Investors' Perception towards Investment Avenues

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Abstract

The study aims to determine the factors influencing investors' perceptions toward various investment avenues in Nepal, focusing on the impact of risk, return, safety, tax benefits, and liquidity. Using a qualitative research design, content analysis was employed on 26 academic articles to identify key variables and their relationships with investment decisions. The primary variables investigated include risk perception, expected return, safety concerns, tax advantages, and liquidity preference. The findings reveal that younger investors exhibit a higher tolerance for risk, while older investors prioritise safety and stability. Metrics such as earnings per share (EPS), rate of return, and dividend per share (DPS) significantly influence investment decisions. The study also highlights the importance of liquidity, with investors favouring assets that can be easily converted into cash without significant loss. Additionally, perceptions of tax benefits and safety, particularly in fixed-income investments, play a crucial role in shaping investment choices. The discussion suggests that regulatory inconsistencies, limited financial instruments, and underdeveloped market infrastructure are key barriers to investment in Nepal. Despite these challenges, the study provides valuable insights for policymakers and financial institutions aiming to enhance market efficiency and attract more investment. Future research should focus on longitudinal studies and the influence of behavioural biases to deepen the understanding of investor behavior in Nepal.

Keywords: Investor perception, investment avenue, liquidity, risk, tax benefit

Introduction

An investment is an asset or item obtained to produce income or increase value over time. Appreciation refers to the rise in an asset's value as time passes. Investing involves spending resources such as time, effort, and money now, expecting a higher return in the future, thereby generating profit (Hargrave, 2019). A financial asset is a liquid asset whose value comes from a contractual right or ownership claim. Examples include cash, stocks, bonds, mutual funds, and bank deposits. Unlike tangible assets like land, property, or commodities, financial assets do not have inherent physical value or form. Their value is determined by market supply and demand, as well as the level of associated risk (Chen, 2021). Investment choices or decisions result from three interrelated factors. The first is factual or informational premises, consisting of data streams representing the observable environment and characteristics of the securities and firms in which an investor might invest. The second factor is expectation premises, which involve subjective and hypothetical expectations about the outcomes of different investments. These expectations are grounded in the available environmental and financial facts, which limit both the range of possible investments and the anticipated outcomes. The third factor is valuation premises, which encompass investors' subjective preferences regarding the size and consistency of income, as well as the safety and liquidity of specific investments or investment combinations, as evaluated over time (Bhalla, 2008).

Ganzach (2000) attempted to explain the relationship between risk assessments and expected return evaluations of financial assets. The writer suggests that for unfamiliar assets, judgments regarding both risk and return are influenced by an overall preference for the asset. Conversely, for familiar assets, these judgments are based on the asset’s inherent risk and expected return values within financial markets. Additionally, he explores how causal schemas and risk attitudes mediate the relationship between risks and return judgments for familiar and unfamiliar assets. The discussion addresses various conceptual and practical issues related to the nature, meaning, and evaluation of risk and expected return. A study by Chaudhary (2022) illuminated investor behaviour in the stock market, highlighting the crucial roles of returns, risk, and external influences in shaping investment decisions. Additionally, it underscored the impact of market volatility on investor confidence and the importance of informed decision-making in achieving financial goals. This comprehensive analysis offers valuable insights for both individual and institutional investors. Nepal’s liberal foreign investment policy, low tax rates, and favourable business environment attract FDIs, especially in hydropower, manufacturing, services, tourism, construction, agriculture, and minerals. Investment opportunities are promising due to Nepal's fertile land, booming tourism from neighbouring India and China, significant hydropower potential, and cost-effective outsourcing and medical tourism sectors. The Investment Board of Nepal, chaired by the Prime Minister, facilitates these investments, offering high returns as the middle class expands (*Investment In Nepal – Ministry of Foreign Affairs Nepal MOFA*, n.d.). Nepalese investors prioritize achieving adequate returns and minimizing risk over enhancing social status when investing in securities. The main factors influencing their choice of securities include Earnings per Share (EPS), rate of return, Dividend per Share (DPS), and the quality of company management. Key motivators for investing in securities are dividends, capital gains, bonus shares, and liquidity, while right shares and voting rights are considered less significant. In the Nepalese securities market, debt and preferred stock are less appealing due to their unattractive returns, making investors less interested in these securities because of perceived risks and concerns about liquidity and marketability. Additionally, most investors establish an investment policy before engaging in securities investment (Neupane et al., 2024).

