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Influence of Behavioral Aspects on Stock Investment Decision-Making

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Abstract

Investment decision making is a complex process influenced by psychological biases, especially in emerging markets such as Nepal, where financial literacy and market transparency remain limited. Traditional finance models assume rational investor behavior, but behavioral finance highlights the significant role of cognitive biases, such as loss aversion, overconfidence, herding, and risk perception, in shaping investment choices. This study examines the impact of these behavioral factors on individual investors in the Nepalese stock market. This study adopted a quantitative approach using a structured questionnaire distributed to 387 respondents. Descriptive statistics and multiple regression analysis were employed to explore the relationship between the independent variables (loss aversion, overconfidence, herding, and risk perception) and dependent variable (investment decision). The results reveal that loss aversion ($B = -1.416$, $p < 0.01$) and risk perception ($B = -1.362$, $p < 0.01$) negatively impact investment decisions, while overconfidence ($B = 0.947$, $p < 0.01$) and herding ($B = 1.723$, $p < 0.01$) have positive effects. Among these, herding has the strongest influence, indicating that social dynamics play a crucial role in investment behavior. These findings emphasize the need for targeted financial literacy programs to address cognitive biases and promote rational decision-making. Enhancing market transparency and access to reliable information can reduce emotional decision-making and improve market stability. This study contributes to behavioral finance literature by offering localized insights into investor behavior in an emerging market context.

Keywords: *behavioral finance, loss aversion, overconfidence, herding, investment decision making*

Introduction

Investment decisions in financial markets can be complex and are driven by multiple economic, psychological, and social factors. Many traditional finance theories, including the Efficient Market Hypothesis (EMH), posit that investors behave appropriately and utilize all available information to maximize returns (Ying et al., 2019). Recent studies in behavioral finance have questioned the rational investment paradigm and have emphasized the importance of such behaviors and emotions in investment decision-making (Sattar et al., 2020). These behavioral influences (such as loss aversion, overconfidence, herding behavior, and risk perception) are significant factors that affect investor behavior, especially in emerging markets such as Nepal, where financial literacy and market transparency are inadequate (Sapkota & Chalise, 2023).

Nepal's stock market is new and underdeveloped relative to its regional peers, yet it has expanded rapidly in recent years (Lamichhane, 2024). Originally established with the issuance of shares by Biratnagar Jute Mills Ltd. and Nepal Bank Ltd. in 1937, this market has gradually become an important part of the country's financial system (Risal, 2019). Nevertheless, the market is still not without weaknesses, including a relatively low level of investor awareness, poor market liquidity, and a lack of an active risk-transfer mechanism (Shrestha, 2024). Moreover, the absence of credible information reinforces the tendency to employ heuristics and emotional stimuli instead of an actual analysis of investment strategies (Hossain & Siddiqua, 2022).

In developing economies, behavioral biases are frequently exacerbated by market conditions and socioeconomic situations (Cao, Nguyen, & Tran, 2021). For example, overconfidence can cause too much trading and a lack of portfolio diversification, whereas loss aversion causes investors to lose stocks longer than they should (Bouteska&Regaieg, 2020). Such herding behavior, induced by social pressure and the fear of missing out, amplifies market volatility and may result in speculative bubbles (Idris, 2024). In contrast, the environment comprising cultural and institutional factors significantly impacts the aforementioned behavioral patterns, warranting exploration of their subsequent impact on the decision-making processes of individual investors in Nepal (Risal & Khatiwada, 2019).

Behavioral finance provides a framework for studying how psychological biases affect investor behavior and market outcomes (Bhanu, 2023). While mainstream financial approaches based on rationality maintain that investors behave without bias, behavioral finance holds that decision makers are not merely logical providers but are also affected by cognitive traps and emotional biases. One of the key principles of the Prospect Theory is loss aversion, which indicates that investors experience the pain of loss more severely than the pleasure of similar amounts of gain (Gal & Rucker, 2018). This can lead to less-than-ideal decision-making, such as panic selling when the market is in a downward trend or holding onto losing stocks in the hope that they turn around (Kuramoto et al., 2024).

