

Impact of Financial Literacy and Cognitive Biases on Individual Investment Decisions in Nepalese Stock Market

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Abstract

This study examines the factors that influence individual investors' decisions in Nepal's stock market, with a focus on cognitive biases (heuristic biases, framing effect, cognitive illusions, and herd mentality) and financial literacy. Structured questionnaires were used to collect data from 251 respondents in Kathmandu Valley, selected through purposive sampling to ensure participants had at least one year of investment experience. The data were analysed using descriptive and inferential statistics via the partial least squares structural equation modelling (PLS-SEM) method. The results show that behavioural biases have the greatest influence on investment decisions, followed by financial knowledge. While the study's judgmental sampling and concentration on the Kathmandu Valley limit generalisability, and the use of self-reported data introduces possible biases, the findings are valuable. Financial advisers and policymakers might use these findings to develop educational programmes that promote financial literacy and risk management. Using Prospect Theory (Kahneman & Tversky, 1979) as the primary theoretical foundation, the study explores how investors' perceptions of gains and losses influence their decision-making, often leading to irrational choices. Additionally, the Theory of Planned Behaviour (Ajzen, 1991) is used to explain how financial literacy shapes investment attitudes and perceived control over financial decisions.

Keywords: behaviour bias, financial knowledge, financial literacy, investment decisions, Nepalese stock market

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INTRODUCTION AND STUDY OBJECTIVES

In recent years, behavioural finance has received increased attention for its role in understanding the impact of financial literacy and cognitive biases on individual investors' stock market decisions. Financial literacy,

defined as the ability to comprehend and apply financial ideas, is critical for making sound investment decisions and managing risks (Lusardi & Mitchell, 2014). Weixiang et al. (2022) and Nugraha et al. (2021) found a link between financial literacy and better investing outcomes, such as increased portfolio diversity and logical decision-making. Individual

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investors have hurdles in developing nations such as Nepal due to low financial knowledge levels (Atkinson & Messy, 2012). Simultaneously, cognitive biases-systematic errors in judgment such as heuristic biases, framing effects, cognitive illusions, and herd mentality-complicate investment decision-making and contribute to poor outcomes (Barberis & Thaler, 2003; Tversky & Kahneman, 1974). These biases can lead investors to make illogical actions, such as excessive trading, relying on mental shortcuts, and following the crowd without sufficient analysis (Kahneman, 2011; Khan, 2020). Given these obstacles, it is crucial to investigate how financial literacy, and cognitive biases influence Nepalese investors' investment decisions on the constantly modernising Nepal Stock Exchange (NEPSE). The NEPSE has grown significantly, particularly with the adoption of the online trading system in 2018, which resulted in a considerable rise in market participation, with over 6.22 million DEMAT accounts and a market value over NPR 3 trillion (CDSC, 2024). Despite this advancement, individual investors still struggle to make optimal investing decisions due to a lack of financial understanding and cognitive biases. According to research, investors with inadequate financial literacy are more likely to make poor investing decisions and be susceptible to biases such as overconfidence, framing effects, and herd mentality (Baihaqqy et al., 2020). The effects of these psychological biases are made worse in emerging nations like Nepal by a lack of financial awareness. The ability to comprehend financial concepts and make wise choices about risk management, investing, saving, and budgeting is known as financial literacy (Lusardi & Mitchell, 2014). Atkinson and Messy (2012) and Dhole et al. (2023)

emphasised that investors are more susceptible to mistakes brought on by heuristic shortcuts, framing effects, and herd behaviour in markets with low levels of financial education. Research by Sharma (2020) and Thapa and K.C. (2020) shows that Nepalese investors are prone to overconfidence, confirmation bias, and reactive behaviour to market movements, and they frequently rely on social signalling. There is an absence of integrated research that evaluates the combined influence of cognitive biases and financial literacy on investing decisions in the Nepalese stock market, even when these studies highlight specific behavioural characteristics or literacy levels. Furthermore, most earlier studies either use established market contexts or focus only on behavioural aspects without examining the potential moderating or interacting effects of financial literacy. Even financially knowledgeable people may not always act logically unless they are additionally trained to understand and manage their behavioural tendencies, according to recent international studies like Suresh (2024) and Ahmed et al. (2022). In order to fill this gap, the current study uses an integrated behavioural-finance approach, based on the Theory of Planned behaviour (Ajzen, 1991) and Prospect Theory (Kahneman & Tversky, 1979), to evaluate how financial literacy and cognitive biases influence the behaviour of individual investors in Nepal. Investors' asymmetrical perception of rewards and losses, which frequently results in irrational risk-taking or avoidance, is explained by prospect theory. Simultaneously, the Theory of Planned behaviour highlights the influence of attitudes and perceived behavioral control, which is influenced by information, on real decision-making and intention. According to Montier (2007), investors frequently use heuristics, which can lead to systematic

errors and inferior results. Similarly, [Shiller \(2003\)](#) stressed the impact of herd behaviour in market bubble formation. As a result, the purpose of this research is to investigate how these factors influence investing behaviour in Nepal's stock market, as well as to propose improvements to financial education and decision-making processes.

