

# Chapter 4

## Does the Bias Towards Under and Overconfidence Affect Investment Decisions? Proof From India

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### ABSTRACT

*This article intends to understand the outcome of heuristic biases “overconfidence” and “underconfidence” in the short-term and long-term investment decision-making behaviour of investors in Indian market. Overconfidence and underconfidence biases have been measured through a well-structured questionnaire of various statements related to heuristic biases. SPSS 22 and the intuitive graphical user interface of PLS-SEM (SmartPLS) have been used to analyse the survey data. This article has found a positive relationship between the long-term and short-term investment decisions with overconfidence bias and a negative relationship between the short-term investment decisions and underconfidence bias. However, no relationship has*

DOI: 10.4018/979-8-3693-9380-2.ch004

*been identified between long-term investment decisions and underconfidence bias. This outcome is partially in sync with the findings of various studies related to overconfidence bias conducted in other countries. Whereas due to the unavailability of literature on underconfidence bias, results cannot be compared with the studies conducted in other countries*

## **1. INTRODUCTION**

### **1.1 Heuristic Biases**

Conventional financial market theories make the assumptions that players are logical, that the market is ideal, and that they make logical decisions. Kubilay & Bayrakdaroglu (2016) recently demonstrated that even participants wished to choose investments sensibly. On the other hand, according to Shah et al. (2018), investors behave irrationally in the real world while making investment decisions. They never gave fundamental valuations any thought; instead, they liked to imitate their peers' tactics. They strive to hold onto loss-making stocks, but they book profits and sell them instead of holding the profitable equities. Rather than considering the future, their decisions are predicated on past performance. Stock market investor behaviour is complicated and frequently demonstrates both illogical and reasonable inclinations. Ideally, rational behaviour would entail investors responding logically to market fluctuations, seeking to maximize returns for a given degree of risk, and basing their judgments on all available information.

In reality, while some investors do behave rationally, a significant number of exhibit irrational behaviours influenced by various biases. This blend of rationality and irrationality can create inefficiencies in the market, sometimes leading to bubbles and crashes. Behavioural finance sheds light on these patterns and highlights methods to assist investors in reaching more unbiased, knowledgeable conclusions. Unlike economists, behavioral finance scholars have claimed that human investors act irrationally. Decisions are influenced by psychological feelings.

The market consists of investors with various levels of experience. Fear and greed often drive investor decisions. For example, during a market downturn, some investors may panic and sell their stocks to prevent losses, while in a bull market, they may buy overvalued stocks due to FOMO (fear of missing out). Even when it may not be in line with their risk tolerance or financial objectives, investors frequently follow the herd by purchasing popular stocks or selling when others do. Loss aversion is the tendency for investors to become “anchored” to particular prices, which causes them to hang onto losing companies even when their fundamentals are weak. Instead of

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