

Influence of Risk Perception On the Relationship Between Psychological and Economic Factors in Indian Stock Market Investments

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Abstract

Within the context of the Indian stock market, the conduct and choices of investors are influenced by a complex interplay between economic and psychological factors. Significantly influencing the correlation between these characteristics and financial performance is the influence that risk perception has on the relationship between two variables. The purpose of this review research is to investigate the ways in which risk perception acts as a mediator in the interaction between economic factors such as interest rates, market conditions, and financial information and psychological qualities such as risk tolerance and cognitive biases. The psychological characteristics of herd mentality, loss aversion, and overconfidence are among the reasons why investors often make irrational judgments about their investments. This is especially true when they fail to appropriately estimate the dangers that are linked with the market. Similarly, the perceptions and evaluations of risk that investors have an effect on economic variables like as the availability of information and the volatility of the market, which in turn have an effect on the decisions that investors make. For the purpose of illustrating the idiosyncrasies of a rising market, this article provides a case study of the Indian stock market. rising markets are characterized by considerable levels of unpredictability, which are experienced by both individual and institutional investors. As a consequence of this study, which relies on a synthesis of past research to explore how perceptions of risk affect the influence of psychological and economic factors, the primary objective of this work is to enhance investment returns via better risk assessment. It is necessary for legislators, financial planners, and investors to have a solid understanding of these dynamics in order for them to be able to devise plans that appropriately take into account the current economic situation and the psychology of investors.

Keywords: Risk perception, psychological, economic, Indian stock market

1. Introduction

The field of behavioural finance is now playing a crucial part in the decision-making process. This is due to the fact that it has such a significant influence on the method by which investors make decisions. Individuals who are interested in putting their money to work could gain something from gaining a more in-depth grasp of behavioural finance. When it comes to making trading decisions, investors often have a tendency to be emotionally biased and lack the capacity to objectively evaluate

the risks and rewards associated with companies. Because of this, it is essential to have a solid understanding of the many factors that play a role in the selection of assets by investors. Although investors are flawed humans, many theories in economics and finance presume that they operate rationally. This is despite the reality that investors might make mistakes. Occasionally, they rely on their gut sentiments in addition to the emotions of the market while making financial decisions. In the early years of the investment, there was a disparity between the returns that were projected and those that were actually realized as a result of decisions that were made throughout the decision-making process, notably irrational ones about investments. After gaining knowledge from their mistakes and putting into practice tactics that would allow them to make the most informed decisions in the future, they eventually came to grips with the fact that psychology plays a part in the decisions that are made about investments.

Researchers in the field of psychology have shown that choices may be influenced by the inexorable emotional and psychological variables that are present. A deeper awareness of these aspects may be beneficial to investors because it enables them to make more thoughtful selections when deciding the best investment option. This, in turn, enables them to avoid making the same errors in the future. The link between stock market risk and return has been investigated by a number of professionals in the area of financial analysis, and they have arrived at the conclusion that the former is positively connected with the latter. Investors are not logical thinkers; rather, they respond emotionally when making decisions, which means that their choices are dependent on how they perceive the dangers and the possible rewards. Risk and return connections are a frequent component of human decision-making processes but investors are not rational thinkers.

Investors have the ability to exercise control over their risk tolerance if they are self-aware of it. Whenever they are determining how to distribute their wealth, investors carefully consider the prospective advantages and disadvantages of the different investments they are considering. The manner in which individuals behave is influenced by their sense of risk when it comes to investing. Those who are risk-averse and focused on high returns likely to have a high risk perception, while those who are risk-seeking and focused on high yields tend to have a low risk perception. Because investors are highly susceptible to the power of situational framing, which can lead to a variety of alternative interpretations of a problem and, ultimately, a variety of possible solutions, behavioural finance experts recommend that investors exercise objectivity when weighing the potential benefits and drawbacks of investment opportunities. This is because investors are highly susceptible to the power of situational framing. It is. According to, it is predicted that the quality of the option will be a reflection of the quality of the information that is supplied. The influence of scenario framing is taken into consideration, and this remains true even after that. According to, information asymmetries have a significant impact on the decisions that an investor makes about financing and investments. This may be seen in the quality of the judgments that are made when the information is used as a measure of its value.

