

Analysis of Investor Psychology and Investment Decision

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Abstract

The study aims to examine on how investors decisions are influenced by psychological factors on the Nepalese stock exchange. The study uses descriptive and causal-comparative research methodologies to address problems related to the influences of economic and psychological factors in investors' decision making on the Nepalese stock exchange. The 150 Nepalese stock exchange investors from Ward No. 5 of Hetauda sub-metropolitan City who are currently making investments make up the study's sample. One hundred and fifty questionnaires are gathered in order to analyze individual investment decision-making. The primary sources of data used in this study were questionnaires with a 5-point Likert scale that were given to NEPSE investors. Individual investor decision-making is the dependent variable, whereas profitability, risk-taking ability, and price movement information effect are the independent variables. Risk-taking ability and price movement information are found to be significantly correlated with individual investors' decision-making. These factors show positive coefficients, suggesting that investors are more inclined to make decisions when they have greater risk-taking capacity and access to price movement information. However, profitability is not statistically significant with individual investors' decision-making. As a result, investors with a higher risk tolerance actively take price movement information into account and exhibit overconfidence while making investment decisions. It is crucial to remember that these conclusions are predicated on the examined data and a particular sample. When making investing selections, investors should take into account a variety of aspects, including their personal risk tolerance, market conditions, and financial objectives.

Keywords: Investors' Investment Decision, Profitability, Risk-taking Capacity

Introduction

The objective of an investment is to make profit. Investors in stock market make decisions based on investment needs, goals, and objectives with constraints in making investment decisions.

However, it is not guaranteed for a rational investment decision at all times. Conventional finance theories have two underlying assumptions about investors' decision with respect to stock market investment: first, investors make rational decisions based on their investment strategies and risk return consideration; second, they have neutral estimation about future stock returns (Kadariya, 2012). An argument against the assumptions of traditional finance theories advocates that investor do not have same nature of investment at all times, and hence their decisions also depend on their perceptions toward various factors that affect the investment decisions (Baghdadabad et al., 2011; Shrestha et al., 2008; Adhikari & Shrestha, 2006). Similarly, Shefrin (2000) and Shleifer (2000) showed that investors' decisions largely depend on behavioral factors internal and external to them. Therefore, Warneryd (2001) argued that there is a need to identify factors affecting investors' behavior that can be effective for different policymakers, issuer of securities and government to come up with additional policies and procedures needed to satisfy investors' desires and to increase market efficiency.

Merikas et al. (2004) examined the factors influencing individual investor behavior in the Greek stock exchange. The study is based on primary data collected from 150 respondents. The study discovered a level of correlation between the factors identified by behavioral finance theory and previous empirical evidence. The study also concluded that investment decisions of an active investors in the Athens Stock Exchange (ASE) influenced by market trends

Baker and Wurgler (2006) through simple theoretical arguments and cross-sectional of stock returns examined investor sentiment, and the Cross-Section of Stock Returns which was based on simple theoretical arguments, historical accounts of speculative episodes, and most importantly a set of novel empirical results to demonstrate the investor sentiment. The study found in the initial phase sentiment that when beginning-of-period sentiment are low, subsequent re-turns are relatively high for small stocks, young stocks, high volatility stocks, un-profitable stocks, non-dividend-paying stocks, extreme growth stocks, and distressed stocks. On the other hand, when sentiments are high, these stocks earn relatively low subsequent returns. Through these studies it can be concluded that sentiments have significant cross-sectional effects.

Kengatharan and Kengatharan (2014) stated that cognition seriously implements in behavioral theory of finance. However, behavioral finance can take into account psychological behavior (such as emotion and panic) that can affect the conduct of individual investors. As a result, irrational behaviour of investors can be understood through the lens of psychology and anthropology. Individual investors do not always act in their own best interests, as behavioral finance suggests. Mitroi (2016) maintained that price anomalies can be examined by using behavioral finance.