LITERATURE REVIEW

A review of the following literature studies was conducted to formulate the research hypothesis and conceptual framework.

Heuristic Bias

Heuristics are mental shortcuts that make decision-making easier but may lead to systematic errors. Heuristic biases in financial decisions include overconfidence, anchoring, and availability. [Weixiang et al. \(2022\)](#) and [Mburu \(2021\)](#) found that heuristic biases regularly cause investors to make poor decisions. For example, overconfidence can lead to excessive risk-taking, whereas relying on specific information (such as a stock's original price) can preclude an objective review of the investment. The dependence on easily available information (availability bias) distorts rational decision-making. These biases can worsen bad investment outcomes in markets with low levels of financial literacy, such as Nepal. [Khan \(2020\)](#) and [Subedi \(2023\)](#) underline the importance of tailored financial education programs in reducing heuristic biases and improving investor results.

Framing Effect

The framing effect is based on Kahneman and Tversky's prospect theory, describes how the presentation of information influences

investing decisions. Investors may react differently to the same financial data based on whether it is presented positively or negatively. For example, when investment opportunities are offered in terms of prospective returns, investors may exhibit risk-averse behaviour, whereas framing the same chances in terms of potential losses may result in risk-taking behaviour. [Subedi \(2023\)](#) and [Khan \(2020\)](#) have demonstrated that investors with little financial awareness are more vulnerable to this prejudice. To overcome the framing effect, financial literacy programs that teach investors how to objectively analyse risks and rewards improve decision-making quality.

Cognitive Illusions

Cognitive illusions, including as the illusion of control, confirmation bias, and hindsight bias, skew investors' perceptions of market events and their own talents. The illusion of control drives investors to assume they have more control over market outcomes than they do, while confirmation bias causes them to seek information that confirms their pre-existing assumptions. Hindsight bias makes past events appear more predictable than they were, leading to overconfidence when projecting future outcomes. [Subedi \(2023\)](#) and [Weixiang et al. \(2022\)](#) found that these cognitive illusions had a negative impact on investment decisions in the Nepali market. Investors may overestimate their abilities to time the market or disregard conflicting facts that could lead to better judgments.

Herd Mentality

Herd mentality is the tendency of investors to follow the activities of a larger group rather than making their own decisions. In stock markets, this is frequently seen when investors copy their peers' purchasing

or selling movements, assuming that the majority is acting on better knowledge. This bias can lead to price bubbles or crashes, as evidenced by [Subedi \(2023\)](#) research of the Nepalese stock market, in which herd behaviour contributed to market instability and poor investment decisions. [Mburu \(2021\)](#) discovered comparable outcomes on the Nairobi Securities Exchange, and [Khan \(2020\)](#) documented herd mentality's impact on Pakistan's market. These studies advocate for financial education that encourages investors to think independently and critically to lessen the impact of herd behaviour. Thus, it is hypothesised that:

H₁: Behavioural biases have a significant favourable influence on the investment decisions of the individual investor.

Financial Land Investment Decisions

Financial literacy includes comprehension and awareness of financial principles, empowering individuals to make well-informed choices concerning their personal finances, investment opportunities, and risk mitigation. Financial literacy plays a crucial role in the Nepalese stock market as it enables investors to assess market circumstances, appraise investment prospects, and properly handle risks, hence influencing their investment decisions. The theoretical basis for financial literacy is rooted in both traditional finance theory, which assumes rational decision-making based on available information, and behavioural finance theory, which acknowledges the influence of cognitive biases and psychological factors on financial behaviours.

