LEADER: International Journal of Business Management

RESEARCH ARTICLE

# Can Risk Perception Moderate the Relationship between Financial Literacy and Investment Decision: An Empirical Study among the Nepal Insurance Industry

Madhusudan Lamichhane[1], Pradip Subedi[2]

[1]Department of Management, Valley State College, PoU, Bharatpur, Nepal
[2]Department of Information Technology, Birendra Multiple Campus, TU, Bharatpur, Nepal

**ABSTRACT:**
This research is to investigate the role of risk perception that could be played in the relationship between financial literacy and investment decision-making among both individual and institutional investors in Nepal's insurance sector. By leveraging the insights of Prospect Theory as well as Bounded Rationality Theory, this study uncovers the profound impact of psychological biases, cognitive constraints, and personal perceptions on financial behavior, even among those equipped with financial knowledge. Through a cross-sectional survey, data were collected from 348 participants across various Nepali cities. The findings are unequivocal: there is a significant positive correlation between financial literacy and investment decisions. Crucially, moderation analysis reveals that risk perception dramatically influences the strength of this relationship. The implications are clear: while financial literacy undeniably enhances individuals' ability to make informed investment decisions, its effectiveness is contingent upon their perception of financial risk. Investors with substantial financial knowledge may still exhibit cautious or risk-averse behavior if their risk perception is heightened. Conversely, a balanced risk perception, when coupled with financial literacy, significantly boosts confidence and decision-making quality. These findings are of paramount importance for financial educators, advisors, and policymakers striving to enhance investment behavior and capital formation in developing economies like Nepal.

**Keywords:** Investment decision, risk perception, financial literacy, insurance, Nepal

**Article History**
Received: 05 Feb 2025
Revised: 04 Mar 2025
Accepted: 06 Mar 2025

**How to cite this article:**
Lamichhane, M., & Subedi, P. (2025). Can risk perception moderate the relationship between financial literacy and investment decision: An empirical study among the Nepal insurance industry. *LEADER: International Journal of Business Management*. 13(1), 53-66.

**Correspondence:** Dr. Madhusudan Lamichhane, Associate Professor, Valley State College, PoU, Bharatpur, Nepal (email - madhusudanlamichhane63@gmail.com)

## Introduction

The insurance industry in Nepal has experienced notable growth in recent years, attracting increased attention from policymakers, investors, and scholars interested in the financial sector's evolving role in economic development. This growth trajectory highlights the importance of understanding the factors that influence investment decisions within this sector. Research in behavioral finance focusing on the Nepalese stock market has shown that investor psychology significantly shapes financial decisions. Specifically, biases such as overconfidence, anchoring, and regret aversion have been identified as key predictors of investor behavior, indicating that individual investors are often swayed by subjective and emotionally charged heuristics rather than purely rational analysis (Gurung et al., 2024).

In contrast, representative bias was found to have minimal influence, and herding behavior showed no statistically significant impact, suggesting a unique behavioral profile among Nepalese investors. While the insurance sector holds considerable potential to facilitate financial stability, risk-sharing, and capital mobilization—thereby acting as a catalyst for economic growth (Feyen et al., 2011)—scholarly focus within Nepal's financial landscape has been disproportionately concentrated on the banking sector, particularly concerning monetary policy and its effects on economic performance (Demetriades & Luintel, 1996). This research gap calls for more targeted investigation into the behavioral and structural dynamics of Nepal's insurance industry, which remains a relatively understudied yet critical component of the national economy.

In light of these observations, it becomes evident that any comprehensive examination of investment behavior in Nepal's insurance industry must consider both behavioral biases and macroeconomic influences. Similar to trends observed in other emerging economies, the development of a robust insurance sector in Nepal could serve as an engine for economic growth by mobilizing long-term investment capital, supporting infrastructure financing, and promoting a culture of risk-taking essential for entrepreneurial activity (Vadlamannati, 2008). However, to realize this potential, regulatory authorities and policymakers must address psychological barriers that hinder rational investment decisions. This includes creating financial literacy campaigns that not only disseminate knowledge but also counteract biases such as overconfidence and loss aversion. Additionally, a more integrated policy framework that connects insurance sector development with broader financial sector reforms is essential for optimizing the industry's contribution to the national economy. Such a multi-pronged approach will not only enhance investor confidence but also position the insurance sector as a central pillar of Nepal's financial architecture.

Although financial literacy is widely recognized as a key factor in promoting sound investment behavior, its true impact is often filtered through an investor's subjective perception of risk. This moderating effect is especially important in developing economies like Nepal, where financial systems are still evolving, and investor confidence may be fragile. For example, even well-informed investors might avoid riskier investment opportunities if they perceive high market volatility or personal risk exposure.

Conversely, when financial literacy is paired with an appropriate level of risk perception, individuals can make confident and balanced investment choices, thereby enhancing financial inclusion and participation in capital markets. Evidence from the literature suggests that financial literacy alone may not suffice to drive optimal investment outcomes unless it is accompanied by favorable psychological traits, such as positive financial attitudes and moderate levels of investor confidence (Maheshwari et al., 2024). Similarly, "risk perception has been shown to fully mediate the relationship between overconfidence and investment decisions, underscoring its role as a psychological bridge between investor cognition and behavior" (Ahmad & Shah, 2020).

Interestingly, research by Jonsson et al. (2017) provides nuanced insights into how different forms of financial literacy affect behavioral outcomes. Their findings indicate that while knowledge of mutual funds and market trends can reduce the disposition effect, technical financial knowledge—such as familiarity with mathematical models or complex financial instruments—has little impact. These

contradictions further highlight the importance of context-specific and applied financial literacy, rather than abstract theoretical knowledge, particularly in markets like Nepal where financial awareness is still developing. Ultimately, these findings advocate for a more integrated approach to investor education—one that combines cognitive training, emotional intelligence, and risk management—to foster better investment decisions.er a more resilient and growth-oriented investment environment in the Nepalese insurance sector.

