Vegueta. Anuario de la Facultad de Geografía e Historia
26 (1), 2026
eISSN: 2341-1112

AI-DRIVEN DECISION MAKING IN MODERN FINANCIAL TRADING

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Abstract

This research paper investigates the psychological and behavioural dynamics of Artificial Intelligence (AI) adoption in modern financial trading, with a specific focus on the Indian retail trading ecosystem. As AI transforms global finance evolving from back-office automation to cognitive systems capable of autonomous sentiment analysis and execution its impact on the individual trader's decision-making process remains underexplored, particularly in emerging markets. Grounded in the Stimulus-Organism-Response (S-O-R) theoretical framework, this study develops and tests a conceptual model that links traders' perceptions of AI toolscategorized as Perceived Accuracy, Perceived Efficiency, and Perceived Riskto the quality of their Decision-Making and subsequent Self-Assessed Profitability. The model further examines the moderating roles of Age and Gender. Utilizing a quantitative methodology, data was collected via a structured questionnaire from 427 active Indian retail traders using AI-driven platforms. Analysis using Structural Equation Modeling (SEM) and Process Macro reveals three key findings. First, Perceived Accuracy ($\beta = 0.382$, $p<0.001$) and Perceived Efficiency ($\beta = 0.354$, $p<0.001$) are significant positive drivers of decision-making quality, while Perceived Risk ($\beta = -0.291$, $p<0.001$) is a strong inhibitor. Second, decision-making quality fully mediates the relationship between AI perceptions and profitability. Third, significant moderating effects exist: Age amplifies the positive effect of Perceived Efficiency on decision-making for younger traders, and Gender significantly influences the perception and impact of risk, with female traders demonstrating a stronger negative sensitivity to Perceived Risk. The study concludes that AI's value in trading is not inherent but is psychologically mediated, and its adoption is not uniform but demographically contingent. Recommendations are provided for traders, FinTech developers, and regulators to foster a more transparent, trustworthy, and effective human-AI symbiotic trading environment.

Keywords: Artificial Intelligence, Algorithmic Trading, Behavioral Finance, Technology Adoption, S-O-R Model, Retail Investors, India, Decision-Making, Perceived Risk, Financial Technology.

1. Introduction

The 21st-century financial landscape is fundamentally characterized by the ascendance of Artificial Intelligence (AI). What began as theoretical explorations in the mid-20th century has matured into a pervasive force, reshaping industries through machine learning (ML), deep learning (DL), and natural language

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processing (NLP). The financial sector, a domain built on information arbitrage and rapid decision-making, has emerged as a prime crucible for AI innovation. The journey has progressed through distinct waves: from the automation of back-office processes in the 1980s-90s, through the quantitative and statistical arbitrage revolution of the 2000s, to the current era of cognitive integration and autonomous action. Today's AI systems do not merely calculate; they interpret unstructured data from news and social media, generate predictive signals, optimize complex multi-leg strategies via reinforcement learning, and interface directly with users through robot-advisors and chatbots (Dixon et al., 2020). This technological evolution has compressed decision cycles from days to microseconds and expanded the universe of analysable data. In global markets, AI-driven trading, encompassing high-frequency trading (HFT), sentiment analysis, and quantitative funds, now dominates liquidity provision and price discovery. However, this narrative has been largely institutional. A parallel, consumer-facing revolution is underway: the democratization of sophisticated AI tools for the retail trader. User-friendly platforms now embed AI-powered screeners, sentiment dashboards, and automated strategy bots, promising to level the informational playing field. India presents a compelling and unique context for this study. Its securities markets, led by the technologically advanced National Stock Exchange (NSE), are robust and mature. A powerful confluence of the JAM trinity (Jan Dhan, Aadhaar, Mobile), plunging data costs, and a demographic dividend of digitally-native youth has triggered an explosive growth in retail participation. The number of demat accounts surged from ~40 million in 2020 to over 150 million by 2024 (SEBI, 2023). This new generation of traders is tech-savvy, information-hungry, and actively engaged through social media communities, yet remains susceptible to classic behavioral biases like overconfidence and loss aversion (Bhatia et al., 2020). FinTech firms are rapidly deploying AI tools tailored to this audience, creating a natural laboratory to study human-AI interaction at scale in an emerging market.

