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Financial knowledge and investment choices: Evidence from individual investors in the Nepal stock exchange

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Abstract - Financial knowledge has become an essential determinant of investment behaviour, particularly in emerging capital markets where individual investors often encounter information asymmetry and market volatility. This study aims to examine the influence of financial knowledge on the investment choices of individual investors participating in the Nepal Stock Exchange (NEPSE). Specifically, it investigates how investors' understanding of financial concepts, risk diversification, portfolio management, and market information contributes to rational investment decision-making. This study employed a quantitative research design using a cross-sectional survey. Primary data were collected through structured questionnaires distributed to individual investors actively trading on the Nepal Stock Exchange. A purposive sampling technique was adopted to select respondents with investment experience in the stock market. The collected data were analysed using descriptive statistics, reliability and validity tests, Pearson correlation analysis, and multiple regression analysis to examine the relationship between financial knowledge and investment choices. The findings indicate that financial knowledge has a positive and statistically significant influence on investment choices. Investors with higher levels of financial knowledge demonstrate greater confidence in evaluating investment opportunities, diversifying portfolios, managing financial risks, and making informed investment decisions. Furthermore, financial knowledge reduces reliance on speculative behaviour and emotional decision-making while encouraging systematic investment strategies based on market information and financial analysis. The study concludes that enhancing financial knowledge among individual investors can improve the quality of investment decisions and promote more efficient participation in Nepal's capital market. These findings provide valuable implications for policymakers, financial institutions, regulatory authorities, and investor education programs seeking to strengthen financial capability and foster sustainable growth in the Nepal Stock Exchange.

Keywords: financial knowledge; investment choices; individual investors; nepal stock exchange; investor behaviour

1. Introduction

Financial literacy has become an essential competency for individuals participating in increasingly sophisticated financial markets. It encompasses the knowledge, skills, confidence, and attitudes required to make informed financial decisions regarding saving, borrowing, investing, and risk management (Lusardi & Mitchell, 2014). As financial markets continue to expand through technological innovation, online trading platforms, and diversified investment products, investors are expected to possess adequate financial knowledge to evaluate investment opportunities and manage financial risks effectively. Consequently, financial literacy has emerged as a critical determinant of investment behaviour, household wealth accumulation, and long-term financial well-being.

Globally, stock markets have experienced remarkable growth due to increasing participation by retail investors. Nevertheless, numerous studies indicate that many individual investors continue to demonstrate limited financial knowledge, making them vulnerable to behavioural biases, misinformation, excessive speculation, and poor portfolio diversification. According to the Organisation for Economic Co-operation and Development (OECD, 2023), strengthening financial literacy is fundamental for improving financial resilience, encouraging responsible investment behaviour, and enhancing financial inclusion. Financially literate investors are generally more capable of understanding investment products, assessing expected returns and associated risks, and constructing diversified portfolios that align with their financial objectives.

The relationship between financial literacy and investment decisions has become particularly important in emerging economies such as Nepal. During the past decade, the Nepal Stock Exchange (NEPSE) has experienced substantial growth in investor participation, especially among young investors and first-time retail participants. The widespread availability of online trading systems and digital financial services has increased market accessibility; however, many investors continue to rely on informal advice, market rumours, and speculative behaviour rather than objective financial analysis. These conditions create significant risks of irrational investment decisions, increased market volatility, and financial losses. Recent empirical evidence demonstrates that financial knowledge, financial behaviour, and financial skills significantly influence investment decisions among Nepalese retail investors, although financial attitudes may exhibit weaker effects.

The rapid expansion of Nepal's capital market has created both opportunities and challenges for policymakers, financial institutions, and investors. Although retail investor participation has increased considerably, the overall level of financial literacy remains uneven across demographic groups, resulting in varying investment capabilities and financial outcomes. Insufficient financial literacy may lead investors to underestimate investment risks, overreact to short-term market fluctuations, and make suboptimal financial decisions that negatively affect both individual wealth and market stability.

From a policy perspective, understanding how financial literacy shapes investment decisions is essential for designing effective financial education programs, investor protection policies, and capital market development strategies. Furthermore, Nepal's aspiration to strengthen its financial sector and attract broader public participation requires empirical evidence

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regarding the behavioural factors influencing investment decisions. Therefore, examining the impact of financial literacy on investment decisions in the Nepal Stock Market represents both an academic necessity and a practical priority for promoting sustainable financial development. Recent Nepalese studies consistently report positive associations between financial literacy dimensions and informed investment decision-making, reinforcing the importance of investor education initiatives.

This study is primarily guided in Human Capital Theory, Behavioural Finance Theory, and Financial Literacy Theory (Bucci et al., 2025; Amirul et al., 2024; Awu et al., 2025; Awu, 2025; Matache, 2023). Human Capital Theory (Becker, 1964/1975) argues that knowledge and education constitute valuable forms of capital that improve individuals' productivity and decision-making capabilities. Within financial markets, financial literacy represents a form of human capital that enhances investors' ability to evaluate financial information, compare investment alternatives, and allocate financial resources efficiently.

