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Impact of Behavioral Biases on Nepalese Mutual Fund Investment Decisions: The Mediating Role of Risk Perception

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Abstract: *This study examines how behavioural biases- overconfidence and herding- influence investor choices in Nepalese mutual funds and investigates whether risk perception mediates the relationships between these biases and mutual fund investment decisions. Using a quantitative, explanatory research design, data were systematically collected through survey questionnaires from 386 active market participants, and subsequently analysed in SPSS 27 and RStudio to examine relationships and test hypotheses. The findings indicate that both overconfidence and herding biases significantly and positively drive mutual fund investment choices. Risk perception acts as a mediating factor, partially elucidating the mechanisms through which each bias influences mutual fund investment decisions. The research highlights the need for investor education and behaviour-based strategies to promote better risk awareness and more rational diversified investment choices.*

Keywords: herding, investment, mutual funds, overconfidence, psychological biases, risk perception.

I. INTRODUCTION

In addition to the factors suggested by conventional investment theory, such as interest rates, expected profitability, and the economic outlook, psychological factors also influence individuals' mutual fund investment decisions, leading to irrational choices (Chaudhary et al., 2025). Behavioural finance challenges the efficient market hypothesis (EMH) by emphasising that cognitive and emotional biases, such as overconfidence and herding, strongly influence investors' decisions and often lead to irrationality (Almansour et al., 2023; Baddeley, 2010). Overconfidence causes investors to overestimate their knowledge and predictive abilities, while herding encourages imitation of crowd behaviour, often

amplifying market inefficiencies. Understanding these behavioural factors is essential, as increased awareness supports rational decision-making (Sitaula & Uprety, 2024).

Recognising overconfidence and herding is essential for prudent investing and for achieving financial goals (Seiben & Postmes, 2025). Overconfidence, defined as the belief in possessing greater knowledge or control than is warranted, often leads to riskier investments. Overconfident investors may disregard factual information, underestimate risks, and incur significant losses (Singh et *al*., 2024; Rawat, 2024). Similarly, herding involves following the majority without critically evaluating alternatives. This behaviour is particularly prevalent in uncertain situations or under social pressure, when investors presume the group possesses superior knowledge (Khurshid et *al*., 2021). Emotional factors and the desire for social acceptance further reinforce this tendency (Scott & Bruce, 1995). Consequently, herding can hinder individual investors from achieving superior performance (Mayruk, 2022).

Risk perception is shaped by emotional, cognitive, social, and cultural factors (Kaban & Linata, 2024). Individuals assess risk based on their beliefs, experiences, and emotions, which often diverge from technical or objective analysis (Priolo et *al*., 2025). As a result, risk perception mediates the effects of overconfidence and herding on mutual fund investment decisions, causing investors to deviate from rational decision-making models in mutual fund contexts (Silwal & Ghimire, 2025). Recognising these biases is therefore critical, as risk perception exerts a substantial influence on investment choices (Almansour et *al*., 2023; Ahmad & Shah, 2022; Ishfaq et *al*. 2020).

These psychological factors are particularly salient in the Nepalese mutual fund market, which is characterised by a developing capital market and collectivist social structure. Such conditions amplify the impact of psychological biases on mutual fund investment decisions and market dynamics (Pathak & Thapa, 2024). Herding bias, as explained by social learning theory (Bandura & Walters, 1977) and information cascade theory (Bikhchandani et *al*., 1992), arises when investors follow group behaviour, presuming the group possesses superior information. With increasing global integration and expanding participation by retail investors, these biases merit careful examination in emerging markets such as Nepal (Pathak & Thapa, 2024).

Previous studies in Nepal have identified heuristics, prospect theory, and herding as drivers of stock investment behaviour (Jain et *al*., 2023; Lama et *al*., 2025). With overconfidence, anchoring, and risk aversion also playing significant roles (Gurung et *al*., 2024). Additional biases, including representativeness, loss aversion, and confirmation bias, further influence stock market behaviour (Dhakal & Lamsal, 2023). However, most studies examining the mediating role of risk perception have focused on stocks, with limited attention to mutual funds (Adhikari et *al*., 2025; Chaudhary, 2025; Lama et *al*., 2025; Amgain et *al*., 2025). Consequently, there is a research gap regarding how these biases, particularly overconfidence and herding, affect mutual fund investment decisions, and the mediating role of risk perception (Gurung et *al*., 2024; Jain et *al*., 2023). In practice, Nepalese mutual

fund investors frequently rely on group sentiment or intuition rather than independent analysis. Behavioural finance theories provide insight into why investors may engage in herd behaviour or excessive trading, potentially impacting market equilibrium and volatility. Accordingly, this study investigates overconfidence, herding, and risk perception in Nepalese mutual fund investing, emphasizing the mediating role of risk perception and illustrating how internal biases shape risk perceptions and mutual fund investment decisions.