Financial literacy is commonly evaluated by survey questionnaires that gauge different

aspects such as familiarity with financial products, comprehension of investing principles, and proficiency in financial calculations. The survey may include inquiries regarding fundamental financial principles (such as interest rates and inflation), investing tactics (such as diversification and risk evaluation), and financial planning (such as budgeting and retirement savings). Comprehending financial literacy is essential in this study as it emphasises the significance of financial education in enhancing investment decisions and results. Prior studies have shown that financial literacy has a beneficial effect on investment choices. [Subedi \(2023\)](#) discovered a positive correlation between higher levels of financial literacy among Nepalese investors and the ability to make well-informed and rational investment decisions. This highlights the importance of implementing financial education programmes to improve investor understanding ([Subedi, 2023](#)). [Weixiang et al. \(2022\)](#) highlighted the importance of financial literacy in mitigating the negative effects of cognitive biases, such as overconfidence and risk aversion. This, in turn, results in more rational and successful investment choices. [Khan \(2020\)](#) highlighted the importance of financial literacy in reducing the adverse impact of cognitive biases on investment decisions in Pakistan. [Khan \(2020\)](#) suggested that focused financial education could be beneficial in enhancing investment results. In addition, [Mburu \(2021\)](#) emphasised the significance of financial literacy in mitigating the impact of herd mentality on investment choices made by individual investors at the Nairobi Securities Exchange. [Mburu \(2021\)](#) advocated for the implementation of comprehensive financial education programs to foster autonomous

decision-making. Every investor has a unique approach to making investment decisions, as they either create their own set of investment principles or adopt the tactics of other investors. Despite increased attention, there is little empirical study on cognitive biases and financial literacy in the Nepalese capital market. By examining the interactions and influences of both dimensions on decision-making, this study closes a significant gap in the literature on behavioural finance in Nepal. Thus, it is hypothesised that:

H₂: Financial literacy has a significant favourable influence on the investment decisions of the individual investor.

RESEARCH METHODS

This study adopts a positivist philosophical approach, using a quantitative, non-experimental, and causal-comparative research design. The main objective is to evaluate the effects of financial literacy and cognitive biases on individual investment decisions in the Nepalese stock market. The study is grounded in the theoretical

frameworks of Prospect Theory (Kahneman & Tversky, 1979) and the Theory of Planned Behaviour (Ajzen, 1991). To gather primary data, a structured questionnaire with Likert scale items was administered to individual investors. The population of interest included investors actively participating in the Nepal Stock Exchange (NEPSE), particularly those based in the Kathmandu Valley. The inclusion criteria required that participants be aged 23 years or older and have a minimum of one year of investment experience. The age threshold was selected to ensure financial maturity and decision-making experience among respondents. A total of 251 responses were collected, exceeding the minimum calculated sample size of 200 as per Hair et al. (2010) guidelines. However, it is acknowledged that this sample size is below the more conservative “10-times rule” for Structural Equation Modelling (SEM), which would recommend a sample size of 410 (based on 41 total indicators and latent variables). Due to resource and time constraints, and following recent methodological flexibility in emerging market research (Benitez et al., 2020), the current sample was deemed adequate for exploratory analysis using PLS-SEM, which

Table 1
Study Variables Measurement Sources

Construct	Source of Measurement
Behavioural Biases	
Heuristic Bias	9 Items (Khan, 2020)
Framing Effect	6 Items (Nugraha et al., 2021)
Cognitive Illusions	4 Items (Weixiang et al., 2022)
Herd Mentality	4 Items (Baihaqqy et al., 2020)
Financial Literacy	5 Items (Weixiang et al., 2020)
Investment Decisions	7 Items (Khan, 2020)

Note. From various literature sources

is known for tolerating smaller samples when compared to covariance-based SEM. The sampling strategy employed was purposive sampling, which involves deliberately selecting participants who meet specific criteria. Although this method does not allow for full generalisability, it was considered appropriate to ensure relevance of responses. Future studies could benefit from using stratified random sampling to enhance representativeness. Data were analysed using Partial Least Squares Structural Equation Modeling (PLS-SEM) via SmartPLS-4, complemented by descriptive statistics processed through Microsoft Excel and the KoBo Toolbox. Measurement reliability and validity, as well as structural path significance, were assessed using standard SEM procedures including bootstrapping (10,000 samples), R^2 , f^2 , and Q^2 evaluations.

DATA ANALYSIS AND DISCUSSION

This section presents the outcomes of descriptive analysis, normalcy assessment, measurement evaluation, and structural model analysis employed for hypothesis testing.

Respondent Profile

Table 2 presents the demographic data collected from respondents on age, gender, marital status, levels of education, occupation, and income level. Out of the total sample size of 251 respondents, the majority are male, constituting 71.71 percent, while females account for 28.29 percent of the sample. Regarding age, respondents span across different age groups, with 63.35 percent falling within the 23-30 years bracket, 29.88 percent between 31-45 years, and 6.77 percent aged above 45

years. Most respondents' 63.35 percent fall within the 23-30 years category, indicating a predominantly young population. This age group often represents individuals in the early stages of their 48 careers or educational pursuits, with varying levels of financial independence and responsibilities.

