Determinants of Individual Investor Behavior in Nepalese Stock Market

Upasana Adhikari and Prof. Dr. R. S. Pradhan*

Abstract

This study examines the determinants of individual investor behavior in Nepalese stock market. The dependent variable of the study is individual investment behavior. Similarly, the selected independent variables are investment opportunities, purpose of investment, sources of information, sources of influence, herding and financial instruments. The primary source of data is used to assess the opinions of the respondents regarding investment opportunities, purpose of investment, sources of information, sources of influence, herding and financial instruments in Nepalese stock market. The study is based on primary data of 120 respondents. To achieve the purpose of the study, structured questionnaire is prepared. The correlation coefficients and regression models are estimated to test the significance and importance of different factors on individual investor behavior in Nepalese stock market.

The study showed that financial instruments and purpose of investment have a positive impact on individual investment behavior. It implies that availability of better financial instruments drives the individual investment behavior. Likewise, multiple purpose of investment leads to increase in individual investment behavior. Moreover, investment opportunity has a positive impact on individual investment behavior indicating that increase in suitable investment opportunities lead to increase in individual investment behavior. Furthermore, source of information has a positive impact on individual investment behavior. It implies that the reliable source of information leads to increase in individual investment behavior. Similarly, the result also revealed that sources of influence have a positive impact on individual investment behavior indicating that proper influential factor in the market leads to increase in individual investment behavior. In addition, herding has a positive impact on individual investment behavior. It reveals that herding factor stimulates the individual investment behavior.

Key words: Stock market, individual investment behavior, financial instruments, investment and herding.

1. Introduction

Investment buying behavior is the process by which individuals make decisions about where to invest their money. This process is influenced by a variety of factors, including individual risk tolerance, investment goals, and

* Ms. Adhikari is a freelance researcher, Kathmandu, Nepal and Dr. Pradhan is the Professor and Academic Director, Uniglobe College (Pokhara University Affiliate), Kathmandu, Nepal. E-mail: upasanaadhikari01@gmail.com

financial knowledge (Sahi et al., 2013). In the fast-paced and ever-evolving world of finance, the study of investment buying behavior has become paramount to comprehend the intricate web of decisions that drive financial markets. The realm of investment buying behavior delves into the psychology and rationale behind individual and institutional investors' choices. It seeks to understand the factors influencing decision-making, the impact of emotions, and the role of market sentiment in shaping portfolios. Individual investors have different levels of risk tolerance. Some people are comfortable with a lot of risk, while others prefer to invest in safer assets. This can affect the types of stocks that people buy and how often they trade (Pompian, 2012). The level of knowledge and experience an investor has in the stock market can significantly impact their behavior. Well-informed and experienced investors may make more rational and informed decisions, while less experienced investors may be more influenced by emotions and market sentiment. Individual investors are susceptible to various psychological biases, such as overconfidence, loss aversion, and herd mentality (Ahmad, 2020). These biases can lead to suboptimal investment decisions. The volatility of the stock market can significantly affect investor behavior. Sharp market fluctuations may cause panic selling or buying, depending on the prevailing sentiment. The financial performance and outlook of specific companies' impact investor behavior. Positive earnings reports and growth prospects may attract investors, while poor performance may deter them. The accessibility and quality of information about listed companies and the stock market can influence how investors perceive opportunities and risks. Similarly, media and social platforms can play a role in shaping investor behavior by disseminating information, market analysis, and opinions. Investors may be influenced by news articles, expert opinions, and discussions on social media platforms (Chen et al., 2014).

Making investment decisions is an intricate endeavor for investors, particularly in a constantly evolving environment with a multitude of diverse alternatives to consider. In a country with a well-developed financial market, individuals are more likely to invest in stocks, bonds, and other financial products. This is because there are a wide variety of investment opportunities available, and individuals have access to the information and resources they need to make informed investment decisions (Farooq and Sajid, 2015). However, in a country with a limited financial market, individuals are more likely to invest in real estate or other tangible assets. This is because there are fewer investment opportunities available, and individuals may not have access to the information and resources they need to make informed investment decisions about financial products. When there are more financial instruments

available, individuals have more choices to choose from. This can lead to more informed decision-making, as individuals can compare different options and choose the one that best meets their needs (Dahiya and Chaudhary, 2016). The more financial instruments available, the lower the barriers to entry for individuals. This means that it is easier for individuals to start investing, even if they have limited knowledge or experience. During periods of economic growth, individuals are more likely to invest in stocks and other risky assets. This is because they are more confident about the future and they are looking for investments that offer the potential for high returns. The availability of financial instruments is just one factor that influences individual investment behavior. Other factors include individual risk tolerance, investment goals, and financial knowledge. However, the availability of financial instruments is an important factor, and it can have a significant impact on how individuals invest their money (Lodhi, 2014).