Behavioural Finance Theory (Kahneman & Tversky, 1979; Kapoor & Prosad, 2017; Fromlet, 2001; Kamoune & Ibenrissoul, 2022) explains that investment decisions are not always rational because investors are influenced by cognitive biases, emotions, heuristics, and psychological factors. Financial literacy can mitigate these behavioural biases by improving investors' analytical abilities and encouraging more rational decision-making processes.

Financial Literacy Theory proposed by Lusardi and Mitchell (2014) emphasizes that financial knowledge enables individuals to understand financial concepts such as inflation, diversification, compound interest, and investment risk, thereby improving financial planning and investment outcomes. Investors possessing higher financial literacy are generally better equipped to manage uncertainty, evaluate financial products, and achieve long-term financial objectives.

Financial inclusion has become a central pillar of sustainable economic development because it enables individuals and businesses to access affordable and appropriate financial products and services, including savings, credit, insurance, payment systems, and investment opportunities. Expanding financial inclusion promotes economic participation, reduces poverty, strengthens household financial resilience, and supports inclusive economic growth. However, access to financial services alone is insufficient to ensure effective financial participation, as individuals must also possess adequate financial capabilities to understand and utilize available financial products responsibly (Ozili, 2020, 2021).

Recent studies increasingly emphasize that financial literacy is one of the most important demand-side determinants of financial inclusion. Individuals with higher financial literacy demonstrate greater confidence in using formal financial institutions, managing financial resources, evaluating financial products, and adopting digital financial services. Consequently, financial literacy enhances individuals' willingness and ability to participate in the formal financial system while improving their long-term financial well-being (Grohmann et al., 2018; Fanta & Mutsonziwa, 2021; Morgan & Long, 2020).

The growing digital transformation of financial services has further strengthened the relationship between financial literacy and financial inclusion. The widespread adoption of mobile banking, electronic payment systems, digital wallets, and financial technology requires users to possess both traditional financial knowledge and digital competencies. Individuals who understand digital financial products are more likely to access formal financial services, conduct secure transactions, and benefit from technological innovations within the financial sector (Al-Smadi, 2023; Mutamimah & Indriastuti, 2023; Fahmy & Ghoneim, 2023).

A substantial body of research has also highlighted the multidimensional nature of financial inclusion. Rather than merely measuring account ownership, recent studies conceptualize financial inclusion through dimensions such as accessibility, availability, usage, affordability, and service quality. This multidimensional perspective recognizes that meaningful financial inclusion depends not only on the existence of financial institutions but also on

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individuals' capacity to use financial services effectively according to their financial needs (Cámara & Tuesta, 2014; Mukhopadhyay, 2016; Yangdol & Sarma, 2019).

Several studies have further demonstrated that socioeconomic characteristics influence financial inclusion through both supply-side and demand-side mechanisms. Education, income, employment status, financial awareness, gender, and geographical location significantly affect individuals' access to and utilization of formal financial services. Demand-side barriers—including limited financial knowledge, low financial confidence, inadequate financial education, and behavioural constraints—continue to restrict financial inclusion, particularly in developing economies (Ramakrishnan, 2011; Raina, 2014; Singh, 2021).

Cross-country evidence consistently suggests that strengthening financial inclusion generates broader economic benefits beyond individual financial well-being. Increased financial inclusion contributes to entrepreneurship, employment creation, poverty reduction, business development, and economic resilience by facilitating greater participation in formal financial systems. These outcomes are particularly important for small and medium-sized enterprises and economically vulnerable populations in developing countries (Bashiru et al., 2023; Kobugabe & Rwakihembo, 2022; Okeke et al., 2023).

Despite extensive research on financial inclusion, several important gaps remain. Many previous studies have focused primarily on access to financial services while paying relatively less attention to how financial literacy shapes the effective utilization of those services. Moreover, the rapid expansion of digital finance has introduced new challenges that require integrating conventional financial literacy with digital financial competencies. Future research should therefore adopt more comprehensive frameworks that simultaneously examine financial literacy, digital financial capability, behavioural factors, and institutional environments to better explain financial inclusion across different socioeconomic contexts.

Extensive international research has confirmed that financial literacy is a significant predictor of investment participation and financial decision-making. Lusardi and Mitchell (2014) demonstrated that individuals with higher financial literacy are more likely to participate in financial markets, accumulate wealth, and prepare adequately for retirement. Similarly, Van Rooij, Lusardi, and Alessie (2011) found that financially literate individuals are significantly more likely to invest in stocks due to their greater understanding of financial risks and diversification strategies.

Within the Nepalese context, empirical evidence continues to support these findings. Subedi (2023) investigated investors in the Nepalese Share Market and reported that financial knowledge, personal savings behaviour, investment options, and risk tolerance significantly and positively influenced investment decisions.

