attendees considered such programmes useful. The survey also reports that social media content, workshops and seminars, video tutorials, online courses and webinars, and WhatsApp campaigns are among the important channels for investor education.

Table 3: SEBI Investor Education Programme Findings

Indicator	SEBI Investor Survey 2024
National participation in investor education programmes	Less than 1%
Urban participation	5.5%
Participants finding programmes useful	91%
Social media as preferred/important channel	70%
Mobile applications	60%
TV/digital advertising	51%
Fraud prevention as demanded topic	59%
Risk management	44%
Investor rights	44%

Source: SEBI Investor Survey 2024.

The significance of these findings extends beyond investor education itself. Behavioural biases frequently operate through limitations in attention, interpretation, risk evaluation, and information processing. Investor education can potentially strengthen the ability of individuals to recognize these limitations and evaluate investment alternatives more systematically. However, financial education should not be interpreted as eliminating behavioural biases. Knowledge and behaviour do not always correspond perfectly because emotional responses, social influences, and psychological reference points may remain important even among financially knowledgeable investors. Therefore, financial literacy is conceptualized in this paper as a **moderating mechanism** rather than a complete solution to behavioural decision-making.

INVESTOR PARTICIPATION AND THE CHANGING INVESTMENT ENVIRONMENT

The growth of investment participation has also been accompanied by regulatory attention to individual investor behaviour. SEBI published dedicated studies in August 2026 examining both trading behaviour and profitability of individual traders in the equity derivatives segment for FY2023–24. This development is particularly relevant because derivative markets provide a setting in which risk perception, overconfidence, trading frequency, and other behavioural mechanisms may become highly important. The regulatory focus on individual trading behaviour demonstrates that investor decision-making is not merely a psychological issue but also a significant financial-market and investor-protection concern.

Table 5: Recent SEBI Research on Individual Investor Behaviour

SEBI Research	Publication Date	Area
Study – Trading Behaviour of Individual Traders in the Equity Derivatives Segment (FY25–FY26)	20 August 2024	Trading behaviour
Study – Profitability of Individual Traders in the Equity Derivatives Segment (FY25–FY26)	20 August 2024	Trading outcomes
Household Savings through Indian Securities Market	20 May 2024	Household investment/savings
Study – Analysis of Intraday Trading by Individuals in Equity Cash Segment	24 July 2024	Individual trading

Source: SEBI Research and Statistics

These regulatory studies should not be interpreted as direct tests of the theoretical propositions developed in this paper. Instead, they establish the contemporary importance of individual investor behaviour within the Indian securities market. Their relevance reinforces the argument that behavioural finance should be connected with the actual institutional and technological environment in which investment decisions are made.

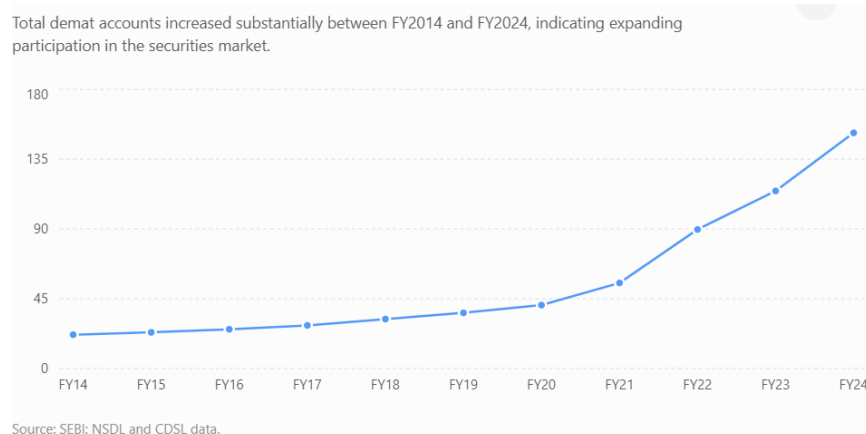


Chart 1: Growth of Demat Accounts in India

CLASSIFICATION OF BEHAVIOURAL BIASES

Behavioural biases can broadly be classified into cognitive and emotional categories. Cognitive biases arise primarily from limitations in perception, memory, attention, judgment, and information processing. Emotional biases are more strongly associated with feelings, preferences, psychological discomfort, and reactions to financial outcomes. Although this classification is theoretically useful, the two categories frequently overlap in practice. Cognitive biases such as overconfidence, anchoring, representativeness, availability, and confirmation bias influence how investors process information. These biases can alter expectations before an investment decision is made. Emotional biases such as loss aversion, regret aversion, disposition effect, and mental accounting influence how investors evaluate outcomes and respond to financial uncertainty.

The distinction therefore should not imply that investors experience one category independently of the other. Investment behaviour may involve a sequence in which cognitive and emotional processes reinforce one another. Such interaction represents one of the central arguments of the present theoretical framework.

