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## ***Overconfidence, Investment Experience, and Herding Behavior: The Role of Financial Literacy in Nepal's Stock Market***

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### **Abstract**

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**Purpose:** This study investigates how overconfidence and past investing experience influence individual investors' herding behavior on the Nepal Stock Exchange. Additionally, it looks into how financial literacy affects these connections, focusing on how it can encourage logical decision-making when behavioral biases are present.

**Methods:** Data from 384 individual investors was analyzed using a cross-sectional and quantitative research design. A stratified random sampling technique was used to choose the participants, and structured survey questionnaires were used to gather the data. Partial Least Squares (PLS) were used to analyze measurement and structural equation models.

**Results:** The analysis demonstrates that herding behavior among investors is significantly influenced by overconfidence and past investment experience. Financial literacy is a critical moderating factor that can either exacerbate or mitigate the effects of these cognitive biases.

**Conclusion:** The study emphasizes how crucial financial literacy is for encouraging self-directed investing choices and reducing the negative consequences of behavioral biases. These findings extend existing behavioral finance theories by illustrating how financial literacy can serve as a corrective mechanism against irrational market behavior, paving the way for future research on the long-term impact of financial education programs and the role of cultural factors in shaping investor psychology. These results underscore the necessity of economic education and policy measures to enhance rational investment behavior in Nepal's equity market.

**Keywords:** Financial knowledge, Herding tendencies, Investment behavior, Biases in behavior

### **I. Introduction**

Behavioral finance challenges the assumptions of traditional financial theories, particularly the Efficient Market Hypothesis (EMH), which posits that investors are rational actors who uniformly process all available information (Fama, 1970). However, mounting empirical evidence from developing economies including Nepal, indicates that investor behavior is

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frequently shaped by psychological and emotional biases (Lamichhane & Kulshrestha, 2022), calling into question the applicability of EMH in such contexts.

In the Nepalese stock market, investors from major financial hubs such as Butwal, Pokhara, and Kathmandu exhibit behaviors that deviate from rational investment paradigms. This geographic focus is crucial in the current context, as these cities represent a microcosm of Nepal's broader socio-economic and informational asymmetries. Despite numerous studies addressing behavioral tendencies in Nepal (e.g., Shrestha & Subedi, 2014; Adhikari & Jha, 2016), few have explored the localized implications of these biases across specific urban financial ecosystems. Thus, there is a pressing need to investigate why these regions remain vulnerable to irrational investor behavior, particularly under market volatility and limited regulatory frameworks.

Among the cognitive biases, overconfidence remains particularly influential. Overconfident investors tend to overrate their knowledge and predictive accuracy while underestimating potential risks (Haseeb et al., 2018; Ali & Haseeb, 2019). This results in reduced susceptibility to herding behavior, as such investors prefer their judgments over market consensus. Yet, this same confidence can also distort decision-making by prompting excessive trading or misinterpretation of signals.

In contrast, herding behavior, the tendency to mimic the decisions of others, often dominates in uncertain or under-informed markets. In Nepal, this phenomenon is exacerbated by low financial literacy and limited access to credible market information, which drives investors to rely on social cues instead of objective analysis (Shrestha & Subedi, 2014; Lamichhane & Kulshrestha, 2022). Consequently, speculative bubbles and price volatility become more frequent, destabilizing the broader financial ecosystem.

Past investment outcomes further influence behavioral tendencies. As Nofsinger (2005) notes, successful past investments may embolden risk-taking, whereas negative experiences foster caution and conformity. These experiential feedback loops further entrench either overconfidence or herding, depending on individual investor trajectories.

Financial literacy is recognized as a vital determinant in mitigating irrational financial behavior. It equips investors with the tools to critically evaluate market signals, reducing reliance on heuristics and social validation. In developing nations like Nepal, financial literacy can act as a stabilizing force amid political and economic instability (Adhikari & Jha, 2016; Altman, 2012). Moreover, empirical research supports the integration of financial education into national curriculums as a pathway to achieving more efficient and rational markets (Thapa, 2019).