Financial instruments are tradable assets that represent a legally binding agreement between two parties regarding the exchange of certain financial terms and rights (Gumus and Pailer, 2019). These instruments are used to transfer and allocate capital, manage risk, and facilitate investment and trading activities in the financial markets. Some common examples of financial instruments are stocks (equities), bonds, mutual funds, exchange-traded funds, options, futures, currencies, commodities, derivatives and real estate investment trusts (Fabozzi and Mann, 2006). Individual investors are subject to behavioral biases, which can lead them to make irrational investment decisions. Some common behavioral biases include overconfidence, anchoring, and loss aversion. Oehler et al. (2018) investigated the relationship between individual investors' use of financial advice and their investment behavior. The study showed a positive relationship between investment behavior and sources of information. In addition, Chordia et al. (2001) analyzed the impact of different sources of information on trading activity in financial markets. The study revealed a positive relationship between investment behavior and sources of information.

Individual investors have different levels of risk tolerance. Some people are comfortable with a lot of risk, while others prefer to invest in safer assets. This can affect the types of stocks that people buy and how often they trade. The purpose of investment refers to the underlying objectives or goals that individuals or entities aim to achieve by allocating their funds into various investment opportunities. Investment purposes can vary depending on an individual's financial goals, risk tolerance, and time horizon. The purpose of

investment for wealth accumulation involves growing one's financial assets over time through capital appreciation, income generation, and compounding returns (Ramanujam and Chitradevi, 2012). The relationship between individual investment behavior and the purpose of investment is an important aspect of understanding how individuals align their investment decisions with their financial goals and objectives. Hira and Mugenda (2000) examined how the purpose of investment is related to investor characteristics, information sources, and risk tolerance. The study showed a positive relationship between investment behavior and purpose of investment. Similarly, Hong and Kacperczyk (2009) examined how investors' personal values, including ethical considerations or social responsibility, impact their investment decisions and the allocation of their capital. The study found a positive relationship between investment behavior and purpose of investment. Individual investors have different investment goals. Some people are saving for retirement, while others are saving for a down payment on a house. These goals can affect the types of stocks that people buy and how long they hold them.

In the context of Nepal, Karmacharya et al. (2022) showed that among the four behavioral variables, market, heuristic, and herding factors have significant effects on investment performance. Manandhar (2022) assessed the relationship between advocate recommendations and a firms' image and how they affect investment decisions in the Nepalese stock market. The study showed that advocate recommendations and firm image have a significant impact on investment decisions. Neupane (2021) evaluated the various factors influencing the risk tolerance of individual investors in Kathmandu Valley. The study showed that amongst the variables, time horizon, herd behavior and consultancy effect, and overconfidence have a positive significant impact on risk tolerance.

The above discussion reveals that the empirical evidences vary greatly across the studies concerning the determinants of individual investor behavior in stock market. Though there are above mentioned empirical evidences in the context of other countries and in Nepal, no such findings using more recent data exist in the context of Nepal. Therefore, in order to support one view or the other, this study has been conducted.

The major objective of the study is to examine the determinants of individual investor behavior in Nepalese stock market. More specifically, it examines the relationship of investment opportunities, purpose of investment, sources of information, sources of influence, herding, financial instruments

with individual investment behavior in Nepalese stock market.

The remainder of this study is organized as follows. Section two describes the sample, data and methodology. Section three presents the empirical results and the final section draws the conclusion.

2. Methodological aspects

The study is based on the primary data. The data were gathered from 120 respondents through questionnaire. The study employed convenience sampling method. The respondents' views were collected investment opportunities, purpose of investment, sources of information, sources of influence, herding, financial instruments and investment behavior. The study is based on descriptive and causal comparative research designs.

The model

The model estimated in this study assumes that individual investment behavior depends on investment opportunities, purpose of investment, sources of information, sources of influence, herding and financial instruments. Therefore, the model takes the following form:

$$IIB = \beta_0 + \beta_1 FI + \beta_2 PoI + \beta_3 IO + \beta_4 SoI + \beta_5 SI + \beta_6 H + e$$

Where,

FI = Financial instruments

PoI = Purpose of investment

IO = Investment opportunities

SI = Sources of influence

SoI = Sources of information

H = Herding

IIB = Individual investment behavior

Financial instruments were measured using a 5-point Likert scale where the respondents were asked to indicate the responses using 1 for strongly

disagree and 5 for strongly agree. There were 5 items and sample items include "I prefer to invest in equity share when investing", "I wish to invest in securities for profit/return." and so on. The reliability of the items was measured by computing the Cronbach's alpha ($\alpha = 0.742$).