The structure of this paper is as follows: Section 2 reviews the behavioural biases and mutual funds. Section 3 outlines research methodology. Section 4 presents results. Section 5 discusses the implications.

II. LITERATURE REVIEW

Based on Prospect Theory and the Psychology of Risk, this study examines why investors in markets like Nepal deviate from the "Rational Man" model. In efficient markets, decisions rely on expected returns and variance; however, Nepal's high volatility and asymmetry drive investors toward psychological shortcuts, or heuristics (Adhikari et *al.*, 2025; Amgain et *al.*, 2025; Gurung et *al*., 2024). Kahneman and Tversky (2013) posited that individuals value gains and losses asymmetrically, leading to inconsistent risk preferences. This explains behaviours like loss aversion – holding losing assets too long – or chasing "winners" regardless of valuation. Similarly, Chaiken's (1980) Heuristic-Systematic Model advocates that when analytical (systematic) processing is cognitively demanding, investors rely on heuristics like anchoring. Further, the Psychometric Paradigm (Slovic, 1987) argues that risk is a subjective construction rather than an objective fact. Social and psychological factors redefine risk perception itself; for instance, overconfidence bias artificially lowers perceived risk, directly inflating investment intentions.

Overconfidence bias and risk perception. Overconfidence derives from the Heuristic-Driven Bias framework (Gigerenzer & Gaissmaier, 2011) and the Self-Attribution Theory (Barberis et *al*., 1998). Overconfident investors overestimate their knowledge, skills, or control over market outcomes. They use their own information and ignore public data (Adil et *al*., 2022). They downplay risks and make riskier investment moves (Singh et *al*., 2024). These behaviours cause surprises and market inefficiencies (Piehlmair, 2023; Thaler & Shefrin, 1988). Overconfidence is a key factor affecting mutual fund investment decisions. Prospect theory (Kahneman & Tversky, 2013) shows that overconfidence distorts risk perception and leads to poor decisions. This shows why awareness and mitigation measures matter (Jain et *al*., 2019; Chaudhary, 2025). Based on the literature, the following hypothesis is proposed:

H1: Overconfidence bias significantly heightens risk perception among mutual fund investors.

Herding bias and risk perception. According to social influence theory (Wood, 2000; Ciatdini, 2004), herding occurs when people in uncertain situations follow others to reduce risk, assuming the group has superior information (Akhtar et *al*., 2018; Pa et *al*., 2022).

Higher risk perception pushes people to take group-approved actions and shapes both personal choices and peer pressure (Hidayat et *al*., 2024). Social learning theory (Bandura & Walters, 1977) and information cascade theory (Bikhchandani et al., 1992) state that herding raises awareness of investment risk. When people see others buying or selling, they are more likely to join in and perceive greater risks if they do not act (Purwidianti et *al*., 2023).

Studies show that herding bias predicts risk perception among individual investors (Kartini & Nahda, 2021). Increased risk perception shapes investment choices (Wibowo et *al*., 2023). Social influence causes individuals to mimic the majority in uncertain situations, raising urgency along with prompting less rational decisions (Ahmed et *al*., 2022). However, Apochi et *al*. (2024) found that herding bias can improve individual investment performance, and financial literacy moderates this effect.

H2: Herding bias significantly increases investors' perception of risk in mutual fund investments.

Risk perception and mutual fund investment decisions. Risk perception is how investors judge financial asset risks based on experience and fear (Ahmad & Shah, 2022). It operates as a cognitive lens revealing how psychological biases manifest in financial decisions. Research shows that herding and overconfidence directly influence a person's risk assessment and ultimate mutual fund investment decisions. Higher perceived risk makes investors more likely to choose high-risk assets. Overconfidence and loss aversion can lead investors to underestimate risk and make bold choices (Chaudhary, 2025). Ahmad and Shah (2022) and Ishfaq et *al*. (2020) argue that risk perception can reduce biases, such as overconfidence and herding, before investing.