Another common bias is overconfidence, which occurs when investors overestimate their knowledge and forecasting abilities (Liu&Tan, 2001). Studies have found that overconfident investors trade more often than they would otherwise and, in doing so, incur transaction costs that reduce their returns. This behavior is particularly common among male investors, who are more likely to exhibit overconfidence than their female counterparts (Yang&Zhu, 2001).In Nepal, poor investment decisions due to overconfidence and limited knowledge of finance demonstrate the need for targeted financial literacy programs (Nepal et al., 2023)

Another important aspect in the context of the Nepalese stock market is herd behavior, that is, the tendency to follow the herd instead of performing an independent analysis (Sitaula & Uprety, 2024). This behavior is frequently motivated by the fear of missing out or a lack of understanding of market conditions, which causes investors to mirror the actions of other investors. Although herding can lead to temporary profits in bull markets, it heightens the potential for market bubbles to burst when investor sentiment shifts (Lu et al., 2024). Insights into the psychological basis of herding behavior are essential for creating policies that ensure excellent market stability and safeguard individual investors' interests.

Risk perception, defined as the subjective judgment of the uncertainty surrounding an investment, is another important determinant of investor behavior (Kurniawati et al., 2022). While objective measures of risk, such as standard deviation, do not change, risk perception changes based on individual experiences, emotions, and cultures. Moreover,

in the Nepalese context, where market volatility and economic uncertainty are quite high (Wagle, 2024), investors tend to follow conservative strategies or avoid the stock market altogether. In addition, improving market transparency and education will reduce biases, encourage more participation in the capital market, and increase investor confidence.

Although most of the literature on behavioral finance theory revolves around developed markets, empirical data on whether these correlations exist in emerging markets such as Nepal are scarce (Nareswari, Balqista, & Negoro, 2021). This is important for a richer understanding of investor behavior that addresses the local context, which is critical given the unique characteristics of the Nepalese market: gatekeeping, small size, lower institutional participation, and associated high reliance on retail investors. It is well documented that demographic characteristics such as age, education, and income level affect investment behavior (Ghimire, 2024). Herding behavior is more common among younger, less experienced investors, while older, more financially literate investors tend to be more risk averse (Rana, 2019).

Previous studies have also underscored the impact of macroeconomic indicators, including inflation, interest rates, and government policies, on investor sentiment and behavior (Adhikari et al., 2024). These external factors also magnify behavioral biases during times of high economic uncertainty in Nepal, which challenge investors in making rational decisions. Understanding how psychological biases and macroeconomic conditions interrelate is crucial for formulating effective interventions to pave the way for more informed investment behavior (Dhungana et al., 2023).

This study examines the influence of key behavioral factors—loss aversion, overconfidence, herding, and risk perception—on stock investment decision making in the Nepalese stock market. By identifying the psychological drivers of investor behavior, this study seeks to provide insights for policymakers, financial advisors, and individual investors. The findings contribute to the growing field of behavioral finance by offering a localized perspective on how cognitive biases affect investment decisions in an emerging market context. Ultimately, this study hopes to inform the development of targeted financial literacy programs and policy interventions that enhance market efficiency and investor well-being.

Review of Literature

Investment decisions are complex and are influenced by many factors, such as market conditions and company fundamentals. Theories within traditional finance include ideas such as the Efficient Market Hypothesis (EMH), which suggests that the market is efficient and that investors are rational in their decisions based on available information (Ying et al., 2019). By contrast, behavioral finance provides an additional view that seeks to understand the psychological biases and emotional factors that lead investors to behave in a manner other than rationally (Sattar et al., 2020).

Nepal's stock market is a nascent but fast-growing sector where it is necessary to learn about investor behavior. Despite its recent growth, the Nepalese Stock Exchange (NEPSE) is still prone to market volatility, information asymmetry, and investor awareness (Rana, 2019). Based on global trends with unique local characteristics, behavioral biases (e.g., overconfidence, herding, loss aversion, and risk perception) significantly impact investment decisions (Sapkota & Chalise, 2023).

Behavioral Factors Influencing Investment Decisions

Overconfidence Bias

Overconfidence bias is one of the most extensively documented cognitive errors in behavioral finance. Overconfident investors are often overconfident in their knowledge and predictive power, leading to high trading activity, which, on average, decreases a portfolio's performance by not meeting the market (Parhi&Pal, 2022). Yang and Zhu (2001) suggest male investors exhibit higher overconfidence (especially in ambiguous situations) and trade more, confirming gender differences and misjudgment under uncertainty.