In the context of Nepal, Risal and Khatiwada (2019) revealed that the hasty decision had relationship with herding behavior. The mood, insights, peer pressure, market factor, motivation and other dimensions of behavioral finance should be considered while making the investment decision. The return on investment could be the ultimate purpose of the investor but the time duration might vary. The factors like dividends and its growth rate, investment for saving purposes or quick benefits through trading had affected the individual investment decisions.

The above discussion shows that the studies dealing with the effect of psychological and economic factors on individual investor's decision making are of greater importance. Hence, this study will focus on the effect of psychological and economic factors on individual investor's decision making of NEPSE.

Problem Statement

In the context of Nepal, Adhikari (2010) examined the investment behavior of Nepalese investors in stock market of Nepal using the data collected from self-administered questionnaire survey. Kadariya (2012) surveyed the factors affecting investor decision making in the context of Nepalese capital market among the sample of 185 stock investors. The study revealed that capital structure and average pricing method are the most important factors that influence the investment decisions followed by factors such as political and media coverage, and financial education. The study primarily concluded that both tangible and intangible information are essential factors affecting investment decision in Nepalese capital market. Hence, this study deals with the effect of psychological and economic factors on individual investor's decision making in NEPSE. Thus, the study deals with the following issue: what is the impact of profitability, risk-taking capacity, and price movement information, effect in decision making of Nepalese stock exchange?

Objective of the Study

The general objective of the study is to analysis of investor's psychology and investment decision. The specific object is: to examine the impact of perception of respondents on profitability, risk taking capacity and price movement information effect in decision making of Nepalese stock exchange.

Rationale of the Study

This study acquire the useful knowledge in understanding the psychological factors and able to make their individual decision for investment in Nepalese stock exchange. The study also provides insight on understanding the behavioral aspects of investor's which can be used to formulate proper policies. This study also used in guiding Nepalese stock exchange and brokers to design and deliver the right decision making for individual. Hence, deeper understanding about the effect of psychological and economic factors on individual investor's decision making helps management and policy makers of Nepalese stock exchange and brokers to build and plan proper marketing strategies that could motivate investors for decision making.

Research Gap

Review of different literatures reveal that different studies conducted in different period of time relating to effect of psychological factors and economic factors on individual investors' decision making. In relation with the present study there is lacking study in Nepalese context as compared to various study that have been conducted in international context. Comprehensive studies are not conducted in countries like Nepal. So, considering the research gap particularly in Nepal, this study proposes a framework to determine the effect of psychological factors and economic factors on individual investors' decision making which is identified as a major research gap.

Research Methods

The study focuses on analysis of investor's psychology and its impact on investment decision. This chapter is divided into five sections; research design, population and sampling, nature and source data collection, methods of analysis, research framework and definition of variable.

Research Design

This research study will be employed descriptive and causal-comparative research designs to deal with the issues associated with effect of psychological factors on individual investor's decision making.

Population and Sample

This study is based on primary sources of data structured in 5-point Likert Scale questionnaires and distributed to the investors in NEPSE. Convenience sampling is used to track the respondents for the study. The sampling technique generally assumes a homogeneous population that means the member of population poses similar characteristics. The sample for this study is the 150 investors of Nepalese stock exchange who are currently engaged in investing from Hetauda -5, where approximately 1519 investors are investing in NEPSE.

Data Collection and Data Analysis

This study has been designed to understanding the opinions of respondents regarding the decision making by the investors while making investment. Investors were humbly requested to provide the degree of agreement and disagreement in the five-point Likert scale questions ranging from (1-Strongly disagree to 5-Strongly agree).

After gathering all the completed questionnaires from the respondents, it was analyzed and presented in proper tables. Descriptive, correlation and regression methods of analysis are used in the study.

