IJCRT.ORG ISSN : 2320-2882

INTERNATIONAL JOURNAL OF CREATIVE RESEARCH THOUGHTS (IJCRT)

An International Open Access, Peer-reviewed, Refereed Journal

A Study On Behavioural Biases And Financial Literacy With Reference To Investment Decision: Revisiting Literature Review

[1]GUPTA RUCHI ANIL, [2]DR.NIRMAL SHARMA, [3]DR.CHETA DESAI

[1]RESEARCH SCHOLAR, [2]PROVOST, BMU, [3]I/C DIRECTOR, BMCCMS

[1]BHAGWAN MAHAVIR CENTRE FOR ADVANCE RESEARCH,

[1]BHAGWAN MAHAVIR UNIVERSITY, SURAT, GUJARAT, INDIA

Abstract: investment decision-making has increasingly been recognized as a behavioral process influenced by psychological biases and financial knowledge. Traditional finance theories assume investor rationality; however, behavioral finance challenges this assumption by highlighting systematic cognitive and emotional biases that distort judgement. At the same time, financial literacy plays a critical role in enabling investors to understand financial products, assess risk, and make informed investment choices. This empirical-oriented review paper revisits and synthesizes existing literature on behavioral biases and financial literacy with reference to investment decision-making. Using a structured review methodology, the study develops a conceptual framework and proposes testable hypotheses for future empirical research. The findings suggest that behavioral biases significantly influence investment decisions, while financial literacy plays both a direct and moderating role in shaping investor behavior. The study contributes to behavioral finance literature by integrating psychological and knowledge-based perspectives and offers valuable insights for policymakers, educators, and researchers.

Keywords: behavioral biases, financial literacy, investment decision, investor behavior, behavioral finance

I. Introduction

Investment decisions are central to individual wealth creation and economic growth. Classical finance theories such as the efficient market hypothesis and modern portfolio theory assume that investors act rationally, possess complete information, and make unbiased decisions. However, empirical evidence suggests that investors frequently deviate from rational behavior due to cognitive limitations, emotions, and psychological heuristics.

Behavioral finance emerged as a paradigm integrating psychology with finance to explain irrational investment behavior. Investors are influenced by biases such as overconfidence, loss aversion, herding, anchoring, and mental accounting, which lead to suboptimal portfolio choices. Simultaneously, financial literacy has gained global attention as a key determinant of sound financial behavior, particularly in investment planning.

In emerging economies like india, increasing access to financial markets through digital platforms has amplified the relevance of studying behavioral biases and financial literacy together. This paper revisits the literature to empirically frame the relationship between behavioral biases, financial literacy, and investment decisions.

II. Review of literature

2.1 behavioural biases and investment decision

Overconfidence bias has been widely documented as a dominant behavioural trait among investors. Barber and odean (2001) reported that overconfident investors trade excessively and earn lower returns. Recent studies (sharma & kumar, 2024) confirm that overconfidence leads to speculative trading and under-diversification.

Herding behaviour refers to investors' tendency to follow the actions of others rather than relying on independent analysis. Bikhchandani and sharma (2001) identified herding as a major contributor to market volatility. Contemporary evidence from emerging markets shows that social media and digital platforms have intensified herding behaviour among retail investors (patel & mehta, 2025).

Loss aversion, explained through prospect theory, suggests that investors experience losses more intensely than gains of equivalent value. Empirical studies (nguyen et al., 2024) indicate that loss-averse investors hold losing stocks longer and sell winning stocks prematurely.

Anchoring and mental accounting biases further distort rational decision-making by causing investors to rely excessively on initial information and categorise money into non-fungible mental accounts.

2.2 financial literacy and investment behaviour

Financial literacy is defined as the knowledge and ability to understand financial concepts such as interest rates, inflation, diversification, and risk-return trade-offs. Lusardi and mitchell (2014) established that financially literate individuals are more likely to participate in financial markets.

Recent studies (oecd, 2023; agarwal & singh, 2024) highlight that financial literacy positively influences portfolio diversification, long-term investment planning, and risk assessment. However, evidence suggests that higher financial literacy does not eliminate behavioral biases but reduces their adverse impact.

