

A Study on Internal and External Factors Influencing the Decision- Making Behaviour of Retail Investors in the Indian Stock Market

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Abstract: *The research explores how internal and external factors affect retail investors' trading patterns in the Indian stock market. Increasing retail investor participation, especially post COVID-19, makes it crucial to understand trading behaviour. The research uses a quantitative approach, gathering primary data through a questionnaire from 100 respondents. The study examines the influence of internal factors (overconfidence, loss aversion, and herd behaviour) and external factors (market volatility, regulatory measures and global events). Variables are analysed using regression analysis. The results suggest that external factors play a more significant role than internal factors in trading behaviour. This research offers suggestions to investors, regulators and financial firms for improving rational investment behaviour and market stability.*

Keywords: Retail Investors, Behavioural Finance, Investor Behaviour, Internal Factors, External Factors, Indian Stock Market, Investor Sentiment

I. INTRODUCTION

In recent years, the Indian stock market has undergone a remarkable evolution with the surge in retail investors. The exponential growth in digital trading platforms, the rise in financial awareness and access to market data have allowed people from different social and economic backgrounds to engage in stock market trading. Telephone and online brokerage firms like Zerodha, Groww and Upstox have made investing in the stock market more convenient and accessible, particularly for investors from Tier-2 and Tier-3 cities.

This has led to improved market liquidity and depth. But it has also led to concerns about the investment decision-making of retail investors. Retail investors may not have the same level of knowledge and experience as institutional investors and may be more prone to psychological biases. This means their investment behaviour can be less rational and inconsistent with conventional financial theories.

Behavioural finance offers insights into these deviations by focusing on psychological factors like overconfidence, loss aversion, herding and anchoring. These internal factors affect investors' risk assessment, information processing and decision-making. For example, overconfidence can result in excessive trading, and herd behaviour can result in investors following the crowd without conducting fundamental analysis.

Aside from internal factors, there are also external factors that affect investor behaviour. These factors include economic conditions, policies, market dynamics, technological innovations, and world events. Interest rates, inflation, geopolitical conflicts, and financial media reports can impact investor behaviour and attitudes. The growing influence of social media and financial news websites has also amplified the effects of external factors on retail investors.

India's retail investment landscape has seen a transformation since the outbreak of the COVID- 19 pandemic. This was characterised by a rise in the number of investors, greater active participation using digital platforms and a focus on



speculative trading. While, some investors embraced value investing, some investors engaged in short-term trading on the basis of market sentiment and the fear of missing out (FOMO).

These events highlight the need to consider the impact of both psychological and market factors on retail investor decision making. While previous research primarily examines these factors in isolation, little research has been conducted on the combined influence. This research seeks to fill this gap by examining the impact of both individual and environmental factors on retail investors in the Indian stock market.

II. LITERATURE REVIEW

The literature suggests that retail investor behaviour is impacted by both psychological factors and market environment. Research by Ali et al. (2024) and Jain (n.d.) highlights the influence of behavioural biases such as overconfidence, loss aversion and herding behaviour on investor behaviour. These biases can lead to irrational trading and market inefficiencies. Additionally, studies like Dasgupta and Chattopadhyay (2020), which developed an Investor Sentiment Index, show a strong association between investor sentiment and trading volume. Likewise, Haritha and Rishad (2020) determined that irrational investor sentiment is an important factor in market volatility. Besides behavioural components, external factors like economic indicators, government policies and other global events also play a crucial role in affecting investor behaviour. Bennet and Selvam (2010) discussed the effects of socio-economic and regulatory risks on investor behaviour.

The recent studies during the post-Covid era (Ganvir & Ansari, 2022; Bansal & Bansal, 2022) show a shift in investor behaviour, such as increased trading, higher propensity to take risks and moving to electronic trading.

In conclusion, the previous studies suggest that although several studies have explored behavioural and external factors independently, few studies have taken into account internal, external and demographic factors jointly in order to gain a holistic view of retail investor behaviour.

III. RESEARCH METHODOLOGY

3.1 Research Design:

The study adopts a quantitative and descriptive research design to examine the impact of internal and external factors on the decision-making behaviour of retail investors. Primary data is collected through a structured questionnaire, and regression analysis is used for data analysis.

3.2 Data Collection:

- Primary Data: Collect through Structured questionnaire

3.3 Objectives of the Study:

1. To understand how internal and external factors influence the decision-making behaviour of retail investors.
2. To determine the major internal and external variables that affect the behaviour of retail investors.

3.4 Hypothesis:

- H_0 (Null Hypothesis):

There is no significant relationship between internal and external factors and the trading behaviour of retail investors.

- H_1 (Alternative Hypothesis):

There is a significant relationship between internal and external factors and the trading behaviour of retail investors.

3.5 Respondents:

The Responses of Retail investors in Shegaon

3.6 Sampling Technique:

In this Paper we use Convenience Sampling

3.7 Sample Size:

The is aprox 100 respondents

3.8 Data Analysis Tools:

- Regression Analysis (used to analyze the relationship between independent and dependent variables).



3.9 Tools for Analysis:

- MS Excel (Microsoft Excel 2021 MSO (Version 2603))

3.10 Data Analysis Model Summary:

Model	R	R Square	Adjusted R Square	Std. Error	Observations
1	0.890	0.792	0.788	0.172	100

Interpretation:

The coefficient of determination R (0.890) shows a positive correlation between internal and external factors and trading behaviour. The R Square (0.792) indicates that 79.2% of the variance in trading behaviour is jointly explained by the independent variables. This shows the model is well fitted.

ANOVA Table:

Source	df	SS	MS	F	Significance F
Regression	2	10.885	5.443	184.850	8.13E-34
Residual	97	2.856	0.029		
Total	99	13.742			

Interpretation:

The significance value ($p = 8.13E-34$) is less than 0.05, which indicates that the model is statistically significant. Therefore, the independent variables significantly explain the dependent variable.

Coefficients Table:

Variable	Coefficient (B)	t-value	p-value
Intercept	1.014	6.997	0.000
Internal Factors (X1)	0.302	9.051	0.000
External Factors (X2)	0.461	12.991	0.000

Regression Equation:

$$Y = 1.014 + 0.302(X1) + 0.461(X2)$$

Interpretation of Variables:

• I. Internal Factors ($\beta = 0.302, p < 0.05$):

Retail investors' decision making is significantly affected by internal factors. This suggests behavioural factors such as emotions, biases, and judgement have an impact on investors' decisions. There is an improvement in trading behaviour following an increase in internal factors.

• II. External Factors ($\beta = 0.461, p < 0.05$):

The external factors have a positive and significant influence on retail investors' decision-making. Price, economic, news and international events have a significant effect on decisions. And the greater the influence of external factors, the bigger the variations in trading.



• **III. Intercept ($\beta = 1.014$, $p < 0.05$):**

The intercept is the level of trading behaviour when both endogenous and exogenous variables are absent. This suggests that there is still some amount of investor behaviour when these variables are zero.

• **Overall Interpretation:**

External and internal variables have the largest coefficient. This implies that retail investors learn more from the market factors and external factors rather than individual's behavioural biases in investment decisions. The variables are significant as p-values are smaller than 0.05.

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