A higher perception of risk reduces investment in stocks (Almansour et *al*., 2023). Stock investments carry inherent risk (Kaban & Linata, 2024). Investors' risk aversion reduces their decisions to invest (Riaz et *al*., 2012). Risk perception negatively associates with investment decision (Robinson & Marino, 2013). Both risk perception and tolerance shape investment decision-making (Nguyen & Rozsa, 2019). Based on this literature, the hypothesis is:

H3: Increased risk perception significantly influences mutual fund investment decisions.

Herding bias and mutual fund investment decisions. Individual investors typically show more herding than institutional investors. They commonly lack sufficient market knowledge to make sound choices (Metawa et *al*., 2018). Herding is a common behavioural bias among individual mutual fund investors, driven more by psychic factors than by strategy (Gothe & Mishra, 2023). In panic situations, investors abandon personal decisions and follow the crowd, hoping for better information (Gao et *al*., 2021).

Herding behaviour influences mutual fund investment decisions negatively (Jiang & Verardo, 2018). It leads individuals, especially the young and less financially literate, to follow others' actions in unstable market conditions. This often results in market inefficiencies, asset

bubbles, and crashes. It adversely influences market stability and price formation. While herding can sometimes signal risk, it generally leads to poor financial outcomes (Ahmad & Wu, 2022). This is especially true among vulnerable groups, such as workers in the job economy and younger investors (Wang & Zhang, 2024). Mavruk (2022) used a machine learning algorithm to examine herding behaviour in stock markets and among investors, comparing portfolios with and without herding. Results show that herding investors do not outperform non-herding investors, suggesting that herding may destabilize markets rather than boost returns. However, Kengatharan and Navaneethakrishnan (2014) and Prasetyo and Ratnawati (2023) found no correlation between investors' herd behaviour and their investment decisions. Thus, the following hypothesis is proposed:

H4: Herding bias significantly increases the likelihood of mutual fund investment decisions.

Overconfidence bias and mutual fund investment decisions. Overconfidence bias occurs when individuals overrate their own skills while overlooking uncertainties (DeBondt & Thaler, 1995). Behavioral biases, such as overconfidence, strongly affect investors' decision-making (Kurnijanto et *al*., 2025; Prasetyo & Ratnawati, 2023). Active investors regularly exhibit overconfidence bias. They rely solely on their own information and abilities, thereby increasing their risk and leading to irrational decisions. Empirical studies show that overconfidence bias harms decisions (Ahmad & Shah, 2022). It increases risk-taking and trading and reduces overall performance (Yanti & Endri, 2024)**.**

Overconfidence deeply affects mutual fund investment decisions by causing investors to overestimate their ability to forecast market trends and manage risk (Piehlmair, 2023). Recent research shows that overconfident investors make riskier, more optimistic decisions, leading to poor financial outcomes such as portfolio mismanagement (Rani et *al*., 2024). Moreover, overconfidence interacts with other behavioural factors, magnifying negative effects and underscoring the need for mitigation strategies. Overconfidence bias thus impairs knowledgeable decision-making (Shah et *al*., 2018). Based on these insights, the proposed hypothesis is as follows:

H5: Overconfidence bias significantly increases the propensity for investors to make mutual fund investment decisions.

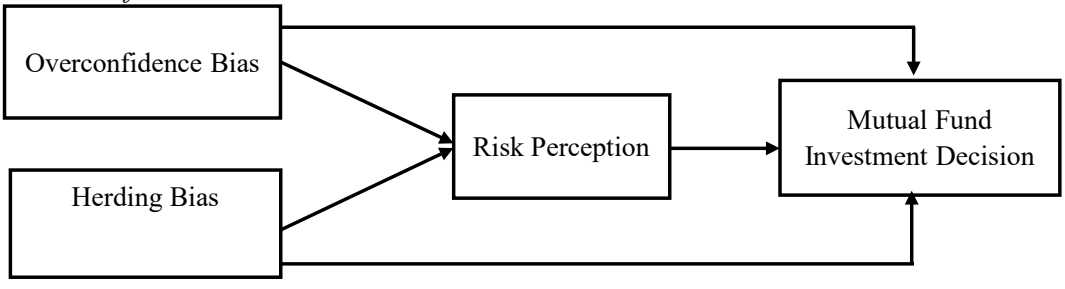
The mediating role of risk perception. Risk perception mediates the influence of herding and overconfidence biases on mutual fund investment decisions by determining how investors evaluate and respond to market risks (Almansour et *al*., 2023). Overconfident investors tend to underestimate risks, leading to riskier investment behaviour (Ahmad & Shah, 2022), while herding indirectly affects decisions by reducing perceived risk. Studies confirm that risk perception increases the effects of these biases on mutual fund investment decisions (Kaban & Linata, 2024). Prior studies have shown that behavioral biases, such as herding and overconfidence, strongly shape investors' risk perception (Gao et *al*., 2021; Hayat et *al*., 2024). Risk perception also affects investors' decision-making (Krueger & Dickson, 1994). Some studies find that overconfidence does not significantly increase risk perception, suggesting that overconfident investors may underrate perceived risk, thereby