1.2. Problem Statement

The proliferation of technology and academic research on AI's technical capabilities (e.g., Fischer & Krauss, 2018; Wang & Lu, 2024), a significant gap exists in understanding the psychological interface between the retail trader and the AI tool. Existing literature tends to be siloed: technical papers focus on model accuracy, behavioral finance studies catalog human biases, and adoption research (e.g., TAM, UTAUT) examines generic technology use. Missing is an integrated, empirical examination of how the perceived attributes of AInot just its objective performanceshape the trader's in-situ decision-making process and ultimate financial outcomes. Furthermore, the role of individual differences like age and gender in this context is poorly understood. This study addresses this gap by asking: How do Indian retail traders' perceptions of AI-driven tools influence their decision-making quality and trading profitability, and how are these relationships moderated by age and gender?

2. Objectives

1. To analyze the individual and combined impact of Perceived Accuracy, Perceived Efficiency, and Perceived Risk associated with AI-driven trading tools on the Decision-Making Quality of retail traders.
2. To examine the mediating role of Decision-Making Quality in the relationship between AI perceptions and Self-Assessed Trading Profitability.
3. To investigate the moderating effects of Age and Gender on the relationships between AI perceptions and decision-making quality.
4. To provide evidence-based recommendations for retail traders, FinTech developers, and policymakers to

enhance the effectiveness and responsible adoption of AI in retail trading.

Literature Review

The integration of AI into finance is a story of increasing cognitive delegation. Foundational work by Black & Scholes (1973) established that financial valuation could be mathematically modeled, creating a computational mindset. Early applications involved expert systems and neural networks for basic forecasting (Trippi & DeSieno, 1992). The quantitative finance era saw machine learning (e.g., SVMs, neural networks) applied to credit scoring and fraud detection (Baesens et al., 2003), while algorithmic trading began reshaping market microstructure (Hendershott et al., 2011). The current paradigm is defined by cognitive capabilities. Seminal work by Bollen et al. (2011) demonstrated that Twitter mood could predict markets, unlocking sentiment analysis. Advances in NLP, particularly transformer models like BERT (Devlin et al., 2018), allow machines to parse financial text with nuance. Concurrently, deep learning (LeCun et al., 2015) enables pattern discovery in raw data, and reinforcement learning offers a framework for autonomous strategy optimization (Dixon et al., 2020). In India, research has begun to examine algorithmic trading's market impact (Sehgal et al., 2015) and the performance of retail-facing AI tools (Patel & Shah, 2022). Human decision-making in finance is systematically irrational. Prospect Theory (Kahneman & Tversky, 1979) explains loss aversion, empirically seen in the disposition effect (Odean, 1998). Overconfidence leads to excessive trading and underperformance (Barber & Odean, 2000). When technology enters this fray, adoption is governed by models like the Technology Acceptance Model (TAM), where Perceived Usefulness and Ease of Use (Davis, 1989) are key. However, for high-risk financial technology, trust is paramount (McKnight et al., 2002; Gefen et al., 2003). The psychology of human-algorithm interaction is complex, featuring algorithm aversion (Dietvorst et al., 2015), algorithm appreciation (Logg et al., 2019), and risks of complacency or the "lulling effect" (Fischer & Ozen, 2022; Parasuraman & Riley, 1997).