Investing in financial assets in Nepal is fraught with several challenges, despite the government's efforts to foster an investment-friendly climate. The regulatory environment is marked by inconsistencies and bureaucratic delays, making the process of obtaining necessary approvals cumbersome for investors (International Monetary Fund. Statistics Dept., 2023; *Investing in Nepal: The Full Guide for 2024 - InvestAsian*, n.d.). The market infrastructure is underdeveloped, with the Nepal Stock Exchange (NEPSE) offering limited investment options and low liquidity. Furthermore, trading platforms lack sophistication, and foreign investors often need to be physically present to open brokerage accounts, complicating the investment process (*Investing in Nepal: The Full Guide for 2024 - InvestAsian*, n.d.). Financial stability remains a concern, as highlighted by the IMF, due to the relative size of the financial sector to the economy and the need for improved regulatory frameworks for banking supervision and crisis management (International Monetary Fund. Statistics Dept., 2023). Additionally, currency risks associated with the pegged exchange rate of the Nepalese rupee to the Indian rupee can affect returns on investments (*Investing in Nepal: The Full Guide for 2024 - InvestAsian*, n.d.). These factors collectively create a challenging environment for investing in financial assets in Nepal, requiring investors to navigate regulatory hurdles, manage currency risks, and contend with infrastructure limitations.

- What are the factors of investors' preferences for different investment avenues in Nepal?

The study aims to identify the various factors of investors' perception towards investment avenues. This study provides crucial insights into the factors that influence investor preferences and decision-making processes in Nepal's financial market. By understanding the drivers behind investment choices, the study helps investors make more informed decisions, aligning their strategies with their financial goals and risk tolerance. Policymakers can use the findings to develop more effective regulations that enhance market efficiency and attractiveness. The study provides valuable insights into investment patterns in developing economies, particularly in Nepal, but several gaps remain for further exploration. There is a need for more cause-and-effect analyses to establish direct relationships between key factors influencing investment behavior. The study also lacks longitudinal research, which would allow for a deeper understanding of how these behaviors evolve. Additionally, future research could benefit from focusing on the role of behavioral biases and how they impact investment decisions in different contexts. Lastly, there is an opportunity to translate these findings into actionable policy recommendations to enhance the investment environment in Nepal.

The current study offers valuable insights into the determinants influencing the investment decisions of Nepalese investors and employs content analysis methodology to explore these factors. However, gaps remain for further exploration. First, while content analysis provides an overview of investor perceptions, it may lack depth in explaining the underlying motivations or psychological biases influencing investment choices. Additionally, the study focuses on a limited set of determinants, leaving room for future research to explore the influence of behavioral factors such as risk tolerance, financial literacy, and social influences on investment preferences. Finally, there is an opportunity to apply comparative studies across various demographic groups to identify how different segments of Nepalese society perceive and select investment options. The existing research advances the understanding of investment behavior among Nepalese investors by incorporating content analysis and focusing on individual perceptions, a departure from the more traditional macroeconomic and quantitative approaches of previous studies. Previous research often generalized findings without focusing on Nepal-specific determinants, whereas the current study highlights these local factors, through further analysis.

Literature Review

Investor and Investor's Perception

Any individual or organization (such as a company or mutual fund) that invests money in the hopes of making a profit is considered an investor. To generate a rate of return and achieve significant financial goals, such as saving for retirement, paying for schooling, or just building up extra wealth over time, investors rely on of various financial instruments (Hargrave, 2019).

