

FACTORS INFLUENCING INVESTMENT DIVERSIFICATION DECISION OF CORPORATE EMPLOYEES IN KATHMANDU.

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Abstract

This study investigates the investment diversification strategies employed by business employees in Kathmandu Valley. It specifically examines the impact of financial literacy, risk perception, investment objectives, and herd behavior. The research investigates the influence of behavioral finance theories and current portfolio theory on the diversification of investments among corporate personnel. It is important for fixed income individuals to make crucial decision regarding allocation of their income in different assets. Using primary data from survey, the study uses mixed method approach. Regression analysis is the main tool used to examine the data. The study concludes whether how behavioral aspects of an employee affects the decision-making regarding investment diversification. From the findings, many strategies and plan are formulated for employees to make investment decisions. This study advances behavioral finance and helps business employees and financial advisors optimize portfolio diversification.

Key Words: Investment, Diversification, Financial Literacy, Risk Perception, Herd Mentality, Investment Goal, Corporate Employees

1. Introduction

As per the statistical data, Kathmandu is the major hub for various employment opportunities. Sources revealed that majority of the employment rate lies inside Kathmandu valley as compared to whole Nepal (Khanal, 2019). Though the minimum standard wage is set to Nrs. 17000 as per Nepal's Latest Labor law, individuals still seem able to allocate some portion of their saving for investment purpose (Pioneer Law Associates, 2023). The variation of earning between different individuals makes a substantial influence on the pattern of saving and investment of the people (Rangith, 2023). Many behavioral aspects play a key role influencing the individual decision for example risk tolerance depends mostly on the level of risk or gain that an individual can endure (de Jong, 2010). Investment diversification decision is one of the highlights of Behavioral Finance. When deciding on financial matter, many factors come into play for example, peoples age, behavior, gender, education, experience, psychology, benefits etc., (Fernando, 2023).

1.1 Statement of the Problem

Individuals face problems while making decision regarding investment and saving (Rangith, 2023). While making investment decision, individuals have hard time on making decision about where to allocate the investment and the proportion of their investment (Agrawal R. , 2015). Many factors tend to influence the decisions of individuals, leading to either right decision or wrong decision (Almansour, Elkrghli, & Almansour, 2023). Investor market behavior relies on psychological principles of decision-making to explain why individuals purchase or sell assets (Bashir, Raza, Jahangir, & Zaigham, 2013). The bias factors can be effectively integrated into financial tools to improve investor awareness and decision-making (Fuertesa, Muradoglub, & Ozturkkalc, 2012). There is a need to elucidate the underlying mechanisms

driving the relationship between financial literacy and investment behavior, understand how contextual factors influence this relationship (Seetharaman, Niranjana, Patwa, & Kejriwal, 2017). Stressing the study's limited application to different cultural contexts, it calls for examining the effects of cultural differences on behavioral finance elements, risk perception, and investment decisions (Cheng & Sang, 2022).

1.2 Objectives` of the Research

The objectives of the study are mentioned below as:

- a. To identify the relation between financial literacy and investment diversification decision
- b. To identify the relation between risk-perception and investment diversification decision
- c. To identify the relation between herd-mentality and investment diversification decision
- d. To identify the relation between investment goal and investment diversification decision

1.3 Research Questions

- a. What are the factors that influence the decision-making process of corporate employees regarding Investment diversification?