Investment opportunities was measured using a 5-point Likert scale where the respondents were asked to indicate the responses using 1 for strongly disagree and 5 for strongly agree. There are 5 items and sample items include "In my opinion, no risk investments are the main attraction of bank deposits", "In my opinion, banking investment has lesser risk" and so on. The reliability of the items was measured by computing the Cronbach's alpha ($\alpha = 0.765$).

Purpose of investment was measured using a 5-point Likert scale where the respondents were asked to indicate the responses using 1 for strongly disagree and 5 for strongly agree. There are 5 items and sample items include "I invest almost half of my annual income", "I usually look for long term investments" and so on. The reliability of the items was measured by computing the Cronbach's alpha ($\alpha = 0.749$).

Sources of influence were measured using a 5-point Likert scale where the respondents were asked to indicate the responses using 1 for strongly disagree and 5 for strongly agree. There are 5 items and sample items include "Other investors' decisions of the stock volume have impact on my investment decisions)", "I think that the laws and regulations highly influence the investment opportunities" and so on. The reliability of the items was measured by computing the Cronbach's alpha ($\alpha = 0.862$).

Sources of information was measured using a 5-point Likert scale where the respondents were asked to indicate the responses using 1 for strongly disagree and 5 for strongly agree. There are 5 items and sample items include "Market information is important for my stock investment", "I rely on social media for making my information decisions" and so on. The reliability of the items was measured by computing the Cronbach's alpha ($\alpha = 0.753$).

Herding was measured using a 5-point Likert scale where the respondents were asked to indicate the responses using 1 for strongly disagree and 5 for strongly agree. There are 5 items and sample items include "When I want to invest, I depend on other people's investment decisions", "I react quickly to changes in other investors' decisions" and so on. The reliability of the items was measured by computing the Cronbach's alpha ($\alpha = 0.874$).

The following section describes the independent variables used in this study along with the hypothesis formulation.

Investment opportunities

Ljungqvist et al. (2006) stated that there is a positive relationship between investment opportunities and individual investment behavior. This means that the more investment opportunities available, the more likely individuals are to invest. In addition, Schwartz (2004) stated that when there are more investment opportunities available, individuals have more choices to choose from. This can lead to more informed decision-making, as individuals can compare different options and choose the one that best meets their needs. Further, Bapna (2019) stated that the more investment opportunities available, the more likely individuals are to take on more risk. This is because individuals have more options to choose from, and they can choose investments that offer higher potential returns but also higher risk. Likewise, Oehler et al. (2018) revealed that the more investment opportunities available, the lower the barriers to entry for individuals. This means that it is easier for individuals to start investing, even if they have limited knowledge or experience. Based on it, this study develops the following hypothesis:

H_1: There is a positive relationship between investment opportunities and individual investment behavior.

Financial Instruments

Barber and Odean (1999) analyzed the investment behavior of individual investors and the impact of their trading activities on investment performance. The study revealed a positive relationship between investment behavior and financial instruments. Similarly, Calvet et al. (2007) examined the investment behavior of individual households and the consequences of investment mistakes. The study showed a positive relationship between investment behavior and financial instruments. Further, Barber et al. (2020) examined how individual characteristics and preferences, as well as the characteristics of financial instruments impact investment behavior in this specific asset class. The study showed a positive relationship between investment behavior and financial instruments. Moreover, Tirumalsety and Gurtoo (2021) showed a positive relationship between investment behavior and financial instruments. Based on it, this study develops the following hypothesis:

H_2: There is a positive relationship between financial instruments and

individual investment behavior.

Sources of information

Ebrahim (2019) found a positive relationship between investment behavior and sources of information. Similarly, Weng et al. (2018) found that there is a positive relationship between investment behavior and sources of information. Moreover, Chordia et al. (2001) analyzed the impact of different sources of information on trading activity in financial markets. The study revealed a positive association between investment behavior and sources of information. Moreover, Goetzmann et al. (2008) explored the relationship between information sources and individual investors' portfolio diversification decisions. The study showed a positive relationship between investment behavior and sources of information. Based on it, this study develops the following hypothesis:

H_3: There is a positive relationship between sources of information and individual investment behavior.