A person or entity that lends money to another in the hopes of making a profit later on is known as an investor. In theory, anyone can invest money; all it takes to be an investor is to invest money (Girardin, 2022). Investors' perception refers to their personalized judgment on the uncertainty of returns associated with financial instruments, influenced by psychological, demographic factors, and behavioral biases (Rangapriya, 2022). Perception plays a crucial role in decision-making, whether it's about mutual funds, insurance, or stock market investments. Studies have shown that factors like return expectations, time horizons, loss aversion, familiarity, overconfidence, and anchoring significantly impact investors' risk attitudes and behaviors (Hawaldar, 2019). While mutual funds offer stability and resource allocation efficiency, the stock market presents attractive yet volatile investment opportunities (Chaudhary, 2022). Understanding investors' perceptions towards different investment avenues involves analyzing their risk propensity, behavioral biases, and demographic traits to tailor investment strategies effectively (Dr. M. & Rupa Devi, 2022; Hawaldar, 2019; Rangapriya, 2022). By considering these factors, investors can make informed decisions aligning with their financial goals and risk tolerance levels.

Investment Avenue

Financial instruments are the main tools used in investment to raise and allocate cash for the expansion and profit of businesses. Common forms are bonds, which are debt obligations that pay interest regularly; stocks, where investors hold shares of the firm; and funds, including mutual funds which pool investor money into a variety of diverse assets. Real estate is the primary focus of investment trusts such as REITs, which provide liquidity through stock market trading. Although they provide a variety of techniques, alternative investments such as hedge funds and private equity—usually need accredited investor status. Choices and commodities traded through futures or exchange-traded funds (ETFs) are examples of derivatives that provide high-risk, highreward choices (Elvis, 2024).

Risk

Veld & Veld-Merkoulova (2008) revealed that most investors use multiple risk measures, with stock investors primarily considering semi-variance and bond investors focusing on the probability of loss. While investors claim the original investment as their main benchmark, followed by the risk-free rate and market return, their behavior in a study indicates the market return is the most significant benchmark. Kahneman & Tversky (2013) argued that "people evaluate potential losses and gains differently, leading to risk-averse behavior for gains and risk-seeking behavior for losses." Their Prospect Theory reveals that investors often overweigh small probabilities and underweight moderate to high probabilities, affecting their risk perception and decision-making processes. Markowitz (1991) "Investors should focus on the trade-off between risk and return when selecting a portfolio," emphasized that diversification can minimize risk. His Modern Portfolio Theory introduces the concept of variance as a measure of risk and highlights the importance of creating efficient portfolios that optimize expected return for a given level of risk. Investment decisions were found to be strongly impacted negatively by risk perception, suggesting that people's perceptions of risk might have a negative influence on their choices. This emphasizes how crucial it is to comprehend and control risk perception as it might result in less-than-ideal investing plans and obstruct the attainment of financial objectives. Increased risk education and awareness in the investment decision-making process are necessary because investors' subjective perceptions of risk may lead them to shun potentially profitable assets or act in an unduly cautious or dangerous manner (Pandia, 2023). Karki & Kafle (2020) concluded that age, investment experience, and financial knowledge significantly influence investors' risk tolerance levels. Younger investors typically have higher risk tolerance, whereas investors with more experience and greater financial knowledge tend to have lower risk tolerance. These findings highlight the importance of adopting personalized approaches in investment decision-making processes to better cater to the varying risk tolerance levels among investors in Nepal.

H_1: There is a significant impact on the Risk perception of Investors towards Investment Avenue.