Education level is another crucial determinant of financial behaviour. Regarding educational attainment, 42.63 percent have up to a higher secondary education, 37.05 percent hold bachelor's degrees, and a substantial portion of respondents 20 percent hold master's degrees or higher qualifications, suggesting a higher level of education within the sample. Higher education levels are often associated with greater earning potential and financial literacy, influencing individuals' financial management practices and investment decisions.

Income distribution reveals a diverse range of earning capacities among respondents. In terms of income distribution, 45.82 percent earn less than or equal to 30,000, 23.51 percent fall in the 30,001-60,000 range, 18.33 percent earn between 60,001-90,000, and 12.35 percent earn above 90,000. Individuals with higher incomes may have more disposable income available for savings and investments, while those with lower incomes may face greater challenges in building financial stability.

Experience in NEPSE provides insight into respondents' familiarity with investment practices. Respondents' experience in NEPSE varies, with 46.22 percent having 1-3 years of experience indicating a relatively recent entry into stock market activities, 35.46 percent with 4-7 years,

Table 2
Profile of Respondents

Variable	Category	Frequency	Percentage
Gender	Female	71	28.29
	Male	180	71.71
	Total	251	100
Age	23-30	159	63.35
	31-45	75	29.88
	Above 45	17	6.77
Education Level	Up to Higher Secondary	107	42.63
	Bachelor's Level	93	37.05
	Master's Degree & Above Others	51	20.32
Monthly Income	Below 30,000	115	45.82
	30,001-60,000	59	23.51
	60,001-90,000	46	18.33
	Above 90,000	31	12.35
Experience in NEPSE	1-3 years	116	46.22
	4-7 years	89	35.46
	More than 7 years	46	18.33
Occupations/Engagement	Private Sector	141	56.18
	Retired	47	18.73
	Self Employed	35	13.94
	Business	19	7.57
	Other	9	3.59

Note. Survey Data (2024)

and 18.33 percent with more than 7 years of experience. Investors with higher experience may exhibit different risk-taking behaviours and investment strategies based on their accumulated knowledge and market experience.

Occupations/Engagement status can also influence financial attitudes and behaviours. Many respondents, 56.18 percent are engaged in private sector while 18.73 percent are retired, 13.94 percent are self-employed,

7.57 percent are Businesspersons, and 3.59 percent are others suggesting potential family-related financial responsibilities and long-term financial planning considerations.

Evaluation of the Outer Measurement Model

Table 3 demonstrates the aspects of reliability and validity pertaining to all the variables under study. The assessment of the measurement model involved evaluating the loadings, average variance explained, and

Table 3
Evaluation of the Outer Measurement Model

Constructs	Observed Items and coding	Factor Loading	AVE	Composite Reliability	Cronbach's Alpha
Heuristics Bias	HB_1	5.755	0.853	0.982	0.978
	HB_2	6.279			
	HB_3	5.88			
	HB_4	6.033			
	HB_5	5.636			
	HB_6	6.294			
	HB_7	5.733			
	HB_8	6.148			
	HB_9	5.131			
Framing Effect	FE_1	3.228	0.777	0.946	0.943
	FE_2	3.912			
	FE_3	3.434			
	FE_4	3.312			
	FE_5	3.316			
	FE_6	2.957			
Cognitive Illusions	CI_1	3.298	0.834	0.937	0.934
	CI_2	3.742			
	CI_3	3.331			
	CI_4	3.613			
Herd Mentality	HM_1	3.915	0.849	0.943	0.941
	HM_2	4.406			
	HM_3	3.801			
	HM_4	3.38			
Financial Literacy	FL_1	3.928	0.755	0.962	0.959
	FL_2	3.093			
	FL_3	3.677			
	FL_4	3.713			
	FL_5	3.753			
	FL_6	3.443			
	FL_7	2.87			
	FL_8	3.332			
	FL_9	3.677			
Investment Decision	ID_1	2.682	0.771	0.962	0.958
	ID_2	3.649			
	ID_3	4.023			
	ID_4	4.145			
	ID_5	3.737			
	ID_6	4.042			
	ID_7	4.095			
	ID_8	3.068			

Note. Survey Data (2024)

Table 4
Discriminant Validity- Fornell and Larcker Criterion

	CI_	FE_	FL_	HB_	HM_	ID_
CI_	0.913					
FE_	0.704	0.881				
FL_	0.53	0.481	0.869			
HB_	0.27	0.367	0.108	0.923		
HM_	0.512	0.421	0.322	0.3	0.922	
ID_	0.545	0.444	0.402	0.281	0.495	0.878

Note. Survey Data (2024)

Table 5
Discriminant Validity- HTMT

	CI_	FE_	FL_	HB_	HM_	ID_
CI_						
FE_	0.749					
FL_	0.559	0.502				
HB_	0.282	0.379	0.11			
HM_	0.546	0.445	0.336	0.311		
ID_	0.567	0.458	0.409	0.287	0.516	