Yet, while prior studies have separately analyzed the moderating or mediating effects of financial literacy, few have jointly examined its moderating-mediating role. Understanding how financial literacy both influences and is influenced by behavioral biases could illuminate the bidirectional relationship between education and market outcomes. Such an integrated approach is particularly relevant in the Nepalese context, where financial behaviors are embedded in unique cultural, economic, and informational environments.

Furthermore, to advance this domain, any proposed research framework must be transparent regarding its theoretical or empirical origins. If it is an original construct, detailed justification, supported by prior research, is necessary to validate its applicability. A coherent explanation of the linkages among cognitive biases, financial literacy, and market behavior is indispensable, especially when exploring urban centers with distinct financial dynamics such as Butwal, Pokhara, and Kathmandu.

In summary, despite an extensive body of literature on behavioral finance in Nepal, the current study is warranted given the localized focus, evolving economic environment, and the need to examine financial literacy's joint moderating-mediating role. Further research could offer insights into how targeted financial literacy interventions may help align investor

behavior more closely with rational models, enhancing market stability in Nepal and similar developing economies.

## **II. Reviews**

### **Behavioral Finance and Herding Tendencies**

Behavioral finance literature emphasizes that investor behavior is frequently shaped by psychological and cognitive biases, leading to systematic deviations from rational economic models. Traditional finance theories, which assume investor rationality, often fail to account for the irrational dynamics observed in actual market behavior (Haseeb et al., 2018; Shrestha & Subedi, 2014). In contrast, behavioral finance integrates insights from psychology and decision science, acknowledging that biases such as overconfidence and reliance on prior experiences often drive market anomalies, including herding behavior.

Herding behavior, in particular, reflects investors' tendency to mimic the actions of others, often in the absence of conclusive information or under conditions of uncertainty. This behavior has been well-documented across both developed and emerging markets, yet the underlying cognitive mechanisms remain insufficiently explored in low-literacy, high-volatility contexts such as Nepal.

### **Overconfidence and Herding Behavior**

Overconfidence refers to an investor's tendency to overestimate the accuracy of their knowledge or predictive abilities, leading to behaviors such as excessive trading and under-diversification (Haseeb & Ali, 2019; Shrestha & Subedi, 2014). Overconfident investors may underestimate risks and assume that their market outlook is superior, which in turn fosters impulsive trading behaviors and a tendency to disregard corrective information (Lamichhane & Kulshrestha, 2022).

While some studies have suggested that overconfidence leads to independent decision-making, others have noted a counterintuitive relationship, wherein overconfident investors still exhibit herding tendencies. Fernández et al. (2011) posited that such investors may align their strategies with broader market sentiment to validate their convictions, especially in volatile or ambiguous conditions. Jain et al. (2015) found that in developing markets like Nepal, this alignment behavior often emerges from a desire to avoid individual blame by conforming to group actions.

However, a critical review of methodologies used in these studies reveals that much of the existing literature is based on simulations or experimental data drawn from developed markets, which may not fully capture the socio-cultural dynamics influencing investor psychology in Nepal. Few empirical studies have utilized real market participant data in stratified urban clusters, a gap this study aims to address.

Hypothesis 1 ( $H_1$ ): Overconfidence is positively associated with the herding behavior of individual investors.

### **Prior Investment Experience and Herding Behavior**

Investors' decision-making is also heavily influenced by their prior market experiences. As proposed by Nofsinger (2005), emotional recollections of past financial outcomes serve as heuristics or mental shortcuts, shaping future investment behavior. When faced with uncertainty, investors who have experienced significant losses may opt for collective behavior as a defensive strategy, minimizing individual accountability.

This phenomenon, known as the "snake bite effect" (Thaler, 2010), suggests that negative past experiences lead to excessive risk aversion, often prompting herding. In markets where information asymmetry and limited access to financial tools persist, such as in Nepal, investors are particularly susceptible to adopting group-based decision-making to navigate uncertainty (Adhikari & Jha, 2016).