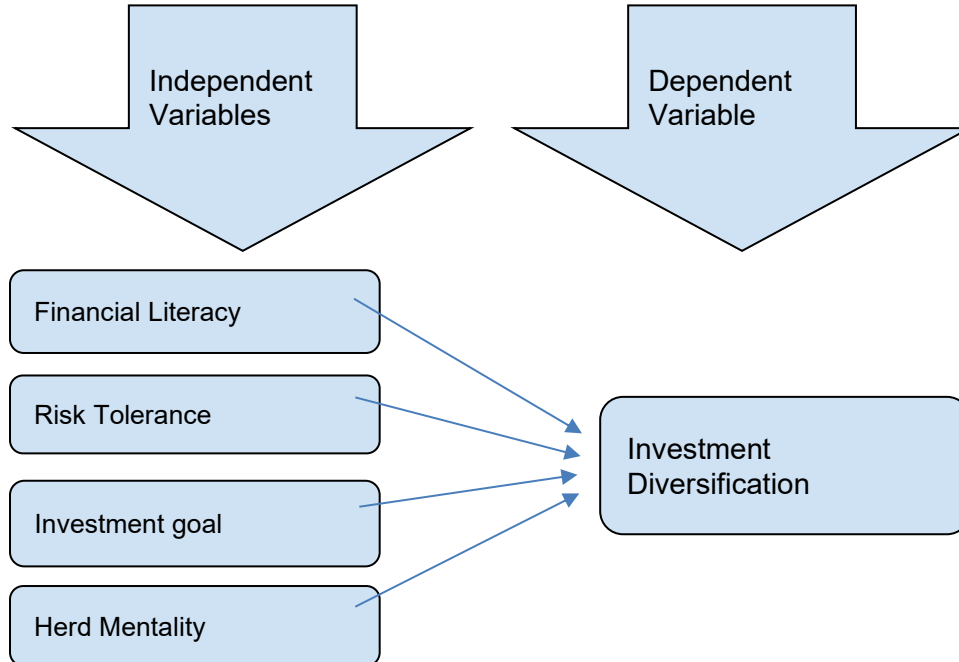
1.4 Hypothesis of the Study

- a. H₁1: Significant relation exists between financial literacy and Investment Diversification decision.
- b. H₁2: Significant relation exists between Risk tolerance and Investment Diversification decision.
- c. H₁3: Significant relation exists between Investment goal and Investment Diversification decision.
- d. H₁4: Significant relation does not exist between Herd mentality and Investment Diversification decision.

1.5 Significance of the Research

- a. It explores the significance gap in the study of Investment diversification in the context of Kathmandu valley.
- b. It will impart the application of Behavioral finance and its principle and its practical implication on corporate sectors.
- c. It provides future insights for academic students and policymakers in the field of behavioral finance.

1.6 Conceptual Framework



2. Literature Review

(Cheng & Sang, 2022) stated that there is correlation between attitude towards investing, investment intention, risk perception and the influence of social factors on attitudes and intentions towards investing.

Risk Tolerance: (Aeknarajindawat, 2020) While considering the elements of trust and financial literacy, the aim was to study the effect of risk perception (RP) and risk tolerance (RT) on individual's decisions about the distribution of hazardous assets inside the context of financial guidance. The main conclusions show that risk tolerance and financial literacy are rather correlated with trust in the Indonesian banking sector. Financial literacy also correlates favorably with risk tolerance; it does not significantly connect with risk perception. The study also revealed that risk perception greatly affected the link between risk tolerance and asset allocation. The study supported other studies by showing beneficial links between risk tolerance, risk perception, and asset allocation together with a negative link between risk tolerance and risk perception (De Giorgi, 2011). **Herd Mentality:** (Merli & Roger, 2011) explores the phenomenon of herding behavior in financial markets and differentiates between rational and irrational forms of herding. Rational herding can be attributed to externalities, reputational effects, and informational externalities. On the other hand, illogical herding refers to the act of imitating other agents without any logical basis, sometimes influenced by fashion or fads. The profitability of engaging in activities such as trading for liquidity benefits increases as the number of participants grows. **Portfolio and Financial Literacy:** (Nguyen, Hoang, Pho, & Nhan, 2023) Financial literacy significantly influences portfolio composition and asset selection, particularly in the context of stock portfolios. Basic financial literacy has a beneficial effect on the selection of equities for a portfolio, but the effects of advanced literacy are uncertain. Knowledge of portfolio risk affects the composition of asset portfolios. Surprisingly, the financial expertise of family members has a harmful impact. The education level of an individual has a favorable influence on the process of selecting stocks for a portfolio.

