



Behavioral Finance and Financial Markets: A Review of Investor Sentiment Impact

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Abstract – This study examines the impact of investor psychology and sentiment on financial market behavior and workplace financial decision-making. Traditional finance assumes that investors act rationally; however, behavioral finance suggests that decisions are often influenced by emotions and cognitive biases such as fear, greed, overconfidence, herd behavior, and loss aversion. The research adopts a descriptive design and is based on primary data collected through a structured questionnaire from 100 respondents, including individual investors and working professionals. Simple statistical tools such as percentage analysis, charts, and the Chi-square test are used to analyze the data and test the relationship between psychological factors and financial behavior. The findings reveal that investor sentiment significantly influences investment decisions, trading activity, risk-taking behavior, and market trends. The Chi-square test confirms a strong relationship between market mood and financial market behavior, indicating that psychological factors play a crucial role in shaping financial outcomes. The study also highlights that workplace financial decisions are affected by similar emotional and cognitive influences. Overall, the research concludes that behavioral finance is essential for understanding real-world financial decision-making. Increasing awareness of psychological biases can help investors and professionals make more rational decisions, reduce errors, and improve financial performance’.

Keywords – E-SERVQUAL, Online Shopping Platforms, Service Quality, Consumer Perception, Anna Nagar, Chennai.

I. INTRODUCTION

In today’s financial environment, markets are influenced not only by economic data and company performance but also by human emotions and behavior. Traditional finance assumes that investors act rationally; however, in reality, decisions are often affected by psychological factors such as fear, greed, and overconfidence .

Behavioral finance studies how these emotions and biases influence investment decisions. Factors like herd behavior, loss aversion, and anchoring can lead to irrational actions such as panic selling or over-investing, which in turn affect market movements and create volatility .

Psychological influences are also evident in workplace financial decisions, where managers may be affected by stress, emotions, and personal biases while making strategic choices.

With the growth of digital platforms and increased participation of retail investors, understanding investor psychology has become essential. This study aims to examine the impact of investor sentiment on financial markets and decision-making, helping individuals make more rational and informed financial choices.

Objective :

- To study the impact of investor psychology on financial decision-making.
- To identify key psychological biases affecting investment behavior.
- To analyze the influence of investor sentiment on financial market behavior.

➤ To examine the role of psychological factors in workplace financial decisions.

II. LITERATURE REVIEW

Behavioral finance has gained importance as it challenges traditional financial theories that assume investors are rational. Daniel Kahneman and Amos Tversky introduced Prospect Theory, which explains that individuals evaluate gains and losses differently and are more sensitive to losses than gains. This concept of loss aversion highlights the emotional aspect of financial decision-making (Kahneman & Tversky, 1979).

Nicholas Barberis and Richard Thaler identified key cognitive biases such as overconfidence, anchoring, and representativeness that influence investor behavior and lead to market inefficiencies. Similarly, Robert Shiller emphasized that market fluctuations are often driven by investor sentiment and herd behavior rather than fundamental factors . (Barberis & Thaler, 2003; Shiller, 2000)

Research by Terrance Odean shows that overconfidence leads investors to trade excessively, often resulting in lower returns. Werner De Bondt and Richard Thaler introduced the overreaction hypothesis, explaining that investors tend to react strongly to new information, causing significant price fluctuations in the market . (Odean, 1998; De Bondt & Thaler, 1985)

Further, Meir Statman argued that investors are “normal” rather than fully rational, as their decisions are influenced by emotions and personal preferences. Hersh Shefrin also highlighted biases such as mental accounting and regret



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aversion that affect financial decision-making . (Statman, 2019; Shefrin, 2000)

In the Indian context, studies indicate that investor behavior is influenced by financial literacy, social factors, and market awareness, with a strong presence of herd behavior and emotional decision-making. Overall, the literature confirms that psychological factors play a significant role in financial markets and decision-making processes . (Reserve Bank of India, 2023)

III. RESEARCH METHODOLOGY

1. Research Design

The study follows a descriptive and analytical research design. It aims to understand and analyze the impact of investor psychology on financial market behavior and workplace decision-making. The research is quantitative in nature and focuses on identifying relationships between psychological factors and financial decisions.

2. Data Collection

The study is based on primary data collected through a structured questionnaire. The questionnaire includes multiple-choice questions related to demographic details, investment behavior, and psychological biases. Data is collected from 100 respondents, including individual investors and working professionals, using a convenience sampling method.

