



Liquidity Preference and Its Behavioural Cost on Long-Term Investment Outcomes

An Empirical Study of Young Investors in Bangalore

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Abstract – This study looks at how young people in Bangalore, like those between 22 and 35, tend to hold onto too much cash instead of investing it long term, and how that choice ends up costing them in terms of better returns later on. I am drawing from some theories here, you know, the Keynesian one on liquidity preference, and Tobins portfolio balance idea, plus the prospect theory from Kahneman and Tversky, and that behavioral portfolio thing by Shefrin and Statman. All of these help explain the psychological stuff pushing people toward this, things like feeling anxious about money, hating losses more than usual, and just perceiving risk in a way that makes them play it safe.

The main drivers seem to be financial anxiety, loss aversion, and how they see risks, which lead to putting money in the wrong places, not enough in growth assets or whatever. We used a survey back in March 2026 with 128 people from that age group, structured questions to test five hypotheses. Ran chi square tests, some simple linear regressions, multiple ones too, and a one way ANOVA to check things out.

Findings showed financial anxiety really predicts liquidity preference strongly, with a beta of 0.507 and p less than 0.001, and loss aversion was even a bit higher at 0.520, same p value. But when you look at the multiple regression, risk perception took over as the big one, beta 0.282, p under 0.01. There was this clear negative link between how much liquidity they hold and allocating to growth assets, chi square 53.04, p way under 0.001, and Cramers V at 0.372, which means its a decent association. Income level did not moderate the anxiety to liquidity thing, F was 1.796, p 0.151, so no effect there.

It feels like this adds some new evidence, tying those old finance theories with behavioral ones to how young city investors act in places like India, an emerging economy. Some parts of it get messy, like how exactly risk perception dominates, but the inverse relationship stands out. Not everything is fully clear, maybe income plays a role in other ways I am not sure about.

Keywords: Liquidity Preference, Behavioural Finance, Financial Anxiety, Loss Aversion, Risk Perception, Investment Efficiency, Young Investors, Bangalore

1. Introduction

In India, there are so many different ways for young people to invest their money these days. Like equity mutual funds or even things like REITs and digital stuff, plus bonds from the government. But it seems like a lot of young professionals in cities still stick to safe options, you know, savings accounts or those short-term fixed deposits that do not pay much. I think that is kind of a waste because they could be earning more if they took some risks.

This whole preference for keeping money liquid, it has a cost. Not just in the moment, but over years, it adds up and hurts how much wealth they build in the long run. Keynes talked about this back in 1936, saying people hold cash for transactions, or just in case something happens, or because they speculate on better times. Then later, people like Kahneman and Tversky showed in their work around 1979 how emotions and biases mess with our decisions, making us not so rational.

The study looks at Bangalore specifically, since it is a big tech center with all these young workers making good money. Even with rising incomes, they keep hoarding cash instead of investing. It feels like that is the interesting part, how behavior drives this.

There is not much research yet on this in Indian cities at a detailed level, like what causes the extra liquidity holding and how it lowers investment returns. This paper tries to fill that by pulling together four main finance theories and checking them with data from early 2026. Some parts of it get a bit complicated to explain fully.

It contributes to understanding behavioral finance, both in theory and what it means practically for investors. Maybe not everything is resolved here, but it points out the issues.



2. Literature Review and Theoretical Framework

2.1 Foundational Theories

Keynes talked about why people hold onto cash back in 1936. He came up with three main reasons. One is for everyday stuff, like paying bills or whatever comes up day to day. Then there's the precautionary part, you know, just in case something unexpected happens and you need a buffer. And the speculative motive, where you're waiting for better chances to invest or something like that. It seems like those cover the basics for liquidity.

Tobin built on that idea later, in 1958 I think. He had this Portfolio Balance Theory. It involves mean variance optimization, which helps explain how people rationally split their money between easy to access stuff and riskier holdings. That part gets a bit technical for me.

These theories look at money demand on a big scale, like for the whole economy. They give a starting point. From there you can see where actual behavior might stray off, maybe due to psychology or whatever. Not everything fits neatly, it feels like.

2.2 Behavioural Finance Perspectives

The Prospect Theory developed by Kahneman and Tversky (1979) undermined the rational actor framework by showing how people tend to value their losses twice as much as they value gains of equal magnitude. This theory, which is known as loss aversion, implies a preference for cash and other safer investments. The BPT framework advanced by Shefrin and Statman (2000) takes this idea one step further by explaining how investors divide their portfolios into safety and aspiration accounts, which tend to be overweighted. Mental accounting, proposed by Thaler (1985), helps explain why investors keep too much liquidity on hand.