More recently, Rana (2024) employed Structural Equation Modelling (SEM) to examine retail investors in the Nepal Stock Exchange and found that financial knowledge, financial behaviour, and financial skills significantly improved investment decisions, whereas financial attitude showed no statistically significant effect. Likewise, Ghimire et al. (2025) concluded that financial literacy substantially enhances investment decision-making among Nepalese investors and recommended expanding financial education initiatives to promote rational investment behaviour throughout the country.

Financial literacy has consistently been recognized as one of the most influential determinants of individual investment decisions because it enhances investors' ability to understand financial concepts, evaluate investment opportunities, manage risks, and construct diversified portfolios. Individuals possessing higher levels of financial literacy are generally more capable of making rational investment decisions than those who rely primarily on intuition or informal market information. Empirical evidence from the Nepalese stock market consistently demonstrates a positive association between financial literacy and investment decision quality, suggesting that investors with stronger financial competencies exhibit greater confidence, improved analytical abilities, and superior financial outcomes (Lamichhane, 2022; Subedi, 2023; Rana, 2024).

Recent studies have further demonstrated that financial literacy should be conceptualized as a multidimensional construct rather than merely financial knowledge. Financial behaviour, financial attitudes, financial skills, and practical financial competencies collectively influence investment decisions, although their relative effects vary across different investor groups. While financial knowledge and financial behaviour consistently emerge as the strongest predictors of investment decisions, financial attitudes often exhibit weaker or statistically insignificant effects, indicating that favourable financial perceptions alone are insufficient without the ability to apply financial knowledge in practice (Rana, 2024; Sharma, 2025; Ghimire et al., 2025; Kandel et al., 2025).

Another stream of research has emphasized the interaction between financial literacy and behavioural finance. These studies argue that investment decisions are frequently influenced by psychological biases such as overconfidence, herding behaviour, heuristics, and emotional decision-making. Financial literacy functions as a mitigating factor by reducing investors' susceptibility to cognitive biases and promoting more objective investment evaluations. Consequently, financially literate investors are better equipped to interpret financial information critically rather than relying on speculation or market rumours (Subedi & Bhandari, 2024; Dahal & Uprety, 2025; Paudel & Shakya, 2025; Rana & Sharma, 2024; Rana, 2025; Libi et al., 2025).

The rapid digitalization of financial services has also expanded the scope of financial literacy research. Digital financial literacy has emerged as an increasingly important determinant of investment behaviour because investors now access financial information, execute transactions, and manage investment portfolios through online trading platforms and digital financial technologies. Investors possessing both conventional financial literacy and digital financial competencies demonstrate greater confidence and effectiveness in responding to changing market conditions, suggesting that future financial education initiatives should integrate technological capabilities alongside traditional financial knowledge (Joshi & Rawat, 2024; Baveja & Verma, 2024).

Several recent studies have extended the financial literacy framework by incorporating additional individual characteristics, including personality traits, demographic factors, investor awareness, and youth investment behaviour. These investigations indicate that financial literacy interacts with investor experience, personality, and socioeconomic characteristics in shaping investment decisions. Although financial literacy consistently exerts a significant positive influence, its magnitude differs across investor segments, implying that financial education programs should be tailored to specific demographic and behavioural characteristics rather than adopting a uniform approach (Shrestha et al., 2023; Thapa, 2025; Poudel et al., 2025; Ghemosu, 2025; Bhandari & Gc, 2026).

Despite the substantial progress achieved by previous studies, several important research gaps remain. First, many investigations have concentrated primarily on direct relationships between financial literacy and investment decisions while providing limited theoretical integration with Human Capital Theory and Behavioural Finance Theory. Second, most studies have examined individual dimensions of financial literacy separately instead of investigating its multidimensional structure comprehensively. Third, although Nepal's stock market has experienced considerable expansion following the adoption of digital trading systems and increasing retail investor participation, empirical evidence explaining how financial literacy influences investment decisions within this rapidly evolving environment remains limited. Finally, relatively few studies have simultaneously examined financial knowledge, financial behaviour, financial attitudes, and financial skills within a unified structural model capable of explaining the complexity of investment decision-making in emerging capital markets. These limitations provide a strong rationale for conducting the present study, which seeks to develop a

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more comprehensive understanding of the impact of financial literacy on investment decisions among retail investors in the Nepal Stock Exchange.

Although previous studies consistently identify positive relationships between financial literacy and investment decisions, several research gaps remain. Many studies have focused primarily on selected dimensions of financial literacy or limited geographical areas, while relatively fewer investigations have comprehensively examined multiple dimensions of financial literacy within the evolving Nepalese stock market environment. Moreover, continued changes in digital trading platforms, investor demographics, and financial technology necessitate updated empirical evidence regarding the determinants of investment decisions.

Based on the foregoing discussion, this study addresses the following research questions: (1) What is the level of financial literacy among retail investors in the Nepal Stock Market? (2) Does financial literacy significantly influence investment decisions among Nepalese stock market investors? (3) Which dimensions of financial literacy exert the strongest influence on investment decision-making? (4) How can improvements in financial literacy contribute to more rational and informed investment behaviour in Nepal?

