Financial Risk Tolerance and Investment Decision in Nepal

Sushil Lamichhane
Assistant Lecturer
Dibya Jyoti Multiple Campus
sushil2043lamichhane@gmail.com

Abstract

This study examines financial risk tolerance and investment decision among investors in Nepal, Rupandehi, focusing on their attitudes, perceptions, and decision- making processes in the stock market. The research aims to find the key factors influencing investment decisions, including risk tolerance, return expectations, and external influences such as peer recommendations and broker guidance. This study specifically explores four key factors investors' attitudes, investors' perceptions, risk, and return based on their significance in the literature. The objectives include analyzing investors' attitudes toward equity investment, understanding the preferred forms of return among investors in securities investment, and examining the factors shaping investment decision in the equity market. Primary data are collected through a structured questionnaire using convenience sampling. The analysis revealed that all tested variables significantly impact investment decisions. The findings indicate that most investors prioritize generating maximum income with asset growth, with a preference for short-term returns in the form of capital gains rather than long-term investments. Furthermore, the stock market in Nepal, Rupandehi, is expanding, attracting more investors. However, a significant number of investors lack financial knowledge and are often influenced by artificial transactions conducted by brokers and peer recommendations.

Keywords: *Investment Decision, Investors Attitude, Investors Perception, Risk, Return*

Background

The stock market plays a crucial role in mobilizing financial resources, thereby contributing to economic growth. Investment in shares typically begins in the primary market, where investors purchase shares through an Initial Public Offering (IPO). Once listed on a stock exchange, these shares can be traded in the secondary market at prevailing market prices. Equity shares, representing ownership in a company, are subject to price fluctuations influenced by supply and demand dynamics. Investors engage in stock trading either by managing their portfolios independently or by relying on professional fund managers such as brokers. The primary objective of investors is to achieve capital appreciation and generate profits. Capital appreciation occurs when shares are sold at a higher price than the purchase price, while dividends serve as an additional source of return (Poudel, 2018).

Investment decisions are often influenced by demographic factors such as age, gender, income level, education, and employment status. Investors exhibit varying levels of risk tolerance, which can be categorized as conservative, moderate, or aggressive. Conservative investors prioritize capital preservation and prefer low-risk investments. Moderate investors seek a balance between risk and return, while aggressive investors are willing to assume higher risks for potentially greater rewards. Poudel (2018) asserts that an individual's financial risk tolerance significantly impacts their investment strategy and asset allocation preferences. However, in many developing economies, like Nepal, financial markets remain underdeveloped, with limited participation from the general public due to low financial literacy and restricted access to sophisticated investment

products. This underdevelopment not only hampers economic growth but also restricts individuals' opportunities to diversify their investment portfolios (Yashaswini, 2019)

Recent research has expanded on the traditional view of risk by incorporating elements of decisional economics. Studies suggest that financial literacy can have a direct impact on risk tolerance, thereby influencing investment decision. For example, individuals with higher financial literacy tend to exhibit a greater willingness to engage with riskier investments, as they can better understand and manage the associated uncertainties (Wang et al., 2016). Conversely, a lack of financial knowledge may lead to an overemphasis on capital preservation and a reluctance to participate in the stock market, ultimately hindering wealth accumulation (Xiao & Wu, 2008).The process of investing typically begins in the primary market through an Initial Public Offering (IPO), where equity shares representing partial ownership in a company are sold to the public. These shares are subsequently traded on secondary markets at prices determined by supply and demand dynamics. In this context, equity shares are not only a source of potential capital gains but also confer voting rights and a claim on the company's earnings in the form of dividends (Yashaswini, 2019)

A significant proportion of rural residents in Nepal suffer from a lack of basic literacy skills, while even in urban areas only a few individuals from families with a commercial or intellectual background exhibit sufficient awareness (Shrestha, 2018). One of the primary factors contributing to the nation's overall developmental challenges is the concentration of wealth in the hands of a small elite, which exacerbates societal underdevelopment (Koirala, 2017). The country's population can be segmented into lower, middle, and upper classes based on income, living standards, and educational attainment; within this framework, the wealth disparity between the affluent and the middle classes is especially pronounced (Acharya, 2018).

