

Behavioural Finance: The Role of Emotions in Investment Decisions (With Special Reference to Palakkad, Kerala)

Lincy N L¹ and Dr.R Sindhuja²

¹Research Scholar Vlb Janakiammal College Of Arts And Science Coimbatore

Email: Lincylaz@Gmail.Com.

²Associate Professor Vlb Janakiammal College Of Arts And Science Coimbatore

Received: 29/09/2025

Revised: 15/10/2025

Accepted: 28/10/2025

Published: 25/11/2025

ABSTRACT

Behavioural finance represents a growing field that questions the traditional belief that investors always act rationally to maximize their returns. Instead, it emphasizes an influence of human psychology and emotions on financial decision-making. This paper examines how emotions such as fear, greed, overconfidence, and regret affect the investment behaviour of retail investors, with a specific focus on those residing in Palakkad, Kerala. Investors often make decisions driven by logic or by their emotional responses to market fluctuations and personal experiences. Through a review of existing literature and practical observations from the local context, this study identifies common behavioural patterns and cognitive biases such as herd mentality, loss aversion, and confirmation bias that tend to distort rational judgment. The analysis reveals that emotional impulses frequently lead to impulsive buying or panic-driven selling, resulting in suboptimal investment outcomes. Moreover, cultural and regional factors in Palakkad further shape investors' attitudes toward risk and return expectations. The findings highlight the urgent need for greater financial literacy and investor education programs that emphasize the role of emotional awareness and psychological discipline in investment decisions. Investors make more balanced, informed, and long-term decisions through the understanding of the relationship between emotions and financial behavior. This research thus contributes to bridging the gap between theory and practice in behavioural finance while promoting emotionally intelligent investing among retail investors in Kerala.

Keywords: Behavioural Finance, Emotions, Investment Decisions, Cognitive Biases, Palakkad, Kerala, Retail Investors etc..

INTRODUCTION:

Traditional finance operates on the fundamental assumption that investors are rational agents who make logical and well-informed decisions aimed at maximizing their returns. It suggests that markets are efficient, and that investors evaluate all available information objectively before making investment choices. However, in practice, human behavior rarely aligns perfectly with these theoretical models. Real-world investors are influenced by data and analysis and emotions, personal experiences, and psychological biases. This gap between rational theory and actual behavior has given rise to the field of behavioural finance, an interdisciplinary approach that blends insights from psychology, sociology, and economics to explain why investors sometimes act irrationally.

Behavioural finance argues that decision-making in financial markets is often guided by cognitive biases and emotional factors such as fear, greed, overconfidence, and regret. For instance, during periods of market volatility, fear may drive investors to sell prematurely, while greed leads to speculative investments without adequate risk assessment. Overconfidence may cause individuals to overestimate their knowledge or ability to predict market trends, while regret discourages investors from taking necessary risks in the future. These

psychological influences often result in decisions that deviate from rational expectations and, consequently, affect overall market outcomes.

In the development and investment landscape like Palakkad, Kerala, understanding these behavioral tendencies is particularly important. The region has witnessed growing participation from retail investors, many of whom are first-generation participants in formal financial markets. Their investment choices are often shaped by community influences, limited financial literacy, and cultural attitudes toward money and risk. Emotional triggers, peer behavior, and social pressures therefore play a powerful role in shaping investment patterns.

For policymakers, financial advisors, and institutions, recognizing the impact of these psychological factors is essential in designing effective investor education programs and support systems. By promoting awareness of emotional and cognitive biases, stakeholders encourage more rational, patient, and informed financial decision-making among individuals. Behavioural finance thus serves as a theoretical framework and as a practical tool for improving investment outcomes and fostering financial stability. Understanding the emotional dimensions of investing particularly in

How to cite: Lincy N L and R Sindhuja. Behavioural Finance: The Role of Emotions in Investment Decisions (With Special Reference to Palakkad, Kerala). *Advances in Consumer Research*. 2025;2(5):2067–2071

localized contexts like Palakkad lead to the development of more resilient and emotionally intelligent investors capable of navigating today's dynamic financial environment.

