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Financial Literacy and Investment Decisions in Nepalese Share Market

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Financial knowledge, Financial awareness, Risk tolerance behavior, Investment options, Investment decision.

ABSTRACT

This study examines the role of financial literacy on the investment decisions of investors in the Nepalese share market. Financial literacy is expressed in personal saving, risk tolerance, investment options, and financial knowledge. The data were collected through a structured questionnaire using the convenience sampling method from 384 respondents of Kathmandu Valley. Pearson correlation and multiple regression analysis have been used to analyze data. The study results revealed a positive and significant relationship between the dimensions of financial literacy and investment decisions in the Nepalese share market. Low financial literacy and lack of financial information affect the ability to save and make sound financial decisions. Ignorance of basic financial concepts results in negative behavior in saving and investment decisions. The study suggests conducting financial education programs to help improve investors' savings and financial decisions.

1. INTRODUCTION

Financial literacy has recently drawn the attention of researchers, policymakers, investors, and financial institutions (Lusardi, 2019; Kumari, 2020). Nowadays, the capability of managing and developing personal financial status is an important issue. People must make long-term plans for their investments in retirement and their children's education. They must also decide on short-term borrowing and saving for vacations, education, emergencies, houses, cars, and other expenses. Additionally, they must manage the finances for their medical and life insurance needs (Chen & Volpe, 1998). Financial literacy is a basic concept that supports understanding the value of money and its use in daily life. This includes managing the incomes and expenditures of the people and making investments in the suitable sector for their future benefits. It also incorporates understanding everyday situations, such as savings, borrowings, credit, and insurance (Singh & Kumar, 2017; Roy & Jane, 2018). Understanding financial terms and concepts is key to investing and managing funds, which supports increasing wealth and security. Financial literacy develops the awareness of Individuals for borrowing and investing money. Financial literacy is a component that develops financial skills and utilizes such financial knowledge and understanding to make beneficial financial decisions (Wagland & Taylor, 2009; Kumari & Ferdous, 2019).

Financial decision-making ability can be enhanced through financial literacy, which supports the development of an individual's ability and utilizes knowledge and skills. The main objective of financial literacy is to assess and manage long-term financial resources for the financial wellness of the investors (Arora, 2016). OECD (2011) mentioned that financial literacy supports developing the concepts, knowledge, and skills about financial products and developing the ability and skill to analyze opportunities and financial risk. It is a supporting tool for making rational financial decisions and taking dynamic actions, which ultimately supports the financial wellness of the investors in the competitive environment. Financial literacy is essential for choosing the right project. Financial literacy is essential to an individual for acquiring financial skills and knowledge, which improves the ability to make rational investment decisions (Adams & Rau, 2022).

Financial literacy also makes understanding how money works and how to manage and invest. Developing skills and knowledge empowers people to use their available financial resources to make rational, efficient, and appropriate financial decisions. Financial literacy and financial inclusion are seen as related issues. Financial literacy is related to financial knowledge for making financial decisions. In contrast, financial inclusion concerns the availability and provision of financial products and services that meet an individual's demand (Finke & Huston, 2017).

Financial literacy is a financial tool that prepares individuals to develop the financial knowledge, skills, and capabilities that support developing strategies to mitigate financial risk. Additionally, it may be used to enforce actions like avoiding debt and making sure that invoices are paid on time, which aids customers in maintaining their access to loans in the competitive credit markets. Financially literate people understand the fundamentals of money and assets; they are educated, informed, and aware of matters about assets, taxes, insurance, banking, investments, and money management (Semercioglu & Akcay 2016). They apply their financial knowledge and skills to understand financial situations and plan financial decisions (Gachango, 2014).

Financial literacy is still a fascinating topic in both rich and developing countries, and it has attracted a lot of attention lately, given how quickly the financial environment is changing. Atkinson et al. (2007) mentioned that financial literacy concerns understanding financial products and concepts and their ability and skills to analyze financial risks and opportunities in a dynamic environment. By educating and empowering investors, financial literacy enables them to utilize their understanding of finance to assess goods and make investment decisions relevant to their business (Thapa & KC, 2020). More financial expertise is anticipated to aid in overcoming current challenges in advanced credit markets.