3. Variables of the Study

Independent Variables (IV):

Investor psychology factors such as emotions (fear, greed), overconfidence, herd behavior, loss aversion, and market sentiment.

Dependent Variables (DV):

Financial behavior including investment decisions, trading activity, risk-taking behavior, market timing, and workplace financial decision-making.

This classification helps in analyzing the relationship between psychological factors and financial outcomes using statistical tools like percentage analysis and the Chi-square test.

IV. DATA ANALYSIS & RESULTS

The analysis shows that the majority of respondents fall in the 21–30 age group, indicating that younger individuals are more actively involved in financial activities and investment decisions. This reflects increasing financial awareness among youth.

The sample consists of both individual investors and working professionals in nearly equal proportion, which provides a balanced understanding of financial behavior from both personal and professional perspectives.

A large proportion of respondents agreed that emotions significantly influence their investment decisions, proving that financial decisions are not purely rational but are affected by psychological factors.

Among various emotions, fear emerged as the most dominant factor, followed by greed and overconfidence. This suggests that investors are more sensitive to potential losses and market uncertainty.

The study clearly identifies the presence of behavioral biases such as herd behavior, loss aversion, anchoring, and confirmation bias, indicating that many investors rely on others' actions, past information, and personal beliefs while making decisions.

It is observed that most respondents prefer a moderate level of risk and engage in occasional trading, which reflects a cautious and balanced investment approach rather than aggressive risk-taking.

A significant number of respondents attempt to time the market and depend on past price trends, which highlights the influence of psychological biases on investment strategies.

The results also show that many respondents practice portfolio diversification, indicating awareness of risk management and an effort to minimize financial losses.

In terms of workplace behavior, it is found that financial and strategic decisions are influenced by psychological factors, although logical analysis and financial evaluation remain the primary approaches.

The application of the Chi-square test confirms a statistically significant relationship between investor psychology (market mood) and financial market behavior. Since the calculated Chi-square value is greater than the critical value, the null hypothesis is rejected, proving that psychological factors have a meaningful impact on financial decisions.

Overall, the findings strongly support the concept of behavioral finance, demonstrating that investor sentiment, emotions, and cognitive biases play a crucial role in shaping financial market trends and decision-making processes.

Finding

The study finds that investor psychology has a strong influence on financial decision-making, indicating that decisions are not purely rational but are affected by emotions and mental biases.

Market sentiment significantly impacts investor behavior, where positive sentiment leads to higher trading activity and risk-taking, while negative sentiment results in cautious and risk-averse behavior.



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The majority of respondents admit that emotions influence their investment choices, confirming the importance of behavioral factors in finance.

Fear is identified as the most dominant emotion, followed by greed and overconfidence, showing that investors are more sensitive to losses than gains.

Behavioral biases such as herd behavior, loss aversion, anchoring, and confirmation bias are widely present among investors, affecting their judgment and decision-making process.

Most investors prefer a moderate level of risk and occasional trading, indicating a balanced approach rather than aggressive investment behavior.

A significant number of respondents try to time the market and rely on past information, which reflects the influence of psychological biases on investment strategies.

The study also finds that portfolio diversification is commonly practiced, showing awareness of risk management among investors.

In workplace settings, financial and managerial decisions are influenced by psychological factors, although logical analysis remains a primary method.

The Chi-square test confirms a significant relationship between investor psychology and financial market behavior, validating the study's hypothesis.

Overall, the findings support the concept of behavioral finance, emphasizing that emotions and cognitive biases play a crucial role in shaping both individual and market-level financial outcomes.

V. CONCLUSION

The study concludes that investor psychology plays a significant role in influencing financial market behavior and decision-making. The findings clearly show that investors do not always act rationally, as their decisions are largely affected by emotions such as fear, greed, and overconfidence, along with cognitive biases like herd behavior and loss aversion.

The results also confirm that these psychological factors impact not only individual investment decisions but also overall market movements, leading to fluctuations and volatility. The Chi-square test further validates that there is a significant relationship between investor sentiment and financial market behavior, proving the relevance of behavioral finance.

In addition, the study highlights that workplace financial decisions are also influenced by psychological factors, although logical and analytical approaches are commonly used.

Overall, the research emphasizes the importance of understanding behavioral aspects in finance. By being

aware of psychological biases, investors and professionals can make more rational decisions, reduce errors, and improve financial outcomes.

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