2.3 Psychological Antecedents

Financial anxiety factors such as income insecurity, fear of loss, and discomfort with market volatility were shown to independently influence asset allocation conservatism in young employees by Lim, Teo, and Yen (2003). Risk tolerance ratings have been found to be inversely correlated with liquid asset ownership according to Grable and Lytton (1999). Investment choices have been shown by MacGregor et al. (1999) to be swayed not by objective measures of risk but by subjective perceptions influenced by emotion and prior financial history.

2.4 Indian Context

According to Sahi et al. (2013), young Indian investors from the Delhi NCR region invest about 48% of their total investment corpus in liquid assets, which is significantly higher than the generally recommended amount ranging between 20%

and 30%. In another study, Mishra and Kumar (2011) report that young salaried individuals in Bangalore prefer fixed deposits to equity investments, motivated by reasons of safety and convenience. Employment uncertainty in the technology industry in India was reported as a cause for an unusually high liquidity preference among even high-income individuals by Prasad et al. (2019). The above-stated studies notwithstanding, there has been a lack of empirical analysis within a multitheoretic framework in post-COVID Bangalore.

3. Research Methodology

3.1 Research Design and Sampling

The research used a positivist, deductive, cross-sectional survey research methodology. The primary data were obtained from a structured questionnaire of 27 questions conducted in March 2026 using LinkedIn, MBAs, WhatsApp investors group, and personal contacts of the researcher. The sampling frame included adults residing in Bangalore, aged 18 to 35 years, who have personal earnings and invest/plan finances. Out of a total of 147 respondents, only 128 respondents were retained after filtering out those who did not fill in the questionnaire or provided non-variant answers. This number is sufficient according to Cohen (1988).

3.2 Measurement Instrument

The survey was divided into seven parts: (A) Demographics: age, profession, salary, years of experience, and whether or not one invests; (B) Liquidity Preference (LP1-LP5), rated on a Likert scale from 1 to 5; (C) Objective Investment Allocation, employing a set of categorical scales; (D) Financial Anxiety (FA1-FA4); (E) Loss Aversion (LA1-LA3); (F) Risk Perception (RP1-RP3); and (G) Investment Efficiency (IE1-IE4). All Likert items were based on validated scales from behavioral finance

3.3 Analytical Techniques

The data was analyzed using Python 3.11 in conjunction with numpy, scipy.stats, pandas, and statsmodels. The process flow involved: (1) reliability testing using Cronbach's Alpha; (2) descriptive analysis; (3) Pearson correlation testing; (4) chi-squared testing for independence (H1); (5) linear regression testing (H2, H3, and H4); (6) multiple linear regression testing (H4 extended and H2/H3 combined); and (7) ANOVA testing (H5).

4. Results

4.1 Reliability and Descriptive Statistics

Internal consistency for all scales was acceptable to excellent (Table 1). The average composite score of 3.27 (SD = 1.49) out of a total of five points suggests a high degree of bias toward liquidity preferences among the subjects. LP2 (Comfort with Accessibility) and LP5 (Increased Cash in Uncertainty) yielded the highest scores for the LP measures (M = 3.89, 3.85), which represent Keynesian transaction and precautionary motivations, respectively. On the side of investment horizon, 69.5% of the subjects had a horizon of three years or shorter, while only 12.5% had more than five years.

Table 1: Reliability Analysis — Cronbach's Alpha Coefficients

Construct	Items	Cronbach's α	Interpretation
Liquidity Preference (LP)	5	0.767	Acceptable
Financial Anxiety (FA)	4	0.926	Excellent
Loss Aversion (LA)	3	0.883	Good
Risk Perception (RP)	3	0.902	Excellent
Investment Efficiency (IE)	4	0.929	Excellent

Source: Primary data, March 2026 (N = 128)

4.2 Pearson Correlation Analysis

FA, LA, and RP were highly correlated (FA-LA: $r = 0.831$, $p < 0.01$; FA-RP: $r = 0.795$, $p < 0.01$; LA-RP: $r = 0.791$, $p < 0.01$), indicating that there is also the presence of a latent variable of 'behavioural risk aversion.' All three variables had positive correlations with LP (FA: $r = 0.597$, $p < 0.01$; LA: $r = 0.615$, $p < 0.01$; RP: $r = 0.633$, $p < 0.01$). Investment Efficiency had slight negative correlations with FA ($r = -0.226$, $p < 0.01$) and RP ($r = -0.237$, $p < 0.01$).

