

Behavioural Finance and Investment Decision Making: Understanding the Psychology Behind Market Choices

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Abstract: *This study explores the intersection of psychology and financial decision-making through the lens of behavioural finance, challenging the traditional notion of investor rationality embedded in classical financial theories. While conventional models assume markets are efficient and investors act logically, behavioural finance reveals that emotional, cognitive, and social factors significantly influence investment decisions. The purpose of this research is to identify and analyse key behavioural biases such as overconfidence, loss aversion, herd mentality, anchoring, and mental accounting and their impact on individual and institutional investment behaviours. Employing a qualitative-descriptive research design, this study reviews relevant literature, real-world case studies, and psychological theories to highlight how these biases contribute to market anomalies and suboptimal decisions. The findings suggest that behavioural factors not only distort investor judgment but also affect market dynamics in measurable ways. Furthermore, the study evaluates mitigation strategies including financial education, regulatory frameworks, and the integration of technology such as robo-advisors. By understanding the behavioural underpinnings of investment choices, this research underscores the need for a more psychologically informed approach to financial decision-making and policymaking. Behavioural finance challenges the traditional assumptions of investor rationality in classical finance theories by integrating psychological insights into financial decision-making. This article explores the fundamental concepts of behavioural finance and its implications on investment behaviour, highlighting cognitive biases such as overconfidence, anchoring, herd behaviour, and loss aversion. By evaluating empirical studies and theoretical models, the article identifies how psychological factors often lead to suboptimal investment decisions. It also discusses strategies to mitigate these biases, such as nudges, financial education, and technology-based advisory tools. This study aims to bridge the gap between rational financial models and the reality of human behaviour in investment decisions.*

Keywords: Cognitive biases, Emotional heuristics, Investor psychology, Market anomalies, Prospect theory, financial irrationality, Risk perception, Trading patterns, Decision framing, financial behaviour models

Introduction

Traditional financial theories such as the Efficient Market Hypothesis EMH and Modern Portfolio Theory MPT have long assumed that investors are rational actors who make decisions aimed at maximizing utility based on complete and accurate information. However, real-world financial behaviour often contradicts these assumptions. Markets frequently display anomalies, investors make

inconsistent choices, and irrational exuberance or panic can lead to bubbles and crashes. These discrepancies have led to the emergence of behavioural finance, an interdisciplinary field that draws on psychology, economics, and finance to better understand how individuals and institutions actually make investment decisions. The purpose of this study is to explore the psychological and emotional dimensions that influence financial decision-making. It seeks to identify the most prevalent behavioural biases such as overconfidence, anchoring, herd mentality, mental accounting, and loss aversion and analyse their effects on individual and group investment behaviours. The scope includes examining both micro-level decisions by retail investors and macro-level patterns affecting markets more broadly. This approach is particularly important as behavioural distortions can undermine efficient market functioning and result in significant financial losses. The research is guided by several key questions: What are the most common behavioural biases in investment decision-making? How do these biases challenge the assumptions of rational market behaviour? And what strategies can be implemented to mitigate their effects? These questions frame a qualitative-descriptive methodology, grounded in a review of existing literature, psychological theories, empirical findings, and real-world case studies. This method allows for a nuanced understanding of how behavioural factors influence financial outcomes (Zik, et al., 2023).

This study is significant in both academic and practical terms. From a theoretical standpoint, it contributes to the growing body of knowledge that questions the universality of rational models in finance. Practically, it offers insight into how better investor education, regulatory frameworks, and technological tools such as robo-advisors can help counteract bias-driven decision-making. The central hypothesis of this research is that behavioural biases are systematic, not random, and thus have a measurable impact on investment behaviour and market trends. The article proceeds in six sections. It begins with a conceptual overview of behavioural finance, followed by a detailed discussion of cognitive and emotional biases affecting investors. The third section presents empirical evidence and case-based illustrations, while the fourth analyses the implications of behavioural finance on market efficiency. The fifth section outlines methods to mitigate behavioural distortions through education, regulation, and technology. The final section offers conclusions and recommendations for future research and policy development. Through this structure, the article aims to bridge the gap between theoretical finance and real-world investment behaviour. Traditional financial theories, such as the EMH and MPT, assume that investors are rational actors who seek to maximize utility based on all available information. However, real-world observations often contradict this premise. Investors frequently make decisions influenced by emotions, cognitive errors, and social factors. Behavioural finance emerged as an interdisciplinary field combining psychology and finance to better understand how these factors affect investment decisions. This research investigates the behavioural tendencies that deviate from rational models, exploring how they shape investor behaviour and influence market outcomes (Padmavathy, 2024).