The nature of the mental processes and activities that go into making judgments about investments has been a topic of discussion for many people. For the most part, the issue of risk perception has been given relatively little attention, despite the fact that several studies have investigated the impact of framing and other factors on the decisions that investors make. It is only via the execution of empirical studies of these links that it is possible to ascertain the true influence that these factors have on investment preference. Considering that people are likely to make various judgments based on the presentation of risk information, it is vital to explore the impact of alternative framing and perceptions on investment decisions. This is because framing reflects the reality that individuals are likely to make

different choices. In addition, these suggestions for researching how these factors influence the behavior of investors are incorporated in the research that is now being conducted. Despite the wealth of research that has been conducted on the effects of risk perception and inclination on investor behavior, only a small number of studies have successfully integrated all three factors at the same time. Numerous research have been conducted to investigate the connection between risk inclination, perceived risk, and the decision-making process of investors. These studies have taken into consideration a variety of other elements that significantly impact these notions. An understanding of the ways in which risk propensity, decision-making, and perception are all connected to one another is not entirely evident.

Despite the fact that the popular knowledge in finance argues that investors make their choices after carefully analyzing the benefits and drawbacks of various investments, it is feasible that investors' subjective experiences with risk have a significantly higher effect than the conventional wisdom suggests. By studying and interpreting the data in a meaningful way, as well as by identifying some basic components that impact investors' conduct under risk and uncertainty, the overriding objective of the research is to provide assistance to investors in making choices about their future investments. The present study has the potential to make a significant contribution to the area of behavioural finance by exploring the ways in which various physiological characteristics impact the overall investment decisions made by investors.

Psychological Factors in Investment Decision-Making

The views and behaviors of investors in the financial markets are significantly influenced by psychological factors, which have their roots in the field of behavioural finance. Individuals who have a high tolerance for risk, an excess of self-confidence, a fear of loss, and a predisposition to follow the herd mentality are examples of important personality traits that may drive them to stray from logical decision-making models. Individuals who are overconfident in their abilities as investors, for instance, may put themselves in danger by placing their trust in their own competence and making hasty judgments on their finances. On the other hand, investors who are risk adverse will avoid risky investments regardless of how much profit they stand to make from them. Due to the fact that these psychological components have an impact on how individuals perceive risk in turbulent markets, it is essential to have an understanding of them.

Economic Factors Affecting Investment Behavior

Moreover, economic factors have a significant amount of effect on the behavior of investors. The characteristics that fall under this category include things like interest rates, inflation, the volatility of the market, and the availability of financial data. Having access to and having a knowledge of market data has a significant influence on the decisions that are made about investments. For instance, when there is a high rate of inflation or when market conditions are unpredictable, investors may become more risk averse and shift their portfolios towards assets that are less risky. People may be more eager to take chances if the economy is performing well, which is the opposite of what you would expect. Investors are confronted with a challenging environment, particularly in growing economies such as India's, as a result of the complex interplay between the aforementioned economic forces and the decision-making processes of humans.

Rauf (2012), A person's age, color or ethnicity, gender, level of education, socioeconomic position, and other demographic characteristics are some of the factors that make them distinctive;

investors are not an exception to this rule. In spite of the fact that they are able to think logically, people often give in to their instincts and emotional biases when it comes to making decisions on investments. This is the most significant challenge that they face. Research conducted in the past has shown that there are a variety of psychological factors that play a role in determining whether or not they choose to invest. In light of this, we developed a research model with the purpose of explaining how risk propensity, asymmetric information, and issue framing impact the decision-making behavior of investors via the mediating role of risk perception. In addition to this, we determine the amount of importance that investors place on each independent variable. When taken as a whole, the discussion arrives at the conclusion that the level of risk an investor is willing to take and the clarity of the information that is provided to them are significant aspects that play a role in the construction of their investment philosophy.

Dr. Ahmed Imran (2015), The purpose of this study is to evaluate the influence that a number of psychological factors have on the choices that Indian investors tend to make about their investments. There are three factors that have an impact on the decision-making behavior of investors: risk propensity, asymmetric information, and problem framing. An analysis of the study model provides a description of the mediating role of risk perception. In the same way, it is the factor that determines the decision-making weights that investors assign to each independent variable. The data for this study was collected via the use of a modified questionnaire in order to determine the correlations that exist between the variables that were being studied. A method known as structural equation modeling was used in order to ascertain the relationships that exist between the variables. With everything taken into consideration, the findings and the discussion indicate to the notion that the manner in which an investor makes decisions is significantly impacted by their level of comfort with risk as well as the information that is presented to them throughout the decision-making process.