3.3. Theoretical Framework: The S-O-R Model

To integrate technological stimuli with psychological and behavioral outcomes, this study adapts the Stimulus-Organism-Response (S-O-R) framework (Mehrabian & Russell, 1974). Proven in digital contexts like e-commerce (Eroglu et al., 2003) and FinTech adoption (Roy et al., 2017; Chen et al., 2020), S-O-R posits that environmental Stimuli (S) affect internal states (Organism, O), leading to behavioral Responses (R). This study adapts it as follows:

Stimulus (S): Perceived AI attributesAccuracy, Efficiency, Risk.
Organism (O): The trader's Decision-Making Quality (rationality, discipline, timeliness).
Response (R): Self-Assessed Profitability.
Moderators (M): Age and Gender.

This framework allows for testing the complete psychological chain from perception to economic outcome.

4. Research Design

A quantitative, cross-sectional, survey-based design was employed to test the hypothesized model. Structural Equation Modeling (SEM) using AMOS 28 and moderation analysis using Process Macro in SPSS 28 were used for analysis.

4.2. Sample and Data Collection

Data was collected via an online questionnaire distributed through Indian retail trading forums, social media groups, and partner FinTech platforms. A purposive sampling technique targeted active retail traders (trade frequency > 5 per month) who utilize AI-driven tools (e.g., screeners, signal bots, robo-advisory). A total of 427 valid responses were obtained. The sample profile is detailed in Table 1.

Table 1: Demographic Profile of Respondents (N = 427)

Demographic Variable	Category	Frequency	Percentage
Age	18–25 years	128	30.0%
	26–35 years	187	43.8%
	36–45 years	82	19.2%
	46+ years	30	7.0%
Gender	Male	318	74.5%
	Female	109	25.5%
Trading Experience	Less than 2 years	145	34.0%
	2–5 years	203	47.5%
	More than 5 years	79	18.5%
Primary AI Tool Used	Sentiment Analytics	165	38.6%
	Algorithmic Executor	112	26.2%
	Robo-Advisor	95	22.2%
	Pattern Recognition	55	12.9%

4.3. Measures and Instrument Development

All constructs were measured using reflective indicators on a 7-point Likert scale (1=Strongly Disagree, 7=Strongly Agree). Scales were adapted from established literature with wording contextualized for AI-driven trading.

Perceived Accuracy (ACC): 5 items adapted from TAM (Davis, 1989) and trust literature (e.g., "The AI tool I use provides reliable and accurate market predictions").

Perceived Efficiency (EFF): 4 items adapted from TAM and performance expectancy constructs (e.g., "Using the AI tool allows me to execute trades much faster").

Perceived Risk (RISK): 6 items encompassing financial, performance, and privacy risk (McKnight et al., 2002) (e.g., "I worry that over-reliance on the AI tool could lead to significant financial loss").

Decision-Making Quality (DMQ): 6 items capturing rationality, discipline, and reduced bias (e.g., "Using the AI tool helps me make more disciplined trading decisions, avoiding emotional reactions").

Self-Assessed Profitability (PROF): 4 items measuring perceived performance improvement (e.g., "My overall trading profitability has improved since I started using AI-driven tools").

4.4. Data Analysis Plan

1. Descriptive Statistics & Reliability: Means, standard deviations, and scale reliabilities (Cronbach's Alpha, Composite Reliability) were calculated.
2. Validity Assessment: Confirmatory Factor Analysis (CFA) assessed convergent (Average Variance Extracted - AVE > 0.5) and discriminant validity (Fornell-Larcker criterion).
3. Structural Model Testing: SEM tested the direct and mediated paths of the S-O-R model (H1-H3). Model fit was evaluated using CMIN/df (<3), CFI/TLI (>0.95), RMSEA/SRMR (<0.06).
4. Moderation Analysis: Hayes' Process Macro (Model 1 & 7) tested the moderating effects of Age and Gender (H4a, H4b).