2. Research Methodology

This study employs a qualitative-descriptive research methodology to explore how behavioural biases influence investment decision-making. Given the psychological and subjective nature of the topic, the research relies on secondary data sources, including scholarly articles, behavioural finance case studies, empirical studies, and theoretical papers drawn from databases such as JSTOR, Google Scholar, and ScienceDirect. The focus is on identifying cognitive and emotional biases such as overconfidence, anchoring, loss aversion, mental accounting, and herd behaviour and examining their impact through documented patterns and real-world market events, including historical bubbles and crashes. The study also incorporates policy reports and behavioural insights from institutions like the OECD and CFA Institute to understand the broader implications. This qualitative approach allows for a holistic understanding of how and why investors deviate from rational models, supporting the development of informed strategies to mitigate bias-driven decision-making.

3. Conceptual Framework of Behavioural Finance

The conceptual framework of behavioural finance is rooted in the intersection of psychology and financial theory. Unlike traditional finance, which assumes that individuals are rational agents who act in their best economic interests, behavioural finance acknowledges that real-world investors are influenced by a range of psychological, emotional, and social factors. These influences often result in decisions that deviate from rational expectations and optimal market behaviour. At its core, behavioural finance challenges the foundational assumptions of the EMH, which posits that markets are always efficient and asset prices reflect all available information. Behavioural finance, by contrast, argues that markets can be inefficient due to predictable patterns of human error. Investors are subject to bounded rationality, meaning they operate under cognitive limitations and incomplete information, often relying on heuristics mental shortcuts that simplify decision-making but may lead to systematic errors. Two primary components underpin this framework: cognitive biases **and** emotional influences. Cognitive biases are distortions in thinking that affect how people perceive information and make judgments. These include overconfidence, anchoring, confirmation bias, and representativeness. Emotional influences, such as fear and greed, also significantly shape investment behaviour, particularly under conditions of uncertainty or stress (Khare & Kapoor, 2024).

Another key element of behavioural finance is Prospect Theory, developed by Daniel Kahneman and Amos Tversky. This theory suggests that individuals evaluate gains and losses asymmetrically, with losses typically perceived as more painful than equivalent gains are pleasurable. This leads to loss aversion, a bias that causes investors to hold on to losing investments too long or sell winning investments too early. Additionally, behavioural finance introduces the concept of mental accounting, where individuals treat money differently depending on its source or intended use, rather than viewing it holistically. This fragmented thinking can lead to inconsistent and illogical financial choices. Social factors also play a role. Herd behaviour, for example, occurs when investors mimic the actions of others rather than relying on their own analysis. This can contribute to market bubbles and crashes, as seen in the dot-com bubble or the 2008 financial crisis. The behavioural finance framework thus serves as a more realistic lens through which to understand investor behaviour and market dynamics. It provides tools for identifying the psychological traps that investors fall into and lays the groundwork for developing interventions such as financial education, behavioural nudges, and algorithm-based investment tools to improve decision-making and market outcomes (Xia & Madni, 2024).

3.1	Definition	and	Scope
	Behavioural finance studies the psychological influences on investor behaviour and their effects on market outcomes. It incorporates elements of cognitive psychology, behavioural economics, and financial theory.		

