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ROLE OF BEHAVIOURAL FINANCE IN INVESTMENT DECISION MAKING: AN ANALYSIS OF HERDING, DEMOGRAPHICS, AND ESG FACTORS

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ABSTRACT

This study makes it clear that financial decisions are not made only with numbers. They are also shaped by psychology, emotions, and culture. The abstract introduces the key areas of the paper like herding behaviour, demographics, and ESG factors. It also highlights why behavioural finance is very important for students and future investors to understand. The goal is to make students realise that behind every chart and number, there are human decisions influenced by fear, confidence, and ethical choices.

Investment decisions are rarely the outcome of purely rational analysis. Traditional financial theories assume that investors carefully calculate risks and returns before acting. In reality, markets often display patterns that are inconsistent with rationality, such as bubbles, crashes, and irrational exuberance. This paper explores the influence of behavioural finance on investment decision-making, with special reference to herding behaviour, demographic factors, and Environmental, Social, and Governance (ESG) considerations. The study integrates insights from existing literature and primary survey responses to show how psychological biases, fear of missing out (FOMO), and demographic differences influence choices in financial markets. It also examines the increasing significance of ESG-based investing as investors seek ethical and sustainable avenues. The findings highlight that investment behaviour is shaped not only by financial data but also by emotions, cultural background, and social influence. The paper concludes that behavioural finance is critical for understanding real-world investor behaviour and recommends strategies for policymakers, advisors, and investors to mitigate irrationality in financial markets.

1. INTRODUCTION

Background

In simple words, traditional finance assumed investors act like robots, always logical. But in real life, investors behave like humans — emotional and sometimes irrational. Events like stock market crashes show us that crowd behaviour often decides prices more than pure analysis. This paper sets the foundation by introducing these ideas in a way that is easier for students to connect with everyday examples, like how friends might invest in the same scheme without research just because others are doing it.

Finance as an academic discipline has historically been dominated by rational models. The Efficient Market Hypothesis (Fama, 1970) argued that markets incorporate all available information, leaving no scope for consistent abnormal returns. Similarly, Modern Portfolio Theory (Markowitz, 1952) assumed that investors make rational choices to maximize returns at acceptable levels of risk. These models painted an idealized picture of financial markets that are efficient and logical. However, the repeated occurrence of market anomalies has challenged these assumptions. The dot-com bubble of the late 1990s and the global financial crisis of 2008 are prime examples of how mass psychology, speculation, and herd mentality can drive markets to extremes. These events demonstrated that investors are not always rational and often act on emotions such as fear, greed, and overconfidence.

This realization gave rise to behavioural finance, an interdisciplinary field that combines psychology and finance to explain how cognitive biases and emotions affect financial decisions. Behavioural finance questions the assumption of perfect rationality and acknowledges that real-world investors are prone to errors in judgment. A major behavioural phenomenon studied in this context is herding behaviour, which occurs when individuals imitate the actions of a larger group rather than relying on their independent judgment. Herding often leads to excessive optimism or pessimism in the market, creating bubbles or panic-driven crashes.

Apart from psychological factors, demographic variables such as age, gender, occupation, marital status, and education significantly influence investment preferences. Younger investors, for example, are generally more risk-

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seeking, whereas older investors prefer safer instruments. Women are often found to be more risk-averse compared to men, while income levels determine the scope of diversification. In recent years, the idea of sustainable and responsible investing has gained prominence through the ESG framework. ESG stands for Environmental, Social, and Governance factors, which investors increasingly consider alongside financial returns. Companies are evaluated not only on profitability but also on their commitment to sustainability, social responsibility, and ethical governance. This trend reflects a shift in investor priorities from short-term profits to long-term societal value creation. Thus, the present study focuses on three critical aspects of behavioural finance: herding behaviour, demographic influences, and ESG considerations, to provide a holistic view of how investors make decisions in contemporary financial markets.

2. REVIEW OF LITERATURE

The literature on behavioral finance has grown significantly over the past few decades, offering insights into the role of psychology and sociology in investment decisions.

Biases and Emotions in Investing:

Bikas (2013) examined the role of emotions in influencing investor behavior, noting that men tend to trade more frequently than women, often due to overconfidence. Women, on the other hand, were more cautious, reflecting a higher degree of risk aversion. This study underscored the importance of gender in shaping financial behaviour. Pujara (2020) focused on Indian investors and identified the strong role of demographic factors such as age, income, and education in determining susceptibility to behavioural biases like regret aversion, anchoring, and overconfidence. Younger investors, in particular, displayed impulsiveness and short-term orientation, while older investors exhibited conservative tendencies.

Herding Behavior:

Rosy Dhall (2020) analyzed the Indian stock market during the COVID-19 pandemic and concluded that herding behavior intensified during periods of uncertainty and volatility. Investors tended to mimic others rather than making independent judgments, leading to significant deviations from fundamental values. Similarly, Patka (2024) employed the CSAD model to demonstrate that herding in India is prevalent during high trading periods, especially when markets experience structural shocks.

Cultural and Social Influences:

Amoah (2024) studied investor behaviour in Ghana and found that cultural and social comfort often outweighed rational financial analysis. Investors trusted community advice and intuition over statistical models, highlighting the embeddedness of finance in culture.

Women and Behavioural Finance:

Kumar (2020) explored the role of demographic parameters among women investors, finding that education, marital status, and occupation significantly affected their investment preferences. The study highlighted how women investors balanced financial goals with family and social responsibilities.

Digital Investing Behaviour:

Li & Wang (2021) examined how digital trading platforms influence impulsive decisions among retail investors. The study found that younger investors exhibit higher levels of overconfidence and are more likely to invest based on market trends influenced by social media.

