

# Factors Considered by Small Investors Before Investing in the Stock Market: A Fundamental Perspective

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**Abstract** -Retail participation in stock markets has increased significantly in emerging economies, particularly in India. With regulatory strengthening by the (SEBI) and technological advancement in trading platforms such as the (NSE) and the (BSE), small investors have gained easier access to equity markets. Despite this accessibility, retail investors often operate with limited financial resources and moderate risk tolerance. Therefore, understanding the fundamental factors influencing their investment decisions is essential. This research paper examines the financial, behavioral, and macroeconomic factors considered by small investors before investing in the stock market from a fundamental analysis perspective. The study integrates classical financial theories, behavioral finance literature, and empirical findings to provide a comprehensive understanding of retail investor decision-making.

**Keywords:** Small Investors, Fundamental Analysis, Retail Investment Behavior, Stock Market, Financial Ratios, Behavioral Finance

## I. INTRODUCTION

The stock market serves as a critical platform for capital formation and wealth creation. Retail investors, often termed small investors, contribute significantly to market liquidity and stability. In recent years, India has witnessed a surge in Demat accounts and retail trading activity, reflecting increasing financial awareness and digital penetration.

Small investors typically focus on long-term capital appreciation, dividend income, and capital preservation. However, their decisions are influenced by a combination of fundamental indicators, macroeconomic variables, and psychological biases.

Fundamental analysis, which involves evaluating a company's financial statements, industry conditions, and economic environment, remains a key tool for retail investors seeking rational investment decisions.

## II. LITERATURE REVIEW

The literature on investment decision-making spans traditional financial theory and behavioral finance.

### 2.1 Traditional Financial Theories

(1970) introduced the Efficient Market Hypothesis (EMH), arguing that stock prices fully reflect all available information. According to Fama (1970), "In an efficient market, prices always fully reflect available information." This theory suggests that fundamental analysis may not consistently yield abnormal returns in highly efficient markets.

Conversely, and (1934), in, emphasized intrinsic value and argued that investors should analyze financial statements to identify undervalued stocks. Graham stated, "Investment is most intelligent when it is most businesslike." This philosophy forms the foundation of fundamental investing.

(1964) developed the Capital Asset Pricing Model (CAPM), which links expected return with systematic risk. CAPM suggests that investors demand higher returns for higher risk exposure.

### 2.2 Behavioral Finance Perspectives

Behavioral finance challenges the assumption of fully rational investors.

and (1979) introduced Prospect Theory, arguing that investors are loss-averse and value losses more heavily than gains. They noted, "Losses loom larger than gains," explaining why small investors may avoid high-risk investments despite potential returns.

(2000) emphasized psychological biases such as overconfidence, herd behavior, and anchoring in investment decisions.

Empirical studies in emerging markets show that retail investors rely on company earnings, dividends, and peer recommendations when making investment choices.

### III. RESEARCH OBJECTIVES

1. To identify fundamental factors influencing small investors' decisions.
2. To analyze the role of financial ratios in retail investment behavior.
3. To examine the impact of macroeconomic and behavioral factors.
4. To evaluate the relevance of classical financial theories in retail investing.

### IV. RESEARCH METHODOLOGY

This study is based on secondary data collected from academic journals, financial reports, SEBI publications, and stock exchange data. The research adopts a descriptive and analytical approach, synthesizing theoretical and empirical findings.

### V. FUNDAMENTAL FACTORS CONSIDERED BY SMALL INVESTORS

#### 5.1 Financial Performance

Small investors examine:

- Revenue growth trends
- Net profit margins
- Earnings Per Share (EPS)
- Return on Equity (ROE)

Consistent profitability signals operational efficiency and financial stability.

#### 5.2 Valuation Metrics

Valuation ratios help determine whether stocks are fairly priced:

- Price-to-Earnings (P/E) Ratio
- Price-to-Book (P/B) Ratio
- Dividend Yield

Retail investors compare these ratios with industry averages before investing.

#### 5.3 Debt and Financial Stability

High leverage increases financial risk. Investors evaluate:

- Debt-to-Equity Ratio
- Interest Coverage Ratio
- Free Cash Flow

Financially stable companies attract risk-averse retail investors.

#### 5.4 Industry and Macroeconomic Conditions

Economic indicators such as GDP growth, inflation, and interest rates influence investor expectations. Government policies and sectoral reforms also impact stock selection.