3.2 Investors Are Not Fully Rational

One of the central tenets of behavioural finance is the recognition that investors are not fully rational in their decision-making processes. In contrast to traditional financial theories which assume that individuals make logical, well-informed choices aimed at maximizing utility behavioural finance acknowledges that real-life investors often act irrationally due to cognitive limitations, emotional influences, and situational pressures. Irrationality in investment decisions manifests in various ways. Investors may react impulsively to market trends, rely on intuition rather than analysis, or allow recent experiences to disproportionately influence their expectations. For instance, during market booms, many investors display excessive optimism, ignoring fundamental indicators and engaging in speculative behaviour. Conversely, in market downturns, fear and panic can lead to irrational selling, even when long-term prospects remain stable. This deviation from rationality does not imply complete chaos or unpredictability. Rather, irrational behaviour tends to follow consistent patterns that can be studied and understood. For example, behavioural biases such as loss aversion, overconfidence, and mental accounting are systematic tendencies that lead investors away from purely rational choices.

Recognizing that investors are not fully rational allows for more accurate modelling of market behaviour and provides insights into why traditional theories often fail to predict real-world outcomes. It also highlights the need for interventions such as financial education, advisory services, and technological tools to help investors make more informed and balanced decisions (Krishnamurthy, 2024).

3.3 Cognitive and Emotional Biases Influence Decisions

Behavioural finance emphasizes that investors are significantly influenced by a range of cognitive and emotional biases, which systematically distort perception, judgment, and financial decision-making. These biases arise from the way the human brain processes information and responds to uncertainty, often leading to irrational and inconsistent investment behaviour. Cognitive biases are mental shortcuts or errors in thinking that affect how people interpret information and assess risk. For example, overconfidence bias leads investors to overestimate their knowledge or predictive abilities, often resulting in excessive trading or underestimation of risk. Anchoring bias occurs when individuals fixate on initial information such as a stock's past price when making current decisions, even if that reference point is irrelevant. Confirmation bias causes investors to seek out information that supports their existing beliefs while ignoring contradictory evidence. In parallel, emotional biases stem from affective reactions such as fear, greed, regret, and excitement. One of the most influential emotional biases is loss aversion, a concept from Prospect Theory, which suggests that investors experience the pain of a loss more intensely than the pleasure of an equivalent gain. This often causes them to hold on to losing assets too long or avoid risk even when it is justified. Herd behaviour, another emotionally driven bias, occurs when investors follow the actions of others, often ignoring their own analysis due to a fear of missing out or being wrong alone. Together, cognitive and emotional biases compromise rational analysis, lead to predictable deviations from optimal behaviour, and contribute to inefficiencies in financial markets. Recognizing these biases is essential for developing strategies such as awareness training, behavioural nudges, or automated decision tools—to improve investment outcomes (Bleda & Pinkse, 2025).

3.4 Investors Use Heuristics

In behavioural finance, it is widely acknowledged that investors often rely on heuristics mental shortcuts or simplified rules of thumb to make complex financial decisions. Heuristics help individuals process information and make judgments quickly, especially under conditions of uncertainty, limited time, or incomplete data. While heuristics can be practical and efficient, they frequently lead to systematic errors and cognitive biases that distort investment decisions. One common heuristic is the availability heuristic, where investors assess the probability or importance of an event based on how easily examples come to mind. For instance, after seeing media reports about a stock's recent rise, an investor might overestimate its potential for future growth, even if fundamentals do not support it. Another example is the representativeness heuristic, in which investors judge the likelihood of an outcome based on how closely it resembles an existing stereotype, such as assuming a successful tech company will always deliver high returns, regardless of changing market conditions. Heuristics can also contribute to anchoring, where investors rely heavily on initial figures or past data (like purchase price or 52-week highs) when making new decisions, rather than considering current, objective information. These shortcuts can prevent investors from adapting to new circumstances or correcting flawed assumptions. While heuristics help reduce the cognitive load of decision-making, their misuse or overreliance often results in predictable patterns of irrationality. Understanding these shortcuts is crucial for improving investment behaviour, particularly through interventions like decision support systems, investor education, and tools that encourage more reflective thinking (Bihari, et al.,2025).