Social Media and Millennial Investors:

Singh & Mehta (2022) studied the role of social media in shaping investment decisions of Indian millennials, concluding that social networking and online discussions increase herding tendencies and short-term trading behaviour.

ESG and Sustainable Investing:

Olsen (2023) explored the psychological foundations of ESG investing, showing that ethical and sustainable preferences are increasingly driving portfolio decisions, especially among younger investors concerned with global issues.

Financial Literacy and Demographics:

Rao & Sharma (2024) analyzed the relationship between financial literacy, behavioral biases, and demographic factors. Their study revealed that better financial awareness reduces susceptibility to biases and herding effects in the Indian context.

Overall, the literature strongly suggests that investment behavior cannot be explained by rational models alone. Instead, behavioral biases, cultural influences, demographics, and sustainability concerns must be considered for a more accurate understanding.

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3. RESEARCH OBJECTIVES

To examine the role of demographic factors such as age, gender, marital status, and occupation in shaping investor psychology.

To analyze how herding behaviour and behavioural biases influence investment decision-making.

To evaluate the significance of ESG considerations in modern investment strategies.

4. RESEARCH METHODOLOGY

In simpler terms, methodology is the way researchers collect and analyse information. This study uses surveys, which are easy to understand for students. It asked people about their age, gender, income, and investment choices. Then the answers were studied to find patterns. By using descriptive methods, researchers could clearly see how factors like gender or age influenced decisions. The use of graphs and percentages makes it easier to present the findings to both students and policymakers.

This study is based on a quantitative approach designed to capture the complex interplay of psychological, social, and demographic factors in investment decisions.

Research Design:

The study follows a descriptive research design to identify and explain behavioural patterns among investors.

Sampling Method:

Simple random sampling was employed to ensure that participants represented diverse backgrounds. Respondents included students, working professionals, homemakers, and retirees.

Data Collection:

A structured questionnaire was developed, consisting of three sections: demographic information, behavioural tendencies (herding, biases, and risk perception), and attitudes toward ESG investing.

Sample Size:

The study surveyed a sizeable number of respondents from various age and income groups, ensuring a broad representation of perspectives.

Data Analysis:

Statistical tools such as frequency analysis and cross-tabulation were used to interpret the data. Percentages were calculated to assess the distribution of responses across demographic and behavioural variables.

This methodology provided reliable insights into how demographics, biases, and ESG considerations interact to shape investment decisions.

5. FINDINGS AND DISCUSSION

Women often choose safe investments, while men are more willing to take risks. Young students prefer quick gains and are influenced by social media trends. Herding was found when people invested only because their peers were investing. ESG (Environmental, Social, and Governance) factors are new but very important. Many investors today prefer investing in companies that care about the environment and society, even if returns are a little lower. The discussion also connects these results to earlier studies, showing how global findings match Indian conditions.

Demographic Influences:

The analysis showed that gender plays a significant role in investment choices. Women were more conservative, preferring fixed deposits and safe investments, while men exhibited higher levels of trading and risk-taking behaviour. Younger investors (18–24 years) formed the majority of the sample and demonstrated a strong reliance on technology and peer networks when making decisions. Single respondents were more open to risk compared to married individuals, who considered long-term financial stability.

Herding Behaviour:

Nearly half of the respondents admitted to being influenced by herding. About 70% followed market trends, 25% relied on media, and 10% depended on peer recommendations. The dominance of FOMO (Fear of Missing Out) was evident among young investors who rushed into trending stocks without analyzing fundamentals.

ESG Considerations:

The survey revealed that more than half of the investors considered ESG as an important factor in their decisions. Around 50% were willing to compromise on financial returns to support sustainable and ethical investments. However, a majority also expressed skepticism about the consistency of ESG ratings, reflecting the need for regulatory oversight. Women investors, in particular, displayed stronger preferences for ESG-compliant investments.

Discussion:

The findings align with existing literature, confirming that demographics and behavioural biases strongly influence financial behaviour. Herding behaviour is prevalent in the Indian market, particularly in times of uncertainty. ESG considerations, while growing in significance, are still constrained by challenges of transparency and standardization.

Implications of the Study

For students, this section shows why behavioural finance matters for real life. It tells investors to learn from mistakes and avoid blindly following the crowd. It tells policymakers to improve financial literacy and make ESG rules stronger. It tells advisors to understand their clients' emotions, not just their money. These implications make the paper practical and useful beyond theory.

The study has important implications for different stakeholders:

For Investors: Awareness of behavioural biases can help individuals make rational decisions rather than following the crowd. Financial literacy programs can empower investors to analyze fundamentals before acting.

For Advisors: Financial advisors must recognize the psychological tendencies of clients and design strategies that accommodate emotional and social factors alongside financial goals.

For Policymakers: Regulators should ensure standardization and credibility in ESG reporting to promote sustainable investing. Investor education campaigns can also reduce irrational behaviour in markets.

6. CONCLUSION

In conclusion, behavioural finance proves that humans are not always rational investors. By mixing psychology and finance, we get a real picture of how markets work. The study also suggests future research, like checking how digital apps or cryptocurrencies influence young investors. This makes the study relevant for students who will be tomorrow's investors.

The study concludes that behavioural finance is indispensable in understanding modern investment decision-making. Investors are influenced by a mixture of logic, psychology, and social cues. Herding behaviour, demographic characteristics, and ethical considerations all play critical roles in shaping choices. While behavioural biases often lead to irrationality, the rise of ESG reflects a positive shift towards responsible investing.

Future research can expand this study by including institutional investors, comparing rural and urban investor behaviour, or analyzing the impact of behavioural finance in emerging asset classes such as cryptocurrencies. Longitudinal studies could also help in understanding how behavioural patterns evolve over time.

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