

Past Behavior and Financial Literacy on Investment Decision Making of Individual Investors

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Abstract

Investment decision-making is a critical aspect of financial management, influenced by cognitive biases, financial literacy, and past behavior. This study examines the impact of past behavior and financial literacy on investment decision-making among Nepalese investors, incorporating the Theory of Planned Behavior (TPB). Using SmartPLS 4, the study analyzes 426 respondents with at least three years of investment experience. The findings reveal that financial literacy significantly influences attitude and investment decisions, while past behavior impacts investment choices. However, perceived behavioral control does not significantly affect investment intention. The measurement model meets reliability and validity criteria, with R^2 values indicating weak to moderate explanatory power. The effect size (f^2) ranges from small to medium, with one strong relationship ($f^2 = 0.506$). Q^2 predict values suggest attitude has higher predictive relevance than other variables. The study highlights the importance of financial education in enhancing investment participation and mitigating biases. Findings provide valuable insights for policymakers, financial institutions, and investors to promote informed financial decision-making. Future research should explore additional psychological and market-related factors influencing investment behavior in emerging economies like Nepal.

Keywords: Past Behavior, Financial Literacy, Investment Decision, Individuals Investor, Mediating Role of Attitude, Perceived Behavior

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Introduction

As individual financing becomes increasingly complex, investment decision-making has gained substantial importance. Investment choices are directly linked to the ability to accumulate financial assets, necessitating effective risk management supported by adequate financial knowledge (Lacalle, 2018). The socio-psychological antecedents of behavioral economic decision-making provide a structured approach to understanding investment behavior by analyzing investor sentiments and their correlation with economic trends. Scholars have asserted that human decision-making is often unpredictable and inconsistent, shaped by cognitive and psychological biases that influence investor behavior (Maria, 2019). These biases impact how investors assess risks and opportunities, leading to deviations from rational financial theories (Porto & Xiao, 2017).

Extensive research highlights the psychological traits that shape financial investing behaviors. Psychological heuristics, or mental shortcuts, serve as fundamental bases for behavioral decision-making (Maria, 2019). Within this framework, past experiences play a pivotal role in shaping investment decisions, often biased by prior successes or failures. Additionally, social influence significantly affects investment behavior, with peer recommendations and social norms shaping investor attitudes and risk-taking tendencies (Han & Jang, 2013). Financial literacy, a key determinant of financial behavior, has been associated with increased stock market participation and improved investment decision-making (Albaity et al., 2019). Information asymmetry due to financial illiteracy can hinder market participation and lead to suboptimal investment decisions.

The financial market provides investors with opportunities to generate returns, offering liquidity and various asset options aligned with investment goals (Akhtar & Das, 2019). Traditional financial theories, such as modern portfolio theory (Markowitz), capital asset pricing model (Sharpe), and efficient market hypothesis (Fama), assume that investors act rationally and risk-averse (Vaid & Chaudhary, 2022). However, behavioral finance challenges this notion, suggesting that financial decisions are often driven by emotions, heuristics, and biases rather than pure rationality (Porto & Xiao, 2017). The Theory of Reasoned Action posits that behavioral intention is shaped by attitude, subjective norms, and perceived behavioral control (Ajzen, 2002). This theory evolved into the Theory of Planned Behavior (TPB), which suggests that investment decisions are influenced by attitudes, perceived behavioral control, and social norms (Sulistianingsih & Santi, 2023).

Past behavior has been identified as a significant predictor of current financial behavior. Investors with prior experience often rely on past successes rather than objective financial analysis, leading to cognitive biases (Aarts et al., 1998). Financial literacy plays a crucial role in shaping investment intentions, enabling investors to evaluate risks, process financial information, and make informed decisions (Mouna & Anis, 2017). Raut (2020) found that financial literacy significantly influences investment decisions by enhancing investor confidence and mitigating cognitive biases.

Empirical research supports the argument that psychological and financial factors influence investment decisions. Studies in Nepal suggest that investors often rely on recommendations from friends, family, and market influencers rather than independent financial analysis (Karmacharya et al., 2022; Shrestha, 2020). Additionally, a significant portion of Nepalese investors lack fundamental knowledge about capital markets, which affects their decision-making abilities (Thapa & K.C., 2020). Psychological biases, such as heuristics and risk aversion, have also been identified as key influencers in investor behavior (Sharma, Chalise, & Dangol, 2017; Dangol & Manandhar, 2020). Prior research in Nepal primarily focuses on demographic, market, and personality factors, without integrating the TPB framework to analyze investment decisions.