INTERACTION AMONG BEHAVIOURAL BIASES

Behavioural biases rarely operate independently in actual investment decisions. An investor may simultaneously experience several cognitive and emotional tendencies, producing a cumulative behavioural effect. For example, overconfidence may lead an investor to establish a strong belief about a security, anchoring may cause the investor to remain attached to the original valuation, confirmation bias may encourage selective attention to supportive information, and loss aversion may subsequently prevent the investor from realizing a loss. This interaction demonstrates the limitations of treating behavioural biases as isolated variables. The same investment decision may reflect several psychological mechanisms operating sequentially or simultaneously. Theoretical models should therefore recognize the possibility of behavioural reinforcement, in which one bias increases the probability or intensity of another. The interaction perspective also helps explain why financial decision-making can become difficult to correct through simple investor education. A single educational intervention may address one bias without addressing the broader psychological process. Effective decision-making therefore requires awareness of multiple behavioural mechanisms and the conditions under which they interact.

BEHAVIOURAL BIASES AND RISK PERCEPTION

Risk perception provides an important theoretical link between behavioural biases and investment decisions. Objective financial risk represents measurable uncertainty, whereas perceived risk reflects the investor's psychological interpretation of that uncertainty. These two dimensions may differ substantially. Overconfidence may cause investors to underestimate risk because they overestimate their ability to predict outcomes. Availability bias may increase perceived risk following highly publicized negative events. Loss aversion may cause investors to place disproportionate psychological weight on potential losses. Herding may reduce perceived risk because investors interpret widespread participation as evidence that an investment is safe. Risk perception can therefore function as a mediating mechanism between behavioural biases and investment decisions. Rather than directly causing a specific investment action in every case, behavioural biases may first alter the investor's perception of risk and return, which subsequently influences the investment choice.

FINANCIAL LITERACY AS A MODERATING MECHANISM

Financial literacy may influence the relationship between behavioural biases and investment decisions by improving investors' understanding of financial products, risk-return relationships, diversification, and market uncertainty. A financially literate investor may be better positioned to recognize when a recent price movement is insufficient evidence of future performance or when emotional responses are influencing an investment decision. However, financial literacy does not eliminate behavioural biases. Knowledge and behaviour represent different dimensions of decision-making. Investors may understand that diversification reduces portfolio risk while still concentrating investments because of overconfidence. Similarly, an investor may understand loss aversion conceptually but still retain a losing security because of emotional attachment. Financial literacy should therefore be conceptualized as a moderating factor that may reduce the intensity of certain behavioural effects rather than as a mechanism that completely eliminates behavioural decision-making.

INVESTMENT EXPERIENCE AND BEHAVIOURAL BIASES

Investment experience can influence behavioural decision-making through learning and familiarity. Experienced investors may possess greater knowledge of market cycles and may have encountered situations in which initial expectations were incorrect. Such experiences

can help investors recognize common behavioural errors. However, experience may also strengthen overconfidence. Investors who have experienced successful outcomes may interpret those outcomes as evidence of personal skill. This can result in increased confidence, higher trading activity, and greater willingness to assume risk. Consequently, experience can simultaneously reduce some biases and intensify others. The theoretical relationship between experience and behavioural bias should therefore be treated as nonlinear and context-dependent. The value of experience depends not simply on the number of years an investor has participated in financial markets but on whether that experience produces genuine learning and reflection.

TECHNOLOGY, SOCIAL MEDIA AND BEHAVIOURAL FINANCE

Technological development has transformed the investment decision-making environment. Digital brokerage platforms, mobile applications, online investment communities, financial websites, and algorithmic recommendation systems have reduced barriers to investment participation. These technologies provide investors with rapid access to prices, financial information, investment products, and trading opportunities. However, technology can also increase behavioural pressures. Instantaneous information can strengthen availability bias, while social media can increase herding and confirmation bias. Mobile trading applications can reduce the psychological and practical barriers associated with executing trades, potentially encouraging impulsive decisions. The continuous availability of financial information may also increase attention to short-term market fluctuations.

Artificial intelligence and robo-advisory systems provide a more complex relationship. Automated investment systems can potentially reduce human biases by applying predetermined allocation rules and systematic portfolio strategies. At the same time, investors still make decisions regarding risk preferences, acceptance of recommendations, and interpretation of algorithmic outputs. Shanmuganathan (2020) therefore provides an important foundation for understanding behavioural finance in an AI-enabled investment environment. SEBI's recent investor-education evidence also demonstrates the increasing importance of digital communication. Social media, mobile applications, and digital advertising have become important channels for communicating with investors. Thus, digital technology represents both a potential source of behavioural risk and a potential mechanism for behavioural education.

HOUSEHOLD SAVINGS AND SECURITIES-MARKET TRANSFORMATION

Recent developments also indicate that Indian household savings are increasingly connected with securities-market instruments. SEBI's 2026 study on household savings through the Indian securities market explains that the methodology for estimating household savings through securities markets has been expanded to incorporate more granular information, including secondary-market activity and newer instruments such as REITs, InvITs, and AIFs. The study reports that the methodological revision increased the estimated gross-savings-to-GDP ratio for 2024–25 by 47 basis points.