Results and Findings

This study is primarily based on primary data analysis, which mainly deals with qualitative aspects in terms of factors influencing individual investor's decision making. This section also reports the result of questionnaire survey conducted among the different respondents. Questionnaire survey was designed to understand the views of the respondents regarding profitability, risk taking capacity, price movement information, overconfidence, optimism, fear of loss and consultancy effect on individual investor decision making of Nepalese stock exchange. A set of questionnaires including multiple choices, and Likert scale questions are provided. The respondents profile along with their personal characteristics and result of the survey are presented in below.

Frequency Analysis

The respondents' profile reveals the personal characteristics of respondents combined on the basis of different personal characteristics such as: gender, age group, marital status, academic qualification, occupation, monthly income, duration of investment, and types of market operated in. Demographic characteristic plays a significant role in understanding behavior of the employees in banking sector. This section therefore describes the demographic characteristics of the respondents.

Table 1
Frequency Analysis of Demographic Factors

Gender	Frequency	Percent
Male	89	59.3
Female	61	40.7
Total	150	100.0
Age	Frequency	Percent
18- 25 years	34	22.7
26-35 years	98	65.3
36-50 years	10	6.7
More than 50 years	8	5.3
Total	150	100.0
Marital Status	Frequency	Percent
Married	56	37.3
Unmarried	94	62.7
Total	150	100.0
Academic Qualification	Frequency	Percent
School level or lower	5	3.3
Intermediate level	16	10.7
Bachelors	56	37.3
Masters or above	73	48.7
Total	150	100.0
Occupation	Frequency	Percent
Salaried employee	105	70.0
Businessman	8	5.3
Professional	10	6.7
Retired	8	5.3

Student	19	12.7
Total	150	100.0

Monthly Income (in Rs.)	Frequency	Percent
Below 10000	25	16.7
10000-20000	15	10.0
20001-30000	17	11.3
30001-40000	79	52.7
40001-50000	14	9.3
Total	150	100.0

Investment Duration	Frequency	Percent
Below 1	25	16.7
1-3 years	67	44.7
3-5 years	40	26.7
5-10 years	12	8.0
Above 10 years	6	4.0
Total	150	100.0

Market Type	Frequency	Percent
Primary Market	69	46.0
Secondary Market	4	2.7
Both	77	51.3
Total	150	100.0

The frequency analysis table 2 provides a breakdown of the participants' characteristics or responses in the study. Each variable is presented with corresponding frequencies and percentages, allowing for a better understanding of the composition of the sample.

Descriptive analysis

Table 2

Descriptive Statistic for Profitability

Items	N	Mean	SD
When stocks' prices are decreasing; I usually hold them longer to wait for increasing trend	150	3.21	1.021
I invest in stocks in which I can get the profit as soon as possible	150	3.65	.795
I am willing to experience the ups and downs of the market for the potential of greater returns	150	3.48	.918
I am more interested in conserving capital than growing my assets	150	3.35	.976
The expected corporate earnings of firm attract me for investment.	150	3.77	.949
Weighted Average Mean and SD		3.49	.93

The table above shows highest mean of 3.77 which suggesting that on average respondents makes investment selections relying on a company's expected corporate earnings. Conversely, they hold on to sinking stocks with a hope of price increase in future which scores the lowest mean 3.21. It suggests that when stock prices drop, people might be more likely to reduce their losses or look for other investing options.

The question with the highest standard deviation (SD), which quantifies the variability or dispersion of responses around the mean, is 1.021. This suggests that respondents' perspectives on this statement differ significantly. On the other hand, the item's lowest SD is 0.795. It suggests that, in comparison to the other items, respondents' opinions on this statement show comparatively less diversity or dispersion. Regarding the respondents' tendency to hang onto sinking equities, there appears to be more agreement or consensus among them.

The table 4 above, the highest mean is 3.77 which indicates that in general respondents make investment decisions based on expected corporate earnings by a company. On the other hand, when stock falls and participants still keep hope with higher price in the future is weighted as the least with a mean of 3.21. This implies that on dropping of stock prices people are prone for exit to either avoid further losses or find another way of investing.