Contrary to the assumption that all financial knowledge equally influences financial decision-making, emerging research distinguishes between two different types and forms of financial literacies, one is objective, and the other one is subjective one, each with unique behavioral implications. Objective financial literacy refers to an individual's actual understanding of financial concepts and numerical skills, while subjective financial literacy reflects their perceived competence in handling financial matters. In their research by Sivaramakrishnan et al. (2017), it is found that "while objective financial literacy significantly affects actual investment behavior, subjective financial literacy plays a more prominent role in shaping investment intentions". This distinction highlights a key psychological dimension of investor behavior: individuals may choose to invest—or avoid investing—based not only on what they know, but also on how confident they feel about their financial knowledge. This divergence suggests that financial decision-making is not purely a rational process but one that is deeply intertwined with self-perception and psychological attitudes toward risk and financial control.

While financial literacy provides the foundational knowledge required to evaluate financial instruments, interpret market trends, and assess investment opportunities, risk perception acts as a filter that either facilitates or obstructs the translation of this knowledge into tangible investment action. As Sahi et al. (2013) rightly noted, it is essential to consider both cognitive competencies and psychological dispositions when analysing financial behavior. This multidimensional perspective offers valuable insights for financial educators, policymakers, and advisors seeking to design more effective investor support systems. Such efforts could lead to more targeted interventions, empowering individuals to make better-informed and more rational investment decisions.

Multiple empirical studies from diverse national and cultural contexts reinforce the positive influence of financial literacy on investment behavior. For example, research in Pakistan by Adil et al. (2021) confirmed that financial literacy significantly enhances investor decision-making and mitigates the detrimental effects of behavioral biases, including overconfidence and herd behavior. These findings suggest that "financially literate individuals are better equipped to evaluate risks, question prevailing market sentiment, and resist impulsive decision-making triggered by emotional responses". Similarly, a study conducted in Saudi Arabia (Seraj et al., 2022) proves it clearly that "a statistically significant and positive relationship between financial literacy and rational investment decisions, indicating that individuals who possess a strong financial knowledge base are more likely to utilize market information effectively and engage in structured investment planning".

Certain studies (Ahmad and Shah, 2020) suggests that even when investors exhibit overconfidence—a common cognitive bias—their behavior is largely influenced by how they perceive and assess investment risks. If risk is perceived as high, even overconfident investors may adopt conservative strategies or refrain from investing altogether. Conversely, a low perceived risk environment may exacerbate risk-taking behavior, leading to potentially irrational or speculative investment choices. These nuanced relationships underscore the need for an integrated framework that incorporates financial literacy, risk perception, and behavioral tendencies to provide a more accurate and actionable understanding of investor behavior in both emerging and developed markets.

This indicates that even when investors possess cognitive biases or financial expertise, their behavior is largely driven by how they perceive and evaluate financial risks. Thus, in contexts such as Nepal—where financial literacy remains low, and market volatility is a common concern—risk perception may serve as a pivotal variable that shapes or even constrains the influence of financial knowledge on investment behavior. These findings underscore the

importance of developing comprehensive educational initiatives that simultaneously address both cognitive literacy and risk sensitivity to foster more effective and confident financial decision-making.

While the specific context of Nepal's insurance industry has not been directly addressed in the provided studies, the existing research indicates that risk perception is likely to play a significant role in moderating the hypothesised correlation between the variables of financial literacy of investors and their investment decisions. Future research focusing on Nepal's insurance sector could provide valuable insights into how risk perception interacts with financial literacy to influence investment behavior in this specific context.

Similarly, Naiwen et al. (2021) reported that "financial literacy is positively associated with investment decisions, reinforcing the importance of financial education in promoting informed financial behavior". However, not all findings are uniformly positive. Mohta and Shunmugasundaram (2023), in a study focusing on millennial investors, revealed that higher financial literacy can sometimes lead to reduced risk-taking behavior, particularly in the context of risky investment intentions. This suggests that "the impact of financial literacy may be context-dependent, influenced by demographic factors such as age, income level, or cultural risk aversion". Regarding the role of risk perception, emerging studies have begun to uncover its potential as a moderating variable in the financial literacy–investment decision relationship. For example, Oehler et al. (2023) demonstrated that financial literacy can indirectly influence participation in financial markets by reducing an individual's aversion to risk, thereby encouraging greater market involvement. This implies that individuals who possess financial knowledge are not only better equipped to evaluate investment options but may also be more willing to take calculated risks.

Adding to this, Miko et al. (2023) found that "both risk perception and financial literacy jointly contribute to increased interest in cryptocurrency investments, a domain often characterized by high volatility and uncertainty". These findings highlight the nuanced and multifaceted role of risk perception—it can act as a barrier or a catalyst, depending on how it interacts with an investor's level of financial understanding. In sum, although research explicitly focusing on Nepal's insurance industry remains scarce, the broader literature suggests that risk perception likely moderates the relationship between financial literacy and investment behavior. However, the strength and direction of this moderating effect may vary based on variables such as investment type (e.g., traditional insurance products vs. market-linked plans), investor demographics, and regional economic conditions. Therefore, there is a clear need for context-specific empirical research in Nepal's insurance sector to better understand how these variables interact and to develop targeted financial literacy programs and investment advisory strategies that reflect the realities of local investors.