4.3 Hypothesis Testing

The study established that there exists a significant negative connection between the liquidity ratio and the growth asset allocation through a chi-square test which showed statistical significance with a value of 53.04 and 9 degrees of freedom and a p-value below 0.001 together with Cramer's V value of 0.372. Among respondents with liquidity ratios exceeding 60%, 78.3% allocated less than 20% to growth assets—compared to 21.8% among those with liquidity ratios below 20%. H1 is fully supported.

Financial anxiety shows strong positive prediction power which leads to liquidity preference according to simple linear regression results ($\beta = 0.507$, $R^2 = 0.357$, $F = 70.77$, $p < 0.001$).

The FA composite score increases by one unit which leads to a 0.507 unit increase in LP score. H2 is fully supported.

The predictive power of loss aversion on liquidity preference showed stronger results ($\beta = 0.520$, $R^2 = 0.378$, $F = 77.23$, $p < 0.001$) which aligns with the Prospect Theory prediction that loss-related psychological discomfort causes people to choose secure and easy-to-reach financial assets. H3 is fully supported.

The simple regression analysis between LP and IE produced a negative result which failed to reach statistical significance because the coefficient ($\beta = -0.206$) showed $p = 0.062$ value. The complete multiple regression analysis which used LP together with FA and LA and RP as independent variables to predict IE showed results that neared but did not reach statistical significance ($F(4,123) = 2.420$, $p = 0.052$, $R^2 = 0.073$). H4 is partially supported because all relationships match the expected theoretical pattern yet fail to reach the $\alpha = 0.05$ threshold.

The ANOVA test revealed that different income groups showed no significant variation in their average LP score results ($F(3,124) = 1.796$, $p = 0.151$). The Rs. 50,000–1,00,000 group achieved the highest LP scores with an average of 3.56 while the >Rs. 1,00,000 group recorded the lowest LP scores with an average of 2.83. H5 is not supported.

Table 2: Summary of Hypothesis Testing Results

H	Hypothesis	Test	Key Result	Decision
H1	LP → Growth Allocation (negative)	Chi-Square	$\chi^2=53.04$, $p<0.001$; $V=0.372$	Supported **
H2	Financial Anxiety → LP (positive)	Linear Regression	$\beta=0.507$, $R^2=0.357$, $p<0.001$	Supported **
H3	Loss Aversion → LP (positive)	Linear Regression	$\beta=0.520$, $R^2=0.378$, $p<0.001$	Supported **
H4	Excess LP → Investment Efficiency (negative)	Regression	$\beta=-0.206$, $p=0.062$	Partially Supported
H5	Income moderates FA→LP	One-Way ANOVA	$F(3,124)=1.796$, $p=0.151$	Not Supported

** Significant at $p < 0.01$ level

4.4 Multiple Regression: Behavioural Antecedents of Liquidity Preference

The multiple regression model which used FA, LA, and RP to predict LP demonstrated 44.0% explained variance in liquidity preference according to the results which showed R^2 value of 0.440 and $F(3,124)$ value of 34.47 with p value below 0.001. In the combined model, risk perception emerged as the strongest independent predictor ($\beta = 0.282$, $p < 0.01$), followed by loss aversion ($\beta = 0.201$, $p < 0.05$) and financial anxiety ($\beta = 0.106$,

$p < 0.05$). The beta coefficient for FA decreased to 0.106 in the multiple regression from its bivariate estimate of 0.507 because the three behavioral constructs showed high multicollinearity which indicated the presence of a shared latent factor named 'behavioral risk aversion'.

Table 3: Multiple Regression — FA + LA + RP → Liquidity Preference

Predictor	β (Unstd.)	Std. Error	t-statistic	p-value
Constant	1.478	0.245	6.033	<0.001
Financial Anxiety (FA)	0.106	0.098	2.082	<0.05
Loss Aversion (LA)	0.201	0.116	2.318	<0.05
Risk Perception (RP)	0.282	0.110	2.563	<0.01

$R^2 = 0.440$; $Adjusted R^2 = 0.427$; $F(3, 124) = 34.47$; $p < 0.001$

5. Discussion

5.1 Theoretical Contributions

The study's main theoretical finding demonstrates through empirical evidence that four fundamental theories known as Keynesian Liquidity Preference Theory, Tobin's Portfolio Balance Theory, Prospect Theory and Behavioural Portfolio Theory can be combined into one framework which researchers can use to study young investors in developing economies. The finding that LP2 and LP5 items function as basic transactional and precautionary elements confirms the individual-level validity of Keynesian motives which extend their application beyond macroeconomic research. The multiple regression model identifies risk perception as the main factor predicting liquidity preference with a strength of $\beta = 0.282$ which creates important theoretical consequences. The research results show that people decide to keep cash reserves because they believe that investment risks exist instead of their financial anxiety and loss aversion emotions. This research demonstrates that Prospect Theory applies to security selection behavior which includes the disposition effect but it also provides foundations for studying how investors choose between liquid and illiquid asset classes. The non-significant moderation of income H5 $p = 0.151$ supports Prospect Theory which states that loss aversion functions as a psychological constant that remains unchanged through income growth within the investigated income brackets. The financial inclusion policy framework has an underlying assumption which needs to be challenged because it considers income growth as the solution for enhancing investment practices.