Portfolio Diversification: (Debasish, 2015) indicates that, for the purpose of reducing risk and increasing returns, investors should diversify their portfolios among a range of investment vehicles. In contrast, concentrating all of the funds in a single asset increases the investor's exposure to risk and lacks the benefits of diversification. Implementing diversification strategies enhances investment returns while simultaneously reducing the total risk of a portfolio. A diversified portfolio exhibits lower risk than individual securities in this aspect (Williams J. O., 1997). As per (FABOZZI, GUPTA, & MARKOWITZ, 2002), In 1952, Harry Markowitz introduced "Portfolio Selection," which served as the cornerstone of Modern Portfolio Theory (MPT). MPT was initially met with limited enthusiasm; however, it eventually acquired widespread acceptance within the financial community, resulting in the ongoing development of new financial models that are rooted in its principles. MPT has had a substantial impact on investment practices, particularly in the realm of asset allocation, despite its normative nature. Asset pricing theory, while distinct from Modern Portfolio Theory (MPT), is analogous to the Capital Asset Pricing Model (CAPM) and functions as a complementary framework.

According to Shefrin (2001), behavior finance is the study of how psychology affects financial decision-making processes and financial markets. Since psychology explores human judgement, behavior and welfare, it can also provide important facts about how human actions differ from traditional economic assumptions. Raiffa and Raiffa (1968), Kahneman and Tversky (1979) noted that the behavior of the individual in theory differs from practice, and classic financial models cannot explain or predict all the financial decisions. Therefore, earlier and now the economic rationality of human beings in its behavior finance is criticized reasonably. Behavioral finance as a science became especially popular after 2002 when Daniel Kahneman was awarded The Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel for having integrated insights from psychological research into economic science, especially concerning human judgement and decision-making under uncertainty. The article deals with theoretical aspects of behavioral finance scientific inquiries in retrospect. The methods of analysis and synthesis, description and comparison were applied in the article (Bikas, Jureviciene, Dubinskas, & Novickyte, 2013).

3. Research Methodology

3.1 Research Philosophy

The primary research philosophy employed in this thesis is Interpretivism.

3.2 Research Approach

This thesis used quantitative and qualitative methodologies to study corporate employees' investment diversification in Kathmandu.

3.3 Research Strategy

The research was conducted through survey and sample was determined using random sampling. The survey shall be done physically and through online platform. This thesis is based on a cross-sectional time frame, and the author's attempt here is to obtain a picture, no matter how small, of the Investment Diversification done by corporate personnel located in the Kathmandu valley at a particular point in time (Wang & Cheng, 2020)

3.4 Collection of Data

The main tool used for data collection of this thesis is a closed structured survey that targets measurable variables. The questionnaire has systematically developed sections that correspond with the research variables; investment diversification preferences, risk taking propensity, knowledge in investment, investment goals, and herd effect. The participants of this thesis study were selected from the corporate personnel of the Kathmandu Valley of Nepal.

3.5 Sampling

The type of sample technique used in this thesis is the stratified random sampling. They are divided into several classes with regards to pertinent factors such as job status of the corporate workforce in the Kathmandu Valley.

As the population was found to be infinite

Now, Using Cochran Equation,

$$n_0 = \frac{z^2 PQ}{e^2} \text{ (Bartlett, Kotrlik, \& Higgins, 2001)}$$

n_0 = Sample size

z = Confidence value from z-table (95%)

P = Variability

Q = 1- Variability (P)

e = margin of error

Sample size was 384.16~385 – Corporate Employees.

Inclusion criteria: Corporate employees who were present for data collection and willing to get involved were enrolled in the research.

3.5 Instrumentation

The responses were gathered via self-administered questionnaires. Queries were generated after studying relevant articles, publications, and reports, as well as talking with a literature review. Likert scale questions were used in the questionnaire.