Investment decision-making is inherently risky, and how investors perceive and manage this risk plays a pivotal role in determining outcomes. Research indicates that individuals may behave either overly cautiously or take undue risks depending on how they interpret financial uncertainties (Weber et al., 2004). Although existing literature from countries like Pakistan and India (Ahmad & Shah, 2022; Shadnan, 2023) provides support in terms of empirical evidence for the positive association between financial literacy and investment decisions, the role of risk perception as a moderating factor remains underexplored, particularly in the context of Nepal. This gap in the literature calls for empirical inquiry in developing economies with low financial inclusion and literacy rates.

## Literature Review

### 1. Risk Perception

Research indicates that "risk perception is influenced by a complex interplay of psychological, demographic, and experiential factors, often leading to deviations from purely rational decision-making" (Ahmed et al., 2022; Saivasan & Lokhande, 2022). Cognitive biases, personality traits, and emotional states significantly impact risk perception and subsequent investment choices. For instance, overconfidence and loss aversion can skew risk perception, leading to either excessive risk-taking or overly conservative

approaches (Makdissi et al., 2024). Personality traits such as conscientiousness and extroversion have been found to influence behavioral biases, which in turn affect risk perception (Singh et al., 2022).

Singh et al. (2022) suggest that risk tolerance may serve as a buffer, mitigating the adverse effects of certain cognitive or emotional predispositions that investors exhibit due to their individual personality characteristics. This perspective challenges the foundational assumptions of traditional finance theories, which largely rely on the notion of rational decision-making by fully informed and logical investors. Contrary to these assumptions, a substantial body of empirical evidence now supports the view that investors frequently make suboptimal decisions due to cognitive distortions and emotional reactions, which, in turn, shape their perception of risk and subsequent financial behavior (Sathya & Gayathri, 2024).

These findings underscore the significance of psychological factors in investment contexts and highlight the necessity of moving beyond purely quantitative models of investor behavior to incorporate qualitative and behavioral elements. Ahmed et al. (2022) specifically highlighted this dynamic in the context of blue-chip stock investments, where investors' misperceptions of risk—often driven by overconfidence, herding, or loss aversion—intervene between their biases and their actual investment choices.

This suggests that even when behavioral biases are present, the manner in which investors perceive and interpret risk can significantly influence the final decision outcome. The interplay among risk perception, behavioral biases, and investment results is thus highly complex and nonlinear. These findings reinforce the critical need for investor education programs that not only enhance financial literacy but also address the psychological and emotional components of financial behavior. By increasing investors' awareness of their own biases and teaching them to evaluate risk more objectively, more informed, balanced, and rational investment decisions can be achieved (Ahmad & Shah, 2020; Pathak & Thapa, 2024). Such integrative approaches are particularly valuable in emerging financial markets, where investor behavior often deviates from rational models due to limited access to financial education and widespread behavioral tendencies.

In financial contexts, risk perception determines an investor's willingness to take or avoid risk. Investors with higher perceived risk are generally risk-averse, leading to conservative investment strategies. Conversely, those perceiving lower risk may adopt riskier investments in search of higher returns (Rettinger & Hastie, 2001). In Nepal, where formal risk education is limited, such perceptions could be heavily shaped by cultural norms and anecdotal experiences rather than data-driven analysis. Research has also shown that risk perception varies across domains and individuals. For instance, the same investment option may be perceived as high-risk by a novice and low risk by an experienced investor (Diacon & Ennew, 2001). These differences underscore the importance of understanding risk perception as an individual-specific and culturally contextual factor in financial behavior studies.

## 2. Financial Literacy

Financial literacy is generally understood as "the ability to comprehend, interpret, evaluate, and effectively apply financial knowledge and skills to make informed decisions about planning, managing, and allocating personal or institutional financial resources" (Huston, 2010). It empowers individuals to weigh the pros and cons of various financial options, foresee the outcomes of their financial choices, and make decisions that align with their life goals and financial objectives.

Seminal studies by Lusardi and Mitchell (2007) and Van Rooij et al. (2007) have shown that "individuals with higher levels of financial knowledge are significantly more likely to invest in diversified portfolios, participate in financial markets, and avoid common financial pitfalls such as fraud or over-indebtedness". These individuals are typically more adept at analysing investment risks, understanding complex financial products, and developing strategies that reflect both their risk tolerance and long-term wealth accumulation goals. Importantly, in the context of South Asian economies, including countries like Nepal, India, Pakistan, and Bangladesh, the importance of financial literacy has become increasingly evident.

With the rapid growth of financial inclusion, digitization of financial services, and increasing exposure of retail investors to capital markets and insurance products, the need for a

financially literate population has never been more critical. Financial literacy not only encourages responsible financial behavior but also plays a crucial role in bridging the knowledge gap that often exists between financial institutions and consumers, thereby facilitating broader participation in formal financial systems and supporting the economic development of the region. As South Asian economies continue to modernize their financial infrastructures, targeted efforts to enhance financial literacy are essential for ensuring that citizens are equipped to make informed, rational, and future-oriented financial decisions.

Research in countries such as India has demonstrated that while financial literacy alone may not exert a strong direct influence on investment behavior, its effectiveness is enhanced when combined with psychological enablers such as positive financial attitudes and a degree of investor confidence (Maheshwari et al., 2024). This indicates that financial literacy often interacts with behavioral and emotional factors, making its influence more dynamic and context dependent. Similarly, in Pakistan, "although behavioral biases—such as overconfidence, herding, and loss aversion—play a dominant role in influencing investor choices, financial literacy serves a moderating function that helps mitigate the negative impact of these biases on decision quality" (Khan et al., 2023). This suggests that financial knowledge acts as a buffer, allowing investors to better recognize and correct for irrational tendencies in their financial thinking. Moreover, findings from Kazakhstan offer additional insights into this complex dynamic.