Conversely, positive experiences often reinforce risk-taking and independent action, though this can vary by context. Merli and Roger (2013) found that even experienced investors may revert to herding in uncertain market conditions, driven more by the emotional imprint of past decisions than by rational forecasting. Despite these insights, most of the cited studies rely on qualitative interviews or small experimental samples, and often neglect the interaction of experience with cognitive or educational variables, limiting the generalizability of their conclusions.

Hypothesis 2 ( $H_2$ ): Prior investment experience significantly influences individual investors' herding behavior.

### **Moderating Role of Financial Literacy**

Financial literacy, broadly defined as the ability to understand and apply financial knowledge, plays a crucial role in moderating irrational investment behaviors. High financial literacy empowers individuals to evaluate risk, discern credible market signals, and resist emotional reactions to short-term volatility (Altman, 2012; Thapa, 2019).

Research suggests that financial literacy can attenuate the effects of cognitive biases such as overconfidence and emotional recall from past investment experiences. Adhikari and Jha (2016) emphasized that informed investors are better equipped to make independent, data-driven decisions rather than relying on heuristic-driven, group-oriented behavior. Nonetheless, Lamichhane and Kulshrestha (2022) argue that the protective role of financial literacy is context-dependent and may be undermined if overconfidence is simultaneously present, leading to over-reliance on perceived knowledge.

From a methodological standpoint, previous studies often operationalize financial literacy using simplistic indices or single-item measures, which fail to capture its multidimensional character. This study addresses this limitation by incorporating a robust, contextually adapted literacy index and examining its interactive role in investor decision-making.

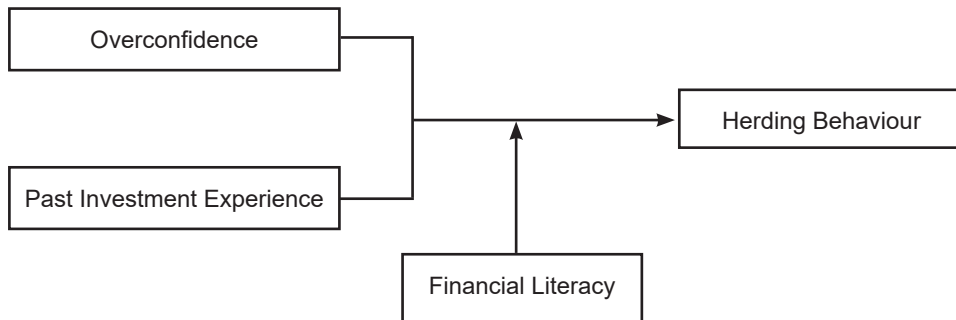
Hypothesis 3 ( $H_3$ ): Financial literacy moderates the relationship between overconfidence and herding behavior.

Hypothesis 4 ( $H_4$ ): Financial literacy moderates the relationship between past investment experience and herding behavior.

### **Conceptual Framework and Theoretical Grounding**

The conceptual framework for this study is grounded in Social Learning Theory, which posits that behavior is shaped by a combination of cognitive interpretation and environmental stimuli. This theoretical lens asserts that individuals learn from observing others, particularly in ambiguous or complex settings like financial markets (Shrestha & Subedi, 2014; Lamichhane & Kulshrestha, 2022). In the context of Nepal, where investment decisions are often influenced by social cues, media narratives, and peer behaviors, this framework is particularly relevant.

As illustrated in Figure 1, the proposed research model integrates cognitive predictors (overconfidence and past experience) and positions financial literacy as a moderator that potentially alters the intensity of their influence on herding tendencies. This integrative approach not only builds on existing behavioral finance literature but also addresses identified gaps related to methodological rigor, variable measurement, and emerging market representation.

