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## The Role of Behavioural Biases in Economic Decision-Making: A Study of Household Financial Behaviour

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• **ABSTRACT**

The aim of this study is to understand the influence of behavioural biases on household financial decisions. Specifically, the study explores how herding bias, loss aversion, and overconfidence have an impact on the spending, saving, and investment patterns of households in Mumbai. Behavioural finance states that many a times individuals make financial decisions without taking rationality into consideration. They get influenced by many factors such as psychological, emotional, and social pressure. The study was conducted using primary data which was collected through a structured Google Form questionnaire with 100 respondents from Mumbai. A five-point Likert scale was used to capture responses related to the three identified behavioural biases. The results indicate that herding bias significantly influences household spending decisions, as many individuals tend to follow financial trends popular within their social groups. Loss aversion was found to strongly affect household saving patterns, with respondents prioritising the avoidance of financial losses over pursuing financial gains. The study also confirms that overconfidence plays a lead role in household financial decisions, as individuals rely heavily on their own judgement and often ignore professional advice. The findings are consistent with previous behavioural finance research and highlight the importance of understanding how psychological biases impact financial behaviour at the household level. The study suggests the need for financial literacy programs and further research on behavioural finance across more diverse population groups

**KEYWORDS:** Behavioural Finance, Household Financial Decisions, Herding Bias, Loss Aversion

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## 1. Introduction

Behavioural finance is a field of study that integrates economics and psychology to elucidate the reasons why individuals frequently make poor financial decisions, such as being overconfident in their abilities, fretting about losing money, or spending excessively. Generally, these decisions are determined by cognitive biases, emotions, and what is the most straightforward for the mind.

It demonstrates that individuals do not always behave in accordance with the principles of "rational economic agents," as traditional economic theory suggests. This term denotes individuals who make decisions by utilising all of their knowledge to maximise its value.

Behavioural finance differs from conventional models in that it acknowledges that emotions, heuristics, and framing are significant non-rational factors that influence the economic decisions of individuals.

Since the behaviour of every individual differs from person to person, they don't always act like "rational economic agents" in real life; hence, it becomes utmost important to understand how behavioural finance creates an impact on households' decision-making.

People sometimes make poor financial choices, which include not saving enough or falling prey to impulsive buying because they are fearful of the uncertainty that they might lose money in the coming time. At times people are overconfident or they follow the pack.

Due to such reasons, it becomes crucial to understand these psychological factors because behavioural finance can help us to formulate financial education, policy design, and risk management better.

This study looks at decisions made at the household level, which is an essential area for increasing daily financial well-being, even though it hasn't been examined enough.

## 2. Literature Review

Behavioural finance has become popular because it can explain why people often don't make reasonable financial decisions. Several studies have found that important behavioural biases including herding, overconfidence, loss aversion, and mental accounting affect how people make financial decisions in their homes. This part gives a thematic review of the literature that is relevant.

Kumar and Phronimos (2023) conducted an empirical study on herding, overconfidence, and loss aversion among 327 Indian stock market investors. The authors found that emotions, fear of missing out, and risk-taking tendencies strongly influenced herding behaviour. The study confirmed that herding is common in household investment decisions, where people follow the financial actions of others without independent evaluation.

Guiso et al. (2013) explored social contagion in mortgage defaults during the U.S. financial crisis. They found that homeowners were significantly more likely to default on their mortgages when nearby neighbours also defaulted, even if their personal financial positions were stable. This behaviour strongly supported the presence of the herding effect in real estate borrowing and household financial decisions.

Ahern et al. (2023) studied rational and irrational herding using large peer-to-peer lending datasets. The researchers observed that herding led by inexperienced participants often resulted in poor financial outcomes. The study highlighted that not all herding is beneficial, especially when individuals follow uninformed or poorly guided decisions.

**Dervishaj (2021)** looked at important behavioural biases such overconfidence, loss aversion, mental accounting, and herding. This was based on the work of Waweru et al. (2008) and Kahneman and Tversky (1974). The study made it clear that biases like framing and heuristics often affect how people make financial decisions for their homes. Dervishaj said that it's important to be aware of and try to reduce these biases in order to make better financial decisions.