According to Bayakhmetova et al. (2023), "higher levels of financial literacy are positively correlated with increased participation in financial investment activities". However, the ability to act on financial knowledge is also heavily dependent on personal income levels, highlighting the interplay between cognitive competence and economic capacity. These findings collectively underscore the notion that while financial literacy is a powerful determinant of rational investment behavior, its effectiveness is often conditioned by other variables—including psychological traits, socio-economic status, and access to financial markets. In conclusion, efforts to improve financial literacy in South Asia and similar emerging markets must adopt a holistic approach—one that integrates knowledge dissemination with behavioral training and considers the broader socio-economic landscape of the target population. Only then can financial literacy fully empower individuals to make confident, informed, and strategically sound investment decisions. However, in Nepal, a significant portion of the population remains financially illiterate, relying instead on informal advice and speculative behavior. This underlines the need for financial education initiatives and further research into how financial literacy translates into investment behavior in such settings.

## 3. Investment Decision

Investment decision-making involves selecting the best investment alternatives from available options, based on individual financial goals and market analysis. While "classical finance assumes investors are rational", behavioral finance argues that "real-world investors often deviate from rationality due to cognitive biases and emotional influences" (Kahneman & Tversky, 1979). Empirical studies from developing economies demonstrate that investment decisions are influenced by a complex interplay of financial literacy, behavioral biases, and socio-demographic factors.

Research indicates that "even those with substantial financial knowledge can fall prey to behavioral biases like overconfidence, loss aversion, herding, and the disposition effect, which can skew decision-making and result in less-than-ideal investment outcomes" (Abideen et al., 2023). These biases function at a psychological level and often override rational thinking, highlighting the limitations of financial knowledge when considered alone. In this scenario, risk perception becomes a crucial mediating factor in the financial decision-making process, affecting how financial literacy translates into actual investment actions. Risk perception represents an individual's subjective understanding of potential financial losses and uncertainties, which in turn influences their willingness to engage with various investment instruments. Depending on the situational and psychological context, risk perception can either enhance or diminish the impact of financial literacy.

For instance, Ahmed et al. (2022) discovered that risk perception mediates the relationship between investing in blue-chip stocks—generally seen as lower risk—and the investor's ultimate decision, indicating that even financially literate individuals depend on perceived risk signals to guide their choices. On the other hand, in cases of behavioral biases like herding and the disposition effect, risk perception was not found to play a mediating role, suggesting that these biases have a more direct and potentially uncontrollable impact on investor behavior. This complex interaction underscores that the influence of financial literacy is conditional—its effectiveness is moderated by how individuals perceive and respond to investment risks and by the presence of ingrained behavioral patterns. Therefore, to improve the quality of investment decisions, financial education must extend beyond traditional knowledge dissemination and include training that focuses on risk awareness and bias recognition, thereby providing investors with the cognitive and emotional tools necessary for truly rational and balanced financial decision-making.

The complex and dynamic interactions between financial literacy, behavioral biases, and risk perception highlight the need for a comprehensive and multifaceted approach to enhancing investment decision-making, particularly within the context of developing economies. While financial literacy is undeniably a fundamental component of informed financial behavior, it may not suffice to ensure rational investment choices. Investors in developing countries often face challenges such as limited exposure to formal financial education, inadequate access to quality financial advisory services, and a high prevalence of cognitive and emotional biases that influence decision-making under uncertainty. As emphasized by Abideen et al. (2023) and Khan et al. (2023), addressing these behavioral and psychological factors is crucial for improving the overall financial well-being of individuals and ensuring that their decisions are guided by both knowledge and sound judgment.

Therefore, any effort to strengthen investment behavior in developing markets, such as Nepal, must be designed to address this interplay of factors. Nepal, like many emerging economies, is in the process of expanding its financial infrastructure and promoting greater financial inclusion. In such an environment, a narrow focus on improving financial knowledge may be insufficient if it does not also incorporate strategies aimed at mitigating behavioral biases (e.g., overconfidence, herding, loss aversion) and fostering more realistic and informed risk perceptions among investors. Developing financial literacy programs that integrate behavioral finance principles—such as awareness of cognitive distortions and risk profiling tools—can lead to more balanced and effective investment strategies. Furthermore, creating policy frameworks that support both investor education and consumer protection is essential for building trust and engagement with formal financial systems. Understanding and responding to the interactions between financial literacy, risk perception, and investment decisions is thus not only theoretically important but also practically indispensable for the economic empowerment of populations in countries like Nepal, where financial decision-making capabilities are still in a critical phase of development.

## Theory and Hypotheses

This study is grounded in two foundational frameworks within decision-making literature: Prospect Theory (Kahneman & Tversky, 1979) and Bounded Rationality Theory (Simon, 1982). Prospect Theory suggests that “individuals assess outcomes relative to a reference point and demonstrate loss aversion, attributing greater psychological significance to potential losses than to equivalent gains”. Consequently, their decisions are often influenced by subjective risk perceptions rather than objective probabilities, resulting in inconsistencies and biases. This theoretical perspective is particularly pertinent to understanding investment behavior, where individuals may irrationally eschew high-return opportunities due to the perceived risk of loss overshadowing potential gains. Even when presented with clear statistical advantages, the fear of loss may lead to conservative behavior.

Complementarily, Bounded Rationality Theory posits that “decision-making is inherently limited by human cognitive constraints, incomplete information access, and time pressures”. Rather than achieving optimal outcomes, individuals often resort to "satisficing" solutions—those that are adequate within given constraints. In the investment context, this implies that even well-informed or financially literate individuals may not

consistently make rational decisions, particularly when faced with uncertainty or complex financial environments. They may rely on heuristics, emotional cues, or risk-averse tendencies instead of conducting thorough analyses of investment alternatives. Thus, when examined through these theoretical lenses, it becomes apparent that financial literacy alone does not ensure rational investment decisions. Perceived risk can significantly distort decision-making, even among knowledgeable investors.

