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Behavioral Aspects of Retail Investors to Accurately Understand Their Decision-Making Process

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Abstract- Investor decision-making has traditionally been explained through rational models rooted in classical finance theory. However, increasing empirical evidence suggests that psychological biases significantly influence retail investors' behavior. This study investigates the behavioral aspects influencing retail investors to better understand their decision-making process. Specifically, it examines the impact of overconfidence bias, herding behavior, loss aversion, anchoring bias, and availability bias on investment decisions. A structured questionnaire was administered to 250 retail investors, and data were analyzed using SPSS (Version 26). Reliability analysis, correlation analysis, multiple regression, and exploratory factor analysis (EFA) were conducted to test the proposed hypotheses. The results indicate that overconfidence and herding behavior significantly and positively affect investment decision-making, while loss aversion negatively influences risk-taking behavior. Anchoring and availability bias also demonstrate statistically significant effects on investment choices. The model explains 62% of the variance in retail investment decisions ($R^2 = 0.62$). These findings confirm that retail investors are not entirely rational and that psychological factors play a crucial role in financial decision-making. The study contributes to behavioral finance literature by offering empirical insights into cognitive and emotional biases affecting retail investors and provides implications for financial advisors, policymakers, and investment educators. Understanding these behavioral dimensions can improve investor awareness, portfolio strategies, and financial market efficiency.

Keywords: Behavioral Finance, Retail Investors, Overconfidence, Herding Behavior, Loss Aversion, SPSS Analysis, Decision-Making

I. Introduction

Traditional financial theories such as the Efficient Market Hypothesis (EMH) and Modern Portfolio Theory (MPT) assume that investors are rational decision-makers who aim to maximize utility. However, real-world financial markets frequently exhibit anomalies that contradict these assumptions. Retail investors, in particular, often make decisions influenced by psychological biases rather than purely rational analysis.
Behavioral finance integrates psychology and finance to explain why investors deviate from rational behavior. Retail investors, unlike institutional investors, are more vulnerable to cognitive errors, emotional reactions, and social influences. These behavioral aspects significantly affect investment timing, asset selection, and risk perception.

The objective of this study is to empirically examine the behavioral biases that influence retail investors and to better understand how these biases shape their decision-making processes.

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II. Literature Review:

Behavioral finance emerged as a response to limitations of traditional finance models. Key psychological biases commonly affecting retail investors include:

Overconfidence Bias
Overconfidence refers to an investor's excessive belief in their knowledge and ability to predict market movements. Studies show that overconfident investors trade more frequently and underestimate risks.

Herding Behavior
Herding occurs when investors follow the actions of others rather than relying on their own information. Retail investors often imitate trends, especially during volatile markets.

Loss Aversion
Based on Prospect Theory, loss aversion suggests that investors feel the pain of losses more strongly than the pleasure of equivalent gains, leading to irrational holding or selling decisions.

Anchoring Bias
Anchoring occurs when investors rely heavily on initial information (e.g., purchase price) when making future investment decisions.

Availability Bias
Investors tend to base decisions on easily available or recent information rather than comprehensive data.

Although several studies examine these biases individually, integrated empirical models explaining retail investor decision-making remain limited, particularly in emerging markets.

III. Research Objectives:

- To identify key behavioral biases influencing retail investors.
- To analyze the impact of psychological factors on investment decision-making.
- To evaluate the statistical significance of behavioral variables using SPSS.
- To propose a predictive model explaining retail investor decisions.

IV. Research Hypotheses:

H1: Overconfidence significantly influences retail investor decision-making.
H2: Herding behavior positively affects investment decisions.
H3: Loss aversion negatively impacts risk-taking decisions.
H4: Anchoring bias significantly affects investment choices.
H5: Availability bias significantly influences decision-making.

V. Research Methodology:

Research Design
This study uses a quantitative, descriptive, and explanatory research design.

Sample Size
Data were collected from 250 retail investors using convenience sampling.

Data Collection Tool
A structured questionnaire using a 5-point Likert scale (1 = Strongly Disagree to 5 = Strongly Agree) was administered.

Variables

- **Independent Variables:**
  - Overconfidence
  - Herding
  - Loss Aversion
  - Anchoring
  - Availability Bias

Dependent Variable:
Investment Decision-Making

Data Analysis Tool
SPSS Version 26 was used for:

- Reliability Analysis (Cronbach’s Alpha)
- Descriptive Statistics
- Correlation Analysis
- Multiple Regression
- Exploratory Factor Analysis (EFA)

VI. Data Analysis and Results :

Reliability Analysis

Variable	Cronbach’s Alpha
Overconfidence	0.84
Herding	0.81
Loss Aversion	0.79
Anchoring	0.77
Availability Bias	0.82
Investment Decision	0.85

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All values exceed 0.70, confirming internal consistency.

Descriptive Statistics
The mean values indicate moderate to high agreement among respondents regarding behavioral bias influence.

Correlation Analysis
All independent variables show significant correlation ($p < 0.05$) with investment decisions.

Multiple Regression Analysis
Model Summary:
R = 0.79
$R^2 = 0.62$
Adjusted $R^2 = 0.60$
F-statistic = 82.45 ($p < 0.001$)
Regression Coefficients:

Variable	Beta	Sig.
Overconfidence	0.31	0.000
Herding	0.28	0.001
Loss Aversion	-0.19	0.003
Anchoring	0.22	0.002
Availability	0.24	0.001

Interpretation:

- Overconfidence has the strongest positive influence.
- Herding significantly impacts investment choices.
- Loss aversion negatively affects risk-taking.
- Anchoring and availability biases are statistically significant predictors.

Factor Analysis
KMO = 0.86
Bartlett's Test ($p < 0.001$)
Five factors were extracted explaining 68% of total variance.

VII. Discussion:

The findings confirm that retail investors are influenced by cognitive and emotional biases. Overconfidence leads investors to overestimate returns and underestimate risks, resulting in excessive trading. Herding behavior shows the social nature of financial decision-making, particularly in volatile markets.

Loss aversion discourages investors from selling losing stocks, consistent with Prospect Theory. Anchoring bias explains why investors fixate on purchase prices, while availability bias indicates reliance on recent or media-driven information.

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These results align with behavioral finance theories and reinforce that retail investors deviate from rational expectations.

VIII. Implications:

Practical Implications
Financial advisors should incorporate behavioral assessments.
Investment education programs must address psychological biases.
Policymakers should design awareness campaigns.

Theoretical Implications
Supports behavioral finance over classical models.
Provides empirical validation using SPSS-based statistical analysis.

IX. Conclusion:

This study provides empirical evidence that behavioral biases significantly influence retail investors' decision-making processes. Overconfidence and herding positively drive investment activity, while loss aversion reduces risk-taking behavior. Anchoring and availability biases further shape investor judgments.

The regression model explains 62% of variance, demonstrating that psychological factors are strong predictors of retail investment behavior. Therefore, understanding behavioral dimensions is essential for improving investment outcomes and market efficiency.

X. Limitations and Future Research:

Limitations:
- Convenience sampling
- Self-reported data
- Cross-sectional design
- Future research :
- Use longitudinal data
- Compare retail vs institutional investors
- Apply structural equation modeling (SEM)

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