Internationally, studies have incorporated the TPB framework to examine investment intentions. Raut (2020) applied an extended TPB model in the Indian context, integrating financial literacy and past behavior as additional constructs. The study demonstrated that attitude and perceived behavioral control mediate the relationship between financial literacy and investment decisions. Similarly, Akhtar and Das (2019) found that subjective norms and financial knowledge significantly influence investment choices. By adopting Raut's (2020) extended TPB model, this study aims to analyze Nepalese investors' stock market decisions, incorporating financial literacy and past behavior biases.

This study seeks to examine how Nepalese investors' intentions to engage in the stock market are influenced by several components of the TPB framework, including attitude, subjective norms, and perceived behavioral control, along with past behavior bias and financial literacy. Specifically, the study evaluates the impact of past behavior and financial literacy on investment decision-making while also examining how attitude and perceived behavioral control mediate these relationships. The research findings will contribute to the field of behavioral finance by providing insights into how cognitive biases and financial knowledge affect investment decisions. The study will be beneficial to policymakers, financial institutions, and investors, as it highlights the role of financial literacy programs in improving investment decision-making and reducing cognitive biases. Regulators and market participants can use the findings to create awareness programs that enhance financial education, allowing investors to make informed choices rather than relying on social influence and heuristics.

Despite its contributions, this study has certain limitations. It primarily focuses on TPB components along with

financial literacy and past behavior, excluding other potential factors that may influence investment decisions. The data is collected through both offline and online surveys, which may introduce respondent biases due to the lack of real-time monitoring. Additionally, the study is limited to urban investors with at least three years of market experience, potentially excluding a broader range of market participants. Psychological factors such as cognitive biases and emotional influences, though integral to investment behavior, may be challenging to quantify accurately within the scope of this research. The use of adapted questionnaires from prior studies in different countries may also raise concerns about their applicability in the Nepalese context. These limitations should be considered when interpreting the study's findings and future research should explore additional factors influencing investment behavior in diverse investor groups. This study builds on prior research in behavioral finance, applying an extended TPB model to analyze investment decisions in Nepal. By integrating financial literacy and past behavior bias, the study aims to bridge existing research gaps and provide empirical insights into investor behavior in an emerging market. The findings will offer a theoretical foundation and practical implications for enhancing financial decision-making among Nepalese investors.

Literature Review

Behavioral finance plays a crucial role in understanding investor decision-making, particularly regarding financial literacy, past behavior, and investment choices. Behavioral Economics Theory challenges the assumption of purely rational decision-making, emphasizing that biases, emotions, and cognitive limitations significantly impact investment behavior (Kahneman & Tversky, 1979). Investors often act based on psychological influences rather than rational financial theories. Bounded Rationality Theory (Simon, 1957) further explains that individuals operate under limited information, time, and cognitive capacity, leading them to make satisficing rather than optimal decisions. Similarly, Prospect Theory (Tversky & Kahneman, 1979) suggests that investors exhibit loss aversion, weighing potential losses more heavily than equivalent gains, thereby influencing risk preferences. Cognitive Dissonance Theory (Festinger, 1957) adds that individuals may resist new financial information contradicting their beliefs, leading to biased decision-making. Heuristics Theory (Tversky & Kahneman, 1974) illustrates how investors rely on mental shortcuts, such as anchoring and availability bias, which often result in systematic errors. These biases influence stock market participation and risk-taking behavior (Virigineni & Rao, 2017). Social Learning Theory (Bandura, 1977) further explains that financial knowledge and investment behavior are acquired through observation and imitation of peers, media, and family, significantly impacting decision-making processes.

The Theory of Reasoned Action (TRA) (Fishbein & Ajzen, 1975) and its extension, the Theory of Planned Behavior (TPB) (Ajzen, 2002), provide structured models for analyzing investment intentions. These theories suggest that investment decisions are influenced by attitudes, subjective norms, and perceived behavioral control. TPB highlights how past behavior and financial literacy impact investment choices, with attitude and subjective norms acting as mediating factors. Research indicates that financial literacy enhances perceived behavioral control, improving investor confidence and reducing reliance on external recommendations (Raut, 2020). By integrating these theoretical perspectives, this study aims to provide a comprehensive framework for understanding how cognitive biases, financial knowledge, and social influences shape investment decision-making.