contributing to more aggressive investment behaviour (Kumari et *al*., 2025). However, Ahmed et *al*. (2022) found that the risk perception does not mediate between behavioural bias and mutual fund investment decisions. Behavioural biases, such as overconfidence and herding, directly affect investors' risk perception and mutual fund investment decisions. These biases also indirectly influence mutual fund investment decisions by shaping risk perception. Therefore, risk perception could mediate the relationship between biases and mutual fund investment decision-making (Ishfaq et *al*., 2020). Based on this body of literature, the proposed hypothesis is outlined as follows:

H6(a): Risk Perception mediates the association between herding bias and mutual fund investment decision-making.

H6(b): Risk Perception plays a mediating role between overconfidence and mutual fund investment decision-making.

Figure 1
Research framework.



Note: Authors' Work

III. RESEARCH METHODOLOGY

This study investigated risk perception as a mediator of behavioral biases in the decision-making of Nepalese mutual fund investors. An explanatory research design with a quantitative approach was used to examine and clarify causal relationships, including the mediating effect of risk perception on behavioral biases among Nepalese mutual fund investors. Explanatory designs facilitate a deep understanding of relationships among variables and underlying mechanisms, providing strong empirical evidence critical for theoretical improvement and practical use in behavioral finance contexts (Lim & Weissmann, 2021). Cochran's formula (Cochran, 1977) was used to determine the sample size that could adequately represent the population. Individuals who participate in financial markets by investing in mutual funds were classified as respondents in this study. Data were collected using a convenience sampling technique, i.e., from a large pool of readily available respondents via standardised questionnaires. Respondents were personally contacted in the broker's office and investment companies to determine whether they invest in mutual funds. Questionnaires were distributed to investors who invest in mutual funds.

Structured questionnaires were distributed to 400 mutual fund investors, but only 386 valid responses were obtained. The remaining incomplete submissions were disregarded.

Measures and definition of the variables. The questions use a 5-point Likert scale, ranging from 1 (strongly agree) to 5 (strongly disagree). The first two units in Section B consist of questions related to behavioural biases, which serve as independent variables; specifically, the first and second units contain three questions each on overconfidence (Waweru et *al*., 2008) and herding bias (Lin, 2011), respectively. The third unit of Section B includes three inquiries on mutual fund investment decisions, which serve as the dependent variable (Scott & Bruce, 1995). Finally, the last unit features four questions about risk perception, which serve as the mediating factor (Weber et *al*., 2002). Table 1 presents the operational definition of the variables.

Table 1

Operational definition and measurement of variables

Variables	Definitions	Measurement	Sources
Overconfidence Bias	Investors' cognitive bias to overestimate the accuracy of their own judgment. In other words, miscalibration of subjective probabilities.	Self-reported confidence.	Sharma and Negi (2025), Prasetyo and Ratnawati (2023), Ahmad and Shah, (2022), Waweru et al. (2008)
Herding Bias	Investors' tendency to mimic the trading behaviour of peers, suppressing private information.	Self-reported behavioral tendency.	Jiang and Verardo (2018), Frey et al. (2014). Hudson et al. (2020), Ahmed et al. (2022), Lin (2011).
Risk Perception	Investors' subjective assessment of potential losses associated with an investment; often functions as a mediator between biases and mutual fund investment decisions.	Self-assessment of riskiness or uncertainty.	Gundala and Chodisetty (2025), Almansour et al. (2023), Hayat et al. (2024), Weber et al. (2002)
Mutual Fund Investment Decision	The outcome variable reflects investors' choices regarding mutual fund investments, such as fund selection, allocation, or intent to invest.	Self-reported intention scales.	Thanki et al. (2025), Manideep and Chodisetty (2025), Scott and Bruce (1995).