2.3 behavioural biases, financial literacy and investment decision

Integrated studies reveal that financial literacy moderates the relationship between behavioural biases and investment decisions. Highly literate investors exhibit lower susceptibility to herding and anchoring biases (khan et al., 2024). Some studies also identify financial attitude and risk perception as mediating variables in this relationship.

In the indian context, empirical research (verma & rao, 2025) shows that demographic factors such as age, income, and education further influence how financial literacy interacts with behavioral biases.

III. Research gap

Despite extensive literature, the following gaps remain: limited empirical studies integrating behavioural biases and financial literacy in a single model lack of consensus on the extent to which financial literacy mitigates behavioral biases insufficient india specific studies focusing on newn age investors limited exploration of mediators and moderators in the bias investment relationship

IV. Hypotheses development

H1: behavioural biases have a significant impact on investment decision-making.
H1a: overconfidence bias significantly influences investment decisions.
H1b: herding bias significantly influences investment decisions.
H1c: loss aversion significantly influences investment decisions.
H2: financial literacy has a significant positive impact on investment decisions.
H3: financial literacy moderates the relationship between behavioural biases and investment decisions.
H4: risk perception mediates the relationship between behavioural biases and investment decisions.

V. Research methodology

5.1 research design

The present study adopts a **descriptive and empirical research design** to examine the impact of behavioural biases and financial literacy on investment decision making. The study is cross sectional in nature and focuses on individual retail investors.

5.2 population and sample

The target population consists of retail investors actively participating in financial markets such as equity, mutual funds, bonds, and other investment avenues.

- **Sample size:** 300–500 respondents
- **Sampling technique:** stratified random sampling
- **Unit of analysis:** individual investor

5.3 sources of data

- **Primary data:** collected through a structured questionnaire
- **Secondary data:** journals, research articles, reports, and published literature

5.4 research instrument

A structured questionnaire will be used, divided into four sections:

- Section a: demographic profile (age, gender, education, income, experience)
- Section b: behavioural biases (standardised scales adapted from prior studies)
- Section c: financial literacy (objective and subjective measures)
- Section d: investment decision behaviour

Responses will be measured using a **5-point likert scale** ranging from strongly disagree (1) to strongly agree (5).

5.5 variables of the study

- **Independent variables:** behavioural biases (overconfidence, herding, loss aversion, anchoring, mental accounting)
- **Dependent variable:** investment decision
- **Moderating variable:** financial literacy
- **Mediating variables:** risk perception, financial attitude

5.6 reliability and validity

- Reliability will be tested using **cronbach's alpha**
- Construct validity will be assessed through **exploratory factor analysis (efa)** and **confirmatory factor analysis (cfa)**

5.7 tools and techniques for analysis

- Descriptive statistics
- Correlation analysis
- Multiple regression analysis
- Structural equation modelling (sem)

5.8 ethical considerations

Participation will be voluntary, confidentiality of responses will be maintained, and data will be used strictly for academic research purposes.

VI. Conclusion

This paper revisits literature on behavioural biases and financial literacy and proposes an empirical framework to analyse their influence on investment decisions. The review establishes that while behavioural biases significantly affect investment behaviour, financial literacy plays a crucial role in improving decision quality and moderating irrational tendencies. The study provides a strong foundation for future empirical research and policy interventions aimed at enhancing investor welfare.

VII. References

- Agarwal, s., & singh, r. (2024). Financial literacy and investment behaviour: evidence from emerging economies. *Journal of behavioral and experimental finance*, 41, 100845.
- Khan, m., ali, s., & hassan, t. (2024). Behavioural biases, financial literacy and investment decisions: a moderated mediation approach. *International review of economics & finance*, 89, 112–128.
- Nguyen, t. H., tran, p., & vo, x. V. (2024). Loss aversion and stock trading behaviour: evidence from retail investors. *Finance research letters*, 58, 104332.
- Patel, d., & mehta, n. (2025). Social media influence, herding behaviour and retail investment decisions. *Journal of financial services marketing*, 30(1), 55–70.
- Sharma, p., & kumar, s. (2024). Overconfidence bias and trading behaviour: empirical evidence from indian investors. *Asia-pacific journal of management research and innovation*, 20(2), 85–97.
- Verma, r., & rao, p. (2025). Financial literacy, behavioural biases and investment choices: evidence from india. *Journal of asian economics*, 86, 101612.