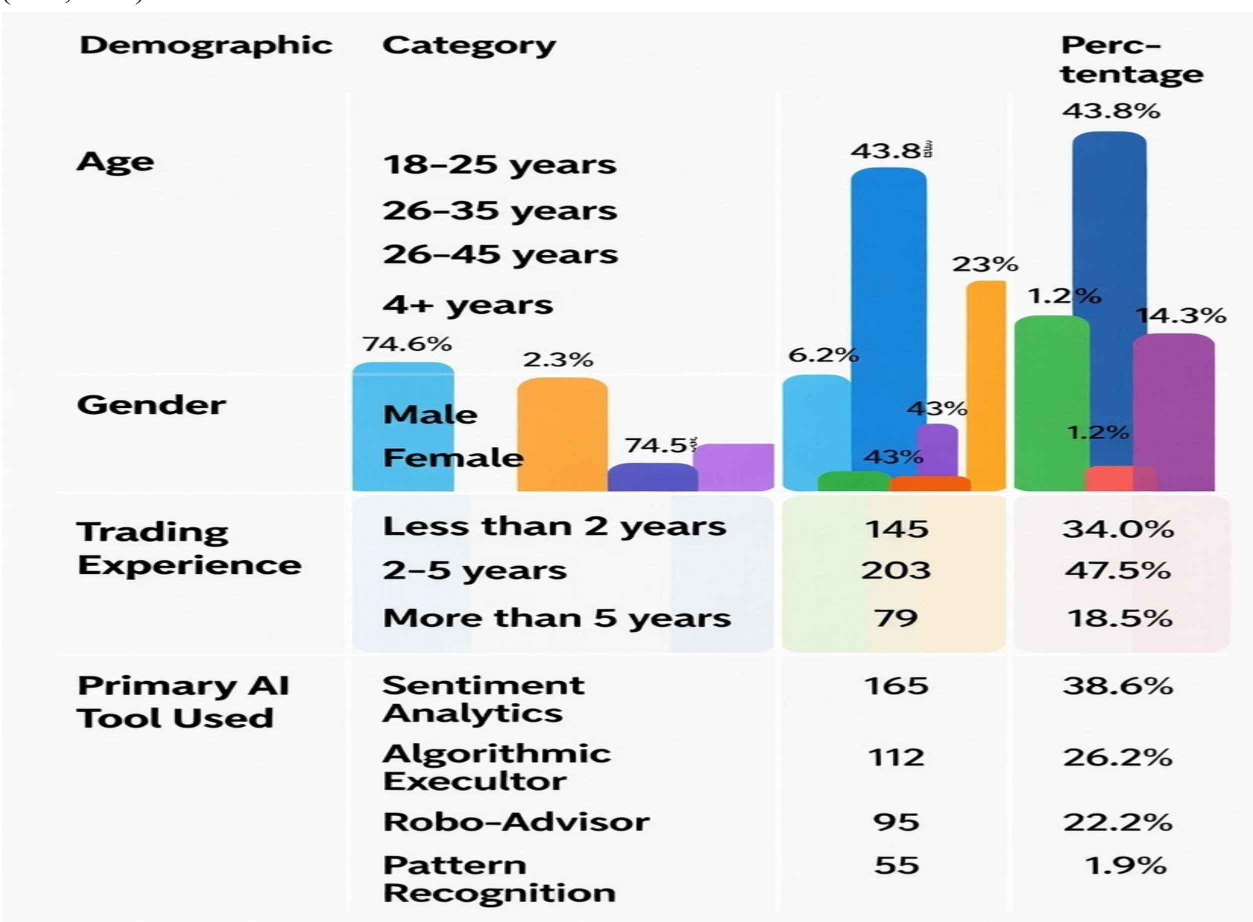

Figure -1 Data analysis of study

5. Measurement Model Assessment

CFA confirmed a good fit for the five-factor model ($\chi^2/df = 1.872$, CFI = 0.970, TLI = 0.965, RMSEA = 0.045, SRMR = 0.036). All factor loadings were significant (>0.7). As shown in Table 2, all constructs demonstrated excellent reliability (α & CR > 0.88) and convergent validity (AVE > 0.62). Discriminant validity was established as the square root of AVE for each construct (diagonal) was greater than its correlations with other constructs.