IV. RESULTS AND DISCUSSION

Demographic profile analysis. The sample of 386 respondents comprised 61.1% male and 38.9% female. Most participants (46.1%) were 26–35 years old, followed by 21.5% aged 36–45, 18.7% aged 18–25, and 13.7% over 45. Regarding education, 52.3% held a master's degree, 34.2% held a bachelor's degree, 13.5% held a Master's degree, and 13.5% held an M.Phil. or Ph.D. By occupation, 43.5% worked in the private sector, 35.3% were self-employed, and 21.2% worked in government. Monthly income was NPR 25,000–50,000 for 36.0%, NPR 50,001–75,000 for 30.6%, above NPR 75,000 for 17.4%, and below NPR 25,000 for 16.1%.

Table 2

Demography profiles

Variable	Category	Frequency (n)	Percentage (%)
Gender	Male	236	61.10%
	Female	150	38.90%
Age Group	18–25 years	72	18.70%
	26–35 years	178	46.10%
	36–45 years	83	21.50%
	Above 45 years	53	13.70%
Education Level	Bachelor's Degree	132	34.20%
	Master's Degree	202	52.30%
	M.Phil./Ph.D.	52	13.50%
Occupation	Private Sector Employee	168	43.50%
	Government Employee	82	21.20%
	Self-Employed	136	35.30%
Monthly Income	Less than NPR 25,000	62	16.10%
	NPR 25,000 – 50,000	139	36.00%
	NPR 50,001 – 75,000	118	30.60%
	Above NPR 75,000	67	17.40%
N		386	100.00%

Note: Field Survey

Validity test. In this study, HTMT values were used to assess discriminant validity among Overconfidence Bias, Herding Bias, Risk Perception, and mutual fund investment decisions. All values were below the 0.90 threshold, with Overconfidence and Herding Bias at 0.898, indicating they are related yet distinct constructs. Other values ranged from 0.683 to 0.829, confirming acceptable discriminant validity and that each latent variable uniquely represents its construct.

Table 3

HTMT Analysis

LVs	Overconfidence Bias	Herding Bias	Risk Perception	Mutual Fund Investment Decision
Overconfidence Bias				
Herding Bias	0.898			
Risk Perception	0.684	0.683		
Mutual Fund Investment Decision	0.809	0.829	0.739	

Note: Authors' Work

Fornel-Larcker Test. The Fornell-Larcker criterion was used to assess discriminant validity among Overconfidence Bias, Herding Bias, Risk Perception, and Mutual Fund Investment Decision. The square root of each construct's AVE ranged from 0.800 to 0.816, exceeding all inter-construct correlations. For example, Mutual Fund Investment Decision's AVE (0.816) exceeded its correlations with the other constructs, confirming that each construct is distinct and demonstrating adequate discriminant validity.

Table 4

Fornel-Larcker Test

LVs	Overconfidence Bias	Herding Bias	Risk Perception	Mutual Fund Investment Decision
Overconfidence Bias	0.800			
Herding Bias	0.644	0.801		
Risk Perception	0.533	0.526	0.806	
Mutual Fund Investment Decision	0.594	0.609	0.583	0.816

Note: FL Criteria table reports the square root of AVE on the diagonal and constructs correlations on the lower triangle.

Note: Authors' Work

Reliability and convergent validity assessment. All constructs demonstrated satisfactory internal consistency and convergent validity. Overconfidence Bias had a Cronbach's alpha of 0.715, composite reliability of 0.841, and AVE of 0.742. Herding Bias and Mutual Fund Investment Decision also met reliability criteria, with similar values, whereas Risk Perception showed the highest consistency ($\alpha = 0.821$, $\rho C = 0.881$, AVE = 0.823). These results confirm the reliability and validity of the measurement model.