4. Cognitive Biases Influencing Investment Decisions

4.1. Overconfidence Bias

Overconfidence bias refers to an investor's unwarranted faith in their own knowledge, judgment, or

predictive ability, often leading them to overestimate their skills in making investment decisions. This cognitive bias is one of the most widely studied in behavioural finance and is particularly relevant in explaining excessive trading, risk miscalculation, and portfolio mismanagement. Investors affected by overconfidence believe they possess superior information or insight compared to others in the market. They may assume they can accurately predict market movements or time entry and exit points better than the average participant. As a result, overconfident investors often engage in frequent trading, take on higher risks, and neglect diversification, believing their strategy will yield above-average returns. Empirical research supports these patterns. Studies have shown that overconfident investors trade more aggressively, yet their net returns often underperform due to higher transaction costs and poor timing. For instance, Barber and Odean (2001) found that individual investors who traded most actively due to overconfidence earned significantly lower returns than those who traded less frequently. This bias is particularly dangerous during bull markets, where past success may reinforce the illusion of skill, leading investors to ignore potential downturns or negative indicators. It also contributes to market bubbles, as overconfident investors inflate asset prices beyond intrinsic value, assuming continued growth without adequate risk assessment. Mitigating overconfidence requires a disciplined investment approach, including setting objective criteria for decisions, using financial advisors or automated tools, and conducting regular performance reviews with honest reflection. Encouraging humility, awareness of cognitive limits, and reliance on diversified, evidence-based strategies can help investors avoid the pitfalls of this bias (Tansuchat & Thaicharo, 2025).

4.2 Anchoring Bias

Anchoring bias occurs when investors rely too heavily on an initial piece of information referred to as the “anchor” when making subsequent decisions, even if that information is irrelevant or outdated. This bias can significantly distort judgment and lead to poor investment choices, particularly when evaluating asset values, setting price targets, or timing market entry and exit. In investment contexts, common anchors include a stock's historical high, the price at which an investor originally purchased an asset, analysts' forecasts, or even round numbers that appear psychologically significant. For example, if an investor buys a stock at ₹100, they may anchor their expectations around that price. If the stock drops to ₹80, they may irrationally hold onto it, expecting it to return to the “original” value, even when market fundamentals suggest otherwise. Anchoring is particularly problematic during volatile markets, where rapid changes in economic conditions should prompt fresh evaluation. Instead, anchored investors tend to make decisions that are slow to adjust to new information. This leads to underreaction in falling markets and overreaction when prices rise, contributing to mispricing and inefficiencies. This bias is also exploited in financial marketing and sales. For instance, showing an artificially high “previous price” for an investment product can manipulate perception, making current prices seem like a bargain regardless of intrinsic value. To mitigate anchoring bias, investors must learn to detach decisions from arbitrary reference points and focus instead on objective data and current valuations. Techniques such as scenario analysis, blind valuations, and consulting third-party financial advisors can help counteract the influence of anchoring and lead to more rational investment strategies (Adedeji, 2025).

4.3 Mental Accounting

Mental accounting is a behavioural bias in which individuals categorize and treat money differently based on arbitrary labels, subjective reasoning, or the source and intended use of the funds, rather than evaluating their financial situation holistically. Coined by Richard Thaler, a pioneer in behavioural economics, mental accounting reveals how people compartmentalize financial decisions, often in ways that violate the principles of traditional economic rationality. In the context of investing, mental accounting leads investors to divide their portfolios into separate “accounts” or “buckets,” such as one for retirement savings, another for speculative investments, and another for daily expenses. While such categorization may offer psychological comfort or budgeting clarity, it often results in inconsistent risk

preferences, inefficient asset allocation, and suboptimal decision-making. For example, an investor might treat a tax refund as “free money” and use it for high-risk investments they wouldn’t otherwise make, rather than integrating it into a diversified portfolio. Similarly, they may refuse to sell a losing stock in one “mental account” to rebalance gains in another, even when doing so would improve overall portfolio performance. Mental accounting also contributes to narrow framing, where decisions are made in isolation rather than in the context of the broader financial picture. Investors may evaluate each investment separately without considering how it affects their entire portfolio’s risk and return profile, violating the core principle of portfolio theory. This bias can be particularly pronounced when investors receive windfalls (e.g., lottery winnings or bonuses) or earmark funds for specific purposes (e.g., vacations or children’s education), which may lead them to ignore the overall opportunity cost of how that money is invested or spent. To overcome mental accounting, investors should adopt a comprehensive financial planning approach, focusing on total wealth rather than isolated accounts. Tools such as integrated portfolio dashboards, goal-based financial advising, and education on opportunity cost and diversification can help encourage more holistic, objective decision-making (Budiman, et al., 2025).