3.6 Data Analysis

Descriptive Statistics: Descriptive analysis, including frequency distribution, mean, and standard deviation, was employed to describe investment diversification, risk tolerance, and financial literacy. Key factors influencing investment behavior were identified through conclusions and regression analysis between investment diversification and independent variables, such as risk tolerance and financial literacy (Bhat).

Software Tools: The study's data analysis was conducted using IBM SPSS software, where responses were coded and various analytical procedures applied. Statistical tools such as descriptive statistics, inferential statistics, correlation, regression, ANOVA, normality tests, and others were used to draw conclusions (Williams K. , 2024).

4. Data Analysis and Interpretations.

Table 1: Age

n = 373

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	18-24	61	16.4	16.4	16.4
	25-34	239	64.1	64.1	80.4
	35-44	62	16.6	16.6	97.1
	45-54	8	2.1	2.1	99.2
	55 and above	3	.8	.8	100.0
	Total	373	100.0	100.0	

Table 2: Gender

n = 373

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Male	241	64.6	64.6	64.6
	Female	132	35.4	35.4	100.0
	Total	373	100.0	100.0	

Table 3: Educational Status

n=373

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	High school diploma	20	5.4	5.4	5.4
	Bachelor's degree	142	38.1	38.1	43.4
	Master's degree	193	51.7	51.7	95.2
	Doctorate	14	3.8	3.8	98.9
	Vocational Training	4	1.1	1.1	100.0
	Total	373	100.0	100.0	

Table 4: Income Status

n=373

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	NPR 20,000 - NPR 40,000	105	28.2	28.2	28.2
	NPR 40,001 - NPR 60,000	206	55.2	55.2	83.4
	NPR 60,001 - NPR 80,000	39	10.5	10.5	93.8
	Above NPR 80,000	23	6.2	6.2	100.0
	Total	373	100.0	100.0	

Table 5: Employment Sectors of the Respondents

n=373

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Government	37	9.9	9.9	9.9
	Private	217	58.2	58.2	68.1
	Public	86	23.1	23.1	91.2
	NGO/INGO	33	8.8	8.8	100.0
	Total	373	100.0	100.0	

Table 6: Investment Familiarity Variables of the Respondents

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Extremely Familiar	35	9.4	9.4	9.4
	Very Familiar	133	35.7	35.7	45.0
	Moderately Familiar	160	42.9	42.9	87.9
	Slightly Familiar	43	11.5	11.5	99.5
	Not Familiar at all	2	.5	.5	100.0
	Total	373	100.0	100.0	

In the demographic variables, majority of respondents belongs to Age grp 25-34, whereas 64% of respondents are male and 35% are female. Majority of respondents has completed Bachelors and Masters Education. Data shows that majority of respondent’s income were in 40k-60k range. Most of the respondent worked in private sector. And majority of the population were familiar with Investment decision and diversification decision.