There is empirical evidence of overconfidence in individual investors, who too often tend to trade based on their judgment and are not in line with the fundamental analysis of Nepal's stock market (Sapkota & Chalise, 2023). This generates transaction costs and entails higher risk for investors, progressively reducing long-term returns (Rana, 2019). Similar trends are observed in other emerging markets, such as Vietnam and Bangladesh, where overconfidence is a significant explanatory factor for speculative trading (Ngoc, 2014; Hossain & Siddiqua, 2022).

Herding Behavior

Herding behavior indicates an inclination toward follow other investors instead of making independent investment decisions (Qasim et al., 2019). This is most common during times of market uncertainty or extreme volatility. As Ayoub and Balwawi (2022) argues, herding behavior fuels bubble dynamics and bursts in the financial market, generating deleterious economic consequences.

In the case of Nepal, studies have shown that herding is common among retail investors, especially in bull markets (Risal & Khatiwada, 2019). Pathak et al. (2024) noticed that less-experienced investors are more susceptible to herding behavior, as they are motivated by fear of missing out (FOMO) and social pressure. Apart from exacerbating market volatility, this tendency further destabilizes the overall stability of the Nepalese stock market.

Loss Aversion and the Disposition Effect

A core component of Prospect Theory, loss aversion, posits that people intuitively feel the anguish of losses more strongly than the delight associated with an equal number of wins (Mallik et al., 2017). Such a bias generates the disposition effect, as investors stay with losing stocks longer but sell winning stocks too quickly to lock in gains (Gärling et al., 2017).

Loss aversion is a key determinant of investment behavior in Nepal (Pokharel, 2020). Loss-averse traders panic-additional during market downturns, amplifying price drops, and market instability. Owing to loss aversion and suboptimal portfolio management conditions, common portfolios in emerging markets cause lower returns (Ngoc, 2014; Rehan et al., 2021).

Risk Perception

Risk perception is a key aspect of the development of investment strategies. While objective risk measures such as volatility or beta exist, risk perception is subjective and influenced by past experiences, emotions, and cognitive biases (Munnukka et al., 2017). High anxiety leads to avoidance of certain strategies, while low anxiety leads to too-risky strategies.

According to Wagle (2024), owing to perceptions of high risk in stock investments, most Nepalese investors consider stock investments to be highly risky and prefer short-term liquidity (Wagle, 2024). Limited access to reliable market information and low financial literacy also fueled this perception of risk. Therefore, there is scope for more active targeting of investor education and market transparency to mitigate subjective risk perceptions in investment decisions.

Empirical Evidence from Emerging Markets

The financial systems of emerging markets present a unique environment for investigating behavioral biases, considering their native volatility, fast-paced economic shifts, and scant regulatory landscapes. In contrast to developed markets, where investor behavior is typically influenced by established financial practices, investors in these regions tend to exhibit stronger behavioral biases such as overconfidence, herding, and loss aversion, owing to high levels of information asymmetry and limited financial literacy (Saivasan & Lokhande, 2022; Cao et al., 2021). This overconfidence manifests as investors thinking they have better knowledge than others in the market, resulting in speculative trading and a surge in market volatility (Dhakar & Lamsal,2023). For example, in Bangladesh, Hossain and Siddiqua (2022) find that frequent and riskier trading is motivated by overconfidence, with anecdotal rather than objective analysis of the mode of information processing, especially for retail investors. In a similar context, Ngoc (2014) discovered that overconfident investors affect the waves of the market in bullish periods in Vietnam, leading to unsustainable price increases. Another key bias, herding behavior, is entrenched in emerging markets, where the tendency to engage in imitation, especially in periods of uncertainty, creates bubbles and market crashes (Balcilar & Demirer, 2015).

Rehan et al. (2021) present evidence from Pakistan that herding is highest under optimistic conditions, primarily because of the irrational behavior of retail investors who do not have access to good data and instead follow the performance of others in the markets. The role of herding is also present in Sri Lanka, in which Kengatharan and Kengatharan (2014) stated that the inexperienced group of savers are the ones most affected by herding behavior, where the severity of herding behavior is not fully understood, leading to rash decisions that increase market volatility. Understanding the nuances of loss aversion, as articulated in Prospect Theory, is pivotal for investment

decision making, especially in emerging markets. Most investors are loss-averse (Hasan & Mustafa,2023) — more sensitive to losses than to comparable gains, and tend to hold onto losing stocks in anticipation that they will recover and sell winning stocks prematurely.