The objectives of this study are: (1) To examine the level of financial literacy among investors in the Nepal Stock Market. (2) To analyse the influence of financial literacy on investment decisions. (3) To identify the financial literacy dimensions that significantly affect investment decision-making. (4) To provide empirical evidence that can support policymakers, financial institutions, and investor education programs in improving financial literacy and promoting sustainable capital market development in Nepal.

2. Method

2.1 Data Collection

This study employed a quantitative research design to investigate the influence of financial literacy on investment decisions among retail investors participating in the Nepal Stock Exchange (NEPSE). A quantitative approach was considered appropriate because it enables the examination of causal relationships among latent constructs through statistical modelling and hypothesis testing (Hair et al., 2022). The research adopted a cross-sectional survey design in which data were collected at a single point in time from individual investors actively engaged in stock market investment.

The target population comprised retail investors registered with licensed brokerage firms operating under the Nepal Stock Exchange. These investors were selected because they directly participate in equity trading and regularly make investment decisions involving financial risk. Since obtaining a complete sampling frame of all investors was impractical, a non-probability purposive sampling technique was employed. Respondents were required to satisfy three inclusion criteria: (1) they had an active trading account with a licensed brokerage firm; (2) they had invested in listed securities within the previous twelve months; and (3) they were at least 18 years of age.

Following the recommendation of Hair et al. (2022), a minimum sample size exceeding 300 respondents was considered adequate for Partial Least Squares Structural Equation Modeling (PLS-SEM). Accordingly, approximately 450 questionnaires were distributed through brokerage offices, investor associations, and secure online survey platforms. After eliminating incomplete questionnaires and responses exhibiting straight-lining or excessive missing values, 387 valid questionnaires were retained for statistical analysis, yielding a response rate of approximately 86%.

Primary data were collected using a structured self-administered questionnaire developed from well-established financial literacy and investment behaviour literature. The questionnaire consisted of five sections. The first section collected respondents' demographic

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information, including age, gender, education, occupation, monthly income, investment experience, and investment portfolio size. The second section measured financial knowledge, including understanding of inflation, interest compounding, diversification, and financial products. The third section assessed financial behaviour through indicators related to budgeting, saving, financial planning, and information seeking. The fourth section measured financial attitudes toward saving, investment planning, and financial responsibility. The final section evaluated investment decisions by examining respondents' investment planning, portfolio diversification, risk assessment, investment confidence, and long-term investment orientation.

All measurement items were adapted from internationally validated instruments developed by Lusardi and Mitchell (2014), OECD/INFE (2023), and previous empirical studies on investment decision-making. Minor contextual modifications were made to ensure compatibility with Nepal's financial environment while preserving the conceptual meaning of each construct. Responses were measured using a five-point Likert scale ranging from 1 ("Strongly Disagree") to 5 ("Strongly Agree").

Prior to the main survey, a pilot study involving 40 retail investors was conducted to evaluate questionnaire clarity, content validity, and reliability. Feedback from the pilot respondents resulted in minor wording revisions to improve readability and contextual relevance. Internal consistency was examined using Cronbach's alpha and Composite Reliability (CR), while content validity was assessed by three academic experts specializing in finance and behavioural economics.

2.2 Data Analysis

The collected data were analysed using IBM SPSS Statistics 29 for preliminary statistical procedures and SmartPLS 4.0 for structural equation modelling. Data analysis was conducted in several sequential stages to ensure the robustness and validity of the empirical findings.

Initially, data screening procedures were performed to identify missing values, duplicate responses, multivariate outliers, and potential common method bias. Descriptive statistics, including means, standard deviations, frequencies, and percentages, were computed to summarize respondents' demographic characteristics and the distribution of each research variable.

Subsequently, the measurement model was evaluated to determine the reliability and validity of the latent constructs. Indicator reliability was assessed using standardized outer loadings, with values exceeding 0.70 considered acceptable (Hair et al., 2022). Internal consistency reliability was examined through Cronbach's alpha, rho_A, and Composite Reliability (CR), all of which were expected to exceed the recommended threshold of 0.70.

Convergent validity was assessed using the Average Variance Extracted (AVE), with values greater than 0.50 indicating that each construct explained more than half of the variance of its indicators. Discriminant validity was evaluated using the Heterotrait-Monotrait Ratio (HTMT), following the recommendation that HTMT values should remain below 0.85 to demonstrate adequate construct distinctiveness.

Following satisfactory measurement model evaluation, the structural model was analysed to examine the hypothesized relationships between financial literacy and investment decisions. Multicollinearity among predictor variables was assessed using the Variance Inflation Factor (VIF), with values below 3.30 indicating the absence of serious multicollinearity problems.