Table 5

Reliability Test

LVs	alpha	rho C	rho A	AVE
Overconfidence Bias	0.715	0.841	0.641	0.742
Herding Bias	0.717	0.842	0.641	0.718
Risk Perception	0.821	0.881	0.65	0.823
Mutual Fund Investment Decision	0.747	0.857	0.667	0.746

Note: Alpha, rhoC, and rhoA should exceed 0.7 while AVE should exceed 0.5

Note: Authors' Work

Coefficient of determination (R^2) analysis. In the model, Risk Perception had an R^2 of 0.341 and an adjusted R^2 of 0.338, indicating that 34.1% of its variance is explained by Overconfidence Bias ($\beta = 0.331$) and Herding Bias ($\beta = 0.313$), reflecting moderate predictive accuracy. Mutual Fund Investment Decision showed an R^2 of 0.499 and an adjusted R^2 of 0.495, with the model explained by Overconfidence Bias ($\beta = 0.246$),

Herding Bias (β = 0.293), and Risk Perception (β = 0.298). These moderate values indicate that behavioral and perceptual factors significantly influence mutual fund investment decisions, supporting the structural model's relevance.

The effect size (f^2) indicates the proportion of variance in the dependent variable explained by each independent variable in the model. According to Cohen (2016), f^2 values of 0.02, 0.15, and 0.35 are considered small, medium, and large effects, respectively. In this study, overconfidence bias had negligible effects on Risk Perception (0.098) and Mutual Fund Investment Decision (0.061). Herding Bias also showed minor effects on Risk Perception (0.086) and Mutual Fund Investment Decision (0.093). Risk Perception had a negligible effect on Mutual Fund Investment Decision (0.118). All other relationships showed no effect (p = 0.000). These results suggest that while each factor matters, its impact is negligible.

Table 6

F-Square Test

LVs	Overconfidence Bias	Herding Bias	Risk Perception	Mutual Fund Investment Decision
Overconfidence Bias	0.000	0.000	0.098	0.061
Herding Bias	0.000	0.000	0.086	0.093
Risk Perception	0.000	0.000	0.000	0.118
Mutual Fund Investment Decision	0.000	0.000	0.000	0.000

Note: Authors' work

Path analysis. Overconfidence Bias significantly affects Risk Perception (β = 0.331, t = 6.171) and mutual fund investment decision (β = 0.246, t = 2.937), though its effect on Risk Perception is more substantial. Herding Bias also significantly influences Risk Perception (β = 0.313, t = 5.638) and mutual fund investment decision (β = 0.293, t = 4.397), indicating group behaviour affects both. Risk Perception strongly affects mutual fund investment decision (β = 0.298, t = 7.001). All paths are statistically significant, supporting the model's hypotheses.

Table 7

Path Model

LVs			Original Est.	Mean	SD	T-stat	2.50% CI	97.50 CI
Overconfidence Bias	->	Risk Perception	0.331	0.329	0.054	6.171	0.224	0.436
Overconfidence Bias	->	Mutual Fund Investment Decision	0.246	0.248	0.084	2.937	0.081	0.408
Herding Bias	->	Risk Perception	0.313	0.316	0.055	5.638	0.203	0.423
Herding Bias	->	Mutual Fund Investment Decision	0.293	0.291	0.067	4.397	0.160	0.422
Risk Perception	->	Mutual Fund Investment Decision	0.298	0.298	0.043	7.001	0.213	0.380

Note: Authors' Work

Total path analysis. The results show that overconfidence bias significantly increases Risk Perception (β = 0.331, t = 6.171) and directly influences mutual fund investment decisions (β = 0.345, t = 4.118), suggesting that overconfident investors perceive higher risk and invest more. Herding Bias also significantly affects Risk Perception (β = 0.313, t = 5.638) and has a substantial direct effect on mutual fund investment decision (β = 0.386, t = 5.605), underscoring the role of social conformity in investment behavior. Risk Perception significantly influences mutual fund investment decision (β = 0.298, t = 7.001), confirming its mediating role. All paths are statistically significant, supporting the model. The measurement model is presented in *Appendix 1.*

Table 8

Path Model

LVs			Original Est.	Mean	SD	T-stat	2.50% CI	97.50 CI
Overconfidence Bias	->	Risk Perception	0.331	0.329	0.054	6.171	0.224	0.436
Overconfidence Bias	->	Mutual Fund Investment Decision	0.345	0.346	0.084	4.118	0.177	0.503
Herding Bias	->	Risk Perception	0.313	0.316	0.055	5.638	0.203	0.423
Herding Bias	->	Mutual Fund Investment Decision	0.386	0.385	0.069	5.605	0.254	0.524
Risk Perception	->	Mutual Fund Investment Decision	0.298	0.298	0.043	7.001	0.213	0.380