**Figure 1***Theoretical Framework*

### III. Methodology

#### Research Design

This study adopted descriptive and causal research design aimed at examining the influence of cognitive factors ,namely, overconfidence, past investment experience, and financial literacy ,on the herding behavior of individual stock investors operating in a developing economy context. Specifically, it focused on retail investors active in the Nepal Stock Exchange (NEPSE). Given the growing popularity of behavioral finance in understanding market inefficiencies and irrational investor behavior, the research was positioned within this broader domain to provide empirical insights from a less-explored South Asian market.

#### Population and Sampling Strategy

The target population consisted of individual investors trading directly or indirectly (through brokerage firms) on the NEPSE. Based on the NEPSE Annual Report (2023), the estimated number of active individual investors stands at 842,437, which was used as the population frame for the study. This estimation reflects the total number of trading accounts registered with the exchange, thereby representing a realistic scope for participant selection.

A stratified random sampling technique based on geographic area was employed to ensure proportional and diverse representation. The sample frame was stratified into three distinct urban investment clusters: Kathmandu, Pokhara, and Butwal. These cities were selected because they house a substantial concentration of brokerage firms and exhibit high trading volumes compared to other regions. Kathmandu, being the capital city, serves as the financial hub, while Pokhara and Butwal were included due to their emerging investor base and accessibility to active trading infrastructure. Stratification on the basis of geographic clusters was deemed essential to account for potential socio-economic, technological, and informational disparities among investors from different urban regions.

A total of 700 individual investors were approached for participation in the study. The survey administration was conducted both physically and electronically. Hard copies of the questionnaire were distributed at selected brokerage firms, while soft copies were shared through investor-focused social media groups and email lists maintained by financial forums. This dual-mode approach increased accessibility and improved response rates across different investor demographics.

Out of 700 questionnaires distributed, 384 were returned completed, resulting in a response rate of 54.86%. After screening for completeness and consistency, 372 valid responses were retained for final analysis, reflecting a net valid response rate of 53.14%. This sample size

was considered sufficient for structural modeling using Partial Least Squares (PLS), as it met the recommended thresholds for power and reliability in regression-based analyses (Hair et al., 2017).

### **Instrumentation and Measures**

The structured questionnaire used in the study was divided into three major sections to ensure comprehensive data collection:

#### **Section I: Demographic Information**

This section collected participants' demographic profiles, including gender, age, education level, employment status, monthly income, and frequency of stock trading activities.

#### **Section II: Cognitive and Behavioral Constructs**

This part focused on capturing psychological constructs such as herding behavior, overconfidence, and past investment experience. The herding behavior items were adapted from Shrestha and Subedi (2014), which were originally validated in the Nepalese capital market context. Items related to overconfidence were modified from Lamichhane and Kulshrestha (2022), who investigated cognitive biases among Nepalese retail investors. The past investment experience dimension was derived from Thaler's (2010) foundational work on behavioral economics and investor psychology.

#### **Section III: Financial Literacy**

Items measuring financial literacy were designed based on the Lusardi and Mitchell (2011) framework, covering both basic and advanced knowledge of financial products, interest rates, risk diversification, and inflation. All items were adapted to reflect the local investment landscape in Nepal and reviewed by finance faculty experts for content relevance.

To enhance contextual validity, all scale items were carefully reworded and pre-tested in a pilot study involving 30 investors. Feedback from this pre-test helped refine language clarity and cultural applicability. The need for modification stemmed from differing levels of financial infrastructure, educational exposure, and regulatory frameworks in Nepal, compared to the settings of the original instruments.

### **Empirical Models and Analytical Approach**

The study employed Partial Least Squares Structural Equation Modeling (PLS-SEM) to analyze the data and test hypothesized relationships. PLS is especially appropriate in behavioral studies involving complex models, multicollinearity among predictors, and small-to-medium sample sizes (Hair et al., 2017). It enables estimation even in the presence of measurement error, non-normal data distributions, and latent variable interactions.