Empirical Review

Empirical studies have examined the relationship between financial literacy, behavioral biases, and investment decisions. Mittal (2022) reviewed five decades of research on behavioral finance and highlighted the growing field of behavioral biases in investment decisions. His study identified key biases such as overconfidence, herd mentality, and emotional investing, which significantly impact financial decision-making. Metawa et al. (2019) examined Egyptian investors and found that demographics such as age, gender, and educational attainment influenced investment behavior, with expertise reducing emotional decision-making. Similarly, Rasool and Ullah (2019) explored the link between financial literacy and behavioral biases among Pakistani investors, concluding that higher financial literacy levels reduce susceptibility to biases. Shafik and Ahmad (2020) investigated Islamic

financial literacy among Malaysian students and found that exposure to financial education significantly improved financial decision-making. These studies highlight the importance of financial literacy in reducing behavioral biases and promoting rational investment choices.

Further empirical research supports the significance of financial and non-financial information in investment decisions. Naveed et al. (2020) analyzed Pakistani stock exchange data and found that corporate reputation mediates the impact of financial reporting on investor choices. Sharif and Naghavi (2020) studied financial information-seeking behavior and its relationship with financial literacy among young investors, demonstrating that parental financial education influences financial decision-making. In the Nepalese context, Karmacharya et al. (2022) found that investors heavily rely on external recommendations and market trends rather than independent analysis. Dangol and Manandhar (2020) confirmed that heuristic biases play a dominant role in investment decision-making among Nepalese investors, while Poudel, Bhusal, and Pathak (2024) reinforced the importance of financial literacy in mitigating these biases. These empirical findings collectively emphasize that while behavioral biases influence investment decisions, financial literacy and market awareness can significantly mitigate irrational financial behaviors, fostering more informed and strategic investment choices.

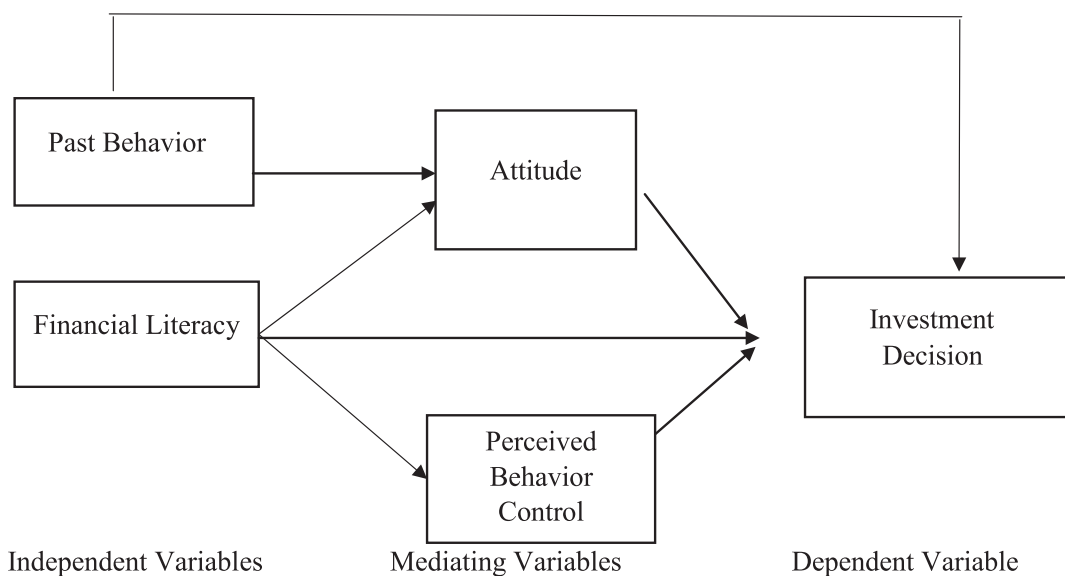


Figure 1. Conceptual Framework

Source: Raut, R. K. (2020)

Previous studies on investment decision-making in Nepal have primarily focused on heuristic biases, market factors, and herding behavior but have not integrated the Theory of Planned Behavior. This study fills the gap by incorporating psychological variables like attitude, perceived behavioral control, past behavior, and financial literacy to analyze their mediating effects on investment decisions.