Note. Survey Data (2024)

composite reliability. It is recommended that the AVE should exceed 0.50. The fact that all AVE values are above 0.5 indicates a strong relationship between the items and their respective constructs (Purwanto & Sudargini, 2021). High composite reliability values (typically above 0.70 or 0.80) indicate that the observed variables effectively measure the latent construct, suggesting strong internal consistency (Hair et al., 2019). This recommendation of having composite reliability values exceeding 0.7 is met, reinforcing the reliability of the measurement model. Typically, Cronbach's alpha values of 0.7 or higher are considered satisfactory (Taber, 2018). The CR coefficients exceeding 0.7 indicate

excellent internal consistency and reliability, while Cronbach's Alpha values exceeding 0.7 across all constructs signify a very high level of reliability in our study.

Similarly, discriminant validity is a measure of the extent to which different constructs or concepts in a research model are distinct from one another. In essence, it helps confirm that the variables intended to measure different aspects of a study are truly distinct and not simply variations of the same underlying construct. The Fornell and Larcker criterion is a widely used method for confirming discriminant validity in structural equation modelling. It asserts that discriminant validity is evident when a

construct's square root of average variance extracted (AVE) exceeds its correlations with other constructs (Fornell & Larcker, 1981).

Table 5 presents that the square root of AVE values for CI (0.913), FE (0.704), FL (0.869), HM (0.922) and HB (0.923) are higher than their correlations with other latent variables in the model (i.e. below the square root of AVE values), presence of discriminant validity can be asserted.

Structural Model Analysis

The structural model was assessed to analyse the intricate relationship between exogenous and endogenous variables. The Variance Inflation Factor (VIF), which assesses the degree of collinearity among the predictor

constructs, is used to examine the problem of collinearity in the inner model, or among the predictors. A value of VIF greater than 5 indicates a considerable likelihood of collinearity problems, a value between 3 and 5 indicates a slight likelihood, and a number less than 3 indicates excellent conditions (Hair et al., 2020). Additionally, as shown in Figure 1, the R square value of 0.384 means that about 38.40% of the variation in the dependent variable is explained by three independent variables in the model. The adjusted R-square, which is slightly lower at 37.10% accounts for the same variability but adjust for the number of independent variables. These values suggest that the model explains a moderate portion of the variation in the dependent variable.

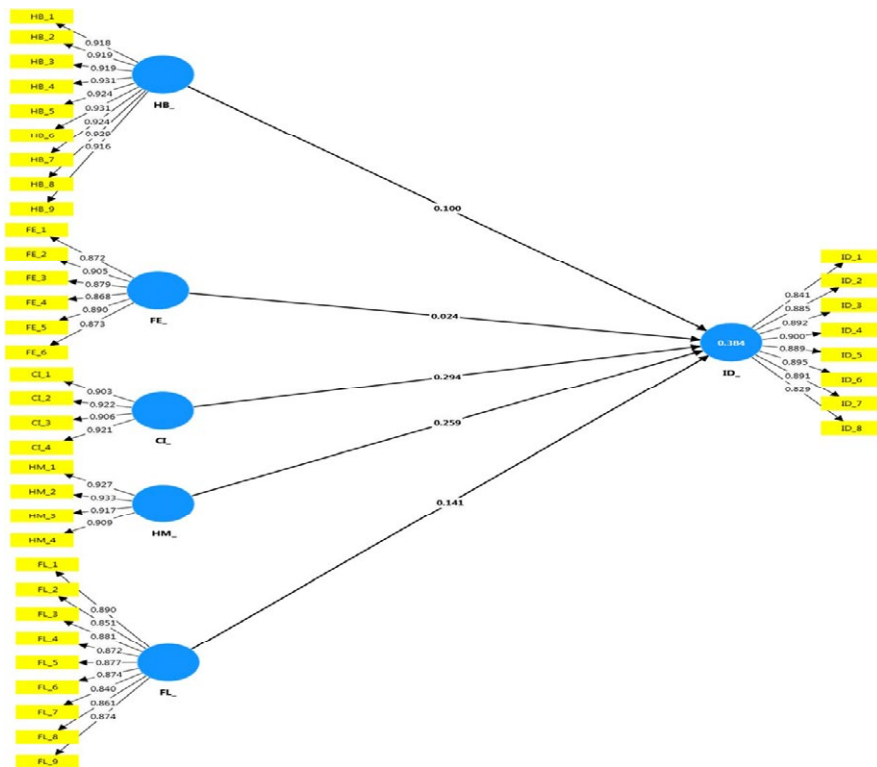


Figure1. Structural Model Analysis
Note. Survey data (2024)

Bootstrap testing was carried out to evaluate the model fit. While 0.887 or above is the NFI for an acceptable fit, 0.113 is the threshold value for SRMR (lower the better). While the SRMR value is within the threshold, the NFI value is somewhat below the satisfactory fit value. The signal of good fit, however, is 0.592 since numbers closer to 1 are thought to be good fits. In PLS-SEM, the values for Chi-square, d_ULS, and d_G are not very significant. Chi-square is dependent on the sample size, while d_ULS and d_G cannot be directly assessed (Yusif et al., 2020).