To help bridge this wealth gap, it is essential to provide small investors with a consistent source of passive income. This can be achieved by investing in a variety of financial instruments and building effective portfolios, thereby empowering individuals with limited resources (Thapa & Gautam, 2020). Despite the potential benefits of investing, research shows that many investors in Nepal tend to associate it with gambling and speculation, even though investing fundamentally involves a systematic process of making logical decisions (Sharma & Rana, 2019). In an ideal scenario, the investment process should begin with the formulation of a clear investment policy, followed by the development of a portfolio, periodic modifications, and ongoing performance reviews (Khatri, 2017).

However, the choice of securities available to these investors is often highly restricted, limiting them to a small set of assets that can be used to design and evaluate efficient portfolios (Bhandari, 2018). This limitation is compounded by a prevailing state of utopian expectations and the over-optimistic belief in rapid wealth accumulation, particularly among middle-class individuals who initially hesitate to invest in securities. When these investors eventually do commit capital, they frequently make decisions based on aphorisms or superficial judgments without conducting a thorough analysis of the associated risks and rewards (Rai, 2020). Factors such as information gaps, a confused mindset, and doubts about the credibility of publicly released financial accounts further exacerbate the situation, leading to investment choices made without sufficient research or direction. Consequently, investors may incur losses or, in some cases, realize returns that differ markedly from their expectations.

Although there is a wide array of investment options available in today's competitive financial landscape, most investors tend to choose equities as their primary investment vehicle because equities typically require less capital and offer higher liquidity, enabling quicker trading (Koirala, 2017). In light of these observations, this research aims to determine how investors' attitudes toward investing influence their investment choices and to identify the key factors that drive these decisions under varying circumstances (Shrestha & Lama, 2020).

The main objective of this research is to analyze the investor's perception and financial risk tolerance on investment decision in the stock market. This study on the financial risk tolerance and investment decision of investors in Nepal, with a focus on stock market investments, faces several limitations. It relies on primary data, which may include incomplete or inaccurate responses requiring certain assumptions, and is based on a relatively small sample of 385 investors that might not represent all investors in Nepal. Moreover, the research employs predominantly descriptive and causal-comparative methods, favoring qualitative approaches over robust quantitative analyses, which limits the application of advanced statistical tools. In addition, the scope is confined to equity investments, excluding other investment avenues such as mutual funds or real estate, and constraints in time and resources have further restricted the study's ability to cover a broader population or monitor decisional changes over time.

Research framework

Acquiring financial information from diverse sources through social learning helps ensure that investors remain well-informed about stock market activity and are equipped to make prudent investment decisions. Guiso and Japelli (2005) argue that investors can enhance their awareness by learning from both challenges and information disseminated by intermediaries, as well as from peers who are similarly informed. This social learning process bolsters investors' overall knowledge, predictive capabilities, and other decisional dimensions. Moreover, financial awareness is also shaped by factors such as an investor's income, financial status, age, and educational background. Consequently, investors' perceptions are impacted by the inverse relationship between perceived risk and both risk-taking and self-esteem rigidity. The first review of the relevant literature served as the foundation for the schematic diagram shown in Figure 1.
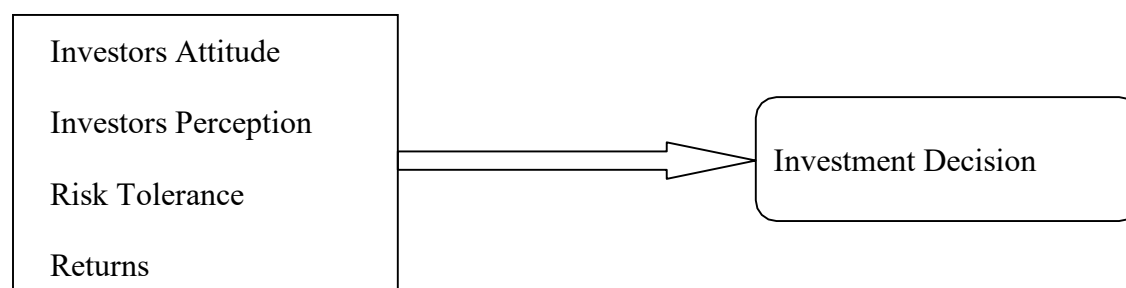