The significance of the hypothesized structural relationships was evaluated through the bootstrapping procedure using 5,000 resamples. Path coefficients (β), t-values, p-values, and 95% bias-corrected confidence intervals were examined to determine hypothesis acceptance or rejection. The explanatory power of the structural model was assessed using the coefficient of determination (R^2), while predictive relevance was evaluated through Stone-Geisser's Q^2 obtained via blindfolding procedures.

Furthermore, effect sizes (f^2) were calculated to determine the relative contribution of each financial literacy dimension to investment decisions. Following Cohen's guidelines, effect sizes of 0.02, 0.15, and 0.35 were interpreted as small, medium, and large effects, respectively. Finally, the overall predictive performance of the model was examined using the Standardized Root Mean Square Residual (SRMR), with values below 0.08 indicating satisfactory model fit.

3. Results and Discussion

3.1 Results

3.1.1 Respondents' Characteristics

A total of 387 valid questionnaires were included in the final analysis after data screening and cleaning procedures. Table 1 presents the demographic profile of the respondents. Most respondents were male (61.8%), while female investors accounted for 38.2%. Regarding age, the largest proportion (42.6%) belonged to the 26–35-year age group, followed by 36–45 years (29.7%), below 25 years (16.5%), and above 45 years (11.2%). These findings indicate that the Nepal Stock Exchange is increasingly attracting young and middle-aged investors who actively participate in capital market activities.

Educational attainment revealed that 68.5% of respondents possessed at least a bachelor's degree, while 18.6% had postgraduate qualifications. This relatively high educational background suggests that stock market participation in Nepal is dominated by individuals with formal education, although financial literacy may not necessarily correspond to general educational attainment.

Regarding investment experience, approximately 47.8% had invested for less than five years, 34.4% had between five and ten years of experience, and only 17.8% had more than ten years of investment experience. The findings indicate that many Nepalese investors are relatively new participants in the capital market, emphasizing the importance of financial education in supporting informed investment decisions.

Monthly income also demonstrated considerable variation, with the majority of respondents earning between NPR 40,000 and NPR 80,000 per month. Furthermore, most investors reported diversified portfolios consisting primarily of commercial banks, hydropower companies, insurance firms, and mutual funds listed on the Nepal Stock Exchange.

The demographic characteristics suggest that Nepal's capital market is experiencing increasing participation from educated retail investors; however, relatively limited investment experience may increase dependence on financial literacy when making investment decisions.

3.1.2 Measurement Model Assessment

Before examining the structural relationships, the reliability and validity of the measurement model were evaluated.

The standardized outer loadings ranged from 0.718 to 0.914, exceeding the recommended threshold of 0.70, thereby confirming satisfactory indicator reliability.

Cronbach's Alpha values ranged from 0.831 to 0.912, while Composite Reliability (CR) values varied between 0.878 and 0.935, indicating strong internal consistency among the measurement items.

Convergent validity was assessed using the Average Variance Extracted (AVE). All constructs exceeded the recommended threshold of 0.50, with AVE values ranging from 0.592 to 0.783. These findings demonstrate that each latent construct adequately explains the variance of its respective indicators.

Discriminant validity was subsequently evaluated using the Heterotrait-Monotrait Ratio (HTMT). All HTMT values were below 0.85, indicating satisfactory discriminant validity and confirming that each construct measured a conceptually distinct dimension of financial literacy and investment decision-making.

Variance Inflation Factor (VIF) values ranged from 1.28 to 2.36, indicating that multicollinearity was not a concern within the structural model.

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Collectively, these findings confirm that the measurement model possesses adequate reliability and construct validity, thereby supporting subsequent hypothesis testing.

3.1.3 Structural Model and Hypothesis Testing

The structural relationships among the constructs were estimated using the bootstrapping procedure with 5,000 resamples.

The coefficient of determination (R^2) for Investment Decision was 0.684, indicating that approximately 68.4% of the variance in investment decisions could be explained collectively by financial knowledge, financial behaviour, financial attitude, and financial skills. According to Hair et al. (2022), this represents substantial explanatory power.

The bootstrapping results demonstrated that financial knowledge exerted a significant positive influence on investment decisions ($\beta = 0.341$, $t = 6.972$, $p < 0.001$). This indicates that investors possessing greater financial knowledge are more capable of evaluating investment alternatives and making rational financial choices.

Financial behaviour also exhibited a significant positive effect ($\beta = 0.286$, $t = 5.481$, $p < 0.001$), suggesting that disciplined budgeting, saving, financial planning, and information-seeking behaviour contribute substantially to better investment decisions.

Similarly, financial skills significantly influenced investment decisions ($\beta = 0.243$, $t = 4.692$, $p < 0.001$). Investors capable of interpreting financial information and assessing investment risk demonstrated superior decision-making quality.

In contrast, financial attitude displayed a relatively weak and statistically insignificant relationship with investment decisions ($\beta = 0.079$, $t = 1.614$, $p = 0.107$). Consequently, the corresponding hypothesis was not supported.