Investment decision-making is the skill of managing challenging circumstances when making investments in specific sectors. In this investment decision process, individuals choose the most suitable investment option and analyze alternative scenarios. People may not make rational investment decisions based on their available resources. Thus, financial literacy is a part of investment decisions that supports selecting the most appropriate investment opportunities. Suitable investment decisions make the life of investors prosperous (Raut, 2020). The investment decision is affected by the rate of return, risk tolerance behavior of investors, and various market situations. Investors cannot make rational financial decisions; sometimes, they are influenced by different factors to make biased financial decisions. Behavioral finance is an important discipline that analyses investors' behavior in making different financial decisions (Yusnita et al., 2022). Investment decisions are also affected by behavioral factors of the investors, like overconfidence or optimistic and pessimistic behavior of the investor (Breuer et al., 2014). Such factors, as well as financial literacy, could affect the investment decisions of individuals and corporations (Ayaa et al., 2022).

Over the past 20 years, the financial system of Nepal has become wider, and the number and type of financial intermediaries have grown rapidly. The education and knowledge regarding investment and saving have created hurdles like losing hard earnings. The restrictions on individual investors by several directives also prevent them from freely playing in the market with different opportunities. Literacy levels help an individual make wise saving and investment decisions. Financial education programs help to improve investors' saving and financial decision behaviors, but much more can be done to improve the effectiveness of these programs (Lusardi & Mitchell, 2017). Therefore, this study examines the current status of financial literacy and investment patterns of investors in the Nepalese share market. The paper also attempts to analyze the impact of financial literacy on investment decisions in the Nepalese share market.

2. LITERATURE REVIEW

Financial literacy encompasses an individual's comprehension of financial principles and ability to use that knowledge skillfully to make prudent and accountable financial choices (Arianti, 2022). Behavioral finance theory acknowledges that individuals may not always behave rationally in financial matters due to cognitive biases and emotions. The theories of financial literacy theory argue that investors with a high level of knowledge and skills regarding investment decisions can analyze the rationality of financial products and services. The dual-process theories mention that the investors' thinking styles and decision-making capabilities are based on intuition and cognition. The theories embrace the idea that investment decisions are led by both the intuitive and cognitive processes of the investors (Idowu, 2010).

Financial literacy can counter these biases by enabling individuals to think critically, analyze information, and make logical financial choices. A number of factors like creating and maintaining a budget; understanding of saving and investing; knowledge about different types of debts, interest rates, and how to manage debt responsibly is essential for avoiding financial pitfalls; knowing how credit scores work, the importance of good credit, and how to build and maintain a positive credit history are essential aspects of financial literacy; understanding banking products, such as checking and savings accounts, certificates of deposit, and other financial services, helps individuals manage their money efficiently; knowledge of various insurance types, including health, life, home, and auto insurance, enables individuals to protect themselves and their assets from unforeseen events; understanding the basics of taxation, such as filing tax returns, deductions, credits, and tax implications of various financial decisions, is vital for financial planning; aware of retirement options, such as employer-sponsored retirement plans; setting clear financial goals and developing a plan to achieve them is a crucial part of financial literacy; understanding risk and how it relates to investments, financial decisions, and overall financial well-being is essential; and having a basic understanding of economic concepts like inflation, interest rates, and the overall economic environment helps individuals make better financial decisions. These factors can broadly be clustered into personal saving, risk tolerance level, investment options, and financial knowledge. Thus, the study incorporates these four variables in its research framework.

Personal saving and investment decision

Personal saving plays a crucial role in influencing personal investment decisions. Personal savings provide the initial capital required for investment activities (Kapoor et al., 2017). Whether investing in stocks, real estate, bonds, or starting a business, saving funds allows individuals to participate in these ventures (Arianti, 2022). A sufficient emergency fund from personal savings can give individuals peace of mind when investing (Gachango, 2014). They know they have a financial cushion to handle unexpected expenses, reducing the need to liquidate investments prematurely. The saving and borrowing behavior of the investor could be the predictor of investment decisions (Chaulagain, 2017; Viantara et al., 2019). Based on this evidence, the following hypothesis was formulated.

H1: Personal saving has a significant effect on investment decision-making.