Table 7: Demographic Variables of the Respondents

Total Respondents = 373

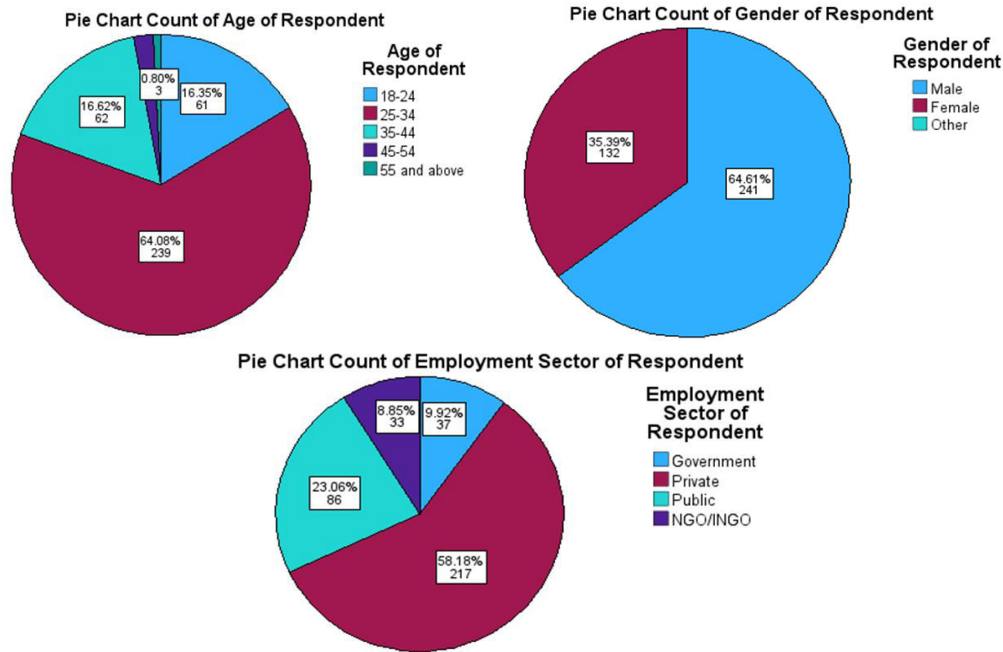


Table 8: Test for Reliability

Variables of the study	No. of items	Cronbach's Alpha
Financial Literacy	5	.721
Risk Perception	5	.860
Herd Mentality	5	.719
Investment Goal	5	.674
Investment Diversification	5	.702

All the variables had the Cronbach's score of higher than 0.700, except one variable that is Herd Mentality. Since the study is related with behavioral aspects of the respondents, such variations can be considered and treated as reliable data. So, all the data can be considered measurable for data analysis purposes.

Table 9: Descriptive statistics for variables

	Mean	Std. Deviation	N
Investment Diversification Decision	4.3436	.38408	373
Financial Literacy	4.3204	.41664	373
Risk Perception	4.1850	.68525	373
Herd Mentality	4.2297	.44127	373
Investment Goal	4.3038	.37887	373

From the table above, Descriptive statistics showed that the respondents demonstrated a mostly positive perspective towards the independent variables that influenced Investment Diversification decisions. Since, the mean values of all the independent variables were above 4, which indicates respondents considered these variables to be significant while making an investment diversification decision. As for the variability, all the variables showed a little variability in these factors, but Risk perception showed little variability, which means there is little variation in opinion regarding Investment Diversification decisions.

Table 10: Test for Correlation

		Investment Diversification Decision	Financial Literacy	Risk Perception	Herd Mentality	Investment Goal
Pearson Correlation	Investment Diversification Decision	1.000	.671	.573	.351	.743
	Financial Literacy	.671	1.000	.516	.328	.643
	Risk Perception	.573	.516	1.000	.290	.491
	Herd Mentality	.351	.328	.290	1.000	.502
	Investment Goal	.743	.643	.491	.502	1.000
Sig. (1-tailed)	Investment Diversification Decision	.	<.001	<.001	<.001	<.001
	Financial Literacy	.000	.	.000	.000	.000
	Risk Perception	.000	.000	.	.000	.000
	Herd Mentality	.000	.000	.000	.	.000
	Investment Goal	.000	.000	.000	.000	.
N	Investment Diversification Decision	373	373	373	373	373
	Financial Literacy	373	373	373	373	373
	Risk Perception	373	373	373	373	373
	Herd Mentality	373	373	373	373	373
	Investment Goal	373	373	373	373	373

Correlation analysis is used to identify the relationship and connection between the variables (Flex Mr). From the Correlation analysis table, it is seen that Investment diversification exhibits a positive correlation with Financial Literacy and Investment goal, represented by $r = 0.743$, $p < 0.001$ for Investment goal and $r = 0.671$, $p < 0.001$ for Financial Literacy. This suggests that the respondents with high financial literacy and investment goals tend to make Investment diversification more.