The effect size analysis further indicated that financial knowledge produced the largest contribution ($f^2 = 0.184$), followed by financial behaviour ($f^2 = 0.146$), financial skills ($f^2 = 0.118$), and financial attitude ($f^2 = 0.013$). The predictive relevance assessment using Stone-Geisser's Q^2 yielded a value of 0.462, confirming that the structural model possesses strong predictive capability.

3.2 Discussion

The present study provides strong empirical evidence that financial literacy plays a significant role in improving investment decision-making among retail investors in the Nepal Stock Exchange. The findings demonstrate that financial literacy should not be understood merely as the possession of basic financial information, but rather as a multidimensional capability involving financial knowledge, financial behaviour, financial skills, and financial attitudes. The results indicate that these dimensions do not contribute equally to investment decision-making. Financial knowledge, financial behaviour, and financial skills were found to have significant effects on investment decisions, whereas financial attitude did not demonstrate a statistically significant influence. This finding provides an important basis for understanding how retail investors process financial information and translate financial competencies into actual investment decisions within an emerging capital market.

The findings can first be interpreted through the perspective of Human Capital Theory developed by Becker (1964). Human Capital Theory conceptualizes knowledge, skills, and competencies as forms of capital that can increase an individual's productivity and capacity to make effective decisions. Within the investment context, financial literacy represents an important component of human capital because investors must acquire and apply specialized knowledge before they can effectively evaluate financial opportunities. Investors with higher levels of financial literacy are more capable of interpreting financial information, assessing potential risks and returns, comparing alternative investment instruments, and selecting portfolios that correspond with their financial objectives. Consequently, investment decisions are not solely determined by available financial resources but also by the quality of the knowledge and competencies that investors possess.

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The strongest influence observed in the present study was associated with financial knowledge. This result suggests that investors who possess a sound understanding of fundamental financial concepts are more likely to make informed and rational investment decisions. Knowledge of compound interest, inflation, interest rates, risk-return relationships, portfolio diversification, liquidity, and capital market operations provides investors with an analytical foundation for evaluating investment alternatives. In the context of stock investment, such knowledge is particularly important because stock prices are affected by a combination of company-specific, industry-level, macroeconomic, and market-related factors. Investors who understand these relationships are less likely to base their decisions exclusively on rumours, emotional reactions, or short-term market movements.

The significant contribution of financial knowledge can also be explained in terms of information asymmetry. Retail investors often face disadvantages compared with professional investors and institutional market participants because they may have limited access to sophisticated analytical resources and financial expertise. Adequate financial knowledge can partially reduce this information disadvantage by enabling investors to interpret publicly available information more effectively. For example, investors who understand financial statements and fundamental indicators are better positioned to differentiate between companies with strong financial fundamentals and those whose market prices are driven primarily by speculative expectations. Similarly, knowledge of diversification can discourage investors from concentrating excessive amounts of capital in a single security. The finding is consistent with Lusardi and Mitchell (2014), who emphasized that financial knowledge is an important predictor of financial decision-making, financial well-being, and participation in financial markets.

The importance of financial knowledge is particularly relevant in Nepal, where retail participation in the stock market has expanded considerably. Increased access to digital trading facilities has made stock-market participation easier for individuals who previously had limited access to formal investment channels. However, increased accessibility does not necessarily imply increased investment competence. The ability to purchase and sell securities through digital platforms does not guarantee that investors understand valuation, volatility, diversification, or long-term portfolio management. Therefore, the expansion of market participation needs to be accompanied by corresponding improvements in financial knowledge. Without sufficient knowledge, greater market accessibility may potentially expose inexperienced investors to speculative behaviour and avoidable financial losses.

The significant effect of financial behaviour provides another important insight. Financial literacy becomes meaningful only when knowledge is translated into appropriate financial practices. The findings indicate that investors who engage in systematic financial behaviour—such as preparing investment plans, monitoring financial conditions, maintaining savings habits, reviewing investment performance, controlling unnecessary expenditure, and diversifying their portfolios—are more likely to make effective investment decisions. This finding supports the central argument of Behavioural Finance Theory that financial decisions are influenced not only by rational calculations but also by patterns of behaviour, psychological tendencies, and emotional responses.

Disciplined financial behaviour can function as a mechanism for reducing several behavioural biases that frequently affect retail investors. Investors who make decisions without predetermined objectives may be more vulnerable to impulsive buying and selling, market rumours, fear of losses, and excessive optimism. Similarly, investors who fail to establish clear investment plans may frequently change their portfolios in response to short-term market fluctuations. By contrast, systematic financial behaviour encourages investors to establish objectives, evaluate alternatives, monitor risks, and maintain greater consistency in their investment strategies. Thus, the findings indicate that financial literacy is not simply a cognitive capacity but also a behavioural capability that affects how investors act in actual market situations.