#### **Model Specifications**

The following empirical models were developed to test direct and interaction effects:

Model 1:

$$HB = \beta_0 + \beta_1(OC)$$

Where:

HB = Herding Behavior (Dependent Variable)

OC = Overconfidence (Independent Variable)

This model examines whether overconfidence significantly predicts herding tendencies among investors.

Model 2:

$$HB = \beta_0 + \beta_1(PIC)$$

Where:

PIE = Past Investment Experience (Independent Variable)

This model investigates the effect of previous market experience on herding behavior.

Model 3:

$$HB = \beta_0 + \beta_1(OC) + \beta_2(OC)(FL)$$

Where,

Herding behavior, or HB, is a dependent variable.

The independent variable, OC, stands for overconfidence.

The moderating variable is financial literacy, or FL.

Model 4:

$$HB = \beta_0 + \beta_1(PIE) + \beta_2(PIE)(FL)$$

Where:

Herding behavior, or HB, is a dependent variable.

The independent variable, OC, stands for overconfidence.

#### **The moderating variable is financial literacy, or FL**

Models 3 and 4 include interaction terms to explore the moderating effect of financial literacy on the relationships between the cognitive factors (OC and PIE) and herding behavior. The product indicator approach was used to construct interaction terms by multiplying each indicator of the independent and moderating variables, thereby creating latent interaction constructs.

#### **Rationale for PLS Approach**

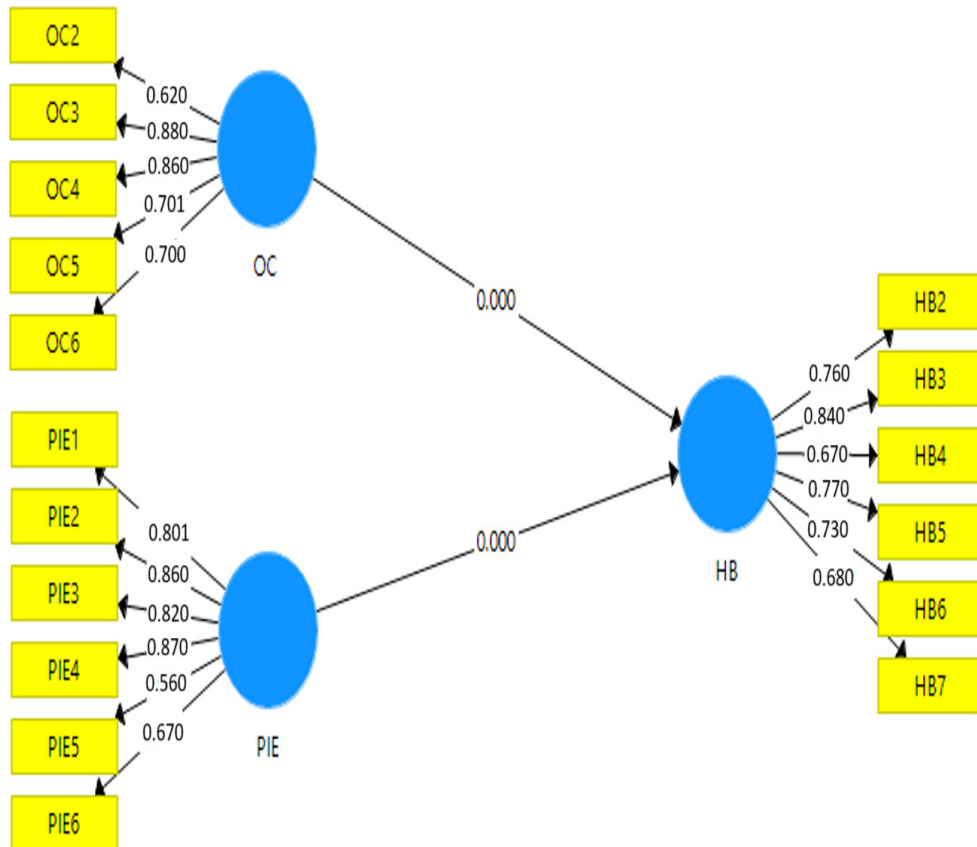
The choice of PLS regression over traditional methods such as Ordinary Least Squares (OLS) was informed by several methodological advantages. PLS is more robust in handling multicollinearity and is capable of working with formative and reflective constructs. Moreover, it does not require data to meet multivariate normality assumptions and is well-suited for exploratory and confirmatory modeling in behavioral finance research. These strengths made PLS an ideal analytical tool for examining the psychological and cognitive determinants of herding behavior in the context of an emerging market like Nepal.