Vijaya (2014) conducted a study in India and concluded that investors influenced by loss aversion and emotional biases often made suboptimal portfolio modifications, contributing to long-run wealth losses. In these markets, where subjective assessments of uncertainty frequently trump objective measures of risk (Munnukka et al., 2017), risk perception is also important. In Vietnam, macroeconomic factors (e.g., inflation and interest rates) are closely related to risk perception, while in Bangladesh, emotion triggered (e.g., fear and regret) is a strong determinant of cautious or speculative behavior (Cao et al., 2021; Hossain & Siddiqua, 2022). In addition, there is a shortage of financial education and a lack of scalability in the market, which makes it difficult for investors to make informed decisions.

Behavioral Finance in Nepal

The Nepalese stock market presents a unique environment for studying behavioral finance because of its relatively small size, heavy dependence on retail investors, and underdeveloped institutional infrastructure (Rana, 2019). Unlike its regional counterparts, NEPSE functions in a landscape marked by extensive information asymmetry, lack of strict oversight, and minimal investor safety—factors that markedly contribute toward cognitive biases and affective decision-making (Giri &Adhikari, 2023; Sapkota & Chalise, 2023). One dominating bias among Nepalese investors is the overconfidence bias, which is observed mainly in high-risk, low-return speculative trading among young and inexperienced investors who are oblivious about fundamental analysis but driven solely based on subjective judgment (Sapkota & Chalise, 2023). The proliferation of digital (online) trading platforms, which provide instant access to market transactions, has also exacerbated this tendency while enhancing the likelihood of relevant impulsive and excessive trading behavior. Mimicking others' actions without performing due diligence is also common in Nepal, particularly under exuberant market conditions, leading to herding behavior (Pathak et al., 2024; Rawat, 2023). During the growth phases, this behavior helps create artificial price hikes and bubbles, while in downturns, it causes panic selling and prolonged market downturns (Pokharel,

2020). In Nepal, individual demographic factors such as age, gender, education, and income strongly impact investment behavior. Cognitive biases, such as overconfidence and herding, are more prevalent in younger investors, whereas older and more experienced investors appear more conservative (Ghimire, 2024). Gender disparity also exists, where male investors are more confident than female investors, which is significant and in line with studies in other emerging markets (Barber & Odean, 2001; Poudel et al.,2024). Moreover, higher-income investors are more likely to take on risk, whereas lower-income investors emphasize short-term liquidity and seek to preserve capital (Adhikari, 2020; Rana, 2019). Market conditions and limited access to reliable information exacerbate this bias. During times of economic uncertainty, investors in Nepal tend to migrate toward safe, low-risk options, such as fixed deposits and government bonds, instead of lucrative long-term equity investments (Wagle, 2024). In addition, many investors, especially retail investors, overlook the factor of financial literacy and make decisions based on informal advice received from friends and family or through social networks, making them more prone to changing market conditions and misinformation (Sapkota & Chalise, 2023; Karki et al.,2024). These deficiencies lead to various problems in the financial market that can be mitigated through targeted intervention measures, such as improving market transparency, regulatory measures, and programs aimed at enhancing financial literacy through mainstream behavioral finance (Karmacharya et al., 2023). Reducing overreliance on short-term gains and encouraging long-term investment strategies can reduce the impact of loss aversion and herding bias.

Notwithstanding the increasing interest in behavioral finance, there are gaps in the literature on Nepal's stock market. First, most studies have focused on individual biases without investigating the interplay among demographic factors, market situations, and technological influences. Second, little is known about institutional investors, who are a significant force in market dynamics (Pathak et al., 2024).

Future research should encompass more comprehensive psychological, demographic and technological variables. An integrated effort will help us better understand investment behavior in Nepal against this backdrop. Exploring how learning about behavioral finance affects irrational decision-making can provide useful tips for economists and companies in the financial market.