This development is theoretically relevant because the growing range of financial instruments increases the complexity of investment decision-making. Investors must evaluate different forms of risk, liquidity, return, maturity, taxation, and market exposure. Greater choice does not necessarily produce better decisions because decision complexity can increase reliance on heuristics. Consequently, the development of India's securities market provides an increasingly important environment for studying behavioural investment decision-making.

DISCUSSION

The theoretical analysis demonstrates that behavioural biases provide an important explanation for deviations from conventional assumptions of rational investment decision-making. Traditional financial theories remain valuable because they provide a systematic framework for understanding risk, return, diversification, and asset allocation. However, behavioural finance extends this framework by examining the psychological processes through which investors interpret financial information. The resulting perspective is not that financial decisions are universally irrational but that systematic psychological tendencies can influence otherwise rational financial objectives. Cognitive biases primarily affect the way investors process information, whereas emotional biases influence the way investors respond to financial outcomes. However, these categories should not be treated as independent. Investment decisions frequently involve sequential psychological processes in which cognitive and emotional biases reinforce one another. An investor may become overconfident after previous success, anchor expectations to an earlier price, selectively seek confirming information, and subsequently refuse to realize a loss. Such a decision represents the combined effect of multiple behavioural mechanisms.

The role of risk perception is particularly important in this integrated framework. Investors respond to perceived risk rather than objective risk alone. Behavioural biases can therefore influence the translation of financial information into psychological perceptions of uncertainty. Overconfidence can reduce perceived risk, availability can increase perceived risk following salient negative events, and herding can create a perception that collective behaviour confirms investment safety. Incorporating risk perception into behavioural models therefore provides a stronger theoretical explanation of how biases influence final investment decisions. The Indian financial environment reinforces the relevance of this perspective. Household financial savings continue to be distributed across deposits, securities, insurance, pension products, and other financial instruments, while mutual fund participation has expanded substantially. Investors therefore face increasingly complex choices. The challenge is not merely whether financial products are available but whether investors can evaluate them without excessive dependence on psychological shortcuts.

Investor education provides another important dimension. SEBI's Investor Survey 2024 demonstrates that participation in formal investor education remains limited, while participants who do attend generally perceive such programmes as useful. This suggests that financial education may have substantial potential but also highlights the need to consider how educational content is delivered. The importance of social media and mobile applications as communication channels means that investor education itself is increasingly becoming part of the digital behavioural environment. Technology creates both opportunities and risks. Automated systems can reduce some human biases by imposing systematic decision rules, but digital environments can simultaneously increase impulsive behaviour and social influence. Consequently, technology should not be considered inherently behavioural-neutral. The behavioural consequences depend on how technological systems are designed and how investors interact with them.

The increasing regulatory attention to individual investor behaviour further reinforces this theoretical argument. SEBI's recent research on individual trading behaviour and profitability in equity derivatives demonstrates the importance of understanding how individuals interact with complex financial markets. Behavioural finance therefore has implications not only for academic theory but also for investor education, market regulation, financial product design, and investor protection.

CONCLUSION

Behavioural biases represent an important theoretical dimension of contemporary investment decision-making because investors do not always process financial information according to the assumptions of complete rationality. Cognitive limitations, emotional responses, social influences, previous experiences, and technological environments can systematically influence the manner in which investors interpret information, perceive risk, evaluate outcomes, and select investment alternatives. The theoretical analysis demonstrates that overconfidence, anchoring, representativeness, availability, confirmation bias, and herding influence information processing and expectations, while loss aversion, disposition effect, regret aversion, and mental accounting influence the psychological evaluation of financial outcomes. These biases should not be regarded as isolated phenomena because multiple biases may interact and reinforce one another during the investment decision-making process.

The Indian financial environment provides an increasingly important context for this theoretical discussion. Household financial saving encompasses a wide range of instruments, while mutual fund participation and securities-market involvement have expanded considerably. RBI and SEBI data demonstrate the growing importance of financial-market participation and investor behaviour within the Indian economy. SEBI's investor survey further demonstrates the importance of investor education and digital communication channels, while recent regulatory research highlights the continuing relevance of individual trading behaviour. The paper therefore proposes that investment decision-making should be understood through an integrated framework in which behavioural biases influence information processing and risk perception, ultimately shaping investment behaviour. Financial literacy, investment experience, investor characteristics, social influence, and technology provide important contextual conditions that may strengthen or moderate these effects.

The theoretical perspective developed in this paper does not suggest that rational financial models should be abandoned. Instead, it argues that traditional financial theory can be strengthened by incorporating realistic assumptions concerning human psychology and decision-making. As financial markets become increasingly digital, accessible, interconnected, and information-intensive, understanding the behavioural foundations of investment decisions will become increasingly important. Behavioural finance therefore provides not only an alternative explanation of investor behaviour but also an important foundation for developing more realistic theories of financial decision-making, investor education, financial product design, and market regulation.

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