### **IV. Results and Discussion**

The structural model was estimated and the measurement model was evaluated using Smart-PLS. The analysis is comprehensively summarized in Figure 2, which displays the results of the measurement model assessment.

#### **Measurement Model Assessment**

Convergent validity and discriminant validity, two crucial aspects of construct validity, were assessed in order to determine the measurement model. The degree to which indicators of a particular construct show strong correlations, reflecting their shared underlying concept, is known as convergent validity. Conversely, discriminant validity guarantees that every construct in the model is conceptually unique and sufficiently different from the others.

**Figure 2***Measurement Model Assessment*

### Confirmatory Factor Analysis

An overview of the constructs' convergent validity is provided in Table 1, which includes factor loadings, Cronbach's alpha, composite reliability (CR), and average variance extracted (AVE). According to Hair et al. (2014), a construct is deemed to have achieved convergent validity when the factor loadings of its items surpass 0.50. Consequently, in order to enhance the measurement scale's reliability, items with factor loadings below this threshold were excluded.

The CR and AVE values were also examined to assess convergent validity. The constructs' convergent validity was substantiated by the fact that the CR for all variables exceeded 0.80, indicating a high level of internal consistency. These results confirm that the measurement model satisfies the convergent validity criteria, which ensures the consistency and reliability of the underlying constructs.



**Table 1***Convergent Validity, Cronbach's Alpha, Composite Reliability (CR), AVE.*

Constructs	Items	Loadings	Cronbach's alpha	CR	AVE
Overconfidence (OC)	OC2	0.620	0.810	0.870	0.575
	OC3	0.880			
	OC4	0.860			
	OC5	0.701			
	OC6	0.700			
Past Investment Experience (PIE)	PIE1	0.801	0.860	0.890	0.590
	PIE2	0.860			
	PIE3	0.820			
	PIE4	0.870			
	PIE5	0.560			
	PIE6	0.670			
Herding Behaviour (HB)	HB2	0.760	0.840	0.880	0.550
	HB3	0.840			
	HB4	0.670			
	HB5	0.770			
	HB6	0.730			
	HB7	0.680			

**Discriminant Validity****Table 2***Heterotrait–Monotrait Ratio*

Constructs	FL	HB	OC	PIE
FL				
HB	0.092			
OC	0.150	0.770		
PIE	0.173	0.784	0.840	

*Note.* FL: Financial literacy, HB: Herding Behavior, OC: Overconfidence, PIE: Past investment experience.

Table 2 displays the Heterotrait-Monotrait (HTMT) ratio values that were employed to evaluate discriminant validity. This method is considered to be highly effective in ensuring that the constructs in a model are sufficiently distinct from one another. In order to verify discriminant validity, the HTMT ratio must not exceed 0.85, as established in prior research (Henseler et al., 2015; Shrestha & Subedi, 2014). This study's HTMT values were all within acceptable limits, which confirmed that the constructs measured in the Nepalese context were sufficiently distinct and not overly correlated.

The accuracy of the measurement model is guaranteed and its suitability for evaluating

investor behavior in the Nepalese stock market is enhanced by adhering to these cutoff points. In developing nations such as Nepal, the credibility of the findings is enhanced by the implementation of a robust discriminant validity assessment, which is consistent with international standards (Lamichhane & Kulshrestha, 2022).