Methodology

This study adopts a descriptive and causal research design to explore the influence of behavioral factors—herding, overconfidence, loss aversion, and risk perception—on individual investors' investment decisions in Nepal's stock markets. The quantitative approach focuses on analyzing the relationship between these independent variables and the dependent variable, which is the investment decision. A structured questionnaire was designed to collect primary data and to emphasize the key aspects of investor behavior and perceptions. Descriptive statistical tools, such as mean, standard deviation, and percentage, were used to summarize the dataset, while multiple regression analysis provided insight into the causal relationships between the variables. The target population for the study consists of individual investors with active DEMAT accounts in the Kathmandu Valley who participate in secondary market trading. A convenience sampling method was adopted, resulting in a sample size of 387 respondents, which was statistically sufficient for a reliable analysis. Google Forms was employed for data collection to maximize reach and efficiency, allowing respondents to complete the questionnaire conveniently without time or location constraints. The structured questionnaire included both multiple-choice and Likert-scale items, with the latter ranging from one (Strongly Disagree) to five (Strongly Agree).

Data were processed and analyzed using SPSS version 25. The demographic characteristics of the respondents were summarized using descriptive statistics, while regression analysis tested the hypothesized relationships between behavioral factors and investment decisions. Each behavioral construct was measured using scales validated in previous studies. Loss aversion, as described by Kahneman and Tversky (1979), captures heightened sensitivity to losses compared with equivalent gains. Overconfidence, derived from Barber and Odean (2001), reflects investors' tendency to overestimate their skills and knowledge, which often leads to excessive trading. Herding behavior, consistent with the framework of Bikhchandani and Sharma (2000), measures the extent to which investors mimic others' actions without independent analysis. Risk perception was assessed as the subjective evaluation of uncertainty and potential loss associated with investment choices following Slovic's (1987) approach. The dependent variable, investment decisions, reflects the respondent's actual investment behavior in the secondary market. A regression model was used to quantify the influence of these behavioral factors on investment decisions, expressed as

$ID = \beta_0 + \beta_1 HB_1 + \beta_2 PA_2 + \beta_3 MS_3 + \beta_4 HEB_4 + e$

Where, ID = Investment Decision
LA = Loss aversion
OC = Overconfidence
RP = Risk perception
HER = Herding
β_0 = Constant
β_1 to β_4 = Coefficient
e = Error terms

The coefficients (β1to β4) estimate the strength and direction of the relationship between each independent variable and the dependent variable, while eee accounts for the error term.

Cronbach's alpha was calculated to ensure reliability and validity, yielding a high internal consistency of 0.949 across the 25 items, indicating that the survey instrument was robust and reliable. This reliability score confirms that the items consistently measured the intended behavioral constructs.

Results and Discussion

Demographic Insights into Investment Participation and Behavior

The demographic analysis reveals key insights into investor characteristics and behavior. Female participants (51.4%) slightly outnumbered males, indicating a balanced gender representation in the investment landscape. Young adults aged 21–30 years dominate the age distribution (51.7%), reflecting a strong interest in stock markets among early career professionals. Education-wise, undergraduates lead at 49.9%, underscoring the growing financial literacy of students and recent graduates. Students represented the largest occupational group (40.8%), followed by business professionals (30%), indicating that investment activities are gaining traction among younger tech-savvy individuals. Most respondents (51.9%) had 1–5 years of experience, while 29.2% were newcomers with less than a year of experience, emphasizing the stock market's attraction to novice investors. Finally, the majority (59.7%) trade occasionally, suggesting a cautious and strategic approach to stock investment favoring long-term financial planning.

Table 1

Demographic Insights into Investment Participation and Behavior

Demographic Variable	Category	Frequency	Percentage (%)
Gender Distribution	Female	199	51.4
	Male	188	48.6
Age Category Distribution	21–30	200	51.7
	31–40	109	28.2
	Above 40	43	11.1
	Below 20	35	9
Education Status Distribution	Graduate	117	30.2
	School Level	77	19.9
	Undergraduate	193	49.9
Occupation Distribution	Business	116	30
	Others	38	9.8
	Service	75	19.4
	Students	158	40.8
Investment Experience Distribution	1–5 Years	201	51.9
	Above 5 Years	73	18.9
	Below 1 Year	113	29.2
Frequency of Trading Distribution	Frequently	77	19.9
	Occasionally	231	59.7
	Rarely	79	20.4

Investment Decision-Making: Reliability and Behavioral Insights

Loss Aversion

The results on loss aversion highlight that investors focus primarily on minimizing losses rather than maximizing gains. The highest mean score (M = 3.39) shows a strong preference for avoiding significant losses, whereas many investors expressed nervousness about large price drops (M = 3.2). The tendency to avoid increasing investments during market downturns (M = 2.99) further reinforces this cautious approach. Lower scores for holding declining shares while selling profitable ones (M = 2.81) and prioritizing capital preservation (M = 2.57) suggest a moderate overall level of loss aversion. These findings indicate that protecting existing capital is a dominant priority for investors, reflecting a conservative decision-making strategy under uncertain market conditions.