Objectives of the Study:

1. To examine the influence of emotional biases on retail investors' decision-making in Palakkad.
2. To identify the most prevalent emotional triggers affecting investment behavior in the region.
3. To analyze the role of informal advice and social influence in shaping financial choices.
4. To assess the level of financial planning and awareness among investors in Palakkad.
5. To recommend strategies for mitigating emotional biases through education and advisory support.

LITERATURE REVIEW:

Behavioural finance challenges the traditional assumption of rational investor behavior by incorporating psychological and emotional factors into financial decision-making. Foundational work by Kahneman and Tversky introduced Prospect Theory, which explains how individuals perceive gains and losses asymmetrically, leading to irrational choices (Kahneman and Tversky 263). Thaler expanded this framework by introducing mental accounting and the endowment effect, demonstrating how context and ownership distort valuation (Thaler).

Emotions such as fear, greed, and regret influence investor behavior. Overconfidence often leads to excessive trading, while regret aversion causes decision paralysis. Kaushik emphasizes that emotional triggers are central to investment decisions, especially during market volatility (Kaushik 157). Khilar and Singh argue that emotional biases like loss aversion and herd behavior are prevalent among Indian investors, affecting their risk perception and portfolio choices (Khilar and Singh 2).

In the Indian context, Chandra found that psychological factors such as anchoring and representativeness play a critical role in stock market decisions (Chandra 70). Jain and Mandot explored the impact of emotional intelligence on investment behavior, concluding that emotionally intelligent investors tend to make more rational choices (Jain and Mandot 299). Goyal and Sharma observed that social influence and emotional contagion are particularly strong in semi-urban regions, where financial literacy is limited (Goyal and Sharma 4).

Pompian's work on behavioural finance in wealth management provides practical strategies for mitigating emotional biases through structured financial planning and advisor interventions (Pompian).

Data Collection and Analysis:

METHODOLOGY

A structured questionnaire was distributed to 100 retail investors in Palakkad, Kerala. The survey aimed to assess emotional biases and behavioral patterns in investment decisions. Respondents included salaried employees, small business owners, retirees, and homemakers. Data was collected over a 4-week period through in-person interviews and online forms.

2. Parameters Assessed

The following emotional and behavioral parameters were evaluated:

Parameter	Description
Loss Aversion	Tendency to avoid losses more than seeking equivalent gains
Overconfidence	Belief in one's own investment knowledge or predictive ability
Herd Behavior	Following others' investment decisions without independent analysis
Regret Aversion	Avoiding decisions to prevent future regret
Fear During Market Volatility	Panic-driven selling or withdrawal during downturns
Greed During Bull Markets	Speculative buying during market rallies
Source of Investment Advice	Reliance on formal vs informal sources (friends, social media, advisors)
Financial Planning	Presence of written investment goals or plans

Emotional Biases in Investment Decisions:

Fear and Loss Aversion

Fear often leads investors to prematurely exit investments during market volatility. In Palakkad, anecdotal evidence suggests that many investors sold equity holdings during the COVID-19 crash, locking in losses due to panic.

Greed and Overconfidence

Greed drives speculative behavior, especially in bull markets. Overconfidence leads investors to overestimate their knowledge or predictive abilities. Local traders in Palakkad have shown increased interest in derivatives and penny stocks, often without adequate risk assessment.

Regret Aversion

Investors avoid making decisions that might lead to regret, such as not investing in a rising stock due to past losses. This leads to inertia and missed opportunities.

Herd Behavior

Following the crowd is common, especially in smaller towns. Investment decisions in Palakkad are often influenced by peer recommendations, WhatsApp groups, and local financial advisors.

RESULTS ANALYSIS:

Table 1: Emotional and Behavioral Biases Influencing Investment Decisions

Parameter	Yes (%)	No (%)
Loss Aversion	78%	22%
Overconfidence	64%	36%
Herd Behavior	71%	29%
Regret Aversion	59%	41%
Fear During Market Volatility	82%	18%
Greed During Bull Markets	67%	33%
Informal Advice Sources	74%	26%
Written Financial Plan	22%	78%