Return

Shefrin & Statman (2000) proposed that investors construct portfolios to maximize returns and fulfill various mental accounts corresponding to different goals. They argue that investors perceive returns through a behavioral lens, often prioritizing specific aspirations and emotional satisfaction over purely financial outcomes. Barberis & Thaler (2003) discussed how investors' expectations of returns are often influenced by cognitive biases and heuristics. They explore how overconfidence and representativeness can lead investors to misestimate future returns, thus affecting their investment decisions and portfolio performance. Graham & Harvey (2001) found that corporate managers often rely on subjective judgment and past performance when setting return expectations. Their survey of CFOs reveals that practical considerations and market conditions heavily influence perceived returns, with a notable gap between theoretical models and real-world practices. Depending on the particular situation, return on investment (ROI) alternatives might have different effects. According to research by Buckle (2022) adding options to an investment portfolio can change how typical metrics like risk, beta, Sharpe ratio, and risk premium are calculated, which may persuade investors to reevaluate their holdings. Furthermore, Diavatopoulos (2011) investigates how the introduction of options affects Real Estate Investment Trusts (REITs), demonstrating higher trading volume, early price drops, and negative returns following the announcement. Additionally, Valentin (2015) researched on MOOCs highlights the financial ramifications and profitability possibilities for different stakeholders, providing insight into the expenses incurred by students and the possibility for income creation related to MOOC programs. Taken as a whole, these observations highlight the complexity of ROI alternatives. Chaudhary (2022) emphasized the significance of returns and individual decision-making in investing decisions, underscoring the need to comprehend investors' attitudes and actions regarding the stock market.

H_2: There is a significant impact of the Return perception of Investors towards Investment Avenue

Safety

Merton (1973) presented a theoretical framework for pricing options, highlighting the importance of investors' perception of safety in financial markets. He argues that investors assess the safety of investments based on the potential for downside risk and the likelihood of adverse outcomes, which influence option pricing and investment decisions. Duffie & Lando (2001) investigated how investors perceive the safety of fixed-income investments, particularly corporate bonds, in the presence of incomplete information. They emphasize the role of credit spreads in reflecting investors' assessments of default risk and the safety of bond investments, highlighting the importance of transparency and disclosure in financial markets. Fama & French (1993) analyzed common risk factors that drive returns on both stocks and bonds, shedding light on investors' perception of safety across different asset classes. They find that factors such as interest rate risk, inflation risk, and credit risk play significant roles in shaping investors' assessments of the safety of bond investments relative to stocks, influencing asset allocation decisions and portfolio construction strategies. Especially when it comes to foreign investments, safety risk is a major factor in investment decisions. DeGhetto et al. (2017) presented safety risk as an institutional issue influencing the location decisions of businesses, and highlight the important role that government-based corruption plays in generating safety risk and eventually discouraging investment. Grzyl et al. (2017) highlighted the influence of risk allocation in construction work contracts on investment decisions and stress the need of effectively expressing mutual interactions in building projects to enable safe and non-conflicting realization. Additionally Rui & Jiang (2010) discussed the use of partial correlation analysis to identify preferred investment directions based on safety factors, enhancing the credibility of investment decisions. Overall, understanding and managing safety risks are essential for firms to make informed investment choices and mitigate potential negative consequences on their investments and projects.

H_3: There is a significant impact on the Safety perception of Investors towards Investment Avenue.

Tax Benefit

Poterba (2002) examined how taxation influences household portfolio choices, particularly focusing on the effects of capital gains taxation and tax-deferred retirement accounts. He finds that lower tax rates on capital gains encourage longer investment holding periods, and tax-deferred accounts significantly boost retirement savings. This work has influenced my understanding of how tax policy can impact individual investment behavior and overall market dynamics. Gale & Scholz (1994) investigated the impact of Individual Retirement Accounts (IRAs) on household saving behavior. Their research shows that IRAs have a positive effect on overall savings rates, although the magnitude of the effect varies across different income groups. This study is frequently cited for its thorough analysis of how tax-advantaged retirement accounts influence savings patterns and its implications for retirement policy. Barberis & Thaler (2003) work on mental accounting explores how individuals categorize and treat money differently based on its source and intended use. This concept is crucial for understanding investor behavior regarding tax-advantaged accounts, as these accounts are often perceived as more valuable due to mental accounting practices. Thaler's insights into behavioral economics have been widely cited and applied in various fields, including finance and public policy. Factors such as government tax exemption for long-term investments, belief in sustaining a savings habit, and the involvement of advisors in investment decisions were emphasized as essential in shaping investment attitudes among the ten quantifiable indicators of general investors' opinion (Narsis, 2022).