Table 2

Loss Aversion

Loss Aversion	Mean	SD
Priority on avoiding significant losses over missing profits.	3.39	0.65
Nervous about large price drops in invested stocks.	3.2	0.69
Avoid increasing investment during market downturns.	2.99	0.68
Hold declining shares, sell those with a rise in value.	2.81	0.66
Prioritize preserving capital; fear losses more than missing profits.	2.57	0.67

Risk Perception

The risk perception results reveal that investors adopt a cautious approach, prioritizing stability. The highest mean score (M = 3.4) indicates minimal concern about missing certain gains, whereas significant caution is exercised regarding unexpected price fluctuations (M = 3.23). Hesitation to invest in historically underperforming stocks (M = 2.99) further emphasizes a conservative stance. Lower scores for avoiding emotional reactions (M = 2.59) and a lack of attraction to trading (M = 2.78) suggest mixed confidence levels. Overall, the findings point to moderate-to high-risk perceptions, with investors showing a clear preference for safer, more predictable investment opportunities.

Table 3

Risk Perception

Risk Perception	Mean	SD
Unconcerned about capitalizing on certain gains in stocks.	3.4	0.64
Cautious about stocks with unexpected price fluctuations.	3.23	0.65
Concerns about investing in historically underperforming stocks.	2.99	0.69
Lack of attraction to the idea of trading in the stock market.	2.78	0.69
Assess investments holistically; avoid emotional reactions.	2.59	0.66

Overconfidence

The results for overconfidence indicate that investors exhibit moderate confidence in their investment decisions. The highest mean score (M = 3.38) suggests a strong belief in their own views over others, while a preference for independent decision making (M = 3.2) reinforces this self-assurance. However, lower mean scores for outperforming the market (M = 3.03), succeeding where others fail (M = 2.81), and valuing diverse

perspectives (M = 2.57) reflected a controlled level of overconfidence. This implies that, although investors trust their judgment, they remain open to external insights and learning opportunities, balancing self-assurance with cautious optimism.

Table 4

Overconfidence

Overconfidence	Mean	SD
Confidence in my investment views over others.	3.38	0.65
Independent decision-making without relying on others.	3.2	0.69
Certain about outpacing the stock market.	3.03	0.69
Success in environments where others fail.	2.81	0.67
Value diverse perspectives; be open to learning.	2.57	0.68

Herding

The findings reveal that herding behavior is moderately prevalent among investors. The highest mean score (M = 3.39) indicates that investment choices are often influenced by other investors' stock selections, followed by the impact of stock volumes on decisions (M = 3.19). Lower mean scores for quick responses to market fluctuations (M = 2.8) and resisting market trends (M = 2.6) suggest that while investors tend to follow market trends, they still maintain a level of independent decision-making. This demonstrates a balanced approach in which social cues play a role but complete reliance on market behavior is avoided.

Table 5

Herding

Herding	Mean	SD
Investment choices influenced by other investors' stock choices.	3.39	0.66
Impact of other investors' stock volume choices on decisions.	3.19	0.69
Decisions influenced by other investors' buying and selling choices.	2.98	0.68
Quick response to other investors' fluctuations and tracking their market responses.	2.8	0.67
Embrace independent decisions; resist market trends.	2.6	0.68

Investment Decision

The results on investment decisions highlight a strong preference for long-term holdings when buying shares (M = 3.41), suggesting that most investors prioritize stability and long-term growth. Trading based on speculative decisions follows (M = 3.19), indicating a moderate inclination toward risk taking. Lower mean scores for observing past stock behavior (M = 2.79) and staying informed about market trends (M = 2.6) reflect a limited reliance on historical patterns and market updates. This indicates that while long-term strategies dominate, some investors remain open to short-term speculative opportunities.