Sources of influence

Calvet *et al.* (2007) examined the relationship between external influences, investment mistakes, and household welfare. The study showed a positive relationship between investment behavior and sources of influence. In addition, Rai *et al.* (2019) analyzed the financial attitude and financial behaviour have strong association with financial literacy of working women than financial knowledge. The study also showed a positive relationship between investment behavior and sources of influence. Moreover, Bagheri *et al.* (2019) showed a positive association between investment behavior and sources of influence. Further, Di Pietro and Buttice (2020) revealed a positive relationship between investment behavior and sources of influence. Based on it, this study develops the following hypothesis:

H_4: There is a positive relationship between sources of influence and individual investment behavior.

Purpose of investment

Fernandez et al. (2017) assessed how individuals' investment decisions in education are influenced by factors such as expected returns, financing constraints, and the socioeconomic context. The study showed a positive

relationship between investment behavior and purpose of investment. In addition, Kumar and Goyal (2021) found a positive relationship between investment behavior and purpose of investment. Further, Wang et al. (2019) showed a positive association between investment behavior and purpose of investment. Likewise, Trotta (2018) showed a positive relationship between investment behavior and purpose of investment. Vismara (2018) found a positive relationship between investment behavior and purpose of investment. Moreover, Gurun et al. (2018) showed a positive correlation between investment behavior and purpose of investment. Based on it, this study develops the following hypothesis:

H_5: There is a positive relationship between purpose of investment and individual investment behavior.

Herding

Scharfstein and Stein (1990) assessed the relationship between herd behavior and investment decisions. The study showed a positive relationship between investment behavior and herding. Further, Cao and Wang (2021) showed a positive relationship between investment behavior and herding. Similarly, Rahayu et al. (2021) found a positive relationship between investment behavior and herding. Likewise, Mallek et al. (2021) revealed a positive association between investment behavior and herding. Further, Adem and Sarıoglu (2020) showed a positive relationship between investment behavior and herding. Based on it, this study develops the following hypothesis:

H_6: There is a positive relationship between herding and individual investment behavior.

3. Results and discussion

Correlation analysis

On analysis of data, correlation analysis has been undertaken first and for this purpose, Kendall's Tau correlation coefficients along with means and standard deviations have been computed and the results are presented in Table 1.

Table 1: Kendall's Tau correlation coefficient matrix

This table presents Kendall's Tau correlation coefficients between dependent variable and independent variables. The correlation coefficients are based on 120 observations. The

dependent variable is IIB (Individual investment behavior). The independent variables are FI (Financial instruments), PoI (Purpose of investment), IO (Investment opportunity), SoI (Source of influence), SI (Source of information) and H (Herding).

Variables	Mean	S.D.	IIB	FI	PoI	IO	SoI	SI	H
IIB	3.543	0.761	1						
FI	3.861	0.684	0.394**	1					
PoI	3.622	0.729	0.324**	0.376**	1				
IO	3.531	0.704	0.247**	0.379**	0.223**	1			
SoI	3.716	0.850	0.411**	0.412**	0.333**	0.319**	1		
SI	3.610	0.740	0.387**	0.408**	0.245**	0.296**	0.339**	1	
H	3.239	0.916	0.470**	0.339**	0.298**	0.227**	0.414**	0.455**	1

Notes: The asterisk signs (**) and (*) indicate that the results are significant at one percent and five percent level respectively.

The study shows that financial instruments is positively correlated to individual investment behavior. It implies that availability of better financial instruments drives the individual investment behavior. Likewise, the result also reveals that purpose of investment is positively correlated to individual investment behavior. It implies that multiple purpose of investment leads to increase in individual investment behavior. Moreover, investment opportunity is positively correlated to individual investment behavior indicating that increase in suitable investment opportunities lead to increase in individual investment behavior. Furthermore, source of information is positively correlated to individual investment behavior. It implies that the reliable source of information leads to increase in individual investment behavior. Similarly, the result also reveals that sources of influence is positively correlated to individual investment behavior indicating that proper influential factor in the market leads to increase in individual investment behavior. In addition, herding is positively correlated to individual investment behavior. It reveals that herding factor stimulates the individual investment behavior.

Regression analysis

Having analyzed the Kendall's Tau correlation coefficients matrix, the regression analysis has been carried out and the results are presented in Table 2. More specifically, it presents the regression results of financial instruments, purpose of investment, investment opportunities, sources of influence, sources of information and herding on individual investment behavior in Nepalese stock market.