Figure 1 Research framework

Investment Decision

When making investment decisions, it's vital to begin by clearly defining your financial objectives and assessing your risk tolerance. These two factors will serve as your compass, guiding you toward the most appropriate investment options. Whether you aim to secure your retirement, save for a home, or grow your wealth, understanding your goals is paramount. Additionally, evaluating your comfort level with risk will help you determine the mix of assets in your portfolio, with higher-risk investments potentially

offering greater rewards but also greater volatility. Equipped with this knowledge, you can then research and select diversified investment opportunities, considering factors like time horizon, costs, and your chosen investment strategy, all while staying informed, patient, and disciplined. Lastly, periodic portfolio reviews and adjustments will ensure that your investments remain aligned with your evolving financial objectives and risk profile (Gnawali, 2020).

Investor's Attitude

A investor's attitude plays a pivotal role in shaping their financial success. A positive and proactive attitude involves a willingness to embrace opportunities while acknowledging and managing risks. It encourages patience and discipline, discouraging impulsive decisions driven by short-term market fluctuations. An open-minded and inquisitive approach encourages ongoing learning about investment options and strategies. Moreover, a long-term perspective allows investors to harness the power of compounding and ride out market volatility. Maintaining emotional resilience and avoiding excessive fear or greed is crucial to staying on course. Ultimately, a well-balanced and informed attitude can help investors navigate the complex world of finance, making prudent decisions that align with their financial goals and risk tolerance (Yashaswini, 2019).

H1: There is a significant effect of investor's attitude on investment decision in Nepalese commercial banks.

Investor's Perception

Investor perception refers to how individuals perceive and interpret information about financial markets, assets, and investment opportunities. These perceptions are often influenced by a variety of factors, including personal experiences, emotions, media coverage, and prevailing market sentiment. Investor perception can significantly impact decision-making, as positive perceptions may lead to increased investment and confidence, while negative perceptions can trigger selling and market downturns. Decisional biases, such as overconfidence or fear, can distort these perceptions, leading to suboptimal investment choices. Successful investors recognize the influence of perception on their decision-making and strive to maintain objectivity, relying on research, data, and a well-informed understanding of the investment landscape to make rational choices that align with their financial goals (Kunwar, 2016).

H2: There is a significant effect of investor's perception on investment decision in Nepalese commercial banks.

Risk

Risk in the context of investments represents the uncertainty and potential for adverse outcomes that investors face when allocating their capital. It encompasses various dimensions, including market risk, which relates to the fluctuations in asset prices due to economic, political, or other factors; credit risk, associated with the possibility of borrowers defaulting on their obligations; and liquidity risk, which pertains to the ease of buying or selling assets without significant price fluctuations. Investors must consider their risk tolerance and time horizon when making investment decisions, as risk and potential reward are typically correlated. Diversification, asset allocation, and risk management strategies are essential tools to mitigate risk and align investment choices with individual financial objectives. Understanding and managing risk is a fundamental aspect of prudent investing (Bhatta, 2019).

H3: There is a significant effect of risk on investment decision in Nepalese commercial banks.

Returns

Returns, in the realm of investments, refer to the gains or losses generated from putting capital into various financial assets. These returns can take different forms, including capital appreciation (increase in the asset's value over time), dividend or interest income, or even rental income in the case of real estate investments. Returns are a critical metric for investors as they gauge the success and profitability of their investments. Investors seek to optimize their returns while managing associated risks, as higher returns often come with higher levels of risk. Additionally, returns can be influenced by factors like market conditions, economic trends, and the specific asset class chosen for investment. Ultimately, achieving a balance between risk and return is central to investment strategy, with the goal of maximizing returns while staying aligned with one's financial objectives and risk tolerance (Adhikari, 2017).

H4: There is a significant effect of returns on investment decision in Nepalese commercial banks.