Table 6

Investment Decision

Investment Decision	Mean	SD
Preference for long-term holding when buying shares.	3.41	0.85
Trading based on speculative decisions.	3.19	0.87
No decision-making during investing.	2.98	0.86
Observing past stock behavior when making investment decisions.	2.79	0.86
Stay informed about market trends for timely choices.	2.6	0.85

Correlation

The correlation matrix provides insights into the relationships among Loss Aversion, Risk Perception, Overconfidence, Herding, and Investment Decisions. Loss Aversion and Risk Perception exhibited a strong positive correlation ($r = .841$, $p < 0.01$), suggesting that loss-averse individuals are likely to perceive higher risks. Overconfidence is positively correlated with both Loss Aversion ($r = .845$, $p < 0.01$) and Risk Perception ($r = .846$, $p < 0.01$), indicating that even confident investors exhibit traits of risk perception and loss aversion. Herding behavior demonstrated strong positive correlations with overconfidence ($r = .860$, $p < 0.01$), Loss Aversion ($r = .843$, $p < 0.01$), and Risk Perception ($r = .838$, $p < 0.01$), implying that herding tendencies coexist with these psychological traits.

Regarding Investment Decisions, Loss Aversion ($r = -.211$, $p < 0.01$) and Risk Perception ($r = -.210$, $p < 0.01$) showed significant negative correlations, indicating that higher levels of these traits discouraged proactive investment. Herding displays a weak positive correlation ($r = .171$, $p < 0.01$) with Investment Decisions, reflecting the influence of collective market behavior. Overconfidence has no significant relationship with Investment Decisions ($r = 0.08$, $p > 0.01$). Overall, these results underscore the nuanced interplay of psychological factors in shaping investment behavior.

Table 7

Correlation Matrix

Variables	Loss Aversion	Risk Perception	Overconfidence	Herding	Investment Decisions
Loss Aversion	1				
Risk Perception	.841**	1			
Overconfidence	.845**	.846**	1		
Herding	.843**	.838**	.860**	1	
Investment Decisions	-.211**	-.210**	0.08	.171**	1

N = 387 for all variables.

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

Regression Analysis

Regression analysis revealed significant relationships between behavioral factors and investment decisions. A constant value of 3.302 represents the baseline level of investment decisions when all the predictors are held constant. Loss aversion (B = -1.416, Beta = -1.053, t = -17.543, Sig. = 0.000) and risk perception (B = -1.362, Beta = -1.012, t = -16.984, Sig. = 0.000) show significant negative effects, indicating that investors who prioritize avoiding losses or perceive high risk are less likely to engage in proactive investment behavior. Conversely, overconfidence (B = 0.947, $\beta = 0.717$, t = 11.356, Sig. = 0.000) and herding (B = 1.723, Beta = 1.29, t = 20.863, Sig. = 0.000) have positive effects, suggesting that self-assured investors and those influenced by collective market trends are more likely to make more active investment decisions. All predictors are statistically significant, emphasizing their crucial role in influencing investors' behavior.

Table 8

Coefficient of Regression

Predictor	B	Std. Error	Beta	t	Sig.
(Constant)	3.302	0.119		27.711	0
Loss Aversion	-1.416	0.081	-1.053	-17.543	0
Risk Perception	-1.362	0.08	-1.012	-16.984	0
Overconfidence	0.947	0.083	0.717	11.356	0
Herding	1.723	0.083	1.29	20.863	0

Note: Dependent variable is Investment Decisions.

The hypothesis that loss aversion positively impacts investment decisions (H1) is rejected because of its significant negative effect (B = -1.416, Beta = -1.053, $p < 0.01$). This implies that individuals who focus on avoiding losses are less inclined to make proactive investment decisions. Similarly, H3, which proposes that risk perception positively affects investment decisions, is also rejected (B = -1.362, Beta = -1.012, $p < 0.01$), indicating that high-risk perception deters active engagement. By contrast, H2, positing that overconfidence positively impacts investment decisions, is accepted (B = 0.947, Beta = 0.717, $p < 0.01$), confirming that confident investors are more decisive in their actions. The strongest support is found for H4, where herding behavior positively influences investment decisions (B = 1.723, Beta = 1.29, $p < 0.01$), leading to acceptance. This underscores the significant role of social influence and collective behavior in shaping investment choices, particularly in emerging markets, such as Nepal.

