Impact of Psychological Biases on Individual Investors Investment Decision Making: Mediation by Risk Perception

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Psychologists found that investors do not behave as traditional finance economist says rationally instead investors' psychology influences their investment decision-making. This research aims to determine the impact of psychological biases on individual investors' investment decision-making in the Indian stock market. Also, attempt to examine the mediating role of risk perception of the individual investors. A cross-sectional study was done through the structured and closed-ended questionnaire. The five-point Likert scale had used to collect data from 704 individual investors. The content validity, reliability, and construct validity of survey instrument was checked through SPSS and AMOS graphics software under the pilot study. Under this study, higher-order measurement invariance analysis of psychological biases comprised two second-order factors and ten zero-order constructs used. The relationship of psychological biases, individual investment decisions measured through SEM, and the mediation effect of risk perception was checked by the Baron and Kenny method. This research provides empirical insight into how psychological biases impact the investment decision-making of individual investors in the Indian stock market. The results show the psychological biases have a positive and significant impact on the irrational investment decision-making of individual investors. Individual investors are susceptible to psychological biases, use mental shortcuts while making investment decisions, and make irrational investment decisions. Risk perception partially mediates the relationship between psychological biases and irrational investment decision-making. The stock market is highly volatile that creates an uncertain and risky situation. Due to uncertainty and risk, investors perceive risk and use mental shortcuts instead of analysing in-depth available information while making investment decisions and making poor decisions. The results of the research have relevant implications for investors, stock market regulators, and researchers. It encourages the investors to understand and avoid to susceptible to psychological biases while making an investment decision. Even this research also helps other financial practitioners like financial advisors to understand the psychological biases of their own and their clients. Furthermore, this study also helps stock market regulators and policymakers that investor's psychology plays a vital role in investment decision-making. This paper also provides insight to researchers on how to report and apply higher-order measurement invariance analysis in SEM.

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