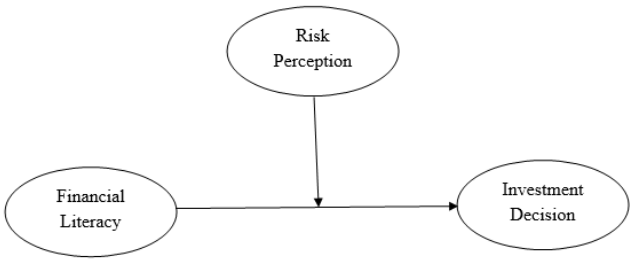
It is suggested that risk tolerance may serve as a buffer, mitigating the adverse effects of certain cognitive or emotional predispositions that investors exhibit due to their individual personality characteristics (Singh et al., 2022). This perspective challenges the foundational assumptions of traditional finance theories, which largely rely on the notion of rational decision-making by fully informed and logical investors. Contrary to these assumptions, a substantial body of empirical evidence now supports the view that investors frequently make suboptimal decisions due to cognitive distortions and emotional reactions, which, in turn, shape their perception of risk and subsequent financial behavior (Sathya & Gayathri, 2024).

While financial literacy may generally enhance an investor's ability to make informed decisions, this positive influence can be diminished if the individual perceives high levels of investment-related risk. For instance, an investor with substantial financial knowledge may still refrain from investing in equities if their perception of market volatility or economic uncertainty is excessively high. This framework elucidates the discrepancies often observed between what investors know and what they actually do. Based on this theoretical foundation and insights from the existing literature, the following hypotheses are proposed for empirical examination:

H1: Financial literacy has a significant positive impact on investment decisions among investors.

H2: Risk perception moderates the relationship between financial literacy and investment decisions, such that higher levels of perceived risk weaken the positive influence of financial literacy.

## Conceptual Model




## Measurement Scales Used

- **Financial Literacy**: Measured using a 5-item scale adapted from Parker and DeCotiis (1983) including items such as "I usually follow the stock market through financial news" and "I am somewhat knowledgeable of stock market activities".
- **Risk Perception**: Measured using items from Hean Tat Keh et al. (2002), e.g., "I want to earn more money than my current income level in the long run" and "I can accurately forecast the demand for my business".
- **Investment Decision**: Adapted from Ahmed (2013), including items like "Money is an important goal of my life" and "Stock markets are unpredictable; that's why I would never invest in stocks".

## Methodology

The present study employs a cross-sectional design, characterized by its descriptive nature, as it builds upon existing literature and aims to explore established variables within a defined timeframe. While primarily descriptive, the study also incorporates elements of causal research, seeking to identify cause-and-effect relationships, specifically examining how financial literacy and risk perception influence investment decision-making. This dual approach provides both observational insights and explanatory depth. The research population comprises both individual and institutional investors actively engaged in financial markets across various urban centers in Nepal.

To collect primary data, a structured questionnaire was employed, utilizing convenience sampling, a non-probability technique that allowed the researchers to access participants who were

readily available and willing to contribute. A total of 350 questionnaires were distributed among potential respondents in key cities, achieving an impressive response rate, with 348 completed questionnaires returned and considered valid for analysis.

The demographic composition of the sample reveals a gender imbalance, with 69.5% male respondents and 30.5% female respondents. Participants also represented a diverse range of age groups, with 39.4% aged 25 years or below, 45.1% between the ages of 26 and 33, and 14.7% falling within the 34 to 41-year age bracket. Regarding educational qualifications, the respondents were relatively well-educated: 20.1% held bachelor's degrees, 26% had completed master's degrees, while the majority, 54%, reported holding MS-level qualifications. The sample also reflected varying levels of professional experience in the financial sector. A significant proportion of respondents (75.8%) reported having five years or less of experience, 15.7% had between six and thirteen years of experience, and 8.5% had accumulated fourteen to twenty-one years in the field. This diverse distribution of demographic and professional characteristics adds richness to the dataset and enhances the generalizability of the findings within the context of investment behavior in Nepal.

## Data Analysis

### Correlation Analysis

**Table 1 Correlation & Reliabilities**

| Sl No. | Variables | Financial Literacy | Risk Perception | Investment Decisions |
|---|---|---|---|---|
| 1 | Financial Literacy | 1 | | |
| 2 | Risk Perception | 0.712 | 1 | |
| 3 | Investment Decisions | 0.653 | 0.515 | 1 |

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

The objective of conducting a correlation analysis is to evaluate the extent and direction of the association between two variables. This analysis aids in determining whether the variables exhibit a tendency to change correspondingly or in an opposing manner or keep indifference. These are respectively known as positive correlation, negative correlation, and no corelation. In this study, the Pearson correlation coefficient was employed to assess the linear relationships among Financial Literacy, Risk Perception, and Investment Decisions. Table 1 presents the correlation coefficients and reliability indicators for the primary variables under investigation.

The findings indicate that a significant positive correlation exists strongly between Financial Literacy and Risk Perception since the values are like $r = 0.712$, $p < 0.01$. This in turn proves the hypothesis that individuals possessing higher level of financial literacy are more likely to hold a higher level of awareness of financial risk or financial risk perception. Furthermore, it is also proved on the basis of this study's data that Financial Literacy is positively associated with Investment Decisions, since the values of r and p are statistically supportive of this ($r = 0.653$, $p < 0.01$). This in turn indicates that individuals having higher financial knowledge would be making stronger and efficient investment decisions. Additionally, it could also be argued that Risk Perception and Investment Decisions are positively correlated since the statistical values are supportive of this ($r = 0.515$, $p < 0.01$). This in turn suggests that that individuals who are more attuned to financial risks are more engaged or cautious in their investment behavior. These significant correlations provide preliminary support for the hypothesized relationships and justify further investigation through regression and moderation analyses.