5. Impact on Market Efficiency

Traditional financial theory, particularly the EMH, assumes that markets are perfectly efficient that is, asset prices always reflect all available information. Under this framework, it is believed that investors act rationally, and any deviations from true value are quickly corrected by market forces. However, behavioural finance presents strong evidence that psychological and emotional factors can lead to persistent inefficiencies in the market, challenging the core assumptions of EMH. One of the most significant impacts of behavioural biases on market efficiency is the mispricing of assets. For instance, overconfidence can drive speculative bubbles, where investors continue buying overvalued assets based on inflated expectations. The dot-com bubble of the late 1990s and the housing bubble of the mid-2000s are classic examples of markets behaving irrationally over extended periods due to collective investor optimism and herd behaviour. Loss aversion **and** mental accounting contribute to delayed selling of underperforming stocks, often creating price inertia or “disposition effects,” where prices do not adjust as efficiently to new information. Likewise, anchoring can prevent investors from updating their valuations in light of changing fundamentals, causing lags in market corrections. Another major factor is herd behaviour, which can result in momentum investing where rising stocks continue to rise and declining ones keep falling, regardless of their intrinsic value. This contributes to volatility and trend exaggeration, deviating from the idea that prices are always rational reflections of value. Behavioural biases also create predictable anomalies such as the January effect, momentum effect, **and** post-earnings announcement drift, which are difficult to reconcile with efficient market models. These anomalies provide opportunities for arbitrage, but often persist longer than expected because rational investors are either not able to act quickly enough or are constrained by institutional limits and risk aversion. the influence of cognitive and emotional biases on individual and collective behaviour undermines the notion of market efficiency. While prices may tend toward equilibrium in the long run, short- and medium-term inefficiencies driven by psychological forces are common. Recognizing these inefficiencies has critical implications not only for portfolio management and asset pricing models but also for regulatory design, financial education, and investor protection policies (Dey & Singh, 2025).

6. Mitigating Behavioural Biases

6.1 Financial Education

Financial education is a crucial tool in addressing and mitigating the impact of behavioural biases in investment decision-making. Many of the cognitive and emotional errors investors make such as overconfidence, loss aversion, and herd behaviour stem from a lack of understanding of financial principles, risk management, and market dynamics. By providing individuals with the knowledge and

awareness to recognize these biases, financial education can promote more rational, deliberate, and goal-oriented investment behaviour. An informed investor is better equipped to understand key financial concepts such as diversification, the time value of money, market volatility, and asset allocation. This foundational knowledge helps in reducing impulsive decisions based on emotions or market hype. For instance, an investor who understands the long-term benefits of diversification is less likely to overreact to short-term market downturns. Similarly, being aware of common biases like anchoring or confirmation bias can help investors critically assess their decision-making processes instead of relying on mental shortcuts or gut feelings. Financial education also improves an individual's ability to evaluate information objectively and apply risk-aware strategies. It encourages disciplined investing by emphasizing long-term planning over speculative behaviour. This is especially important in the age of digital investing, where ease of access to trading platforms can exacerbate behavioural errors if users are not adequately informed. Moreover, financial education should not be limited to formal institutions. It can be effectively delivered through community workshops, online courses, public awareness campaigns, and even employer-sponsored financial wellness programs. Interactive methods such as simulations, case studies, and real-world scenarios can further enhance the practical understanding of how behavioural biases operate in investment settings. Ultimately, while no amount of education can completely eliminate biases, increasing financial literacy is a powerful step toward minimizing their effects. By encouraging critical thinking, promoting awareness of psychological traps, and supporting informed decision-making, financial education not only benefits individual investors but also contributes to the stability and efficiency of financial markets as a whole (Iyer, et al., 2025).