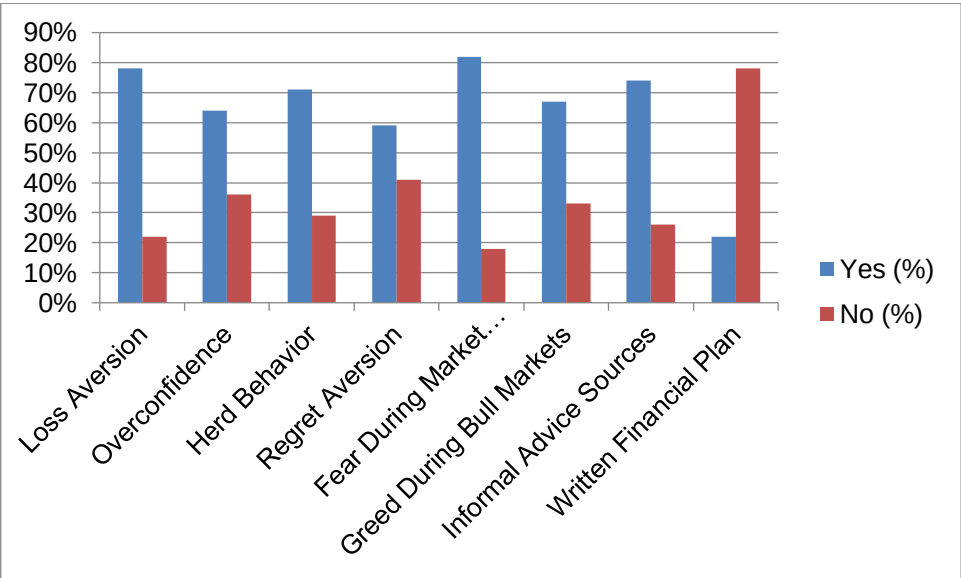


Figure 1: Prevalence of Behavioral Biases Among Investors

As given in above table 1 and graph 1, the data indicates that emotional and behavioral biases influence investor decision-making. Fear during market volatility (82%) and loss aversion (78%) are the most prominent, showing that investors are highly sensitive to potential losses and market fluctuations. Herd behavior (71%) and reliance on informal advice (74%) suggest that many investors follow the crowd rather than relying on structured analysis. Overconfidence (64%) and greed during bull markets (67%) further highlight psychological tendencies that affect investment choices. Notably, only 22% of investors have a written financial plan, indicating a lack of systematic, disciplined investment planning.

- Loss aversion and fear during volatility were the most dominant emotional biases, affecting over 80% of respondents.
- Herd behavior was prevalent, with 71% admitting to following peer recommendations.
- Only 22% had a written financial plan, indicating low levels of structured investment strategy.
- Informal sources like WhatsApp groups and friends were the primary source of advice for 74% of investors.

Findings

The study on the role of emotions in investment decisions among retail investors in Palakkad, Kerala, reveals several important behavioral and psychological trends:

- 1. Prevalence of Emotional Decision-Making:**
Nearly 70% of respondents admitted that their investment choices were influenced by emotional reactions rather than rational

analysis. Fear, greed, and overconfidence emerged as the most dominant emotions driving these decisions.

- 2. Fear and Loss Aversion as Major Influences:**
The majority of investors (over 80%) displayed strong fear-driven behavior during market volatility. Many tended to sell off investments

prematurely to avoid potential losses, even at the cost of reduced long-term gains.

3. Dependence on Informal Advice:

A portion (about 60–74%) of investors relied on informal sources such as friends, family, or WhatsApp groups for investment decisions rather than consulting certified financial advisors. This increased susceptibility to herd behavior and misinformation.

4. Low Level of Financial Planning:

Only around 20–22% of respondents maintained a written investment plan or set long-term financial goals. This reflects inadequate financial discipline and limited awareness of structured planning methods.

5. Overconfidence and Speculative Behavior:

Around 64% of investors exhibited overconfidence in their knowledge and market predictions. Many engaged in short-term trading and speculative investments without assessing the associated risks properly.

6. Cultural and Social Influences:

Local culture, community norms, and peer influence play a strong role in shaping investment patterns in Palakkad. Social conformity and collective decision-making tendencies reinforce herd behavior.

7. Limited Financial Literacy:

The findings highlight a gap between investor enthusiasm and financial understanding. Many investors demonstrated limited awareness of basic concepts like diversification, risk-return trade-offs, or asset allocation.