Research Methods

The study aims to examine the impact of financial literacy and past behavior on investment decisions in Nepalese stock markets, incorporating the Theory of Planned Behavior. The research investigates how psychological factors such as attitude and perceived behavioral control mediate these relationships. A descriptive and causal research design has been adopted to establish the extent and nature of cause-and-effect associations between the independent variables—past behavior and financial literacy—and the dependent variable, investment intention. By analyzing these interactions, the study provides insights into how investor behavior shapes financial decision-making.

The study population comprises Nepalese investors actively engaged in stock market trading, with a specific focus on those with at least three years of investment experience. Due to the unknown total number of experienced

investors, a purposive sampling approach was used. A sample size of 426 was determined using Cochran's formula (1977) with a 95% confidence level and a 5% error margin. The respondents were selected through peer referrals and social networks to ensure participation from individuals with relevant investment experience.

Data collection was conducted using structured questionnaires distributed both online via Google Forms and in printed copies. The questionnaire included sections on demographic details, financial literacy, past behavior, and investment intentions, measured using a five-point Likert scale. Reliability testing using Cronbach's alpha confirmed that all variables exceeded the 0.6 threshold, ensuring internal consistency. Smart PLS 4 was used for data analysis, incorporating descriptive statistics, correlation, and structural equation modeling to test hypotheses and mediation effects.

Results

Descriptive statistics organize and summarize data systematically, highlighting key patterns and trends (Rozalia, 2010; Mtembu, 2017). It includes respondents' socio-demographic profiles and research variables, presented in tables for clarity, ensuring a comprehensive understanding before inferential analysis.

Table 1

Demographic Profile

Variables	Category	Frequency	Percentage
Gender	Male	224	52.58
	Female	202	47.42
Age	Up-to 20 years	27	6.34
	21-30 years	276	64.79
	31-40 years	110	25.82
	41-50 years	8	1.88
	Above 50 years	4	0.94
Academic Qualification	Intermediate	61	14.32
	Bachelors	161	37.79
	Masters	204	47.89
Marital Status	Married	251	58.92
	Unmarried	175	41.08
Occupation	Student	97	22.77
	Salaried	240	56.34
	Self Employed	88	20.66

Table 1 presents the demographic profile of respondents in the study on the impact of past behavior and financial literacy on investment decision-making in NEPSE. The sample consists of 52.58% males and 47.42% females. The majority (64.79%) are aged 21–30 years, with 47.89% holding a master's degree. Most respondents are married (58.92%), and 56.34% are salaried employees. The diverse demographic composition provides a comprehensive understanding of how financial literacy, past behavior, attitude, and perceived behavioral control influence individual investment decisions in NEPSE.

Measurement Model

A measurement model explains the relationships between variables that are observed and those that are not. This word denotes the relationship between the outcomes of a measurement tool (i.e., the observed indicator variables) and the underlying constructs they were meant to evaluate (i.e., the latent variables) (Byrne, 2020). An assessment of the measurement model's quality was made after it was examined. The examination of the quality criteria begins with an analysis of the factor loadings and proceeds to the determination of the discriminant reliability, construct, reliability and validity.

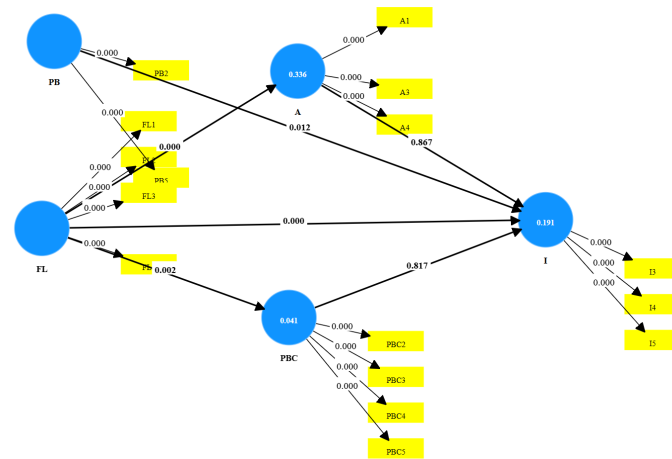


Figure 2. Measurement Model (with dropping poor factor loadings)

The Variance Inflation Factor (VIF) is used to assess multicollinearity among indicators. According to Hair et al. (2016), if the VIF value is less than 3, multicollinearity is not a serious concern. Table 2 presents the VIF values in this study, which range from 1.147 to 2.318, indicating no significant multicollinearity issues within the dataset. Each outer loading exhibits a satisfactory VIF value, confirming that no independent variable is excessively correlated with another. The results suggest that all constructs are distinct and appropriately measured without redundancy in the dataset. Therefore, the study meets the acceptable threshold for multicollinearity, supporting the robustness of the measurement model.