6.2 Decision Aids and Nudges

In the realm of behavioural finance, decision aids and nudges have emerged as effective tools to guide investors toward more rational and beneficial financial choices. These interventions do not rely on restricting options or mandating behaviour; instead, they subtly influence decision-making by changing how choices are presented, making it easier for individuals to avoid common cognitive and emotional traps. Based on the work of behavioural economists like Richard Thaler and Cass Sunstein, nudges and decision aids are designed to improve outcomes without limiting freedom of choice. Decision aids include any tools or frameworks that assist investors in processing complex financial information more effectively. These can range from budgeting apps, portfolio tracking software, and risk assessment questionnaires to robo-advisors and automated investment platforms. By simplifying decision-making, reducing the information load, and providing structured guidance, such tools help investors overcome biases like overconfidence, inertia, or narrow framing. For example, a robo-advisor might automatically rebalance a portfolio, preventing the investor from irrationally clinging to underperforming assets. Nudges, on the other hand, are subtle design choices that alter the decision environment in a way that promotes better financial behaviour. One common nudge is default options such as automatically enrolling individuals into retirement savings plans with a pre-selected contribution rate. Research shows that such defaults dramatically increase participation rates because they counteract procrastination and status quo bias. Other nudges include framing effects, where investment information is presented in terms of potential gains rather than losses to encourage participation, or sending personalized reminders to prompt review and adjustment of financial plans. The effectiveness of decision aids and nudges lies in their ability to align with human psychology rather than working against it. Rather than expecting investors to become perfectly rational actors, these tools help structure environments where the path of least resistance leads to better outcomes. Importantly, they also preserve autonomy, allowing investors to opt out or modify decisions if they choose. As part of a broader strategy to enhance financial behaviour, decision aids and nudges can complement financial education and regulatory frameworks. When integrated thoughtfully into financial products, advisory services, and public policy, they can significantly improve investor decision-making, reduce the impact of behavioural biases, and contribute to more stable and inclusive financial systems (Senaya, 2025).

6.3 Regulatory Interventions

Regulatory interventions play a critical role in mitigating the adverse effects of behavioural biases on investment decisions and promoting fair, transparent, and efficient financial markets. While individual investors can be educated or guided through tools and nudges, systemic behavioural issues often require institutional oversight to ensure that markets are not manipulated, and investors are not misled or exploited due to psychological vulnerabilities. Regulators recognize that cognitive and emotional biases such as overconfidence, herd behaviour, and loss aversion can be amplified by misleading marketing practices, asymmetry of information, and complex financial products. As a response, many jurisdictions have implemented protective regulations aimed at enhancing disclosure, simplifying financial choices, and safeguarding retail investors. For example, regulators often require financial advisors and firms to follow “suitability” and “best interest” standards, ensuring that investment recommendations align with a client’s goals, risk tolerance, and financial capacity rather than serving the advisor’s incentives. One significant regulatory approach is the standardization of product information. By mandating clear, concise, and comparable disclosures such as risk labels, fee breakdowns, and performance histories—investors are better able to make informed decisions. These combat anchoring and framing biases that may otherwise distort perceptions based on selective or complex data presentations. Another intervention involves restrictions on high-risk products or speculative trading practices. For instance, regulations may limit the marketing of complex derivatives to unsophisticated investors, or impose cooling-off periods to discourage impulsive decision-making influenced by emotional biases or social pressure. During periods of market volatility, temporary trading halts or circuit breakers are also used to prevent panic-driven crashes caused by herd behaviour. Moreover, regulatory nudges have gained traction, where public policy incorporates behavioural insights to influence investor behaviour positively. Automatic enrolment in retirement plans, default investment portfolios with age-appropriate risk, and prompts for regular portfolio reviews are examples of government-backed initiatives designed to guide financial behaviour without limiting choice. financial consumer protection agencies **and** central banks have also embraced behavioural finance as a lens for regulatory strategy. They increasingly use empirical behavioural research to test policy outcomes and identify where behavioural interventions can improve market conduct, trust, and stability. regulatory interventions are essential for correcting market distortions caused by widespread behavioural biases. By establishing rules that enhance transparency, protect vulnerable investors, and structure financial choices more thoughtfully, regulators act as a counterbalance to irrational behaviour, contributing to more stable, inclusive, and resilient financial systems (Davis, 2025).