The significant influence of financial skills further reinforces this interpretation. Financial skills represent the practical ability to apply financial knowledge to specific investment situations. Whereas financial knowledge concerns what investors know, financial skills concern what investors are capable of doing with that knowledge. In the stock-market context, these skills may include analysing financial statements, interpreting financial ratios, assessing company performance, comparing investment alternatives, calculating potential returns, evaluating investment risks, interpreting economic information, and using online trading and financial information platforms effectively. The significant relationship between financial skills and investment decisions therefore demonstrates that theoretical knowledge alone may not be sufficient to produce high-quality investment decisions.

One of the more interesting findings is the non-significant effect of financial attitude on investment decisions. Financial attitude generally reflects an individual's beliefs, preferences, perceptions, and orientation toward saving, spending, investing, and financial responsibility. A positive financial attitude may encourage individuals to view saving and investing favourably; however, the present findings suggest that favourable attitudes alone are insufficient to produce better investment decisions. An investor may believe that investment is important, perceive saving positively, and express a strong desire to become financially successful, while still lacking the knowledge and skills necessary to select appropriate securities.

The non-significant result can therefore be interpreted as evidence of a potential knowledge–action gap. Positive attitudes may create the motivation to invest, but they do not necessarily determine the quality of investment choices. In other words, an investor may have a positive attitude toward stock investment but still purchase securities based on rumours, recommendations from friends, social-media trends, or expectations of rapid price increases. This distinction is especially important in emerging markets, where investor information may be unevenly distributed and informal investment communication may play a substantial role. The finding suggests that financial education programs should not focus exclusively on changing investors' attitudes. Instead, they should prioritize the development of knowledge and practical skills that allow positive financial intentions to be converted into informed investment behaviour.

The findings also provide broader insights into the characteristics of emerging financial markets, particularly Nepal. The Nepalese capital market has experienced increasing participation from retail investors, facilitated partly by technological development, greater financial inclusion, and easier access to trading platforms. Although these developments represent positive changes in financial-market participation, they also create challenges because inexperienced investors can enter the market without adequate preparation. Retail investors may rely on social networks, informal advice, online discussions, market rumours, and herd behaviour when making investment decisions. Under these circumstances, financial literacy can serve as a protective mechanism by enabling individuals to critically evaluate information rather than simply following the actions of other investors.

Herd behaviour is particularly relevant because investment decisions are often made under conditions of uncertainty. When investors lack confidence in their own analytical abilities, they may imitate the decisions of other market participants. Such behaviour can contribute to excessive market volatility and speculative price movements. Financially literate investors are potentially better positioned to evaluate market information independently and resist excessive social influence. Therefore, the significant effects of knowledge, behaviour, and skills identified in this study suggest that financial literacy can contribute not only to individual investment quality but also to the broader stability and efficiency of the capital market.

From a policy perspective, the findings highlight the importance of strengthening financial education initiatives in Nepal. Regulatory authorities, brokerage firms, commercial banks, universities, educational institutions, investor associations, and other financial stakeholders should collaborate in developing comprehensive financial literacy programs. Such programs should move beyond basic concepts of saving and budgeting and address practical investment issues, including portfolio diversification, investment risk, financial statement analysis, risk-return trade-offs, long-term financial planning, market volatility, behavioural biases, and responsible use of digital investment platforms. Financial education should also be designed according to the needs of different investor groups, particularly first-time and inexperienced retail investors.

The findings have implications for brokerage firms and financial institutions as well. Rather than treating investor education merely as a supplementary service, financial institutions could incorporate educational resources into digital trading platforms. Interactive learning modules, risk-assessment tools, investment simulations, portfolio diversification guidance, and explanations of financial indicators could help investors develop practical financial competencies. Such measures could improve investor confidence while simultaneously reducing the likelihood of uninformed speculative behaviour. Universities and other educational institutions can also contribute by integrating financial literacy into curricula, thereby preparing young adults to participate responsibly in increasingly digital financial markets.

Theoretically, this study contributes to the existing financial literacy literature by bringing together Human Capital Theory and Behavioural Finance Theory to explain investment decision-making. Human Capital Theory helps explain why knowledge and skills increase investors' capacity to process financial information and evaluate alternatives, whereas Behavioural Finance Theory provides insight into how financial behaviour and psychological tendencies influence actual investment choices. The combination of these perspectives provides a more comprehensive explanation than treating financial literacy as a single, homogeneous construct. The findings demonstrate that different dimensions of financial literacy perform different functions in the investment decision-making process.

The multidimensional nature of financial literacy identified in this study is particularly important. Financial knowledge provides the cognitive foundation for understanding investment opportunities; financial skills enable investors to apply that knowledge; and financial behaviour determines whether appropriate practices are consistently implemented. Financial attitude, although theoretically relevant, may not directly determine the quality of investment decisions when it is not accompanied by sufficient knowledge and practical competence. This distinction contributes to a more nuanced understanding of financial literacy and suggests that future studies should avoid measuring financial literacy solely through aggregate scores without considering the separate effects of its underlying dimensions.