After that, the Risk perception shows the moderate correlation value of $r = 0.573$, $p < 0.001$, which suggests that people who perceive high levels of risks tend to make their diversification decision more. Among these all variables, Herd Mentality shows the weakest correlation, represented by $r = 0.351$, $p < 0.001$, which suggests that social influence does less influence while making investment diversification decisions. Among the independent variables, Financial Literacy and Investment showed moderate correlation i.e., $r = 0.643$, $p < 0.001$, which implies that these factors combinedly impact investment diversification decision.

Table 11: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics						
					R Square Change	F Change	df1	df2	Sig. F Change	Durbin-Watson	
1	.804 ^a	.646	.643	.22963	.646	168.184	4	368	<.001	20.719	1.865

- a. Predictors: (Constant), Investment Goal, Risk Perception, Herd Mentality, Financial Literacy
- b. Dependent Variable: Investment Diversification Decision

Model Summary table evaluates the overall fit of the regression model to analyze the impact of independent variables on the Investment diversification decisions (Anand, 2021). From the above table, it can be seen that the value of R is 0.804, which implies that there is strong positive correlation between the independent variables and Investment diversification decision. The value of R² 0.646, suggests good model fit for the variability of the Investment diversification decision. Here the lower value of the standard estimate is 0.22963 which indicates more precise prediction of the model. Whereas, F-statistic value is 168.18 and Significance (Sig. F Change) is less than 0.001 indicates that the model is statistically significant. Thus, the combination of these variables can explain the variance in Investment Diversification decision.

Table 12: Test for ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	35.473	4	8.868	168.184	<.001 ^b
	Residual	19.404	368	.053		
	Total	54.877	372			

- a. Dependent Variable: Investment Diversification Decision
- b. Predictors: (Constant), Investment Goal, Risk Perception, Herd Mentality, Financial Literacy

From the above ANOVA table, the value of the Regression sum of squares is 35.473, indicating the variation in the model and Residual sum of square is 19.404, indicating less variation in the model. Here also, High F-value of 168.184 and p-value of less than 0.001, indicates that the model is significant.

Table 13: Test for Coefficient

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics		
	B	Std. Error	Beta			Tolerance	VIF	
1	(Constant)	.819	.154		5.326	<.001		
	Financial Literacy	.238	.039	.258	6.083	<.001	.533	1.875
	Risk Perception	.117	.021	.209	5.593	<.001	.688	1.453
	Herd Mentality	-.037	.031	-.042	-1.183	.238	.746	1.341
	Investment Goal	.502	.046	.496	10.979	<.001	.471	2.121

a. Dependent Variable: Investment Diversification Decision

In the above table, P-value is taken for each variable which determines the significance level of the proposed hypotheses. Among the variables, Financial Literacy, Risk Perception and Investment Goal shows significance level of lower than 0.05 (5%) that is <0.001, which means the null hypothesis related to these variables is rejected and the alternative hypothesis is accepted. As for Herd Mentality, P-value is 0.238, showing significance level higher than 0.05 (5%), which means the null hypothesis for Herd mentality is accepted and alternative hypothesis is rejected. Thus, Financial Literacy, Risk Perception and Investment goal shows significant association with the Investment Diversification decision, whereas, Herd mentality does not show association with the Investment diversification decision. The standard equation set for this regression model can be shown as follows:

$$ID = 0.238xFL + 0.117xRP - 0.037xHM + 0.502xIG + 0.819$$

Where,

Constant = 0.819

ID = Investment Diversification (Dependent Variable)

FL = Financial Literacy (Independent Variable)

RP = Risk Perception (Independent Variable)