### Regression Analysis

**Table 2 Results for Regression Analysis of investment decision Investment decision**

| | Investment Decisions | | |
|---|---|---|---|
| Predictors | B | R Square | Delta R Square |
| Control Variables | | | 0.356 |
| Financial Literacy | 0.425*** | 0.553 | 0.152 |
| | 0.193*** | 0.387 | 0.59 |

n=348, Control variables were, Gender, Age, Experience and Qualification, ***p<.000 and ***p<.000

Multiple regression analysis was employed to evaluate the causal links and predictive abilities among variables. This method allows for estimating the extent to which an independent variable, specifically Financial Literacy, influences a dependent variable, namely Investment Decision, while accounting for demographic factors such as Gender, Age, Experience, and Qualification. The results of the regression analysis are displayed in Table 2.

Initially, demographic variables were added to the model as control variables, resulting in an $R^2$ of 0.356, indicating that these background variables alone explain 35.6% of the variance in investment decisions. When Financial Literacy was introduced as the main predictor variable, the model's $R^2$ rose to 0.553, with a $\Delta R^2$ of 0.152, demonstrating a significant improvement in the model's explanatory power. The regression coefficient, often represented as β, was 0.425* for Financial Literacy ($p < 0.001$). This indicates a significant positive correlation between financial literacy and investment decision-making. Therefore, it can be concluded that Hypothesis 1 of this study is supported.

**Table 3 Moderation analysis results for Risk perception Investment decision**

| | Investment Decisions | | |
|---|---|---|---|
| Predictors | B | R Square | Delta R Square |
| Control Variables | | 0.315 | |
| Financial Literacy | 2.471 | | |
| Risk Perception | 1.682 | 0.546 | 0.285 |
| Financial Literacy and Risk Perception | -0.625 | 0.572 | 0.068 |

n=348, Control variables were Gender, Age, Experience and Qualification, ***p<.001

To investigate the moderating role of Risk Perception in the relationship between financial literacy and investment decisions, a moderation analysis was conducted. This analysis utilized the interaction term between these two variables. As shown in Table 3, the model that included only control variables produced an $R^2$ of 0.315. The addition of Financial Literacy and Risk Perception increased the $R^2$ to 0.546, and the subsequent inclusion of the interaction term (Financial Literacy × Risk Perception) further improved the model to an $R^2$ of 0.572, with a $\Delta R^2$ of 0.068, indicating a modest yet meaningful moderating effect. Notably, the regression coefficient for the interaction term was $\beta = -0.625^*$ ($p < 0.001$), which is statistically significant and negative.

This finding suggests that the relationship between Financial Literacy and Investment Decisions may be moderated by Risk Perception, such that higher levels of perceived risk reduce the positive influence of financial literacy on investment behavior. In other words, even well-informed investors may be less inclined to act on their financial knowledge if their perception of risk is particularly high. Based on this finding, Hypothesis 2 is also accepted.

**Discussion**

Notably, both objective financial literacy (actual knowledge of financial matters) and subjective financial literacy (self-perceived financial competence) significantly influence investment intentions and behavior (Sivaramakrishnan et al., 2017). This dual influence suggests that possessing accurate financial knowledge is important, but an individual's confidence in their financial understanding also plays a critical role in encouraging proactive investment behavior. Therefore, enhancing financial literacy at both cognitive and attitudinal levels is crucial for empowering investors to make informed, strategic, and future-oriented investment decisions. These findings have significant implications for policymakers, educators, and financial advisors, who must prioritize financial education initiatives to promote inclusive financial participation and long-term economic resilience.

Interestingly, while financial literacy generally leads to better investment decisions, it can also moderate the relationship between behavioral biases and market anomalies. Research indicates that “financial literacy can help mitigate the negative effects of behavioral biases on investment decision-making” (Abideen et al., 2023). However, during extreme market events like the COVID-19 crash, even institutional investors with presumably higher financial literacy engaged in behaviors that amplified price crashes, suggesting that financial knowledge alone may not always lead to optimal decisions in highly volatile

situations (Glossner et al., 2025).

In conclusion, while financial literacy is generally associated with more informed and rational investment decisions, its impact can vary depending on market conditions and individual circumstances. Improving financial literacy through education and training programs could positively impact capital formation and market stability (Khan et al., 2020; Prasad et al., 2020). However, it's important to note that financial knowledge should be complemented with an understanding of behavioral biases and market dynamics for truly effective investment decision-making.

Conversely, those with limited or no financial education are at a clear disadvantage, often lacking the basic understanding required to evaluate investment options effectively. Such individuals may refrain from investing altogether or make poor investment choices due to misconceptions, lack of risk assessment skills, or susceptibility to misinformation. Furthermore, the study identified significant variations in financial literacy levels across demographic segments, particularly along gender lines. Consistent with earlier literature, the analysis revealed that female respondents exhibited lower levels of financial literacy compared to their male counterparts. This gap in financial knowledge may partly explain disparities in investment confidence and participation between genders, emphasizing the need for targeted financial education programs.

Research demonstrates that financially literate investors are inclined to make more informed investment choices, often holding a higher proportion of stocks in their portfolios, which can lead to potentially higher returns (Clark et al., 2015). However, financial literacy alone does not ensure aggressive investment behavior. Even well-informed investors may display conservative tendencies or hesitancy when confronted with perceived market risks. This perspective challenges the foundational assumptions of traditional finance theories, which largely rely on the notion of rational decision-making by fully informed and logical investors. Contrary to these assumptions, a substantial body of empirical evidence now supports the view that investors frequently make suboptimal decisions due to cognitive distortions and emotional reactions, which, in turn, shape their perception of risk and subsequent financial behavior (Sathya & Gayathri, 2024).