Validating Reflective- Reflective Higher Order Reflective Order Construct-Behaviour Biases

Behaviour Bias (BB) is the higher order construct in the study, derived from four subordinate constructs: Heuristic Bias, Framing Effect, Cognitive Illusions, and Herd Mentality. BB is assessed as a reflective higher-order concept in the study. The factor loadings, reliability, and validity were evaluated to establish the higher-order construct.

All factor loadings for the indicators of BB above the minimum acceptable threshold of 0.70 (Hair et al., 2010), and no items were eliminated due to insufficient factor loadings. Reliability was evaluated by Cronbach's alpha and composite reliability, with both statistics exceeding the required threshold of 0.70 for the higher-order construct, hence suggesting strong reliability (Henseler et al., 2016). Convergent validity was deemed satisfactory as the Average Variance Extracted (AVE) exceeded 0.50 for the higher-order construct. Similarly, the VIF scores for all indicators were below 3, indicating the absence of multicollinearity

concerns. Discriminant validity was evaluated using HTMT, Fornell-Larcker analysis, and cross-loading. The square root of the Average Variance Extracted (AVE) for the construct exceeds its correlations with all other constructs, and the HTMT results indicate that the HTMT ratio is below the requisite threshold of 0.85. Therefore, discriminant validity is confirmed for the higher-order construct of FL.

Assessment of Structural Models

After a thorough evaluation of the outer measurement models, the structural model is assessed to address the study's structural paths and hypotheses. The inner model encompasses the theoretical concepts and their proposed relationships, outlining the foundational structural theories of the path model and the connections between latent variables (Benitez et al., 2020; Götz et al., 2010). Likewise, the researcher used a 10,000 resampling rate boot strapping approach to assess the study model. Similarly, the assessment of structural model is reinforced by examining the coefficient of determination, predictive relevance, magnitude and significance of path coefficients, effect sizes, and robustness checks, all of which are discussed in the subsequent sections.

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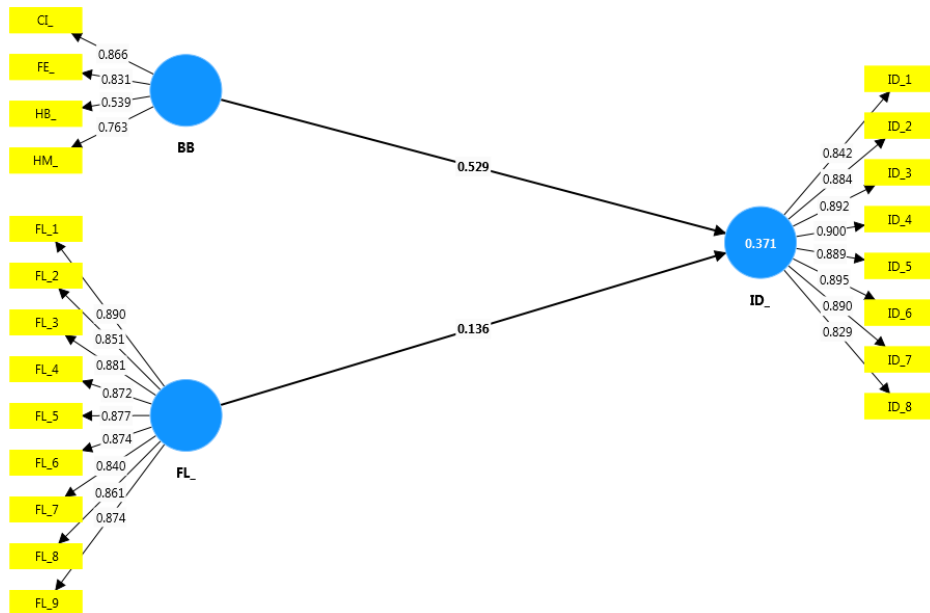


Figure2. Hypothesis Testing

Note: Calculations based on data from Field Survey data (2024)

resampling rate boot strapping approach to assess the study model. Similarly, the assessment of structural model is reinforced by examining the coefficient of determination, predictive relevance, magnitude and significance of path coefficients, effect sizes, and robustness checks, all of which are discussed in the subsequent sections.