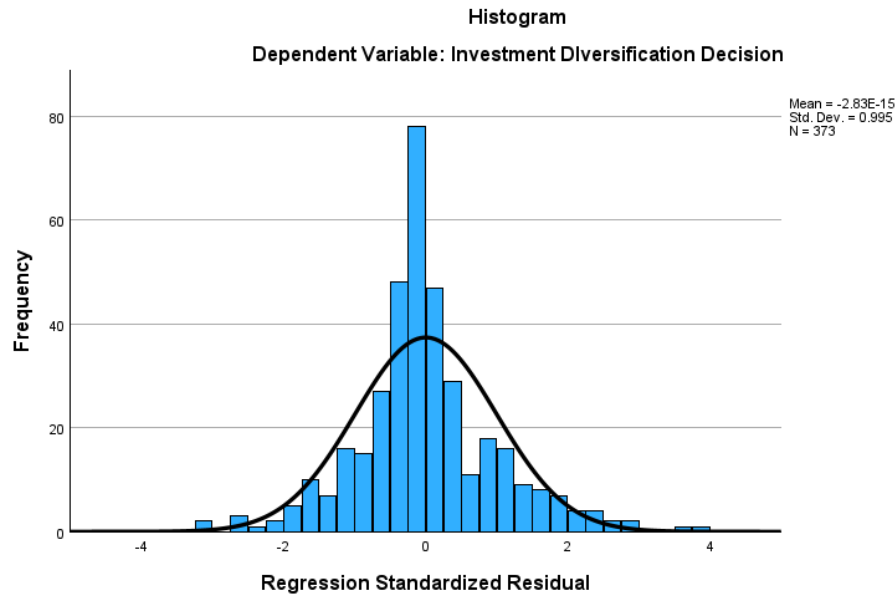
HM = Herd Mentality (Independent Variable)

IG = Investment Goal (Independent Variable)

Here, 0.238, 0.117, 0.037 and 0.502 is the slope for FL, RP, HM and IG respectively.

The above equation shows the association of Investment diversification with independent variables. This is used to analyze how much of investment diversification decision is affected due to change in one unit of independent variable. As per the equation, the highest impact of Financial Literacy and Investment goal is seen to be impacting Investment diversification decision, whereas herd mentality showed lower and negative impact on Investment diversification decision.