Interestingly, personality traits and risk perception also play crucial roles in investment decisions. It is noted that “more extraverted individuals tend to be less risk-averse, while neurotic individuals are more risk-averse” (Oehler & Wedlich, 2018). Additionally, “women investors generally weight risk attributes more heavily and emphasize risk reduction in portfolio construction compared to their male counterparts” (Olsen & Cox, 2001). These findings suggest that factors beyond financial literacy, such as personality and gender, can influence investment behavior and risk perception. For instance, new investors or those with limited income may be particularly risk-averse, driven by the fear of monetary loss or a lack of clarity about financial instruments. This behavior supports the notion proposed by MacCrimmon and Wehrung (1986, 1990), who found that risk-taking behavior is deeply intertwined with investment decisions and is influenced by both personality traits and contextual factors such as income and experience. Risk perception, therefore, plays a dual role—not only influencing overall investment behavior but also acting as a filter through which financial literacy is applied.

Some investors may be inherently risk-tolerant, readily engaging with high-return investment vehicles, while others may be risk-averse, avoiding investment opportunities despite possessing adequate financial knowledge. These psychological orientations significantly impact investment decision-making and must be considered in financial planning and advisory services. The study's data can aid fund managers in assessing investor readiness, evaluating risk tolerance levels, and constructing personalized investment portfolios that align with the goals and comfort levels of individual clients. Moreover, it provides a framework for developing investor education programs that do not solely focus on increasing knowledge but also on helping investors manage their perceptions of risk, thereby promoting more confident and informed financial behavior. In summary, the insights gained from this research hold significant practical utility for both individual investors and financial institutions in shaping strategies that lead to sustainable and rational investment outcomes.

## Conclusion

This study empirically confirms that financial literacy is a major factor that could influence the investment decisions in the Nepalese insurance industry. Individuals with better level of financial knowledge could make senseful investment decisions in a better manner, even after controlling for key demographic variables. However, the study also highlights a crucial nuance: financial literacy alone does not guarantee optimal investment behavior. Risk perception emerges as a significant moderating factor that can either enhance or diminish the impact of financial knowledge. In situations where perceived risk is high, even financially literate investors may avoid investing or adopt overly conservative strategies. These findings align with established behavioral finance theories, illustrating the interplay between cognitive biases, emotional responses, and financial decision-making.

Importantly, this research contributes to the limited but growing literature on behavioral finance in South Asian contexts, specifically within Nepal's evolving financial market. It underscores the need for comprehensive investor education programs that address not only financial concepts but also risk awareness and management. Policymakers and financial service providers should consider developing tools and platforms that help investors assess their risk tolerance more accurately, along with initiatives that promote financial literacy across diverse demographic groups. These efforts can empower investors to make more confident, calculated, and ultimately rewarding financial decisions. As Nepal continues to develop its financial infrastructure, integrating behavioural insights into policy and practice will be essential for fostering inclusive and sustainable economic growth.

## References

Abideen, Z. U., Saleem, S., & Baig, A. (2023). Influence of behavioral biases on investment decision-making: The moderating role of financial literacy. *Journal of Behavioral and Experimental Finance, 38*, 100775. https://doi.org/10.1016/j.jbef.2022.100775

Adil, M., Muhammad, A., & Ahmed, I. (2021). The impact of financial literacy on investment decisions: The mediating role of behavioral biases. *Journal of Finance and Accounting Research, 3*(1), 35–49.

Ahmed, A. (2013). Effect of behavioral factors on investment decision making: A study of individual investors in Pakistan. *Interdisciplinary Journal of Contemporary Research in Business, 4*(9), 630–645.

Ahmed, N., & Shah, S. M. H. (2020). Behavioral biases and investment decisions: The mediating role of risk perception. *International Journal of Management Studies and Research, 8*(6), 1–9.

Ahmed, N., Shah, S. M. H., & Rehman, K. (2022). The mediating role of risk perception between behavioral biases and investment decision-making in Pakistan stock exchange. *Journal of Economics and Sustainable Development, 13*(1), 60–70.

Ashfaq, M., Aslam, M., & Abbas, R. (2023). Impact of financial literacy and risk tolerance on investment decisions: Evidence from Pakistan. *International Journal of Finance & Economics, 28*(1), 175–192.

Bayakhmetova, K., Tulegenova, A., & Turumbetova, A. (2023). The impact of financial literacy and income on investment behavior: Evidence from Kazakhstan. *Journal of Financial Services Marketing, 28*, 83–97.

Clark, R. L., Lusardi, A., & Mitchell, O. S. (2015). Financial knowledge and 401(k) investment performance: A case study. *Journal of Pension Economics & Finance, 14*(4), 1–27. https://doi.org/10.1017/S1474747215000030

Demetriades, P. O., & Luintel, K. B. (1996). Banking sector policies and financial development in Nepal. *Oxford Bulletin of Economics and Statistics, 58*(2), 355–372.

Diacon, S., & Ennew, C. (2001). Perceptions of financial risk: The impact of advice on savings and investment decisions. *The Journal of Risk and Insurance, 68*(3), 489–509.

Feyen, E., Lester, R., & Rocha, R. (2011). What drives the development of the insurance sector? An empirical analysis based on a panel of developed and developing countries. *World Bank Policy*

*Research Working Paper No. 5572*.

Glossner, S., Matos, P., & Ramelli, S. (2025). Do institutional investors destabilize stock prices during crises? Evidence from the COVID-19 crash. *Review of Financial Studies, 38*(1), 45–83.