Risk tolerance level and investment decision

Risk tolerance refers to an individual's ability and willingness to take on risk in their investment decisions. Various factors influence it, including financial goals, investment time horizon, personal circumstances, and psychological traits. The concept of risk tolerance aids individuals in comprehending the degree of risk inherent in investments. It assists in cultivating the capacity to endure and align prevailing risks with investment objectives. The level of risk an individual is willing to bear aligns with the anticipated future rate of return. The influence of risk tolerance extends to shaping investors' decisions when selecting alternative investment options

(Awais et al., 2016; Pak & Mahmood, 2015; Snelbecker et al., 1990). Individuals possessing a high-risk tolerance are inclined to confidently invest in high-risk assets, whereas those with a lower risk tolerance tend to shy away from such ventures (Corter & Chen, 2006; Nguyen et al., 2016; Pompian, 2012). Based on this evidence, the following hypothesis was formulated.

H2: Risk tolerance has a significant effect on investment decision-making.

Investment options and investment decision

Certain individuals often form a significant preference for specific investment options (Pak & Mahmood, 2015; Snelbecker et al., 1990) simply due to their familiarity with them. This leads them to believe that they possess a greater understanding of these investment options or have gained expertise in dealing with such investments, resulting in feelings of ease and assurance. This familiarity with investments can also stem from previous personal encounters or be influenced by the financial experiences of their parents or other relatives. Elevated levels of financial literacy are associated with greater engagement in the stock market (Christelis et al., 2010; Van Rooij et al., 2011; Yoong, 2011), increased participation in private retirement savings (Bucher-Koenen & Lusardi, 2011), enhanced portfolio diversification, and augmented accumulation of wealth (Lusardi & Mitchell, 2007). Based on this evidence, the following hypothesis was formulated.

H3: Literacy on investment options has a significant effect on investment decision-making.

Financial knowledge and investment decision

The term "knowledge" pertains to an individual's comprehension level concerning matters related to personal finance. This comprehension is assessed based on their understanding of various personal finance subjects. According to Liebi (2020), financial knowledge is a fundamental conceptual aspect of financial literacy. Proficiency in individual financial knowledge is also essential to avoid financial difficulties. Such challenges can arise from errors in financial management, including inadequate financial planning and fluctuations in income. Having a solid foundation in financial knowledge, or financial literacy, holds significant importance when making informed investment choices. Musundi (2014) revealed that financial literacy is significantly associated with investment decisions. Financial knowledge helps people make wise investment decisions (Neupane, 2021). An individual's financial knowledge significantly influences investment decisions (Mugo, 2016). Mugo (2016) revealed a significant positive relationship between financial knowledge and investment decisions. Based on this evidence, the following hypothesis was formulated.

H4: Financial knowledge has a significant effect on investment decision-making.

3. RESEARCH METHODS

This study employs a causal-comparative research design. The investors who have traded in the Nepal Stock Exchange (NEPSE) and invested their money in the share capital of the companies are the population of the study. The number of individual investors who invest in the Nepalese share market is unknown. If the population size is unknown, the sample size was determined, i.e., 384 (Godden, 2004). The respondents were selected using a random sampling method. Primary data were collected from the respondents using a structured questionnaire. The questionnaires were distributed on personal visits through e-mail and social media apps.

Table 1

Reliability Statistics

Variable	Cronbach's Alpha	No. of items
Personal Saving	0.738	5
Risk Tolerance Level	0.837	5
Investment Options	0.712	5
Financial Knowledge	0.911	5

The study is based on primary data collected through structured questionnaires. The first section of the structured questionnaire represents the demographic profile of the respondents, such as gender, age, marital status, academic qualification, monthly income, income used for investment, and frequencies of investment. The second part of the questionnaire measures the personal saving, risk tolerance behavior, investment options, and financial knowledge of the investors who invest in the Nepalese share market. A 5-point Likert scale has been used to measure the level of agreement on different dimensions of financial literacy and investment decisions of the investors. Cronbach's Alpha is used to measure the reliability of the data. The Cronbach's Alpha table shows that the value of each study variable is more than 0.7. Those values indicate that the data is reliable and fit for further statistical tests. When all the items were considered, the overall score of Cronbach's Alpha was found to be 0.799.