#### 5.5 Management Quality and Corporate Governance

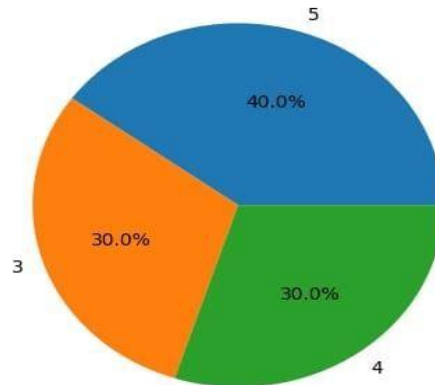
Transparent governance practices, ethical leadership, and consistent strategic direction build investor confidence. Companies with strong governance structures are preferred by retail investors.

#### 5.6 Risk Diversification

Following modern portfolio theory, investors diversify across sectors to minimize unsystematic risk. Risk-return trade-off remains central to decision-making.

#### Data Analysis & Interpretation of Graphs

Financial Performance Importance Distribution



1Pie Chart – Financial Performance Importance Distribution

What the Graph Shows:

The pie chart presents the percentage distribution of ratings (3, 4, and 5) given by 50 respondents regarding the importance of Financial Performance.

- 40% rated it 5 (Very High Importance)
- 30% rated it 4 (High Importance)
- 30% rated it 3 (Moderate Importance)

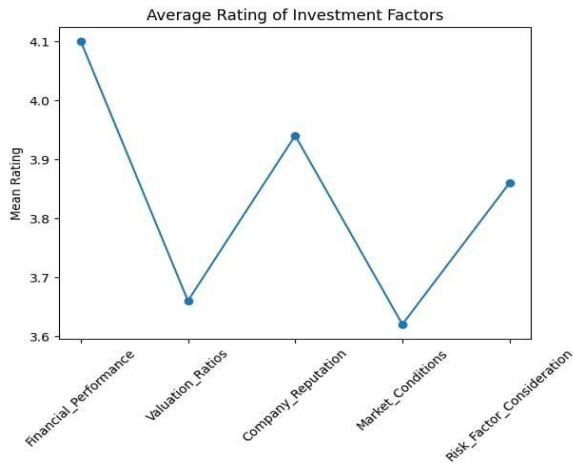
Interpretation:

The majority (70%) of respondents rated financial performance as either high or very high importance. This clearly indicates that small investors strongly rely

on company fundamentals such as revenue growth, net profit, and earnings per share before investing. This finding supports the fundamental analysis theory proposed by Benjamin Graham, who emphasized evaluating intrinsic value based on financial statements.

**Research Insight:**

Financial performance is the primary decision-making factor among small investors.



**2 Line Graph – Average Rating of Investment Factors**

What the Graph Shows:

The line graph compares the mean (average) ratings of five investment factors:

Factor	Mean Rating
Financial Performance	4.10
Company Reputation	3.94
Risk Factor Consideration	3.86
Valuation Ratios	3.66
Market Conditions	3.62

**Interpretation:**

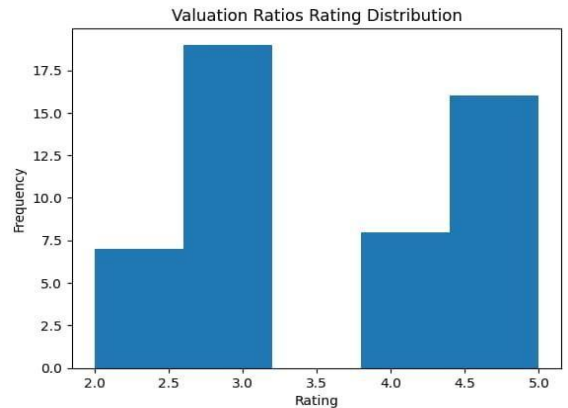
- Financial Performance ranks highest.
- Market Conditions ranks lowest among the five factors.
- All means are above 3.5, indicating overall importance.

**Research Insight:**

Small investors focus more on internal company fundamentals than external macroeconomic conditions.

This partially challenges the strong form of the Efficient Market Hypothesis developed by Eugene

Fama, which assumes that all available information is already reflected in stock prices.



**3 Histogram – Valuation Ratios Distribution**

What the Graph Shows:

The histogram displays the frequency distribution of ratings for Valuation Ratios (P/E, P/B, Dividend Yield).