Following the assessment of the overall effect size (R^2), the researcher evaluated the specific effect size (f^2) to ascertain the contribution of exogenous constructs contributions to the R^2 values of the endogenous latent variable. According to Cohen (1992), effect size (f^2) of 0.02, 0.15, and 0.35 suggests small, medium, and large impacts, respectively. All the (f^2) values ranged from 0.012 to 0.643, which suggests that the study was deemed to have a small to larger effect. FL has lower effect on ID (0.022) Similarly, BB has large effect on ID (0.33) Thus, the study found lower, moderate and larger effects of

the exogenous constructs on the endogenous constructs because their effect size fell within the criteria of 0.02, 0.15, and 0.35.

As an indicator of the model's predictive relevance, or ability to make predictions, studies based on the PLS technique must also report the value of Stone-Geisser's Q-2 value in addition to the magnitude of R^2 (Henseler et al., 2009). In the study, the PLS-predict technique was utilised in the study to examine the target constructs, specifically ID, with 10 repetitions and a 10-fold cross-validation. The Q2 values of all the exogenous variables, ID (0.351) all of which are higher than Zero (0) and shows that the model is predictive. the Q2 values show the model's significant predictive relevance. Hence, the results suggested that the prediction made by the construction is applicable and relevant (see Table 5: Falk & Miller, 1992). Similarly, the researcher checked the distribution and found to be symmetrical and used the value

of RMSE. Furthermore, the PLS-SEM prediction errors for each item of exogenous constructs were fewer in terms of RMSE than the prediction errors arising from the linear model (LM), suggesting that the PLS model has a medium predictive power.

The reflective characteristics of each construct render the study appropriate for a uniform algorithm (Dijkstra & Henseler, 2015). The model fit index relies on the SRMR value, as it is one of the most effective indices for evaluating model fit (Hair et al., 2020). In this investigation, the SRMR value was found to be 0.063, which is below the 0.08 criteria, indicating that the model possesses strong explanatory power.

Hypothesis Testing

Additionally, the study investigated the causal link by analyzing the direct impacts of independent variables on the dependent variable, as well as performing mediating and moderating analyses. Following standard bootstrap procedures, all the path coefficients of all the direct relationship are statistically significant.

The relationship between Behavioural Bias (BB) and Investment Decision (ID) exhibits a robust positive impact, as evidenced by a substantial T statistic of 9.491, indicating a highly significant outcome. The P-value of 0.000 verifies the strength and reliability of this association, indicating that behavioural beliefs have a considerable impact on the desire to make decisions.

The relationship between Financial Literacy (FL) and Investment Decision (ID) is positive, although not as strong as the relationship between BB and ID. The

T statistic of 2.251 suggests a statistically significant effect, however it is relatively weaker compared to BB. The P-value of 0.024 indicates that there is a statistically significant relationship between financial literacy and decision-making intentions, while the effect size is moderate.

The investigation identifies two major factors that have a considerable impact on decision-making intentions: behavioural attitudes and financial literacy. Behavioural bias exerts a more potent and statistically significant influence on Investment decision compared to financial literacy. Nevertheless, both criteria have been demonstrated to be significant in influencing investment decisions, with financial literacy exerting a considerably more nuanced impact.

DISCUSSION

The results of the hypothesis testing demonstrate substantial associations between the independent factors (behavioural biases and financial literacy) and the dependent variable (investment decisions). The hypothesis testing results are presented in Table 6.

Behavioural bias (BB) and investment decision (ID)

The association between behavioural biases and investment decisions is very significant, as evidenced by a path coefficient of 0.529, a T-statistic of 9.491, and a P-value of 0.000. These results indicate a considerable positive impact of behavioural biases on investment decisions. The association between Financial Literacy (FL) and Investment Decision (ID) is statistically significant, with a path coefficient of 0.136, a T-statistic of 2.251, and a P-value of 0.024. These values indicate a beneficial impact of financial literacy

Table 6
Hypothesis Testing

	Original sample (O)	Sample mean (M)	Standard deviation (STDEV)	T statistics (O/STDEV)	P values
BB -> ID_	0.529	0.535	0.056	9.491	0
FL_ -> ID_	0.136	0.135	0.06	2.251	0.024

on investment decisions, but the effect is relatively weaker. The results are consistent with prior studies, such as [Kahneman and Tversky \(1979\)](#) Prospect Theory, which emphasises the impact of cognitive biases on decision-making. This study affirms the idea that cognitive biases, such as overconfidence and herd behaviour, have a substantial impact on investors' decision-making. This finding is in line with research conducted by [Barber and Odean \(2001\)](#). Furthermore, the notable albeit less potent impact of financial literacy supports the findings of [Lusardi and Mitchell \(2014\)](#), who highlight the importance of financial education in improving investing choices.