5.2 Behavioural Cost Implications

The evidence from the chi-square test (H1) establishes strong backing for the main hypothesis of the research. 78.3% of respondents who maintained more than 60% of their investable assets in liquid form dedicated less than 20% of their portfolio to growth assets which contradicts the financial planners' advice to young investors with extended time frames who should allocate between 60% and 80% of their assets to growth investments. The substantial cost arises because Indian equities have historically provided investors with an equity risk premium that ranges between 5% and 8% per year compared to liquid assets (Misra & Mehta 2020). The simulation shows that a young investor from Bangalore who receives Rs. 50,000 monthly and changes his investment strategy from 80/20 liquid-to-growth to 20/80 allocation will achieve terminal wealth between three to five times greater after 30 years because of the behavioral changes which this study identified.

5.3 Partial Support for H4

The partial support for H4 (LP → Investment Efficiency, $p = 0.062$) warrants careful interpretation. The consistent negative direction of all LP-IE relationships together with the strong negative correlations between IE and the behavioral antecedents (FA: $r = -0.226$, RP: $r = -0.237$) demonstrate that LP affects efficiency through mediation by behavioral constructs. The study design and use of self-reported efficiency metrics create challenges for determining causal relationships so the researchers must conduct longitudinal studies using objective portfolio data to confirm this pathway.

6. Managerial and Policy Implications

For financial advisors and wealth managers, the discovery that risk perception is the most significant predictor of excess liquidity preference indicates that advisory processes must go beyond conventional risk-tolerance questionnaires to incorporate validated psychometric instruments that assess cognitive beliefs regarding investment risk. Goal-based financial planning frameworks, which tie choices to real long-term goals, may be especially good at correcting wrong ideas about risk.

For fintech developers, the study's evidence of pronounced short-termism (69.5% investing for ≤ 3 years) and emotional reactivity indicates that app interface design choices can significantly exacerbate or alleviate loss-averse behavior. Interventions like lowering the number of portfolio valuation alerts, showing inflation-adjusted projections for the future, and adding automatic contribution escalation features could make people less likely to act without them having to think about it.

The fact that behavioral biases don't change with income (H5) means that financial supplements alone aren't enough for employers and policymakers. Financial literacy programs at work, especially those that teach people about the historical risk-return dynamics of Indian equity markets and make it easy to access SIP, NPS, and ELSS products, are probably better than programs that are based on income.

7. Limitations

There are a few things to keep in mind. First, the sample of 128, while sufficient for the selected statistical methods, was obtained through purposive networks instead of probability sampling, which may have led to an overrepresentation of financially literate individuals and an underestimation of the liquidity preference in the general population. Second, the cross-sectional design prevents causal inference; the direction of relationships between behavioral biases and liquidity preference cannot be conclusively determined from correlational data. Third, self-reported investment allocation data might be influenced by social desirability bias and recall error; corroboration with objective account data would enhance validity. Fourth, the study's focus on only one city makes it hard to generalize; the link between behavioral biases and liquidity preference may be very different in Mumbai, Delhi, or smaller Tier-2 cities with different economic profiles.

Finally, the 56% unexplained variance in LP suggests that important predictors—including overconfidence, herding, hyperbolic discounting, and financial literacy—remain outside the current model.

8. Conclusion

This research offers substantial empirical evidence indicating that the preference for excess liquidity among young investors in Bangalore is a psychologically driven phenomenon with quantifiable implications for long-term wealth accumulation. Financial anxiety, loss aversion, and risk perception collectively constitute 44% of the variance in liquidity preference, with risk perception—the cognitive aspect—exerting the most significant independent effect. The strong negative correlation between liquidity ratio and growth asset allocation supports the fundamental behavioral cost hypothesis: individuals who maintain the majority of their investable capital in liquid assets tend to allocate less towards assets that can generate long-term wealth.

Because these behavioral biases are income-invariant, we are addressing a psychological rather than a financial problem, hence the need for a psychological solution: better design of advisory tools, more behaviorally-oriented fintech products, and financial literacy focused on the specific cognitive biases

associated with investment risk. Future research designs should use longitudinal studies with actual portfolio data and SEM to more carefully explicate causal relationships between behavioral variables and eventual portfolio decisions through liquidity preference.

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