Literature review

Munivel (2015) investigated how demographic factors, especially gender, influence investors' choices and preferences for different investment avenues in Vijayawada, Andhra Pradesh. Using a descriptive design with convenience sampling, the study gathered data via questionnaires and interviews and analyzed it with methods such as chi-square, ANOVA, and non-parametric tests, concluding that investors diversify their allocations to pursue both short- and long-term gains. In a similar vein, Raju and Patra (2016) examined factors shaping investment decisions in the Visakhapatnam District and found that while the Indian stock market is highly volatile and reacts swiftly to unforeseen shocks, there is no significant link between an investor's age and their preferred investment options. Sebastion (2017) focused on the challenges faced by frequent stock market participants trading futures and options in the Ernakulum District, revealing that retail investors are willing to engage in derivatives trading when assisted by third parties, emphasizing the importance of understanding the derivatives market from a regional perspective.

Satya and Padam (2018) explored retail financial risk tolerance toward asset allocation in Coimbatore, Tamil Nadu, using data from 385 investors. Their findings indicate that investment decisions—conceived as current commitments aimed at yielding future returns—are influenced by factors ranging from macroeconomic variables to company-specific characteristics. Meanwhile, Yashaswini (2019) assessed financial risk tolerance for stock investments in Karnataka, categorizing investors into cautious, moderate, and aggressive groups based on demographic variables such as gender, age, income, education, and employment. Komalasari et al. (2021) compared investors' perceptions of the Indonesian stock market before and after the COVID-19 pandemic using a paired sample t-test on 239 responses, and noted significant shifts in decision driven by heightened perceived risk and external influences during the pandemic.

Gnawali and Niroula (2021) examined investor perceptions regarding initial public offerings (IPOs) in Nepal, Rupandehi, using regression and correlation analyses on data from 290 respondents across five brokerage firms; they identified quality management,

corporate goodwill, company performance, company sector, and market intelligence as critical determinants in the investment decision process. In another study, Karmacharya et al. (2022) used a structural model based on 350 samples from various brokerage companies across five major cities to demonstrate that market sentiment, heuristic decision, and herding significantly affect the performance of the Nepal Stock Exchange. Finally, Md Husin et al. (2023) investigated the impact of financial risk tolerance on investment decision-making among 250 Malaysian investors in the Klang Valley, using SPSS and SEM–PLS. Their findings reveal that both brand familiarity and perceived trust, when mediated by investor attitude, play significant roles in shaping investment choices in the context of Islamic stock investing.

Research Methodology

The study employs a descriptive and causal-comparative research design as a strategic framework to achieve its objectives of exploring financial risk tolerance and stock market investment decisions among investors in Nepal. This design allows the researcher to investigate and analyze the cause-and-effect relationships between various influencing factors, while simultaneously presenting a comprehensive picture of investors' decisions. Primary data were gathered from a target sample of 385 investors through a semi-structured questionnaire composed of 30 items using a 5-point Likert scale (1 = Strongly Disagree to 5 = Strongly Agree).

The population of interest encompasses individual investors in the stock market; however, due to practical constraints such as time, cost, and logistical challenges, the study focuses on investors who are active in the stock market in Nepal. Convenience sampling was employed to select participants who were accessible and willing to respond, ensuring that the sample, though not entirely representative of all Nepalese investors, reflects the financial attitudes and risk tolerance of this subgroup (Munivel, 2015). A total of 400 questionnaires were distributed, and after rigorous screening, 385 valid responses were retained for analysis.

Data collection relied primarily on the self-administered questionnaire. This instrument was designed to capture multiple dimensions of financial risk tolerance and investment decision-making processes, incorporating both closed and open-ended questions to gather a wide range of qualitative and quantitative insights (Satya & Padam, 2018). The questionnaire's design was informed by previous studies in the field, ensuring that it effectively addressed key issues such as investment preferences, risk perceptions, and the influence of demographic factors. The collected data were coded and tabulated using Microsoft Excel before being imported into SPSS for further analysis.

The data analysis phase utilized a variety of statistical techniques to ensure a robust examination of the research questions. Descriptive statistics, including means, standard deviations, and frequency distributions, were calculated to outline the central tendencies and variability of respondents' answers. Inferential statistics such as the t-test, ANOVA test were applied to test for significant differences and relationships among variables. Moreover, correlation analysis was conducted to evaluate the strength and direction of associations between financial risk tolerance, investment decisions, and other influencing factors (Raju & Patra, 2016). Regression analysis was also performed to determine the extent to which multiple independent variables collectively influence the dependent variable—investment decision-making decision.