Ghadeer (2016), The purpose of this study was to investigate the ways in which psychological and economic factors manifest themselves in different ways when it comes to the decisions that individual investors make. In order to achieve this objective, a questionnaire was used to obtain primary data from investors in the stock market via the usage of methods that included simple sampling. We received a total of 254 responses to our survey. In order to determine which parts of the economic and psychological factors were the most significantly essential, we used factor analysis. Comparatively, the psychological component was responsible for 61.671% of the entire variance, whereas the economic component was responsible for 56.697% of the overall variation. According to the results, the decision-making process of individual investors is impacted by several factors, including those that are psychological and economic in nature. The findings of regression analysis indicate that psychological factors, as opposed to monetary factors, have a more significant influence on the decision-making behavior of individuals. A statistically significant association between gender and the decision to invest was not found, according to the results of a t-test. Using a one-way analysis of variance, it was discovered that there is a link that is statistically significant between the monthly income of investors and the decisions that they make about their investments.

Ammar (2023), Stock prices are said to correctly reflect all essential information since the market is efficient, according to the ideas that are currently being used in finance. However, according to the idea of behavioural finance, emotions and thoughts have the potential to influence stock prices. The purpose of this study is to evaluate the impact that behavioural finance factors have on the decisions that individuals in Saudi Arabia make about their investments in the stock market via the lens of risk

perception. There were a total of 150 individual investors who were issued an online questionnaire; 134 of them have responded to it and are now accessible for review. The analysis of the data is carried out with the use of structural equation modeling (SEM). The results of herding, the disposition effect, and blue chip bias all demonstrate that risk perception is positively impacted by these aspects of the phenomenon. It is only when it comes to making judgments about finances that overconfidence has a positive effect; when it comes to the perception of danger, it has absolutely no influence at all. There is a link that is both positive and statistically significant between an individual's sense of risk and the choices that they make about their finances. Because of the effect that each of the four behavioural finance factors has on risk perception, investment decision making is favorably influenced by one of these characteristics. The findings may not be applicable to other cultures due to the fact that they are based on research that was conducted in Saudi Arabia. In addition, additional factors may have an impact on how risk is perceived and how investment decisions are made; however, this study only looked at four aspects of behavioural finance. The results emphasize the need of taking into consideration an individual's risk perception when making decisions about their portfolio performance. This is because an individual's risk perception may have a significant impact on their risk tolerance and, therefore, their portfolio performance. According to the results, investors have to give some thought to the behavioural biases that they themselves possess, and advisors and politicians ought to devise strategies that might mitigate the impact of these prejudices.

Dilli (2024), Defining characteristics of the Nepalese stock market include significant volatility and emerging market dynamics. Variables such as legislative changes, economic conditions, and investor sentiment all have a role in shaping the growth trajectory and the behavior of investors. The purpose of this study is to analyze the ways in which psychological factors influence investment decisions in the Nepalese share market. The research focuses on the role that financial literacy plays as a mediator. Using a structured questionnaire that was disseminated using a random sample technique, data were gathered from the primary source in order to meet the stated aim. This was done in order to get the information that was needed. A total of four hundred and ten individual investors from the Kathmandu Valley participated in the data collection process. Through the use of SmartPLS 4.0, the structural linkages of the proposed theoretical model were investigated. This study has shown that psychological factors have a positive and statistically significant impact on the investing decisions that Nepalese share market investors make. The findings of this research have proved that these effects are accurate. When it comes to Nepal's unpredictable and expanding market-driven stock market, individuals often make bad selections about their investments due to the biases that exist in their thinking. According to the findings, investors who have a better understanding of personal finance are better able to make reasonable and well-informed decisions about their investments. This is because they are able to reduce the influence of psychological biases associated with investing. According to the findings of the study, we need improved financial education programs if we want to see investors who are better educated and markets that are more efficient throughout the whole spectrum. It is possible for policymakers and financial institutions in Nepal to provide a more safe environment for investment if they have a better understanding of the connection between financial literacy and psychological concerns.