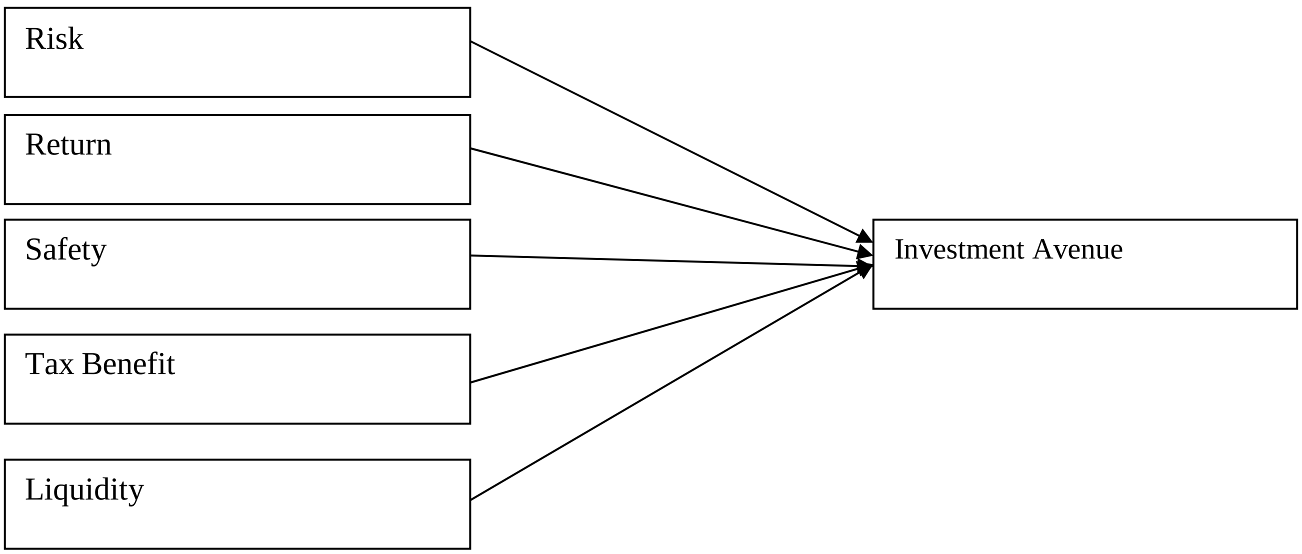
H_4: There is a significant impact of Tax Benefit perception of Investors towards Investment Avenue.

Liquidity

Investors' risk aversion influences their liquidity preference. Gromb & Vayanos (2002), argued that more risk-averse investors prefer liquid assets because they provide a safeguard against the potential need for immediate cash. The ability to quickly convert assets to cash without substantial loss is particularly valued in uncertain market conditions. Behavioral biases also affect liquidity preferences. A study by Barberis & Thaler (2003) discussed how cognitive biases such as overconfidence and herd behavior can lead investors to overvalue liquid assets. These biases can result in mispricing and excess demand for liquidity, impacting overall market stability. Regulatory frameworks and policies can enhance or hinder market liquidity. Brunnermeier & Pedersen (2009) highlighted how financial regulations, such as capital requirements and transaction taxes, can impact liquidity provision by market participants. Policies that improve transparency and reduce transaction costs tend to enhance liquidity**.** Because it has an impact on asset price, investment prospects, and business performance, liquidity is a critical factor in determining investment paths. Studies reveal that market liquidity has a favorable effect on an organization's operational profitability and performance, which in turn increases the company's worth (Raković, 2018). It is well acknowledged that liquidity factors have an impact on investment expenditure and that financial limits arise from businesses' difficulties disclosing confidential information to outside parties (Chirinko & Schaller, 1995). Furthermore, in emerging economies like India and Pakistan, where companies with greater liquidity have access to more attractive investment chances, internal and external liquidity metrics like cash flow and stock spread have a substantial influence on investment opportunities (Shahid, 2017). Liquidity is valued more highly in the commercial banking industry than profits since it may have far-reaching effects on society as a whole (Aggarwal, 2016). All things considered, liquidity's impact on investment opportunities highlights how crucial a role it plays in determining financial choices and market dynamics.