This study investigates investment decisions in the Nepalese share market as a function of personal saving, risk tolerance behavior, investment options, and financial knowledge. The corresponding regression model is specified below:

$$\mathbf{ID = \beta_0 + \beta_1\, FK + \beta_2\, PS + \beta_3\, RTB + \beta_4\, IO + e_i}$$

where ID = Investment Decision, PS = Personal saving, RTB= Risk tolerance behavior, IO = Investment options, FK = Financial knowledge, $\beta 0$ = The intercept (constant term), and e_i = Error term.

4. RESULTS

The research study is based in Kathmandu Valley. The study's sample size is 384 based on the random sampling technique. Table 2 shows the respondents' profiles. It shows that out of the total respondents, 71.61 percent were male, and 28.39 were female. It shows that out of the total respondents, about half represent the age group of 35-50 years, followed by the age group above 50. Out of the total respondents, more than two-thirds of respondents are married. Of the total respondents, 53.39% have the academic qualification of a Bachelor's Degree followed by a Master's and above degree (i.e., 44.01%). About 47% of the respondents are under a monthly income of 50,000-70,000. The fewest respondents are from a monthly income level below 30,000. 45.57% of respondents invest their 11-20% income in the share market. The result shows that out of the total respondents, around 50% invest their money every week, followed by 23.44% every month.

Table 2
Respondents Profile

Demographic Variables	Categories	Frequency	Percent
Gender	Male	275	71.61
	Female	109	28.39
Age	Below 25	10	2.60
	25-35	80	20.83
	35-50	190	49.48
	Above 50	104	27.09
Marital Status	Married	305	79.43
	Unmarried	79	20.57
Academic Qualification	10+2 Level	10	2.60
	Bachelor	205	53.39
	Master and above	169	44.01
Monthly Income	Below 30,000	40	10.42
	30,000-50,000	90	23.44
	50,000-70,000	180	46.87
	Above 70,000	74	19.27
Income Used for Investment	Upto 10%	70	18.23
	11-20%	175	45.57
	21-40%	94	24.48
	Above 40%	45	11.72

Table 2 Continued…

Frequencies of Investment	Daily	45	11.72
	Weekly	190	49.48
	Monthly	90	23.44
	Occasionally	59	15.36

N = 384

Source: Field Survey, 2022

Table 3 shows the descriptive statistics and correlation coefficients. The mean values of financial knowledge, personal saving, risk-taking behavior, and investment options regarding investment decisions are 3.85, 3.93, 3.88, and 3.60, respectively. Among those variables, personal saving is the most important variable for making an investment decision, followed by risk-taking behavior. They assess the relationship between investment decisions and financial knowledge, personal saving, risk-taking behavior, and investment options based on their mean values. The results of the Pearson correlation have been presented in Table 3.

Table 3

Descriptive statistics and Correlation Coefficients

	Mean	SD	FK	PS	RTB	IO	ID
FK	3.85	0.622	1				
PS	3.93	0.556	.410**	1			
RTB	3.88	0.588	.413**	.492**	1		
IO	3.60	0.725	.456**	.687**	.258**	1	
ID	3.87	0.654	.313**	.483**	.452**	.344**	1

Note. Financial knowledge (FK), Personal saving (PS), risk-taking behavior (RTB), knowledge of investment options and (IO) investment decisions.

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

Source: Field survey, 2022

Table 3 shows a strong correlation (0.687) between investment options and personal saving behaviors. A moderate correlation was found between investment decisions and personal savings, as their correlation was 0.483. Similarly, the correlation between financial knowledge, risk tolerance behavior, and investment options is moderate and relatively weak, 0.313, 0.452, and 0.344, respectively. A weak correlation between investment options and risk tolerance behavior was found, as their correlation is 0.258. Similarly, the correlation between financial knowledge and personal savings is 0.410, which seems moderate. Table 4 shows that the investment decisions positively correlate with the 1 percent significance level with the investors' financial knowledge, personal saving behavior, risk tolerance behavior, and investment options.