The results of this study provide significant insights into the behavioral factors influencing investment decisions among individual investors in Nepal's emerging stock market. These findings confirm that, in some instances, they diverge from established behavioral finance theories and empirical research conducted in other emerging markets.

Loss aversion has emerged as a dominant factor, with investors displaying a strong preference for minimizing losses rather than maximizing gains. This aligns with Prospect Theory (Peng, 2025), which suggests that losses are more psychologically impactful than equivalent gains. In Nepal, the significant negative effect of loss aversion on proactive investment decisions (B = -1.416, $p < 0.01$) reinforces findings from prior

studies that highlight panic-selling and conservative strategies during market downturns (Pokharel, 2020). This behavior can exacerbate market instability, as observed in other emerging economies, such as India and Bangladesh (Vijaya, 2014; Rehan et al., 2021).

Risk perception also plays a crucial role in shaping investment strategies, with high-risk perceptions deterring active investment participation ($B = -1.362$, $p < 0.01$). Unlike objective measures of risk such as volatility or beta, subjective risk perception often leads to overly cautious approaches, especially in markets characterized by high uncertainty and limited information access (Ahmed et al., 2022). In Nepal, this heightened risk perception is further fueled by economic volatility and insufficient market transparency (Wagle, 2024). These findings are consistent with observations in other emerging markets, where subjective assessments of risk significantly influence investment behavior (Cao, Nguyen, & Tran, 2021).

Conversely, overconfidence positively influences investment decisions ($B = 0.947$, $p < 0.01$), confirming the hypothesis that self-assured investors are decisive and willing to engage in active trading. This aligns with research by Rana (2024), who find that overconfident investors tend to trade more frequently and often overestimate their knowledge and skills. In Nepal, overconfidence is particularly prevalent among younger investors with limited experience, mirroring the trends observed in studies of male-dominated investor groups in developed markets (Rana, 2024). This behavior, while potentially beneficial in fostering decisive action, can also expose investors to excessive trading risks and lower long-term returns.

Herding behavior demonstrated the strongest positive effect on investment decisions ($B = 1.723$, $p < 0.01$), emphasizing the role of social influence and collective behavior in shaping market trends. This finding is consistent with Shiller's (2000) argument that herding leads to speculative bubbles and heightened market volatility. In Nepal, herding is particularly prominent in bull markets, driven by the fear of missing out and limited access to reliable information (Pathak et al., 2024). Similar patterns are observed in Sri Lanka and Vietnam, where inexperienced investors are highly susceptible to social pressure and market trends (Ngoc, 2014; Kengatharan & Kengatharan, 2014).

The rejection of hypotheses related to loss aversion and risk perception highlights the need for targeted investor education programs that address emotional biases and promote rational decision-making. Enhancing financial literacy and market transparency could mitigate these biases, enabling investors to adopt more balanced strategies. On the

other hand, the acceptance of overconfidence and herding hypotheses underscores the importance of monitoring market sentiment and collective behavior. Policymakers and financial advisors must develop interventions that encourage independent analysis and long-term investment strategies to reduce reliance on short-term market cues.

Conclusion

Behavioral factors—loss aversion, risk perception, overconfidence, and herding— had a significant influence on investment decisions in Nepal's stock market. Loss aversion and risk perception negatively affect proactive decision making, while overconfidence and herding encourage more active investment behavior. Herding emerged as the most influential factor, reflecting the role of social dynamics in collective decision making. These findings emphasize the need to address cognitive biases, especially in an emerging market such as Nepal, where limited information and high volatility amplify emotional responses. This study contributes to the behavioral finance literature by offering localized insights into investor behavior and underlines the importance of improving financial literacy and market transparency to promote rational decision making. Several strategies have been proposed to improve investment practices and enhance the market stability. First, targeted financial literacy programs should focus on reducing biases such as loss aversion and risk perception. Policymakers should enhance market transparency and provide better access to reliable information. Financial institutions should promote long-term investment strategies, while discouraging speculative trading. Monitoring herding behavior and developing early warning systems can help prevent market bubbles. Integrating behavioral insights into policy design will strengthen market resilience. Collaboration among regulators, financial institutions, and educational bodies is essential for building a more informed and rational investor base.

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