Table 2

Factor Loadings and Variance Inflation Factors

	Outer loadings	VIF
A1 <- A	0.768	1.310
A3 <- A	0.761	1.247
A4 <- A	0.774	1.265
FL1 <- FL	0.798	1.752
FL2 <- FL	0.843	1.863
FL3 <- FL	0.811	1.761
FL5 <- FL	0.699	1.337
I3 <- I	0.895	2.318
I4 <- I	0.871	1.988
I5 <- I	0.881	2.209
PB2 <- PB	0.601	1.147
PB5 <- PB	0.961	1.147
PBC2 <- PBC	0.735	1.342
PBC3 <- PBC	0.708	1.432
PBC4 <- PBC	0.782	1.654
PBC5 <- PBC	0.758	1.299

Construct Reliability and Convergent Validity

To estimate construct reliability, Cronbach's Alpha (CA), Composite Reliability (CR) (ρ_a), and Composite Reliability (ρ_c) were examined in Table 3. The values of CA ranged from 0.527 to 0.857. Although the CA value of PB (0.527) is below 0.70, other constructs exhibit acceptable reliability, with CA values exceeding 0.651, demonstrating no major reliability concerns (Hair et al., 2016). Since CA is a conservative measure, additional robust indicators such as CR ρ_a and CR ρ_c were considered.

The values of CR ρ_a ranged from 0.652 to 0.858, and CR ρ_c ranged from 0.774 to 0.913, ensuring that the

constructs meet the recommended reliability criteria (Hair et al., 2016). Moreover, the Average Variance Extracted (AVE) values range between 0.557 and 0.778, confirming adequate convergent validity, as each construct explains more than 50% of the variance in its respective indicators. Therefore, the study satisfies the construct reliability and convergent validity requirements of the measurement model.

Table 3

Constructs Reliability and Convergent Validity

	Cronbach's alpha	Composite reliability (rho _a)	Composite reliability (rho _c)	Average variance extracted (AVE)
PB	0.527	0.952	0.774	0.643
A	0.651	0.652	0.811	0.589
PBC	0.738	0.745	0.834	0.557
FL	0.797	0.803	0.868	0.624
I	0.857	0.858	0.913	0.778

Using the average variance explained (AVE), convergent validity was evaluated. Convergent validity is established when the item converges to measure the underlying concept and the Average Variance Explained (AVE) values are more than or equal to the suggested value of 0.50 (Fornell & Larcker, 1981). In the measuring model, the values of AVE range from 0.557 to 0.778. The computed measurement model's AVE values demonstrated the model's convergent validity.

Discriminant Validity

It describes the extent to which measurements of several ideas differ from one another. The fundamental premise is that precise measurements of each should not show unduly large correlations if two or more ideas are truly unique (Bagozzi et al., 1991). The Heterotrait-Monotrait Ratio (HTMT) and the Fornell and Larcker Criterion are the two most widely utilized techniques for proving discriminant validity. First, discriminant validity has been shown when a concept's square root of AVE is greater than its correlation with every other construct, according to Fornell & Larcker's (1981) criterion. The study's discriminant validity of the measuring model was demonstrated by the finding that, for each construct, the square roots of AVE were bigger than their correlation with other constructs.

Table 4

Discriminant Validity (Fornell-Larcker Criterion)

	A	FL	I	PB	PBC
A	0.767				
FL	0.58	0.79			
I	0.275	0.415	0.882		
PB	0.459	0.519	0.333	0.802	
PBC	0.285	0.202	0.112	0.174	0.746

The correlation estimation between constructs forms the basis of the Heterotrait-Monotrait (HTMT) ratio, which is used to establish discriminant validity. According to Hair et al. (2016), the HTMT ratio should be less than 0.90 to confirm that constructs are distinct from one another.

Table 5 presents the results of the HTMT ratio for this study, with the maximum value recorded at 0.803. These findings indicate that all constructs maintain adequate discriminant validity, as none of the HTMT values exceed the recommended threshold. This confirms that the constructs used in the model are well-differentiated, supporting the robustness of the measurement model.