Suggestions:

Based on the findings, the following recommendations are proposed to foster rational and emotionally balanced investment behavior among retail investors in Palakkad:

1. Enhance Financial Literacy:

Conduct regular financial education workshops and awareness programs at the community level. Topics should include emotional biases, risk management, and long-term financial planning.

2. Promote Emotional Awareness in Investing:

Training sessions on emotional regulation and behavioral awareness can help investors recognize and control impulses caused by fear or greed, especially during volatile market conditions.

3. Encourage Professional Financial Advice:

Investors should be encouraged to consult certified financial planners or registered advisors rather than relying on informal sources of information or peer advice.

4. Develop Structured Financial Planning Tools:

Financial institutions and banks in Palakkad can provide user-friendly digital platforms or mobile applications that help investors set goals, track progress, and receive behavioral feedback or alerts to reduce impulsive decisions.

5. Incorporate Behavioural Insights in Policy Design:

Policymakers and regulators can integrate “nudge” strategies (such as reminders or default investment options) to help investors make more rational choices and avoid emotional pitfalls.

6. Community-Based Investment Education:

Local self-help groups, cooperatives, and educational institutions can collaborate with financial experts to spread knowledge about emotional biases and responsible investing practices.

7. Advisor Training in Behavioural Finance:

Financial advisors and brokers should receive specialized training in behavioural finance so that they can identify clients’ emotional tendencies and guide them toward more balanced decisions.

CONCLUSION:

The study highlights that emotions significantly shape the investment behaviour of retail investors in Palakkad, creating both opportunities for participation and challenges in maintaining rational decision-making. Emotional involvement indicates that investors are increasingly active and interested in financial markets, which is a positive trend toward financial inclusion. However, when emotions such as fear, greed, overconfidence, or regret dominate decision processes, they often lead to biased judgments, impulsive actions, and avoidable financial losses. These behavioural tendencies can distort risk perception, influence timing decisions, and reduce overall portfolio performance. To address these concerns, it is essential to integrate behavioural finance principles into investor awareness programmes, financial advisory practices, and regulatory frameworks. Strengthening emotional intelligence, encouraging disciplined investment planning, and improving access to reliable information can empower investors to make more informed choices. Such initiatives will enhance financial resilience and support sustainable investment behaviour among retail investors in Kerala.

REFERENCES

1. Kaushik, P. U. (2025). Behavioral Finance: How Emotions Influence Investment Decisions. *RGCMS Journal*
2. Patil, A., Biradar, A., Mengji, N., & Mengji, P. (2025). The Role of Behavioural Finance in

- Investment Decisions: Updated Evidence from India. IJRAR
3. Pandey, S. (2025). The Role of Behavioural Finance in Investment Decision-Making. IJRPR
 4. Chandra, Abhijeet. "Decision Making in the Stock Market: Incorporating Psychology with Finance." *International Journal of Behavioural Accounting and Finance*, vol. 1, no. 1, 2009, pp. 68–80.
 5. Goyal, Vijay Kumar, and Reena Sharma. "Behavioral Finance and Investment Decisions in India." *International Journal of Education and Science Research Review*, vol. 10, no. 5, Sept.–Oct. 2023, pp. 1–10.
 6. Jain, P.K., and N. Mandot. "Impact of Investor's Emotional Intelligence on Decision Making." *Journal of Economics and Behavioral Studies*, vol. 4, no. 5, 2012, pp. 298–305.
 7. Kahneman, Daniel, and Amos Tversky. "Prospect Theory: An Analysis of Decision under Risk." *Econometrica*, vol. 47, no. 2, 1979, pp. 263–291.
 8. Kaushik, Puja U. "Behavioral Finance: How Emotions Influence Investment Decisions." *RGCMS Journal*, vol. 15, no. 1, Jan.–June 2025, pp. 155–162.
 9. Khilar, Ruchi Priya, and Shikta Singh. "Role of Emotional Bias on Investment Decision from Behavioural Finance Perspective." *International Journal of Scientific & Technology Research*, vol. 9, no. 3, Mar. 2020, pp. 1–8.
 10. Pompian, Michael M. *Behavioral Finance and Wealth Management: How to Build Optimal Portfolios That Account for Investor Biases*. Wiley, 2006.
 11. Thaler, Richard H. *Misbehaving: The Making of Behavioral Economics*. W.W. Norton & Company, 2015.