Note: Authors' Work

Mediation analysis. This study tested Risk Perception as a mediator between Herding Bias, Overconfidence Bias, and mutual fund investment decisions. Herding Bias affects mutual fund investment decisions both directly (0.293) and indirectly through Risk Perception (0.093), yielding a total effect of 0.386 and a VAF of 24.13%, indicating partial mediation. Overconfidence Bias also shows partial mediation, with an indirect effect of 0.099, a direct effect of 0.246, a total effect of 0.345, and a VAF of 28.62%. These results confirm Risk Perception's important partial mediating role. The hypotheses results is presented in *Appendix 2.*

Table 9

Mediation Analysis using VAF

S.N.	Pathway (IV → Mediator → DV)	Indirect Effect (a × b)	Direct Effect (c′)	Total Effect (a × b + c′)	VAF (%)	Mediation Type
1	Overconfidence Bias → Risk Perception → Investment Decision	0.099	0.246	0.345	28.620	Partial Mediation
2	Herding Bias → Risk Perception → Investment Decision	0.093	0.293	0.386	24.130	Partial Mediation

Note: Authors' Work

Discussion. Overconfidence Bias has a significant positive effect on Risk Perception (β = 0.331, t-value = 6.171, and p < .001). The study showed that individuals with overconfidence bias tend to take higher risks, indicating that overconfidence significantly influences how investors perceive and manage risk. Investors with higher confidence, therefore, are more likely to favour riskier investments (Adhikari et *al*., 2025; Chaudhary, 2025; Kurnijanto et *al*., 2025). The significant association between overconfidence bias and mutual fund investment decisions (β = 0.246, t-value = 2.937, p < .001) was also supported by previous research (Adil et *al*., 2022; Ahmad & Shah, 2022; Kumar & Goyal, 2016). This indicates that investors' overconfidence significantly affects their mutual fund investment decisions.

Herding Bias has a significant positive effect on Risk Perception (β = 0.313, t-value = 5.538, and p < .001). This finding is consistent with the findings of Purwidianti et *al*. (2023). The study found that herding bias significantly increases risk perception, underscoring how social influences shape investors' awareness and risk assessment. The results showed that behavioral biases affect decision-making, with herd behavior having the most significant impact (β = 0.293, t = 4.397, p < .001). Previous studies also support these results (Khurshid et *al*., Madaan & Singh, 2019). This means that investors typically follow the actions and choices of others in the market more than they rely on their own independent analysis, thereby strongly influencing their mutual fund investment decisions.

The study's findings also confirm that risk perception has a positive and significant effect on mutual fund investment decisions (β = 0.298, t(1, 1) = 7.001, p < .001). This result is consistent with the findings of Shindu and Kumar (2014). The study argues that investors' risk perception significantly and positively affects mutual fund investment decisions, leading investors with high-risk perceptions to reconsider their investments and diversify to manage risk.

Further, the study reveals that risk perception mediates the relationship between behavioral biases (herding and overconfidence) and mutual fund investment decisions (as presented in Table 9). This finding aligns with Ahmad and Shah (2022), Ishfaq et *al*. (2020), and Riaz and Hunjra (2015). It means that these biases affect how investors perceive and interpret risk, and that this altered risk perception, in turn, guides and shapes the mutual fund investment decisions they ultimately make. Thus, risk perception functions as a crucial channel that explains why and how these behavioral biases significantly affect mutual fund investment decision-making outcomes. No recent, renowned references were identified that significantly dispute or contradict the mediating role of risk perception in the relationship between behavioral biases and mutual fund investment decisions in Nepal.