7. Theoretical Contributions and Limitations

Behavioural finance has made significant theoretical contributions by challenging the assumptions of traditional financial models and introducing a more psychologically grounded framework for understanding investor behaviour. Its primary contribution lies in its rejection of the notion that investors are fully rational agents operating in perfectly efficient markets. Instead, it recognizes that decision-making is often influenced by cognitive limitations, emotional impulses, and social pressures. This shift in perspective has enabled scholars and practitioners to better explain phenomena such as asset bubbles, market crashes, and persistent anomalies that classical theories struggle to account for. One of the most influential theoretical contributions is Prospect Theory, which redefines how individuals perceive gains and losses, demonstrating that people value losses more heavily than equivalent gains. This insight has reshaped the understanding of risk-taking behaviour in financial markets. In addition, behavioural finance has introduced concepts such as mental accounting, framing, heuristics, **and** herd behaviour, all of which help explain why actual investment decisions often diverge from normative models like the Efficient Market Hypothesis or Modern Portfolio Theory. Despite its contributions, behavioural finance also faces several limitations. First, it lacks a unified theoretical framework; rather than offering a single, predictive model, it presents a collection of observed biases

and heuristics that vary across individuals and contexts. This fragmentation makes it difficult to generalize findings or build consistent models of investor behaviour. Second, behavioural explanations are often descriptive rather than prescriptive, meaning they help explain past behaviour but offer limited guidance for forecasting future market trends or formulating policy. Moreover, empirical validation of behavioural concepts can be challenging. Many biases are difficult to quantify or isolate, and behavioural experiments often rely on artificial settings that may not fully replicate real-world decision-making. There is also the **risk of hindsight bias** in behavioural interpretations, where analysts explain market events post hoc without the ability to predict them in advance. Another theoretical criticism is that behavioural finance sometimes underestimates the corrective mechanisms of the market. Rational arbitrageurs and institutional investors can, in some cases, counterbalance the irrational actions of biased individuals, preserving a degree of market efficiency over time. , while behavioural finance has enriched the theoretical understanding of financial behaviour by incorporating insights from psychology and sociology, it is still evolving as a discipline. Its strength lies in explaining anomalies and irrational patterns in investment decisions, but its limitations include a lack of theoretical cohesion, difficulty in measurement, and challenges in predictive application. Future research may bridge these gaps by integrating behavioural insights with more robust empirical and computational models (VALLE, et al., 2025).

8. Conclusion

This research highlights the critical importance of understanding behavioural finance in the context of investment decision-making. By examining the psychological and emotional biases—such as overconfidence, anchoring, mental accounting, and herd behaviour—that routinely affect investors, the study challenges the long-standing assumptions of rationality and efficiency in traditional financial models. It becomes evident that investment decisions are not always the result of logical analysis but are often driven by cognitive shortcuts and emotional reactions, which can lead to suboptimal outcomes and systemic market inefficiencies. The implications of this understanding are far-reaching. For individual investors, recognizing these biases can lead to more disciplined and rational investing. For financial advisors and institutions, it can help in designing more effective investment strategies and advisory services that align with actual investor behaviour. For policymakers and regulators, incorporating behavioural insights into financial regulations can enhance investor protection and market stability. Moreover, the integration of financial education, decision aids, and behavioural nudges offers promising tools to mitigate the negative impact of these biases. Looking forward, future research should focus on developing unified, predictive models that combine behavioural insights with traditional financial theories. Longitudinal studies could better measure the persistence and variability of behavioural biases across different investor profiles and market conditions. Additionally, with the rise of digital platforms and algorithm-based investment tools, there is a growing need to explore how technology can both amplify and correct behavioural distortions. Ultimately, a deeper understanding of behavioural finance will not only improve individual investment decisions but also contribute to more resilient and equitable financial systems. Behavioural finance provides a more realistic understanding of investor behaviour by acknowledging the role of psychology in financial decisions. While it complicates the simplicity of rational choice models, it better explains anomalies and irrational market outcomes. Future research should focus on integrating behavioural insights into practical investment strategies, improving financial literacy, and using AI tools to support rational decision-making.

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