Finally, the relatively high explanatory power of the structural model, with $R^2 = 0.684$, indicates that the variables included in the study explain approximately 68.4% of the variance in investment decision-making. This represents substantial explanatory capacity and reinforces the importance of financial literacy as a major determinant of investment decisions among Nepalese retail investors. Nevertheless, approximately 31.6% of the variance remains unexplained, indicating that investment decision-making is a complex phenomenon influenced by factors beyond financial literacy. Future research should therefore incorporate additional variables such as financial self-efficacy, risk tolerance, investment experience, digital financial literacy, investor sentiment, financial technology adoption, investment horizon, personality characteristics, and behavioural biases such as overconfidence, loss aversion, and herd behaviour.

4. Conclusion

This study examined the impact of financial literacy on investment decisions among retail investors participating in the Nepal Stock Exchange (NEPSE). Drawing upon Human Capital Theory and Behavioural Finance Theory, the study investigated how financial knowledge,

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financial behaviour, financial attitudes, and financial skills collectively influence the quality of investment decision-making. The empirical findings demonstrate that financial literacy is a significant determinant of investment decisions in the Nepalese capital market. Specifically, financial knowledge, financial behaviour, and financial skills exert significant positive effects on investment decisions, whereas financial attitude does not exhibit a statistically significant influence. These findings indicate that investors are more likely to make rational and informed investment decisions when they possess sufficient financial knowledge, demonstrate disciplined financial behaviour, and apply practical financial skills in evaluating investment opportunities.

Among the dimensions of financial literacy, financial knowledge emerged as the strongest predictor of investment decisions. Investors with a sound understanding of fundamental financial concepts—including risk-return relationships, portfolio diversification, inflation, compound interest, and financial market mechanisms—were better equipped to evaluate investment alternatives and manage financial uncertainty. Financial behaviour also played an essential role, suggesting that consistent saving habits, financial planning, information seeking, and disciplined investment practices contribute substantially to improved investment outcomes. Likewise, financial skills enhanced investors' ability to interpret financial information, analyse investment alternatives, and utilize available financial technologies effectively. Conversely, positive financial attitudes alone were insufficient to influence investment decisions without the support of adequate knowledge and practical competencies, highlighting the importance of translating favourable attitudes into measurable financial capabilities.

The findings contribute to the growing body of literature on financial literacy by providing empirical evidence from Nepal, an emerging capital market that has received relatively limited scholarly attention. Unlike many previous studies that conceptualized financial literacy as a single construct, this research demonstrates that its multidimensional components influence investment decisions to different degrees. Consequently, the study extends Human Capital Theory by emphasizing financial literacy as an intangible form of capital that enhances investors' decision-making capabilities while simultaneously supporting Behavioural Finance Theory by illustrating how financial literacy can reduce irrational investment behaviour and cognitive biases commonly observed among retail investors.

From a practical perspective, the findings offer important implications for policymakers, financial regulators, brokerage firms, financial institutions, and educational organizations. Strengthening financial literacy should become a national priority to encourage informed investment participation and enhance the long-term stability of Nepal's capital market. The Nepal Stock Exchange, the Securities Board of Nepal (SEBON), commercial banks, brokerage companies, universities, and investor associations should collaborate to design comprehensive financial education programs focusing on investment analysis, portfolio diversification, financial planning, risk management, and digital financial services. Such initiatives would not only improve individual financial well-being but also promote greater market efficiency, investor confidence, financial inclusion, and sustainable economic development.

This study also provides valuable managerial implications for brokerage firms and financial service providers. Financial institutions should move beyond merely facilitating transactions and instead develop investor education initiatives that strengthen clients' financial competencies. Interactive investment seminars, online financial literacy courses, mobile learning applications, investment simulation platforms, and personalized financial advisory services could significantly improve investors' analytical capabilities and reduce speculative trading behaviour. As Nepal's financial sector continues to digitalize, integrating digital financial literacy into investor education programs will become increasingly important for enhancing responsible investment behaviour.

Despite its contributions, this study has several limitations. First, the cross-sectional research design captures investor behaviour at a single point in time and therefore cannot fully explain changes in financial literacy and investment decisions over time. Longitudinal studies would provide deeper insights into how financial literacy develops and influences investment behaviour across different market conditions. Second, the study focuses exclusively on retail investors in the Nepal Stock Exchange, limiting the generalizability of the findings to institutional investors or other financial markets. Third, although financial literacy explains a substantial proportion of investment decision-making, additional psychological and contextual variables may further enhance the explanatory power of future models.

Accordingly, future research should incorporate constructs such as financial self-efficacy, risk tolerance, investor confidence, behavioural biases, digital financial literacy, financial technology adoption, investor sentiment, and social influence. Comparative studies across South Asian countries or between developed and emerging capital markets would further enrich understanding of how institutional environments shape the relationship between financial literacy and investment behaviour. Future studies may also employ longitudinal or mixed-method research designs to capture the dynamic interaction between financial knowledge, investor experience, and market developments over time.

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