The influence of independent factors on profitability is predicted using multiple linear regression analysis. The following equation is the equation for the influence of independent variables:

Linear Regression Model

$EMP = \alpha_1 + \beta_1 TRF + \beta_2 TRN + \beta_3 CHR + \beta_4 LFR + ei$

Where,

$D = \alpha + \beta_1 SA + \beta_2 SB + \beta_3 R + \beta_4 RE + e$

Where, α = Constant Term, D = Investment Decision, SA = Investors Attitude, SP = Investors Perception, R = Risk, RE= Returns

Validity and reliability

According to this research, each variable's Cronbach's alpha is more than 0.80, indicating the reliability of the data. If other validity indicators are similarly strong, a rating over 0.80 is regarded as excellent, and a value above 0.70 indicates a high degree of dependability (Churchill et al., 1991). The dependability rating shouldn't drop below 0.70, however.

Analysis and Results

The descriptive analysis of data collected from 385 respondents via questionnaires. It uses statistical metrics such as mean, standard deviation, and frequency to explain the data. The mean and standard deviation are presented in a table. Bank workers responded to survey items on a five-point Likert scale, ranging from 1 (Strongly Disagree) to 5 (Strongly Agree).

Table 1
Descriptive Statistics

	Minimum	Maximum	Mean	Std. Deviation
Investment decision	1.00	5.00	1.7862	1.017
Investors attitude	1.00	4.83	1.1889	1.008
Investors perception	1.00	4.70	1.5241	0.9058
Risk	1.00	5.00	1.7448	1.0526
Return	1.00	4.92	1.9448	1.0915

Note: From Researcher Calculation

Table 1 provides the investment decision variable, values ranged from 1.00 to 5.00, with a mean of 1.79 and a standard deviation of approximately 1.02. This indicates that, on average, participants tended to give low ratings to their investment decision scores, although there was a moderate degree of variation in their responses. Similarly, the investors' attitude variable, with a minimum value of 1.00 and a maximum of 4.83, had a notably lower mean of 1.19 and a standard deviation of about 1.01. This low mean suggests that, overall, the respondents exhibited relatively conservative or cautious attitudes toward investment, with a similar spread of responses as observed in the investment decision scores.

In contrast, the investors' perception variable, which also ranged from 1.00 to 4.70, showed a slightly higher mean of 1.52 and a standard deviation of 0.91. This implies that while perceptions about financial matters are still on the lower side, there is a modest increase compared to attitudes, and the responses were somewhat more consistent among participants. Likewise, the risk variable, the values again spanned from 1.00 to 5.00, with a mean of 1.74 and a standard deviation of 1.05. This pattern mirrors that of the investment decision variable, indicating that the average risk score provided by investors is relatively low, though with a fair amount of variability.

And, the return variable, with a minimum of 1.00 and a maximum of 4.92, had the highest mean of 1.94 and a standard deviation of 1.09. Although still below the midpoint of the scale, this higher mean suggests that participants might expect marginally better returns relative to their overall conservative investment decisions and risk assessments.

Table 2
Correlation analysis

		Investment Decision	Sig. (2-tailed)
Investors attitude	Pearson Correlation	.466**	.005
Investors perception	Pearson Correlation	.719**	.000
Risk	Pearson Correlation	.573**	.000
Return	Pearson Correlation	.751**	.000

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

Note: From Researcher Calculation

Table 2 shows the Pearson correlation coefficients between the variable Investment Decision and four other variables: Investors' Attitude, Investors' Perception, Risk, and Return. All correlations are statistically significant at the 0.01 level, indicating a strong association between Investment Decision and each of these factors. Specifically, the correlation coefficient between Investment Decision and Investors' Attitude is 0.466 (p = 0.005), suggesting a moderate positive relationship. The strongest correlation is with Return, at 0.751 (p = 0.000), implying that higher return expectations are closely associated with investment decisions. Additionally, Investors' Perception (r = 0.719, p = 0.000) and Risk (r = 0.573, p = 0.000) also show strong positive correlations with Investment Decision. These findings indicate that as investors' attitudes, perceptions, risk tolerance, and return expectations increase, their investment decision scores tend to be higher as well.