V. CONCLUSION AND IMPLICATIONS

The study investigated the mediating role of risk perception in the relationship between behavioral biases (overconfidence and herding) and Nepalese mutual fund investment decisions. Analysis of 386 investors' behavior using RStudio revealed that both overconfidence and herding biases significantly influence mutual fund investment decisions. Overconfidence leads to excessive trading, as investors believe they can

outperform the market, thereby increasing transaction costs and reducing net returns. Herding behaviour prompts Nepalese mutual fund investors to imitate peers' trading, potentially leading to momentum-driven bubbles or crashes in mutual fund flows. The study also identified a positive association between risk perception and mutual fund investment decisions, suggesting that heightened risk perception encourages more informed decisions. These findings indicate that behavioral biases affect mutual fund investment decisions primarily through their impact on risk perception, rather than through direct effects. In volatile environments, social influence heightens urgency, often leading to less rational, more emotionally driven investment choices. This study contributes to the literature by empirically establishing the mediating role of risk perception in linking herding and overconfidence biases to Nepalese mutual fund investment decisions. Further, addressing these behavioural biases and risk perceptions is essential for enhancing market stability and supporting policymakers, advisors, and investors in making more coherent mutual fund investment decisions. The study also highlights the need for further research, recommending that future studies expand the sample to include diverse investor types, consider moderating factors such as financial literacy and cultural influences, and utilize mixed-methods approaches to provide a comprehensive understanding of behavioral biases and Nepalese mutual fund investment decisions.

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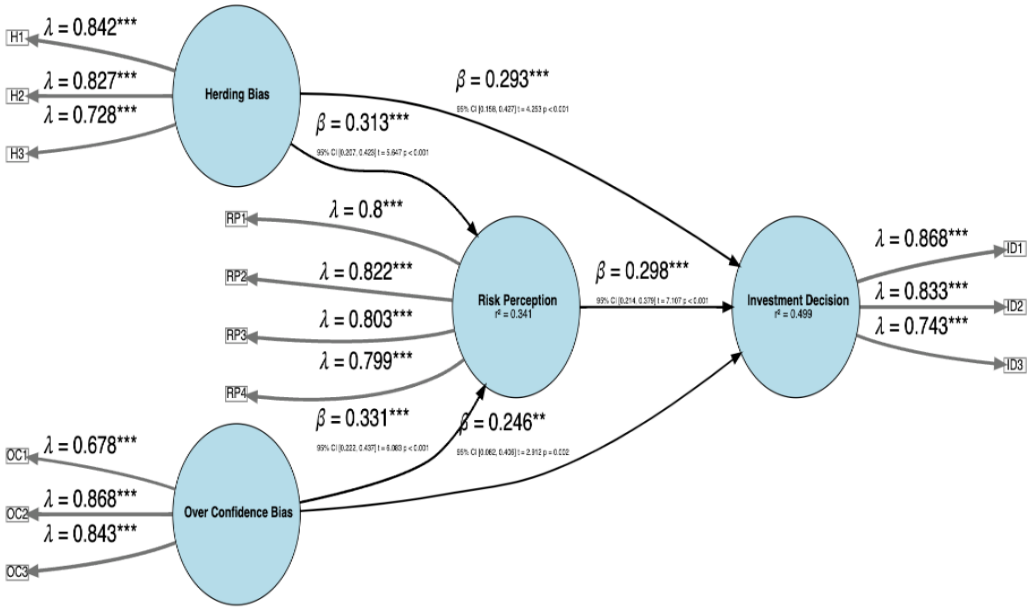
APPENDICES

Appendix 1

Path analysis with mediating effects.



Appendix 2

Hypothesis Test

S.N.	Alternative Hypothesis Statements	Path	β (Beta)	t-value	p-value	Result
H1	Overconfidence bias significantly heightens risk perception among mutual fund investors.	OC → RP	0.331	6.171	< 0.001	Supported
H2	Herding bias significantly increases investors' perception of risk in mutual fund investments.	HB → RP	0.313	5.538	< 0.001	Supported
H3	Increased risk perception significantly influences mutual fund investment decisions.	RP → ID	0.298	7.001	< 0.001	Supported
H4	Herding bias significantly increases the likelihood of mutual fund investment decisions.	HB → ID	0.293	4.397	< 0.001	Supported
H5	Overconfidence bias significantly increases the propensity for investors to make mutual fund investment decisions.	OC → ID	0.246	2.937	0.002	Supported
H6 (a)	Risk Perception mediates the association between herding bias and mutual fund investment decision-making.	HB → RP → ID (VAF = 24.13%)	0.0932	—	—	Partial Mediation
H6 (b)	Risk Perception plays a mediating role between overconfidence and mutual fund investment decision-making.	OC → RP → ID (VAF = 28.62%)	0.0986	—	—	Partial Mediation