The link between behavioural biases and investing decisions is significant, indicating that these biases result in irrational investment behaviour, as proposed by behavioural finance theory. These findings suggest that cognitive biases play a significant role in influencing investors' judgments, resulting in less-than-optimal choices that diverge from the expectations of traditional finance theory ([Barber & Odean, 2001](#); [Kahneman & Tversky, 1979](#)).

While financial literacy has a considerable impact on investment decisions, its influence is smaller compared to behavioural biases. This shows that although financial knowledge helps in making informed judgments, it may

not completely negate the effects of cognitive biases. This underscores the intricate interaction between financial acumen and psychological elements, as elucidated in Prospect Theory ([Kahneman & Tversky, 1979](#); [Lusardi & Mitchell, 2014](#)). The behavioural bias theory posits that cognitive biases have a significant impact on financial decision-making, resulting in irrational choices. This discovery highlights the necessity for initiatives that target these prejudices to enhance investment results ([Barber & Odean, 2001](#); [Kahneman & Tversky, 1979](#)).

Traditional finance theory predictions are not always accurate because investors often behave in ways that are not consistent with the theory. This shows that models like the Efficient Market Hypothesis, which assume rational behaviour, are limited in their ability to explain irrational actions influenced by cognitive biases ([Fama, 1970](#); [Kahneman & Tversky, 1979](#)). The findings are consistent with Prospect Theory, which demonstrates how investors' choices are affected by perceived benefits and losses, rather than logical calculations. Financial education programmes must address cognitive biases and improve decision-making, as emphasised by [Kahneman and Tversky \(1979\)](#) and [Lusardi and Mitchell \(2014\)](#).

In relation to the Nepalese stock market, our findings indicate a crucial requirement for

financial literacy initiatives that specifically target behavioural biases. Improving financial education can reduce the negative impacts of biases and enhance market efficiency (Subedi, 2023).

CONCLUSIONS AND IMPLICATIONS

This study emphasises the crucial influence of cognitive biases and financial literacy on investment decisions in the stock market of Nepal. Although financial literacy has a positive impact on decision-making, it is typically overshadowed by cognitive biases such as overconfidence and herd behaviour, which can lead to irrational judgments. This highlights the need for investor education programs that cover both financial knowledge and behavioural biases, ensuring that investors have the necessary tools to make well-informed decisions. This study contributes to closing a significant gap in existing research by providing nuanced insights into the distinctive investment behaviour patterns within the Nepalese market context, therefore proving the applicability of behavioural finance and Prospect Theory in this environment. Important points to consider include the necessity of customised financial education programs that integrate financial literacy with behavioural training, assisting investors in identifying and reducing biases. Adopting this two-pronged strategy is crucial for improving investor results and promoting a more secure and effective stock market in Nepal.

This research establishes a basis for future investigations and the formulation of policies with the goal of enhancing financial literacy and mitigating cognitive biases among

investors. This, in turn, will promote the expansion and stability of Nepal's financial markets.

This study provides valuable theoretical insights by expanding the utilisation of behavioural finance and Prospect Theory to the stock market in Nepal. The statement illustrates that cognitive biases have a substantial influence on investment choices, even when individuals possess a high level of financial knowledge. This highlights the significance of including psychological and behavioural aspects in financial decision-making models, which contradicts the conventional finance theories that presume investors always act rationally. The study enhances our comprehension of investor behaviour in emerging markets by examining the correlation between financial literacy and cognitive biases. It provides a framework for future research in comparable circumstances.

The results underscore the importance for investors to recognise their cognitive biases and take proactive measures to reduce their impact. Investors can achieve improved financial outcomes by comprehending the impact of biases such as overconfidence and herd mentality on their decision-making process, enabling them to make more logical and well-informed choices.

These insights can be utilised by financial institutions and managers to create training programs that improve financial literacy and simultaneously tackle behavioural biases. Managers can enhance organisational performance by creating a conducive atmosphere that promotes logical decision-making, leading to improved investment strategies and outcomes.

This study emphasises the significance of financial education programs that are customised to the cultural and economic circumstances of Nepal at a society level. Through the enhancement of financial literacy and the promotion of knowledge regarding cognitive biases among the general population, these initiatives have the potential to improve overall financial well-being and stability. This,

in turn, can contribute to economic growth and mitigate the likelihood of financial crises. This research provides significant insights on how to improve investor behaviour through education and awareness. It also promotes more informed decision-making among individuals and institutions and supports economic development in emerging countries such as Nepal.

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