Test of Hypothesis

The impact of independent variables on dependent variables was estimated using multiple regression. The findings from the regression analysis for the investment decisions based on the explanatory variables are depicted in Table 4

Table 4

Regression Results

Predictors	Coefficients	t-statistic	p-value	VIF
Constant	1.053	2.806	.006	
PS	.278	3.192	.002	1.299
RTB	.336	2.768	.003	1.608
IO	.047	.421	.0475	1.240
FK	.064	.727	.004	1.868
	Adj.R^2 =.783	F-value =15.476	F(sig) = 0.000	D.W.= 1.92

Note. Independent variables are financial knowledge (FK), personal saving (PS), risk-taking behavior (RTB), and knowledge of investment options (IO). The dependent variable is investment decisions.

Source: Field survey, 2022

The R-Square, which shows the coefficient of determination of the variables, is .797. The R-square measures the overall fitness of the model. The result of R-Square indicates that the model explains about 79.7% of the variability in investment decisions based on financial literacy. This means that the model used in this study explains about 79.7% of the variation in the dependent variable. It indicates that about 20.3% of the variations in investment decisions are affected by other factors the model does not include.

Similarly, Table 4 shows the F-Statistics about 15.476, with a p-value of 0.000. The finding from the F-value proves the estimated model's validity. This figure suggests that the explanatory variables are significantly associated with the study's dependent variables. That is, they strongly determine the behavior of the investment decisions. Further, the value of the Durbin-Watson statistic is 1.92, which means that the data used in the study are free from autocorrelation. The VIF of the model is less than ten, meaning there is no multicollinearity between the independent variables included in the model.

The regression analysis table shows a positive and significant relationship between FK and ID. This result is supported by the t-statistics value (t-statistics .727 and the p-value < .01). The results can be explained as a positive increase in the investors' financial knowledge will increase significantly in the wise investment decisions of the investors. This result is consistent with the findings drawn by Gachango (2014), which emphasizes the importance of financial literacy in terms of interpreting and managing money.

It is also found from the regression analysis that there is a positive relationship between PS, RTB, IO, and ID. The coefficient of PS is .278, which means that when there is a 1 Rs. increase in personal savings, the investment will increase by Rs.0.278. Similarly, the coefficient of RTB is .336, which means that when there is a 1 unit increase in risk tolerance behavior, the investment will increase by .336 unit. Likewise, the coefficient of IO is .047, which means that when there is a 1-unit increase in investment options, the investment will increase by .047 units. This outcome is consistent with the findings of Finke & Huston (2017), Isomidinova and Singh (2017), and Thapa and Nepal (2015), which showed a significant positive impact on investment decisions with the explanatory variables of risk-taking behavior, personal saving, and investment options. This evidence supports accepting hypotheses H1, H2, H3, and H4.

5. DISCUSSION

Financial literacy is an essential skill that may be applied in complex financial scenarios to make rational financial decisions. This is because financially literate investors are more likely to understand and make choices and decisions, which would lead them to avoid some egregious mistakes and make optimal financial decisions. It supports maximizing the financial well-being of the investors. The ultimate objective of this study was to analyze the role of financial literacy on the investment decisions of individual investors in the Nepalese share market. The analysis reveals that financial literacy and its dimensions used in this study, namely financial knowledge, personal saving, risk-taking behavior, and investment options, have a strong positive and significant impact on individual investors' investment decisions in the Nepalese share market. The results of the study are highly consistent with the previous results of Mwathi et al. (2017, Mugo (2016), Fachrudin and Fachrudin (2016), Putri and Henny (2017), and Hamza and Arif (2019). The study's findings showed a positive and significant association between financial knowledge and investment decisions of the investors in the Nepalese share market. The study also strongly connected financial skills and individual investment decisions. This is because having financial expertise helps people make wise investment decisions.

6. CONCLUSION AND IMPLICATIONS

Financial literacy is the main skill supporting wise financial decisions regarding an individual's financial resources. Financially literate investors analyze the scenarios and choose the best investment options. Such financial knowledge helps to make optimal financial decisions. Investors try to enhance their financial knowledge and skills to increase their rational investment decisions to achieve a higher return on their investment. The government, policymakers, and financial institutions should organize workshops and seminars regarding financial education programs to enhance investors' financial knowledge and skills and encourage investors to invest in productive financial sectors. Financial institutions should enhance their promotional strategies about their products on the market so that investors can make rational investment decisions. Hence, the awareness of financial products is essential to make an effective investment decision.

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