Table 14: Test for Normality

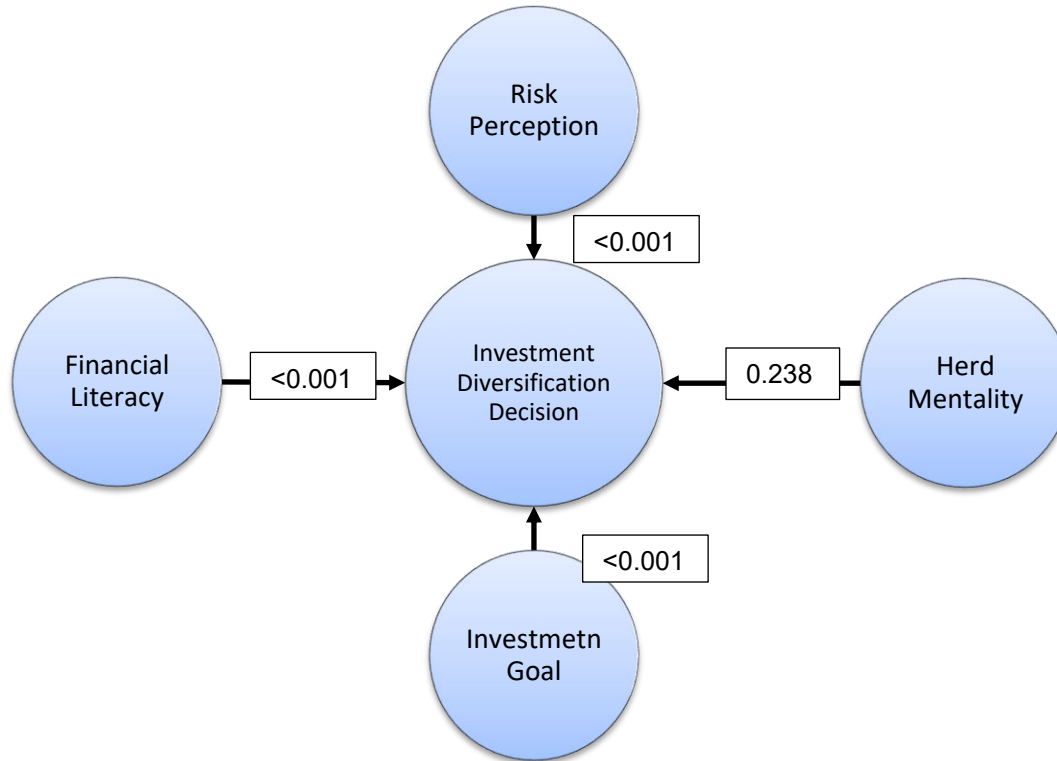


From the figure of Normality curve, the data showed a symmetric dispersed distribution, meaning the normality curve is in bell-shaped figure (Mishra, et al., 2019). Most of the data has been clustered at the center i.e., towards the mean value. However, some data lies in the outliers in both end as shown in the figure. Thus, the regression model for Investment diversification decision is normally distributed with mean centered around zero and standard variation around one, supporting the validity of the model.

5. Interpretation of findings

The study was conducted to discover the association between the independent variables i.e., Financial Literacy, Risk Perception, Herd Mentality and Investment goal, and dependent variable i.e., Investment diversification decision. The demographic data considered for the study were Age, Gender, Education level, monthly income, employment sector, investment experience of the corporate employees inside Kathmandu valley. From the total demography, the majority of the respondents belonged to the age group 25 to 34 years. 64.61% of the total population were female whereas 35.39% were male respondents. Majority of the respondents worked in the private sector followed by the public sector. Majority of the Master's degree respondents were seen in the survey. Majority of the respondent's monthly income was from 40,000 Nrs to 60,000 Nrs. It was found that Majority of the respondents were familiar with investment diversification i.e., familiar for more than 6 years.

Different statistical analyses were used to analyze the data obtained from respondents. Reliability and Validity of every variable were around 0.700 and above 0.700 which stated the validity of the data. The P-value obtained from the Regression analysis were below 0.05 for financial literacy, Risk perception and Investment goal which indicated strong association with the Investment diversification decision. The adjusted R square value obtained from the Regression analysis is 64.30% which is the fluctuation level for dependent variables by the independent variables.



6. Limitations

- The study's findings are based on corporate sector employees, limiting the generalizability of the results. Expanding the research to different sectors and areas would provide broader insights.
- The limited sample size restricts the study's ability to support alternative hypotheses. A larger sample would enhance the robustness of the conclusions.
- The study focused on a few variables—Financial Literacy, Risk Perception, Herd Mentality, and Investment Goals. Given the numerous factors that influence diversification decisions, relying on these limited variables weakens the basis for forming hypotheses.

7. Conclusion

Based on the findings, it can be concluded that the key factors influencing investment diversification decisions are Financial Literacy, Investment Goals, and Risk Perception. Individuals with higher financial literacy are more likely to understand the benefits of diversification and, consequently, diversify their investments across various assets. Those with low risk tolerance tend to mitigate risk by spreading their investments, while individuals driven by specific investment objectives are more inclined to diversify. Although herd mentality influences individuals' thinking, it does not significantly impact the diversification decisions of corporate employees.

8. Implications

This study highlights the importance of financial literacy and risk awareness in shaping employees' investment diversification decisions within the corporate sector. By implementing financial education and risk management programs, organizations can empower employees to make informed decisions about diversifying their portfolios. The study also underscores the need for employees to set clear investment goals and align their strategies with asset quality and return expectations. Additionally, it suggests that beyond herd mentality, other behavioral finance factors may influence diversification decisions, warranting further exploration in future research

9. Recommendations

- a. Corporate sectors should implement financial literacy programs to enhance employees' understanding of investment diversification, with a focus on its benefits.
- b. Risk awareness programs should be introduced to help employees assess and manage the risks associated with inadequate diversification.
- c. Employees should plan and set clear investment goals before diversifying. Strategies should be aligned with asset quality and return duration.
- d. Other aspects of behavioral finance, beyond herd mentality, should be considered, as they may also influence diversification decisions.

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