**Sharma and Kumar (2022)** conducted a comprehensive literature review covering studies from 1970 to 2021. The authors identified 17 common behavioural biases that influence financial decisions, with overconfidence, herding, and loss aversion being the most frequent. Their work confirmed that these biases broadly affect individual investors and households in routine financial behaviour.

**Wesslen et al. (2021)** looked at how different ways of presenting information affect retirement investment decisions, with a focus on myopic loss aversion. The study indicated that standard bar charts made people more sensitive to short-term losses, which made them less likely to invest in stocks. The study also found that when uncertainty was shown via interval plots, people focused more on long-term profits, which made loss aversion less of a problem. The study showed that the way financial information is designed and presented can have a big effect on how people make decisions.

The literature review makes it evident that behavioural biases such herding, overconfidence, and loss aversion have a big impact on financial decisions made by both individuals and households. Most of the research that has been done so far has either been about stock markets or retirement planning. There hasn't been much direct research on how these biases affect everyday decisions about spending, saving, borrowing, and investing. This study tries to fill that gap by looking at how people's financial behaviour at home is linked to their behavioural biases.

Most of the research that has been done in behavioural finance thus far has focused on professional investors, stock markets, or retirement planning. There is not a lot of research that looks at how behavioural biases affect the financial decisions families make every day. Many previous studies have not examined the impact of these biases on household spending, saving,

borrowing, and investment. The main goal of this study is to look at how behavioural biases affect people's financial decisions in their homes. So, Objectives of the Study, To look into how herding bias affects how families spend their money, To investigate the relationship between loss aversion and saving behaviour and To learn how people's financial decisions are impacted by overconfidence.

### 3. Research Methodology

This study is both descriptive and analytical. It wants to find out how behavioural biases affect household financial choices like saving, spending, and investing.

People who make financial decisions in their households are the target demographic for this study. The survey is only about those who live in Mumbai.

The study will use 100 people as a sample size. The sample size was set based on practical factors like how much time was available and how easy it was for respondents to get to through internet platforms.

The study gathers data using convenience sampling. Respondents were chosen depending upon their availability and willingness to take part in the poll. This strategy was chosen since it was easy to get in touch with participants online.

The researcher got primary data by using a structured questionnaire made in Google Forms. The questionnaire had statements that were rated on a five-point Likert scale that went from • Strongly Agree • Agree • Neutral • Disagree • Strongly Disagree

The survey was mostly about three main behavioural biases:

- Loss Aversion • Overconfidence • Herding Bias

The researcher used straightforward, direct statements to see how each prejudice affected the spending habits of families.

The data collected from 100 respondents through a structured questionnaire was analysed using descriptive methods. The analysis focused on identifying common behavioural patterns among households in relation to herding bias, loss aversion, and overconfidence. Instead of statistical tests, the study applied a trend-based approach to understand the overall responses aligned with each behavioural category.

The goal was to interpret the primary data in a clear and structured manner by grouping the responses under the relevant behavioural biases. This method provided meaningful insights into how households perceive and react to financial decisions, enabling the researcher to evaluate the extent to which each objective was achieved.

#### 4. Finding

This section presents the findings of the primary data collected from 100 respondents through a structured questionnaire. The study aimed to analyse the influence of behavioural biases, specifically herding bias, loss aversion, and overconfidence on household financial decisions.

The analysis focuses on identifying key behavioural patterns that emerged from the responses and linking them to the study's stated objectives. The responses have been interpreted collectively under each bias category to provide a clear and structured discussion of household financial behaviour.

##### **Objective 1: To understand how herding bias influences household spending decisions**

Across several response items related to social influence on spending, a substantial portion of respondents showed agreement with statements indicating that they often base their spending choices on what others around them are doing. This reflects the presence of **herding bias**, where individuals mirror the financial behaviour of peers or family even without full information. This shows that herding tendencies do play a role in shaping household expenditures.