Table 5

Discriminant Validity (HTMT Ratio)

	A	FL	I	PB	PBC
A	1				
FL	0.803	1			
I	0.366	0.498	1		
PB	0.738	0.731	0.422	1	
PBC	0.41	0.266	0.135	0.238	1

Structural Model

The study tested 10 hypotheses using the bootstrapping technique with a 10,000-sample size to examine the relationships among key constructs. The findings indicate that most hypotheses were supported, except for H1 and H6, which were rejected due to insignificance. Hypothesis H1, which proposed that Attitude (A) positively influences Investment Decision (I), was rejected as the results showed no significant effect ($\beta = 0.009$, $t = 0.167$, $p = 0.867$). On the other hand, Financial Literacy (FL) positively influenced both Attitude (A) and Investment Decision (I), as shown by significant results (H2: $\beta = 0.58$, $t = 14.283$, $p < 0.05$; H3: $\beta = 0.324$, $t = 5.321$, $p < 0.05$). These findings suggest that financial literacy plays a crucial role in shaping attitudes and driving investment decisions. Similarly, Financial Literacy (FL) positively influenced Perceived Behavioral Control (PBC) (H4: $\beta = 0.202$, $t = 3.077$, $p = 0.002$), indicating that individuals with greater financial knowledge feel more confident in making investment decisions. Additionally, Past Behavior (PB) positively influenced Investment Decision (I) (H5: $\beta = 0.158$, $t = 2.501$, $p = 0.012$), reinforcing the idea that prior investment experience contributes to future investment activities.

Hypothesis H6, which examined whether Perceived Behavioral Control (PBC) positively influences Investment Decision (I), was rejected due to its insignificant effect ($\beta = 0.017$, $t = 0.231$, $p = 0.817$). This finding indicates that an individual's perception of control over investment decisions does not necessarily lead to actual investment behavior. Overall, the results highlight that financial literacy and past investment behavior are the strongest predictors of investment decisions, whereas attitude and perceived behavioral control alone do not significantly influence actual investment choices. These insights emphasize the importance of financial education initiatives and awareness programs to enhance investment participation.

Table 6

Results of Structural Model Path Coefficient

	Beta coefficients	SD	t value	P values	2.50%	97.50%	Decision
A → I	0.009	0.057	0.167	0.8670	-0.103	0.119	Rejected
FL → A	0.58	0.041	14.283	0.0000	0.495	0.652	Accepted
FL → I	0.324	0.061	5.321	0.0000	0.201	0.439	Accepted
FL → PBC	0.202	0.066	3.077	0.0020	0.033	0.317	Accepted
PB → I	0.158	0.063	2.501	0.0120	0.031	0.279	Accepted
PBC → I	0.017	0.072	0.231	0.8170	-0.174	0.135	Rejected

Predictive Analysis

The predictive analysis assesses explanatory and predictive power using R^2 values, effect size (f^2), Q^2_{predict} , and path coefficients. According to Hair et al. (2019), R^2 values of 0.75, 0.50, and 0.25 indicate substantial, moderate, and weak explanatory power, respectively. The study shows moderate explanatory power for A (0.702), while other variables exhibit weak to very weak power. Effect size (f^2) values range from 0.021 to 0.507, suggesting mostly small to medium effects, with one variable having a large impact (0.506). Path coefficients reveal FL → A (0.507) has a moderate effect, while other relationships are weak or insignificant. Q^2_{predict} values suggest that attitude (0.33) has higher predictive relevance than intention (0.179) and perceived behavioral control (0.029),

aligning with the model's weak to moderate explanatory power.

Conclusion and Implications

This study examined the impact of past behavior and financial literacy on investment decision-making among Nepalese investors, integrating the Theory of Planned Behavior (TPB). The findings indicate that financial literacy significantly influences attitude and investment decisions, while past behavior impacts investment choices. However, perceived behavioral control does not significantly affect investment intention. The model demonstrated weak to moderate explanatory power, emphasizing the role of financial knowledge in reducing cognitive biases and improving investment decisions.

The findings have significant implications for policymakers, financial institutions, and investors. Financial literacy programs should be strengthened to enhance investment participation and rational decision-making (Raut, 2020; Karmacharya et al., 2022). Regulators should implement awareness initiatives to mitigate biases and encourage informed investment behavior (Dangol & Manandhar, 2020). Future research should explore additional psychological and market-related factors influencing investment decisions, ensuring a more holistic understanding of investor behavior in emerging markets like Nepal.

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