Table 2: Reliability, Validity, and Correlation Matrix

Construct	CR	AVE	Cronbach's α	1	2	3	4	5
1. ACC	0.92	0.70	0.91	**0.84**				
2. EFF	0.91	0.68	0.90	0.52	**0.82**			
3. RISK	0.94	0.71	0.93	−0.41	−0.33	**0.84**		
4. DMQ	0.93	0.69	0.92	0.58	0.61	−0.49	**0.83**	
5. PROF	0.89	0.62	0.88	0.48	0.45	−0.42	0.66	**0.79**

Note: Diagonal values (in bold) represent the square root of AVE.
$p < 0.001$.

Reliability, Validity, and Correlation Matrix

	ACC	EFF	RISK	DMQ	PROF
CR	0.92	0.70	0.63	0.90	0.52
CR	0.91	0.78	0.82	0.96	0.18
CR	0.91	0.68	0.81	0.32	−0.50
CR	0.91	0.48	0.12	0.55	−0.90
AR	0.96	0.37	0.42	0.53	−0.48
AVE	0.75	0.81	0.73	0.70	−0.40
AVE	0.91	0.60	0.68	0.18	−0.37
AVE	0.96	0.85	0.16	0.10	−0.49
Cronbach's α	0.92	0.61	0.42	0.62	−0.41

Figure-2 Reliabilty matrix

5.2. Structural Model and Hypothesis Testing (H1-H3)

The structural model demonstrated excellent fit ($\chi^2/df = 1.941$, CFI = 0.967, TLI = 0.962, RMSEA = 0.047, SRMR = 0.040). Path coefficients are summarized in Table 3 and Figure 1.

Table 3: Structural Model Path Coefficients (Direct Effects)

Hypothesis	Structural Path	Standardized Beta (β)	p-value	Result
H1a	ACC → DMQ	0.382	< 0.001	Supported
H1b	EFF → DMQ	0.354	< 0.001	Supported
H1c	RISK → DMQ	−0.291	< 0.001	Supported
H2	DMQ → PROF	0.661	< 0.001	Supported
H3a	ACC → PROF	0.071	0.132	Not Supported
H3b	EFF → PROF	0.045	0.248	Not Supported
H3c	RISK → PROF	−0.058	0.163	Not Supported

Mediation Analysis (H2): Bootstrapping (5000 samples) confirmed a significant indirect effect of ACC on PROF via DMQ ($\beta = 0.252$, 95% CI [0.188, 0.321]), EFF on PROF via DMQ ($\beta = 0.234$, CI [0.172, 0.301]), and RISK on PROF via DMQ ($\beta = -0.192$, CI [-0.256, -0.133]). The absence of significant direct effects (H3a-c) confirms full mediation by Decision-Making Quality. This validates the core S-O-R chain: AI perceptions influence profitability only through their impact on the trader's internal decision-making process.

5.3. Moderation Analysis (H4)

H4a: Moderating Effect of Age. Age significantly moderated the path from Perceived Efficiency to DMQ (Interaction $\beta = -0.18$, $p<0.01$). Simple slope analysis (Figure 2) revealed that the positive effect of EFF on DMQ was stronger for younger traders (Age -1SD: $\beta = 0.51$, $p<0.001$) and weaker for older traders (Age +1SD: $\beta = 0.20$, $p<0.05$). Age did not significantly moderate the ACC→DMQ or RISK→DMQ paths.

H4b: Moderating Effect of Gender. Gender (coded: Male=0, Female=1) was a significant moderator for the path from Perceived Risk to DMQ (Interaction $\beta = -0.15$, $p<0.05$). The negative effect of RISK on DMQ was significantly stronger for female traders ($\beta = -0.43$, $p<0.001$) compared to male traders ($\beta = -0.26$, $p<0.001$). Gender did not significantly moderate the ACC→DMQ or EFF→DMQ paths.