Gurung, B., Sharma, D., & Thapa, R. (2024). Behavioral biases and investment decision-making: Evidence from the Nepalese stock market. *Nepalese Journal of Management Science and Research, 4*(2), 110–125.

Huston, S. J. (2010). Measuring financial literacy. *The Journal of Consumer Affairs*, *44*(2), 296–316.
Jonsson, D., Lindholm, C., & Ullen, J. (2017). Effects of financial literacy on the disposition effect: Evidence from Swedish investors. *International Review of Economics & Finance, 51*, 154–164.

Kahneman, D., & Tversky, A. (1979). Prospect theory: An analysis of decision under risk. *Econometrica, 47*(2), 263–291.

Khan, A., Shahzad, F., & Qureshi, J. (2020). Financial literacy and investment decision-making: The mediating role of financial attitude and financial behavior. *Journal of Accounting and Finance in Emerging Economies, 6*(1), 173–186.

Khan, M. Z., Rehman, A., & Ali, K. (2023). Financial literacy, behavioral biases and investment decisions: Moderating role of financial self-efficacy. *Journal of Economic and Administrative Sciences, ahead-of-print*. https://doi.org/10.1108/JEAS-02-2023-0045.

MacCrimmon, K. R., & Wehrung, D. A. (1986). *Taking risks: The management of uncertainty*. Free Press.

MacCrimmon, K. R., & Wehrung, D. A. (1990). Characteristics of risk-taking executives. *Management Science, 36*(4), 422–435.

Maheshwari, S., Tripathi, A., & Tiwari, S. (2024). Does financial literacy moderate the impact of behavioral biases on investment decisions? Evidence from Indian millennials. *Journal of Behavioral Finance, 25*(1), 47–63.

Makdissi, P., Zaiem, M. B., & Jellal, M. (2024). Personality traits, behavioral biases, and risk perception in investment decision-making. *Journal of Economic Psychology, 94*, 102631.

Miko, D., Hassan, M. K., & Waisman, M. (2023). Financial literacy, risk perception and crypto investment: New insights from an emerging market. *Finance Research Letters, 51*, 103467.

Mohta, A., & Shunmugasundaram, S. (2023). The dark side of financial literacy: Its negative impact on risky investment intentions among millennials. *International Journal of Consumer Studies, 47*(2), 451–463.

Naiwen, L., Zhang, Y., & Zhao, Y. (2021). Financial literacy and investment decisions: Evidence from China. *Journal of Economic Behavior & Organization, 185*, 547–566.

Oehler, A., & Wedlich, F. (2018). Gender differences in risk-taking: A review and research agenda. *Journal of Economic Psychology, 68*, 1–28.

Oehler, A., Wendt, S., & Wedlich, F. (2023). Risk perception, financial literacy, and market participation: Evidence from Germany. *Review of Behavioral Finance, 15*(3), 390–412.

Olsen, R. A., & Cox, C. M. (2001). The influence of gender on the perception and response to investment risk: The case of professional investors. *Journal of Psychology and Financial Markets, 2*(1), 29–36.

Parker, D. F., & DeCotiis, T. A. (1983). Organizational determinants of job stress. *Organizational Behavior and Human Performance, 32*(2), 160–177.

Pathak, R., & Thapa, D. (2024). Risk perception and investment behavior: A behavioral finance perspective. *South Asian Journal of Management, 31*(1), 23–38.

Prasad, R. K., Tripathi, V., & Yadav, R. K. (2020). Enhancing financial literacy to promote capital formation: Evidence from India. *Indian Journal of Finance, 14*(3), 15–30.

Rettinger, D. A., & Hastie, R. (2001). Content effects on decision making. *Organizational Behavior and Human Decision Processes, 85*(2), 336–359.

Sahi, S. K., Arora, A. P., & Dhameja, N. (2013). Role of financial knowledge, financial socialization and financial risk attitude in financial satisfaction of college students. *International Journal of Social Economics, 40*(6), 548–560.

Sathya, M., & Gayathri, M. (2024). Behavioral finance and investor decision-making: Evidence from Indian capital markets. *Asian Journal of Research in Banking and Finance, 14*(1), 61–78.

Seraj, M., Khan, R. A., & Alqahtani, A. (2022). Financial literacy and investment decision-making: Evidence from Saudi Arabia. *International Journal of Economics and Financial Issues, 12*(1), 152–160.

Shadnan, M. H. (2023). Behavioral biases and financial decisions: Evidence from Indian retail investors. *Finance India, 37*(3), 123–145.

Simon, H. A. (1982). *Models of bounded rationality: Behavioral economics and business organization* (Vol. 2). MIT Press.

Singh, D., Kaur, R., & Arora, P. (2022). Personality traits, behavioral biases and risk tolerance: An empirical study of Indian investors. *International Journal of Emerging Markets, 17*(3), 715–738.

Sivaramakrishnan, S., Srivastava, M., & Rastogi, A. (2017). Attitudinal factors, financial literacy, and stock market participation. *International Journal of Bank Marketing, 35*(5), 818–841.

Vadlamannati, K. C. (2008). Do insurance sector growth and reforms affect economic development? Empirical evidence from India. *The Journal of Applied Economic Research, 2*(1), 43–86.

Van Rooij, M. C. J., Lusardi, A., & Alessie, R. J. M. (2007). Financial literacy and stock market participation. *NBER Working Paper No. 13565*.

Weber, E. U., Blais, A.-R., & Betz, N. E. (2004). A domain-specific risk-attitude scale: Measuring risk perceptions and risk behaviors. *Journal of Behavioral Decision Making, 17*(4), 263–290.