##### **Objective 2: To explore the role of loss aversion in saving behaviour**

Responses revealed a common preference for avoiding losses over making gains. Many participants expressed hesitation to invest due to the fear of losing money and indicated that the pain of financial loss lingers longer than the joy of gains. This supports the idea that loss aversion significantly impacts saving decisions and often leads to conservative financial behaviour, such as holding cash or avoiding risky but potentially rewarding investments.

##### **Objective 3: To examine how overconfidence influences financial decision-making**

Many respondents displayed a high level of confidence in their own financial judgment. A notable number reported rarely seeking advice, believing their financial choices were generally correct. This reflects **overconfidence bias**, which may lead individuals to overestimate their abilities and ignore expert guidance. The findings suggest that such bias can lead to bold or misinformed decisions without adequate risk assessment.

The objectives set at the start of the study have been meaningfully addressed through trend-based interpretation of the questionnaire responses. Each of the three behavioural biases—herding, loss aversion, and overconfidence—was evident in the financial attitudes and decisions of the respondents. While statistical testing was not applied, the descriptive patterns clearly reflect the influence of behavioural finance concepts at the household level.

## 5. Conclusion

The present study aimed to analyse the impact of behavioural biases on household financial decisions, with a specific focus on herding bias, loss aversion, and overconfidence. Based on responses collected from 100 participants in Mumbai, the study finds that these three behavioural biases significantly influence how households spend, save, and invest.

The analysis revealed that many individuals tend to be influenced by the financial actions of others, reflecting the presence of herding bias in everyday decision-making. Similarly, a strong preference for avoiding financial losses over pursuing potential gains indicated the influence of loss aversion on saving behaviour. Overconfidence was also evident, with several respondents expressing high self-trust in their financial judgement and limited reliance on external advice.

Overall, the study reinforces the idea that psychological factors play a critical role in shaping financial decisions at the household level. The findings contribute to the growing body of behavioural finance research and suggest that increased awareness of these biases could help individuals make more informed and balanced financial choices.

### Limitations of the Research

While this study provides useful insights into how behavioural biases influence household financial decisions, there are a few limitations to consider:

1. **Sample Size Limitation:** The study is based on responses from 100 participants, which may not fully represent the larger population of Mumbai or other urban areas. A larger sample size could have provided more accurate and generalisable results.
2. **Geographical Limitation:** The data was collected only from residents of Mumbai. As a result, the findings may not reflect the financial behaviour of people living in other cities, rural areas, or different cultural settings.
3. **Sampling Method Limitation:** The study used convenience sampling, meaning participants were selected based on easy accessibility. This method may have introduced selection bias, and the sample may not fully capture the diversity of different education levels, age groups, or economic backgrounds.
4. **Reliance on Self-Reported Data:** The study is based on self-reported answers, which can sometimes be influenced by personal biases, memory errors, or the tendency to give socially acceptable responses instead of completely honest ones.
5. **Descriptive Nature of Analysis:** The study relied on a descriptive analysis approach to interpret trends in household behavior. While this method effectively captured broad patterns linked to behavioral biases, incorporating advanced statistical tools in future research could strengthen the findings and allow for deeper exploration of relationships between variables.

**Suggestions:**

1. **Promote Financial Awareness:** Financial awareness and literacy programs should be organised to help individuals recognise and manage their behavioural biases in financial decisions.
2. **Encourage Rational Decision-Making:** People should be encouraged to focus on proper financial planning and research, rather than relying on social trends, emotions, or overconfidence.
3. **Seek Professional Financial Advice:** Households should be made aware of the importance of consulting financial experts before making major financial decisions, especially to reduce the impact of overconfidence and social pressure.
4. **Incorporate Behavioural Finance in Education:** Educational institutions should include behavioural finance as part of the curriculum to help students and future investors understand common financial biases from an early stage.
5. **Scope for Further Research:** Future studies can be conducted with larger and more diverse samples, covering other cities, age groups, and using advanced statistical tools to validate the results.

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## ETHICAL CONSIDERATION

Authenticity of the texts, honesty and fidelity has been observed.

## CONFLICT OF INTEREST

Author/s confirmed no conflict of interest.