Table 2
Regression analysis

Variables	B	Std. Error	t	Sig.
(Constant)	.310	.134	2.244	.030
Investors attitude	.220	.043	5.073	.000
Investors perception	.067	.094	.711	.481
Risk	.017	.006	2.606	.012
Return	.424	.056	7.522	.000
Adj. R^2	.68			
F-value	15.367			

P-value	.000

Table 2 presents the regression analysis results with Investment Decision as the dependent variable and Investors' Attitude, Investors' Perception, Risk, and Return as the independent variables. The constant is 0.310 (p = 0.030), indicating that when all independent variables are zero, the predicted investment decision score is 0.310. Among the predictors, Investors' Attitude has a coefficient of 0.220 (t = 5.073, p = 0.000), signifying a significant positive impact; for every one-unit increase in attitude, the investment decision score is expected to increase by 0.220 units. Similarly, the Return variable shows a strong positive effect with a coefficient of 0.424 (t = 7.522, p = 0.000), meaning that higher return expectations are closely associated with increased investment decision scores.

In contrast, Investors' Perception does not show a statistically significant impact (coefficient = 0.067, t = 0.711, p = 0.481), suggesting that changes in perception do not reliably predict changes in investment decisions within this model. The Risk variable, however, does have a significant, though smaller, effect (coefficient = 0.017, t = 2.606, p = 0.012), indicating that higher risk tolerance is associated with a modest increase in the investment decision score. Overall, the regression model explains 68% of the variance in investment decisions (Adjusted R^2 = 0.68), and the model as a whole is statistically significant (F = 15.367, p = 0.000). This analysis implies that among the variables studied, Investors' Attitude and Return are the most influential factors in determining investment decision decisions among the sample.

Conclusion and Recommendations

According to the survey, investors' opinions and perceptions of equity investing are usually varied. The stock market is more likely to be seen as a beneficial source of financial gain by those who have a good outlook on investments and a positive attitude toward them. Furthermore, pupils who understand the possible advantages of returns also often show a greater interest in equity investing. Although it exists, risk tolerance differs from person to person, meaning that some investors are prepared to take chances in hopes of making money, while others are cautious.

The study reveals important connections between investors' judgments on stock investments and their beliefs, attitudes, risk tolerance, and returns. Higher involvement in equity investments is substantially correlated with a good attitude and positive opinion of investing. Investors' investing selections are also influenced by their concentration on possible rewards and their willingness to accept measured risks. Nonetheless, the results indicate that attitudes and perceptions influence investing decision more than risk tolerance. According to the study's findings, investors' attitudes and beliefs are very important in influencing their choices on equity investments. Investors are more likely to participate actively in financial markets if they have a positive outlook and believe that investments are lucrative. Although risk tolerance affects investing choices, attitudes and beliefs seem to have a greater effect. One of the main factors encouraging investors to investigate equity investing is the anticipation of profits. All things considered, investors' involvement in the stock market may be greatly increased by cultivating favorable attitudes and views via focused education and awareness campaigns. In conclusion, the study underscores the critical role of transformational, transactional, charismatic leadership and laissez-faire leadership styles in enhancing employee productivity. These findings suggest that organizations should focus on fostering these leadership qualities to improve employee performance and achieve organizational goals. Laissez-faire leadership, while still relevant, appears to have a less pronounced effect on productivity,

indicating that a more proactive leadership approach may be more effective in driving employee performance.

From the above discussion, these are the recommendations:

- This research aims to increase knowledge in the area and shed light on how an investor's decision or mindset may affect trading or investing.

- The study will be very beneficial to the NEPSE, government organizations, institutions, potential listed companies, researchers, investors, and citizens in Nepal.

- Because this study has a deep grasp of the crucial factors that affect investors' views and risk returns while investing in the share market, it will be helpful to all researchers and investors who want to undertake share market research.

- This study is entirely based on primary data; no secondary data is utilized. Consequently, future research may be built on secondary data or a mix of primary and secondary data.

- Because the study's sample size is modest, future research may utilize more advanced statistical approaches and bigger sample sizes over longer time periods.

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