Table 3

Descriptive Statistic for Risk Taking Capacity

Items	N	Mean	SD
I consider risk in investments as an opportunity.	150	3.42	.985
I invest in stocks which have price fluctuation	150	2.78	.776
When stocks' prices are decreasing; I usually hold them longer to wait for increasing trend	150	3.47	.849
I invest mostly in companies with stable expected returns	150	3.78	.722
I am willing to be more aggressive and face greater fluctuations in portfolio value in order to pursue the possibility of above average returns	150	3.03	.831
Weighted Average Mean and SD		3.30	.83

The analysis from the mean score show that respondents are more inclined to the stocks that guarantee stable and predictable returns. This shows that many investors place importance on security and reliability, leaning toward lower-risk options with more consistent outcomes. In contrast, respondents showed less inclined towards the stock which have high price fluctuations, suggesting a weaker interest in highly volatile investments.

The standard deviations show how different the responses are. The highest SD indicates that opinions are very different when it comes to seeing risk as an opportunity. Some respondents see risk as a way to get higher returns, while others are more careful and prefer to avoid it. While, the lowest SD shows that respondents agree that they have higher preferences to invest in stocks that have stable returns.

Table 4*Descriptive Statistic for Price Movement Information*

Items	N	Mean	SD
Market information and stock investment	150	3.81	.972
Price change and investment in stock	150	4.19	.639
Considerations of previous trends and investment considerations	150	3.82	.544
Analysis of previous performance helps to determine future value of a stock	150	3.78	.612
Investment in profitable stock	150	4.36	.638

The weighted average mean shows that respondents mostly prefer stocks that can give higher profit, which means they focus more on possible returns when investing. The lowest mean suggests that respondents do not fully believe that future stock value can be predicted only by looking at past performance, so they may consider other factors as well. For the standard deviation, the highest SD indicates that respondents have different opinions about price movement. Meanwhile, the lowest SD shows that respondents have more similar views when using past stock trends in making investment decisions.

Table 5*Descriptive Statistic for Decision Making*

Items	N	Mean	SD
I consider accounting information for decision.	150	3.83	.689
I make investment after detailed analysis.	150	3.75	.962
The advocate recommendations help me for investment decision.	150	3.65	.743
I consider firm image/ self-image coincidence for investment decision.	150	3.90	.693
I believe that my skills and knowledge of the market help me to outperform the market.	150	3.41	.753
Weighted Average Mean and SD		3.71	.77

Examining the means (averages) of the items, we find that the highest mean 3.90 indicates that, on average, respondents take into account the alignment between the firm's image and their self-image when making investment decisions. Conversely, the item with the lowest mean 3.41 suggests that, on average, respondents are less confident in their skills and knowledge of the market leading to outperformance. They may have a more modest belief in their abilities to surpass the overall market performance.

Correlation Analysis

Table 6 shows significant correlation of decision making (DM) with profitability (PROF), risk-taking capacity (RTC), and price movement information (PMI) at the 0.01 level. The value of 0.339 ($p < 0.01$) indicate that profitability is positively associated with investment decisions. Likewise, correlation between DM and risk-taking capacity (RTC) is also significant at the 0.01 level, with an r value of 0.511, $p < 0.01$, indicating investors with risk taking attitude are more active in their decisions.

Table 6*Correlation Analysis*

Variables	PROF	RTC	PMI	DM
PROF	1			
RTC	0.486**	1		
PMI	0.342**	0.355**	1	
DM	0.339**	0.511**	0.499**	1

** Correlation is significant at the 0.01 level (2-tailed)

* Correlation is significant at the 0.05 level (2-tailed)

The correlation between decision making and price movement information is significant at the 0.01 level, with an r value of 0.499, $p < 0.01$, indicates investors who regularly study the price movement show more confidence their investment decisions.