### Structure Equation Modelling

The structural model was evaluated using the bootstrapping process in Smart-PLS, a dependable statistical technique designed for complex model analysis. Key metrics, including beta coefficients, R<sup>2</sup> values, and their corresponding t-values, were evaluated as part of this evaluation. The significance of the connections between the various constructs and the model's capacity for explanation are illuminated by these metrics. The bootstrapping technique, which involves resampling to generate empirical t-values, was employed to evaluate both direct and moderating effects among the variables in the context of the Nepalese stock market (Shrestha & Subedi, 2014; Lamichhane & Kulshrestha, 2022).

This methodological approach is consistent with the guidelines for structural equation modeling, particularly in the context of behavioral finance research conducted in developing countries. The analysis is guaranteed to account for potential data complexities, such as multicollinearity, by utilizing Smart-PLS, which provides reliable estimates of both direct and interaction effects (Henseler et al., 2015).

### Path Modeling

**Table 3**

*Direct Effects*

Hypothesis	Relationship	Std.Beta	S.E.	t-Value	P-Value	Decision
H <sub>1</sub>	OC->HB	0.382	0.052	7.346	0.000	Supported
H <sub>2</sub>	PIE->HB	0.390	0.051	7.647	0.000	Supported

The bootstrapping technique was employed in the study to evaluate the significance of path coefficients in the structural model. The results provide strong empirical support for H<sub>1</sub>, as they demonstrate a significant and positive association between overconfidence and herding behavior ( $\beta = 0.382$ ,  $t = 7.346$ ), as illustrated in Table 3. Similarly, the results substantiate H<sub>2</sub> by demonstrating that herding behavior is significantly enhanced by prior investment experience ( $\beta = 0.390$ ,  $t = 7.647$ ). These findings underscore the extent to which cognitive factors influence the herding behaviors of investors.

**Table 4**

*Moderating Effect Results*

Hypothesis	Relationship	Std.Beta	S.E.	t-Value	P-Value	Decision
H <sub>3</sub>	OC*FL->HB	0.19'	0.070	2.714	0.003	Moderation
H <sub>4</sub>	PIE*FL->HB	-0.160	0.064	2.500	0.020	Moderation

Table 4 presents the findings of the bootstrapping analysis for indirect effects, which show that financial literacy provides strong support for H<sub>3</sub> by significantly moderating the association between overconfidence and herding behavior ( $\beta = 0.19$ ,  $t = 2.714$ ). Additionally, the findings provide empirical support for H<sub>4</sub> by indicating that financial literacy significantly moderates the association between herding behavior and prior investment experience ( $\beta = -0.160$ ,  $t =$

2.500). These results highlight how important financial literacy is in determining how investors' herding behavior is influenced by cognitive factors.

The analysis demonstrated that herding behavior among stock market investors is significantly and favorably associated with overconfidence, as indicated by a standardized coefficient ( $\beta$ ) of 0.382 and a t-value of 7.346. This discovery suggests that investors are more susceptible to herding behavior as their level of overconfidence increases. The results also indicated that prior investment experience has a positive impact on herding behavior, with a t-value of 7.647 and  $\beta = 0.390$ .

The investigation also examined the impact of financial literacy on the relationships between herding behavior, overconfidence, and prior investing experience. The results indicate that financial literacy significantly moderates the association between overconfidence and herding behavior, as indicated by a t-value of 2.714 and  $\beta = 0.19$ . This positive coefficient suggests that the impact of overconfidence on herding behavior is exacerbated by increased financial literacy.

However, the moderating effect of financial literacy on the association between prior investment experience and herding behavior was determined to be significant but negative, with a t-value of 2.500 and  $\beta = -0.160$ . Financial literacy mitigates the influence of prior investment experience on herding behavior, as evidenced by the negative  $\beta$ -value. These findings underscore the significance of financial literacy in enhancing the decision-making processes of investors, mitigating the adverse effects of previous experiences, and promoting more rational investing practices.