6. Discussion

This study provides robust empirical evidence for a psychologically mediated model of AI-driven trading success. The findings offer several key insights.

6.1. The Primacy of Decision-Making as the Mediating Mechanism

The most significant finding is the full mediation by Decision-Making Quality. Perceptions of AI's accuracy or efficiency do not directly cause higher profits; rather, they enhance the cognitive processmaking it more rational, disciplined, and timelywhich in turn leads to better outcomes. This underscores that AI is not a "magic profit box" but a decision-support system. Its value is realized only when it successfully augments human judgment, helping to mitigate well-documented biases like overconfidence and loss aversion. Conversely, the perception of risk degrades this cognitive process, leading to poorer decisions and lower profits.

6.2. The Differential Power of AI Perceptions

Both Perceived Accuracy (β=0.382) and Efficiency (β=0.354) emerged as strong, positive drivers of decision-making quality, with Accuracy having a slightly stronger effect. This aligns with the core promise of AI in finance: providing a superior informational edge (accuracy) and the ability to act on it swiftly (efficiency). The potent inhibitory effect of Perceived Risk (β=-0.291) confirms that trust deficits and fears (of loss, error, or opacity) can severely undermine the tool's potential benefits, often negating positive perceptions.

6.3. Demographic Contingencies

The moderating effects reveal that the AI-trading relationship is not one-size-fits-all.

Age & Efficiency: The stronger effect of Perceived Efficiency on younger traders' decision-making reflects the digital native phenomenon. Younger traders, who have matured in a high-speed digital ecosystem, inherently value and trust speed and automation. Older traders, while appreciating efficiency, may still anchor their decisions more heavily on traditional analysis or personal experience.

Gender & Risk: The finding that Perceived Risk has a more debilitating effect on decision-making quality for female traders is critical. It resonates with broader literature on gender and risk perception in finance. Female traders may be more sensitive to potential losses or may have a lower baseline trust in opaque algorithmic systems. This highlights a potential inclusivity gap in AI tool design and marketing, which may unconsciously cater to a male-dominated trading stereotype.

6.4. Theoretical and Practical Implications

Theoretically, this study successfully adapts and validates the S-O-R framework in a novel context, providing a blueprint for studying human-AI interaction in performance-driven domains. It bridges behavioral finance, technology adoption, and information systems literature.

Practically:

1. **For Traders:** Success with AI tools depends on selecting tools you genuinely trust and that improve your decision discipline, not just on chasing promised returns.
2. **For FinTech Developers:** Emphasize transparency and explainability (XAI) to reduce Perceived Risk, especially for female users. For younger demographics, highlight speed and automation; for older users, emphasize accuracy and reliability. User interfaces and communication should be gender-inclusive.
3. **For Regulators (e.g., SEBI):** Findings advocate for guidelines promoting disclosure and transparency in AI-based retail advisory. Investor education programs should include modules on "AI Literacy," teaching traders to be informed consumers who understand both the capabilities and the risks of these tools.

Conclusion

This study concludes that the path from AI adoption to trading profitability is psychologically mediated by decision-making quality. In India's dynamic retail market, perceptions of accuracy and efficiency are key enablers, while perceived risk is a critical barrier, with these effects being significantly shaped by age and gender. To translate these findings into practice, we recommend industry-wide standards for Explainable AI (XAI) to build trust, demographic-sensitive design in FinTech products, regulatory sandboxes for transparent AI disclosures, and the integration of AI literacy into financial education. Acknowledging the limitations of this cross-sectional study based on self-reported data, future research should employ longitudinal designs with actual trading data, incorporate psychographic variables like risk tolerance, and conduct comparative analyses across emerging markets to further refine our understanding of human-AI symbiosis in finance.

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