Prakash (2024), The field of behavioural finance explores the ways in which the emotional responses and cognitive biases of investors have an effect on the dynamics and behavior of markets on a global scale, particularly in emerging nations such as Nepal. This research focuses primarily on the impacts of overconfidence, loss aversion, herd behavior, anchoring, and risk perception on investing in

the Nepal stock market. Additionally, the study investigates the consequences of these factors on investment. At NEPSE, herding tendency is the most important factor on stock investment choices. It has a beta value of 0.463, which indicates that it has a significant effect on investor conduct. The behavioural characteristics that influence stock investment decisions among Nepali investors have an impact on the economic efficiency of the market as well as the potential for growth of the NEPSE. The purpose of this research is to combine descriptive and analytical methodologies in order to get a better understanding of the actions taken by investors and how biases influence their investments. The survey of 384 NEPSE investors was conducted with the use of structured questionnaires and SPSS. The results bring to light the need of improved financial education, investor awareness campaigns, and regulatory initiatives in order to lessen the detrimental effects of biases and to enhance the efficiency and stability of the market. Both a limited focus on NEPSE and a lack of attention to other factors that influence market dynamics are examples of constraints. Other constraints include a lack of attention to other factors. It is recommended that future research expand the scope of their studies and raise the size of their samples in order to enhance the reliability and general ability of their findings to other financial scenarios.

Bharti (2019), In light of the fact that market anomalies and irrational conduct were the factors that caused stock market movements, a variety of behavioural biases and variables that influence the decision-making process of individual investors have been investigated. This study was motivated by the primary objective of determining the extent to which heuristic, prospect, market, and herding influences the decisions made by NSE investors. A Likert scale is used in the questionnaire in order to collect data. It was determined that the reliability of the questionnaire could be determined by using the Cronbach alpha value, which was found to be 0.728. It has been determined that regression analysis and exploratory factor analysis are necessary. Through the use of Cronbach's alpha, the internal consistency of the element was examined. Cronbach's alpha placed an emphasis on maintaining consistency at an acceptable level with regard to all of the following factors: heuristics, prospects, markets, herding, investment performance, and investor decisions that were considered. According to the findings of the research, the four characteristics had a substantial impact on both the investment decision and the return on investment. The premise that all behavioural variables have a major impact on investors' decision-making processes served as the foundation for the assumptions that were made about the degree to which behavioural elements influence the decision-making processes of individual investors.

Abhijeet (2018), When it comes to making judgments, individual investors often take into account a variety of factors, including their age, level of education, income, and investment portfolio. When it comes to investing, however, the significance of the behavioural component is often ignored. In the course of this research, we will endeavour to get an understanding of the ways in which the psychological and behavioural characteristics of investors influence their decision-making, as well as the ways in which their perspective on risk influences their decision-making. During the course of the research, the literature that is relevant to investor psychology and behavioural decision-making was used. A number of sources, including the author's previous works and the works of others, as well as secondary data that can be accessed online in the domains of economics, investments, and finance, are used in this research. Through the integration of the data, it may be possible to get a better understanding of the dynamic relationship that exists between investor risk perception, behavioural factors, and decision-making in the context of India. In contrast to the propositions made by traditional finance

theory, the author of this research comes to the conclusion that individual investors do not always make decisions about their investments that are reasonable. The judgments that they make about their finances are heavily influenced by a variety of factors, including cognitive biases, emotional and rational biases, heuristics, mental accounting, and anchoring. Therefore, it is essential to take into consideration these behavioural elements as possible hazards when making decisions about investments. Financial experts and investment advisors need to take behavioural challenges into consideration as risk factors in order to develop effective investment plans for individual clients. This is because behavioural difficulties are a risk element. The most recent factor that has to be taken into consideration when creating plans for investments is behavioural issues. This is done in order to establish confidence among investors in the stock market. Through the use of this research, investment advisors and financial experts will be able to more accurately evaluate the level of risk tolerance shown by investors, which will ultimately lead to superior investment selections.

OBJECTIVES

1. To critically examine how risk perception moderates the link between psychological characteristics
2. To explore how risk perception affects investing behavior in the Indian stock market due to economic variables

The Role of Risk Perception in Investment Decisions

The term "risk perception" refers to the subjective evaluations that investors make on the severity and probability of a danger. It is of the utmost importance when it comes to the regulation of the connecting factors between psychological and monetary variables. The degree to which investors are willing to take risks is directly proportional to the manner in which they evaluate the prospective advantages and disadvantages of a variety of economic and financial situations. Unpredictable market conditions may be seen by some investors as opportunities for significant returns, while others may see them as warning signs that should prompt them to steer clear of risky investments. This is only one example of how different investors may have different opinions on risk. What other examples can you think of? People's perceptions of risk have an impact on the choices they make about their investments and on the market as a whole when there is a high level of uncertainty and volatility.