## Discussion

The objective of this study was to identify and analyze the cognitive determinants, specifically, overconfidence and past investment experience that influence herding behavior among individual investors actively trading on the Nepal Stock Exchange (NEPSE). The study also examined the moderating role of financial literacy in shaping these relationships.

The findings provide empirical support for Hypothesis H<sub>1</sub>, indicating a statistically significant positive relationship between overconfidence and herding behavior. This suggests that overconfident investors are more inclined to imitate others' trading decisions, potentially due to an inflated belief in their interpretative capabilities. These results are consistent with Fernandez et al. (2011) and Chuang and Lee (2006), who similarly argue that overconfident investors tend to overestimate the validity and value of their private information, leading to group-oriented decision-making behavior. However, this study extends their findings by demonstrating that such behavior persists in developing financial markets like Nepal, where formal market information and investor education are relatively limited.

The moderating effect of financial literacy (Hypothesis H<sub>3</sub>) reveals that financially literate investors exhibit a stronger relationship between overconfidence and herding tendencies. This contrasts with the traditional expectation that financial literacy curbs irrational behavior, and instead suggests that financial literacy can amplify cognitive biases when combined with high confidence. This finding aligns with Müller and Weber (2010), who suggest that literacy enhances investors' analytical confidence, potentially reinforcing their belief in the accuracy of their assessments and increasing their likelihood to follow group behavior when they believe others share their knowledge.

In relation to Hypothesis H<sub>2</sub>, the study found a significant positive association between past investment experience and herding behavior, corroborating the work of Merli and Roger (2013). This result indicates that prior exposure to the market may encourage patterns of collective behavior, particularly if previous success reinforces the belief that following market consensus is a reliable strategy. However, when financial literacy is introduced as a moderating variable (Hypothesis H<sub>4</sub>), the study finds a negative moderating effect, indicating that financially literate investors are less likely to allow past experiences to influence their

herding behavior. This suggests that financial knowledge helps investors contextualize past outcomes and resist the pull of group behavior.

## V. Conclusion and Implication

This study highlights how psychological traits and investment experience influence the behavior of retail investors in Nepal's emerging stock market. Overconfidence stands out as a key driver of herding behavior, suggesting that investors who overestimate their judgment are more likely to follow the crowd rather than make independent decisions. Prior investment experience, often assumed to foster better judgment, also appears to reinforce this behavior, implying that experience alone does not protect investors from falling into herd mentality. Financial literacy plays a complex role. It helps soften the effect of prior experience on herding, suggesting that informed investors may be better equipped to assess and correct for past mistakes. Yet, the same financial knowledge seems to intensify the impact of overconfidence, perhaps by giving investors a false sense of mastery. This dual influence suggests that financial education is not a straightforward solution to irrational behavior, its effectiveness depends on how it's applied and internalized.

For individual investors, the findings serve as a reminder to remain aware of psychological blind spots, especially overconfidence, which can quietly distort decision-making. Gaining experience or knowledge isn't enough; investors also need to reflect critically on how these factors influence their behavior in practice. For those involved in financial education and advisory services, the takeaway is clear: educational programs must go beyond teaching financial concepts. They should also include behavioral components that help investors recognize and manage the biases that can undermine rational thinking. Training should combine financial skills with psychological insight, ideally through practical exercises or decision-making simulations. For regulators and policymakers, the results point to the need for a more nuanced approach to investor protection. Efforts to promote financial literacy should be coupled with initiatives that reduce the market signals that fuel herding, such as unclear pricing, lack of transparency, or emotional media narratives during periods of market stress.

In the context of Nepal, where retail investor participation is growing but structured investor education remains limited, these findings suggest a strong case for integrated programs that address both knowledge gaps and behavioral tendencies. Supporting the development of capital markets requires more than regulatory oversight; it requires equipping investors with both the tools and the mindset for long-term, independent decision-making.

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