Overall, the results show that investors' decisions are influenced by the factors like profitability, risk-taking capacity, and price movement information. Also, overconfidence, optimism, and others advices also influence their decisions. However, fear of losing money does not show a clear relationship with how investors make their choices. This means that investors are more likely to rely on their own decisions when they focus on profit, are willing to take risks, pay attention to price movement, feel confident and optimistic, and seek advice when needed.

Regression Analysis

The R-square value of 0.517 in Table 7 shows that more than half of the changes in individual investors' decision making can be explained by the variables used in the model. This model analysis helps to explain the data to the reasonable level. The standard error of the estimate refers to the usual amount of error in the results; showing how close or far the predicted values are from the actual values.

Table 7*Model Summary*

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.719	.517	.493	.33434

Predictors: (Constant), RTC, PMI, PROF)

Note: PROF: Profitability; RTC: Risk taking capacity; PMI: Price movement information; DM: Individual investors' decision making

Table 8*Analysis of Variance (ANOVA)*

	Model	Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	16.974	7	2.425	21.692	.000
	Residual	15.873	142	.112		
	Total	32.847	149			

Dependent Variable: DM

Predictors: (Constant), RTC, PMI, PROF)

The result from ANOVA test shows that the model is significant as a whole the F-value (21.692) and p-value (0.000). Here, the F-value checks if all the regression coefficients are zero, suggesting independent variables have no influence investors on decision making. Since the p-value is very small (less than 0.05), it shows that the model is statistically significant.

Discussion

This study shows how investors are influenced by economic and psychological factors in their decision making. The study basically focuses on the factors such things like profitability, risk-taking, price movement information, overconfidence, optimism, fear of losing money, and other experts' advices. The results are the outcome of the analysis from among 150 surveys completed by investors. The investors are not always rational in decision making; instead they are influenced by psychological and economic factors, risk taking, which contradicts with traditional finance theory (Bakar & Yi, 2016; Mitroi & Oproiu, 2014). The study also found some important links between economic and psychological factors and the way investors make decisions. For example, a correlation of 0.339 ($p < 0.01$) shows a positive relationship between decision-making and profitability (PROF). This means investors who care more about profit are likely to make decisions based on their own analysis. These results are similar to what Gyanwali and Neupane (2021), Risal and Khatiwada (2019), and Dominic and Gupta (2020) found. Risk-taking capacity (RTC) also has a strong positive correlation with decision-making, with a coefficient of 0.511 ($p < 0.01$). Investors who are ready to take bigger risks usually make their own decisions about where to invest. This is similar to what Dominic and Gupta (2020) and Gyanwali and Neupane (2021) found. Looking at price movement information (PMI), it also seems to affect investors' choices. Investors who follow the market trends, price changes, and past performance are more self-deciders. This is also highlighted by Gyanwali and Neupane (2021) and Cao et al. (2021). Overall, the study shows that both economic and psychological factors affect how investors' make decisions. Things like profit, taking risks, price information, being overconfident or optimistic, and getting advice from consultants all seem to play a role. Knowing this can help investors and advisors understand why people make the choices they do in the market.

Conclusion

Profitability, risk-taking ability, and price movement information all have a positive effect on the decision-making of individual investors in the Nepal Stock Exchange. The study also shows that the consultancy effects, followed by price movement information, are the most influential factors for explaining how investors make decisions. It was also found that there is a significant relationship between decision-making and factors like risk-taking ability and price movement information. These factors have positive effects, meaning that investors who are more willing to take risks or have access to price movement information are more likely to make their own investment decisions.

Limitations

Data problem is the main problem in conducting this kind of study in the context of Nepal. Despite of the efforts made for arriving at meaningful conclusions from the study, some limitations are considered in order to obtain reliable interpretation of the results. The major limitations of the study are as follows:

- i) The study is completely based on the primary sources of data regarding psychological factors on individual investor's decision making. Therefore, the reliability of conclusions of the study depends upon the accuracy of information provided by the respondents.
- ii) The information collect through the respondents are assumed to be correct. The data are collected through mail so it may be biased as the study depends upon the information provided by the respondents.

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