The Indian Stock Market Context

Within the context of the Indian stock market, doing research on the influence of risk perception presents a unique situation. The position of India's market as a growing market is characterized by a variety of features, including increased volatility, changes in regulation, and a rising number of individual and institutional investors. When attempting to make sense of the actions taken by Indian investors, it is essential to take into consideration how individuals perceive risk. Differences in their levels of financial literacy, the availability of information, and their exposure to external market forces are some of the elements that contribute to this perception. Moreover, since investors might vary from individual savers to enormous financial organizations, their perspectives on risk can be quite different from one another, which in turn has a variety of effects on the dynamics of the market.

The objective of this study is to construct, as an extension of the model developed by Sitkin and Pablo, a model of problematic decision-making behavior that can be used for the purpose of analyzing the influence that psychological elements of investors have on the choices that they make about their investments. This study lends credence to the findings of earlier studies, which have shown that the level of risk an investor is willing to take is a significant factor in the decision-making process. Despite the fact that they consider themselves to be in risk while making investment decisions, the possibility of gaining profits from such investments encourages them to continue investing. In the past, researchers have determined the impacts of problem framing by using fundamental situations in settings that were under controlled conditions. It was ensured that those responsible for making decisions were aware of how to alter the advantages and losses. Expanding on previous studies that have been conducted on the impacts of framing, the finding that problem framing is partially mediated by risk perceptions has the potential to be statistically significant. According to the findings of this research, investors may be able to effectively achieve their aim of boosting or reducing their risk taking attitude by examining problem framing and other aspects that impact risk perception. It should be mandatory for investors to have a fundamental comprehension of several concepts related to investing, including asymmetric information, investors' biases, and risk in the investment environment. Because of this, they will be able to get private information in a short amount of time and have the ability to make judgments based on an accurate and fair estimation of the stock market. Considering that we now know that the mediator variables properly predict the risky decision-making behavior of investors, it is feasible that a more effective method of anticipating the risk behavior of investors might be achievable. The findings of this study provide support to the concept that investors' risk perceptions have a major influence on their risk-taking behavior, and that this perception, in turn, affects the impact of other factors on the decision-making processes of investors.

Through the viewpoint of the investors, the strengths and limits of the research will be better recognized, as well as the relative relevance of the independent variables. In conclusion, the perspective of the investors will be better appreciated. Knowledge of the issue of subjectivity and performance will be beneficial to companies, who will therefore be more motivated to strive towards decreasing these biases in order to boost profitability. Insight into decision-making and better knowledge of the problem will be beneficial to corporations.

Conclusion

In order to get a better understanding of the irrational behaviors that investors take in this domain, a risk perception mediated model was developed. This model was designed to investigate the impact of a number of behavioural variables on investment decisions. There is evidence from previous research that shows that a number of variables, such as information asymmetry, risk-taking behavior, and the context in which decisions are made, impact how investors perceive the risk in any particular investment situation. Given the significance of risk propensity, it seems to reason that those who are inherently risk-averse would avoid making decisions that might have potentially devastating consequences, in contrast to those who are more likely to pursue opportunities that involve taking calculated risks. Research in the field of psychology indicates that the mental frames of investors have a substantial influence on their perception of risk when it comes to making decisions about their finances. With this in mind, it is reasonable to assert that the stock market and the investor's current financial

situation both have an impact on the investor's perception of risk. The incompleteness of the information is a significant factor that leads to the construction of this perception. The dissemination of information, such as decisions made by government agencies, news reports, and other forms of information, may have an impact on the value of stocks. The behavior of the stock market and recent facts are the primary factors that stock investors consider when making investing decisions. According to the prospect hypothesis, investors are more inclined to avoid risk in situations that are depicted in a positive light, while they are more likely to seek out risk in situations that are framed in a negative manner. The way in which framing affects the perceived riskiness of a situation is directly responsible for the observable behavioural responses of the individuals in question. The act of expressing that the glass of water is half-full rather than half-empty is an example of positive framing, which has the ability to impact how one perceives the presence of danger. There are a number of additional behavioural and psychological factors that might be the topic of future study. These factors have the potential to influence the decision-making processes of investors when they are considered. As a result of the fact that this study just used a portion of Sitkin and Pablo's model, it is possible that future research may build upon this by investigating the other components that they discovered. In addition to this, it is essential to carry out empirical tests in order to ascertain the actual relevance of the variables that are listed in the model.

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