Table 2: Estimated regression results of financial instruments, purpose of in-

vestment, investment opportunities, sources of influence, sources of information and herding on individual investment behavior in Nepalese stock market

The results are based on 120 observations using linear regression model. The model IIB = $\beta_0 + \beta_1$ FI + β_2 PoI + β_3 IO + β_4 SoI + β_5 SI + β_6 H + e, where the dependent variable is IIB (Individual investment behavior). The independent variables are FI (Financial instruments), PoI (Purpose of investment), IO (Investment opportunity), SoI (Source of influence), SI (Source of information) and H (Herding).

Model	Intercept	Regression coefficients of						Adj. R_bar^2	SEE	F-value
		FI	PoI	IO	SI	SoI	H			
1	1.309 (3.805)**	0.579 (6.597)**						0.265	0.652	43.515
2	1.788 (5.666)**		0.485 (5.674)**					0.209	0.676	32.194
3	2.046 (6.184)**			0.424 (4.612)**				0.147	0.703	21.275
4	1.679 (6.431)**				0.502 (7.320)**			0.308	0.633	53.583
5	1.669 (5.524)**					0.519 (6.331)**		0.249	0.659	40.081
6	1.835 (9.197)**						0.527 (8.888)**	0.398	0.590	79.005
7	1.005 (2.815)**	0.421 (3.967)**	0.253 (2.538)*					0.298	0.637	25.991
8	0.891 (2.391)*	0.372 (3.224)**	0.230 (2.257)*	0.108 (1.049)				0.298	0.637	17.709
9	0.783 (2.210)*	0.237 (2.055)*	0.178 (1.825)	0.006 (0.055)	0.318 (3.756)**			0.370	0.604	18.323
10	0.618 (1.736)	0.164 (1.388)	0.163 (1.635)	0.022 (0.215)	0.275 (3.215)**	0.201 (2.215)*		0.391	0.594	16.141
11	0.813 (2.415)*	0.155 (1.401)	0.107 (1.178)	0.045 (0.476)	0.202 (2.472)*	0.023 (0.233)	0.330 (4.143)**	0.467	0.555	18.237

Notes:

i. Figures in parenthesis are t-values
ii. The asterisk signs (**) and (*) indicate that the results are significant at one percent and five percent level respectively.
iii. Individual investment behavior is the dependent variable.

Table 2 shows that beta coefficients for financial instruments are positive with individual investment behavior. It indicates that financial instrument has a positive impact on individual investment behavior. This finding is similar to the findings of Tirumalsety and Gurtoo (2021). Likewise, the beta coefficients for purpose of investment are positive with individual investment behavior. It indicates that purpose of investment has a positive impact on individual investment behavior. This finding is consistent with the findings of Kumar and Goyal (2021). Moreover, the beta coefficients for investment opportunity are positive with individual investment behavior. It indicates that investment opportunity has a positive impact on individual investment behavior. This finding is similar to the findings of Ljungqvist et al. (2006). Further, the beta coefficients for sources of influence are positive with individual investment

behavior. It indicates that source of influence has a positive impact on individual investment behavior. This finding is consistent with the findings of Calvet *et al.* (2007). Likewise, the beta coefficients for sources of information are positive with individual investment behavior. It indicates that source of information has a positive impact on individual investment behavior. This finding is similar to the findings of Goetzmann et al. (2008). In addition, the beta coefficients for herding are positive with individual investment behavior. It indicates that herding has a positive impact on individual investment behavior. This finding is similar to the findings of Adem and Sarıoglu (2020).

4. Summary and conclusion

Individual investor behavior in the stock market is influenced by a variety of factors, ranging from personal traits and emotions to external market conditions and socioeconomic factors. Investors with a strong understanding of financial markets and investment strategies tend to make more informed decisions. Conversely, those with limited knowledge may be more influenced by market trends or media hype. Individual investors often follow the crowd, especially during times of market euphoria or panic. Herding behavior can lead to market bubbles or crashes, as investors tend to buy when prices are high and sell when prices are low.

This study attempts to examine the determinants of individual investor behavior in Nepalese stock market. The study is based on primary data with 120 observations.

The study showed that investment opportunities, purpose of investment, sources of information, sources of influence, herding, and financial instruments have positive impact on individual investment behavior in Nepalese stock market. The study concludes that investors may be influenced by recent or easily accessible information rather than conducting comprehensive research. This can lead to overlooking critical factors or making decisions based on incomplete information. Some individuals are more risk-averse and prefer safer, low-volatility investments, while others are more comfortable taking on higher risks in pursuit of potentially higher returns. The study also concludes that herding followed by sources of influence is the most influencing factor that explains the changes in individual investment behavior in Nepalese stock market.

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