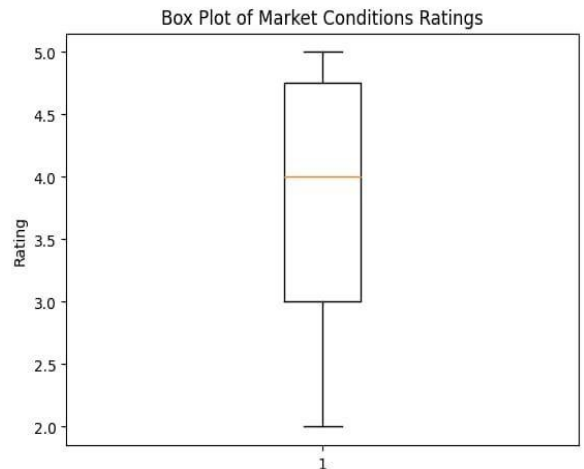
Ratings are spread between 2 and 5, with more concentration around 3 and 5.

**Interpretation:**

- Some investors moderately rely on valuation ratios.
- A significant portion considers them highly important.
- A small group shows lower importance (rating 2).

**Research Insight:**

This variation indicates differences in financial literacy among small investors. Some investors actively analyze valuation metrics, while others depend more on basic financial performance.



4Box Plot – Market Conditions Ratings

What the Graph Shows:

The box plot illustrates:

- Minimum rating: 2
- Maximum rating: 5
- Median: 4
- Moderate spread (interquartile range)

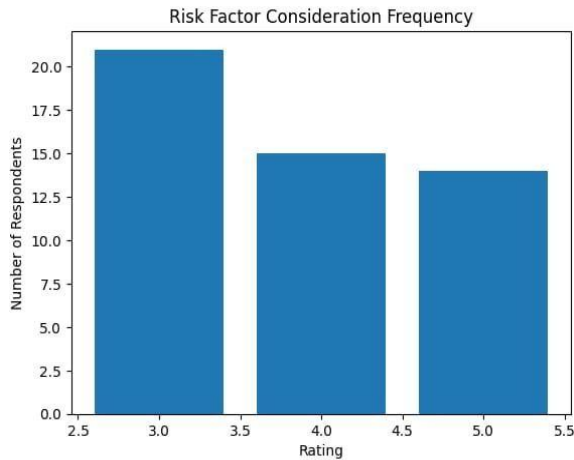
Interpretation:

The variability suggests differing opinions regarding macroeconomic factors such as inflation, GDP growth, and interest rates.

Some investors actively track economic trends, while others focus only on company-specific fundamentals.

Research Insight:

Macroeconomic awareness exists but is not uniformly strong among retail investors.



5 Bar Chart – Risk Factor Consideration Frequency

What the Graph Shows:

Most respondents rated risk consideration between 3 and 5.

- Majority show moderate to high concern about risk.
- Very few low-risk ratings.

Interpretation:

Small investors are generally risk-conscious but not extremely risk-averse. They consider factors such as:

- Market volatility
- Company debt levels
- Liquidity risk

This finding aligns with Prospect Theory introduced by Daniel Kahneman and Amos Tversky, which explains that investors are sensitive to potential losses.

Research Insight:

Risk perception plays a significant but secondary role after financial performance.

Conclusion from Graphical Analysis

The graphical analysis clearly indicates that small investors adopt a fundamental perspective while making stock market decisions. Financial performance and company reputation strongly influence their choices, while macroeconomic conditions and valuation metrics play supportive roles.

The findings reflect a blend of classical fundamental analysis and behavioral finance influences. Investors appear rational in evaluating financial data but differ in sensitivity toward market-wide factors.

6. DISCUSSION

The findings suggest that small investors combine rational analysis with behavioral tendencies. While fundamental indicators such as earnings and valuation ratios form the basis of decisions, psychological factors influence timing and risk perception.

The relevance of Graham’s intrinsic value theory remains significant among retail investors. However, behavioral biases identified by Kahneman and Tversky explain deviations from rationality.

In emerging markets like India, regulatory oversight by SEBI and increased transparency by NSE and BSE enhance investor protection, encouraging long-term participation.

7. CONCLUSION

Small investors consider a combination of financial performance, valuation metrics, macroeconomic conditions, and behavioral influences before investing in the stock market. Fundamental analysis remains the cornerstone of retail investment decisions, especially for long-term wealth creation.

While classical theories such as EMH and CAPM provide theoretical frameworks, behavioral finance offers practical insights into real-world investor behavior. Policymakers and regulators should continue promoting financial literacy to strengthen rational investment practices.

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