H_5: There is a significant impact on the Liquidity perception of Investors towards Investment Avenue.

From the above literature, we can prepare the following framework for the study.



Sources: (Krishna & Sulatan, 2019; Velmurugan et al., 2015)

Research Methodology

The study applied qualitative research design using content analysis method. Going through 26 articles the study has added the risk, return, safety, tax-benefit, liquidity variables as the determinants of investment options through investors' perception. The study is based on the relationship between variables extracted from the review of articles.

Discussion

Through an analysis of Nepalese investors' investing behavior, this study clarifies the intricate interactions among numerous elements that shape their choices for distinct investment opportunities. A thorough comprehension of the information gathered from different articles highlighted important patterns and connections within Nepal's investment environment (*Investing in Nepal: The Full Guide for 2024 - InvestAsian*, n.d.; Kandel, 2022). Fundamental information on investor preferences showed that younger investors are often more willing to take on risk than elderly investors, who place a higher value on stability and safety when making investment decisions. This is consistent with research that shows age and investing experience have a major impact on risk tolerance levels. A predilection for financial instruments that provide observable returns and liquidity is also reflected in the elements that have emerged as crucial decision-making drivers for investors: rate of return, dividend per share (DPS), and earnings per share (EPS) (Barberis & Thaler, 2003; Buckle, 2022; Chaudhary, 2022).

Various studies explored the causal linkages between investor perceptions and investment decisions. Researchers' results that risk perception might have a detrimental impact on investing strategies. Which showed that risk perception had a considerable impact on investment decisions. The study also demonstrated the significant influence that tax advantages and return expectations have on investor behavior. Expected returns substantially impact investors' actions, as evidenced by behavioral insights from many academics that highlight the part cognitive biases and heuristics play in return expectations (Barberis & Thaler, 2003; Gromb & Vayanos, 2002; Serdar Raković, 2018). Investor views of safety and liquidity also played a significant role in their decision-making process; they were particularly drawn to liquid assets that could be quickly converted into cash without suffering a significant loss. This desire for liquidity highlights how Nepal's markets need to be better equipped to handle transactions more easily and effectively (DeGhetto, et al., 2017). Notwithstanding the knowledge gained, the study has drawbacks, namely about the accessibility and accuracy of investor behavior data. Furthermore, the findings' generalizability was hampered by Nepal's limited selection of financial instruments and the quickly evolving regulatory landscape. To capture changing patterns and reactions to changes in the economy and in regulations over time, future research should take into account longitudinal studies.

Conclusion

The variables affecting investor preferences and decision-making procedures in Nepal's financial market are thoroughly observed in this study. The research provides important insights into the demographics, risk-return trade-offs, and behavioral biases that influence investing behaviors by qualitative research design with content analysis. Important findings show that while making investment selections, Nepalese investors give priority to metrics like earnings per share (EPS), rate of return, dividend per share (DPS), and liquidity. While older and more experienced investors often favor safer and more stable investing channels, younger investors tend to demonstrate a higher tolerance for risk. The study also emphasizes how important it is for investors to consider the influence of return expectations, safety concerns, tax benefits, and risk perception. These findings are consistent with theoretical frameworks and empirical research from other studies.

Targeted policy interventions and infrastructural upgrades are necessary to establish a more favorable investment climate, as highlighted by the obstacles identified, which include regulatory inconsistencies, inadequate market infrastructure, and restricted investment possibilities. These insights may be used by financial institutions and policymakers to improve market efficiency, draw in more foreign and local capital, and create investment products that are specifically designed to meet the needs of Nepalese investors. In the end, this study adds to the body of knowledge about investing patterns in developing economies and lays the groundwork for further research. More in-depth understanding of the dynamic nature of investment behavior in Nepal and other contexts can be obtained by future researchers by addressing the constraints and utilizing cause-and-effect and longitudinal study methodologies. This all-encompassing strategy will direct research and development as well as real-world implementations, assisting in the establishment of a stronger and more alluring investment environment in Nepal.

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