

Herding Behavior on Stock Market Investment Decisions

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Abstract

The effect of herding behavior in the stock market is analyzed using evidence from the retail investor segment of the Nepal Stock Exchange (NEPSE). Herding behavior occurs when investors copy each other and make investment decisions based on the actions of other investors rather than their own analysis and independent judgment. The study employed a causal comparative research design to examine the effect of herding behavior among retail investors in Nepal. Primary data collected from retail investors who are active market participants in NEPSE constitutes the main source of information. A total of 200 responses were collected using a structured questionnaire. The results suggest that herding behavior has a statistically significant impact on investment decision-making and market participation by retail investors. Specifically, investment sentiment, market volatility, information asymmetry, and past market returns were all found to significantly influence investment decisions. The regression model explained 36.0% of the variance in investment decisions ($R^2 = .360$, $F = 27.427$, $p < .001$). The study carries implications for investors, policymakers, market regulators, and financial institutions in raising awareness about behavioral biases and in formulating measures to make the stock market more efficient.

Keywords: Herding Behavior, Investment Decision, Retail Investors, Behavioral Finance, NEPSE, Market Volatility, Information Asymmetry, Investment Sentiment

Introduction

Financial markets are complex ecosystems driven not only by economic fundamentals but also by the psychological disposition of the participants who inhabit them. Traditional finance theory assumes that investors are rational agents who make decisions aimed at maximizing utility based on all available information (Idris, 2025). However, decades of empirical research in behavioral finance have demonstrated that real-world investors frequently deviate from this idealized rationality. One of the most documented and impactful deviations is herding behavior, the tendency of individuals to mimic the financial decisions of a larger group rather than making independent choices based on personal analysis (Alamsyah et al., 2023).

Herding behavior in financial markets manifests when investors follow the crowd, buying assets because others are buying and selling because others are selling, often without regard for underlying fundamentals (Sahoo et al., 2026; Khadka et al., 2025). This mass conformity can produce significant market distortions, fuel asset price bubbles, and precipitate sudden market crashes. The consequences of herding are therefore not merely individual; they ripple across the broader market and can threaten systemic stability.

Emerging markets such as Nepal present a particularly fertile ground for the study of herding behavior. The Nepal Stock Exchange (NEPSE), as the sole securities exchange in the country, is characterized by a relatively limited number of listed companies, lower levels of financial literacy among the general investing population, restricted availability of high-quality financial information, and heightened susceptibility to rumor and social influence (Adhikari et al., 2025). These structural features create an environment where behavioral biases are amplified and where herding is likely to be more pronounced and consequential than in developed markets. Understanding herding in NEPSE is therefore not merely an academic exercise. It carries direct practical significance for multiple stakeholders. Individual investors need to recognize and guard against the cognitive biases that lead them to follow the crowd to their own financial detriment. Policymakers and market regulators must understand the mechanics of herding in order to design interventions that foster more stable and efficient markets. Financial institutions can benefit from this knowledge in refining their advisory and risk management frameworks. This study investigates herding behavior among retail investors in NEPSE by examining the influence of four key dimensions: investment sentiment, market volatility, information asymmetry, and past market returns. Using primary data gathered through structured questionnaires administered to 201 retail investors, the study applies both correlation analysis and multiple regression to assess the nature and magnitude of these relationships. The findings contribute to the growing body of behavioral finance literature with specific reference to the Nepalese market context.

Statement of the Problem

Despite growing awareness of behavioral finance globally, empirical research on herding behavior within the context of Nepal's stock market remains relatively sparse. NEPSE, as a frontier market, operates under conditions of information opacity, relatively low regulatory sophistication, and a retail investor base that may be particularly susceptible to peer influence

and emotional decision-making. The absence of rigorous empirical evidence on how herding operates within this specific context represents a significant gap in the literature.

The core problem addressed by this study is the extent to which herding behavior, as manifested through investment sentiment, market volatility, information asymmetry, and past market returns, influences the investment decisions of retail investors in NEPSE. By quantifying these relationships, the study seeks to provide a more nuanced and empirically grounded understanding of the behavioral forces shaping Nepal's stock market.

Objectives of the Study

The study is guided by the following three primary objectives:

1. To analyze the perception of retail investors towards herding behavior and its relationship with stock market investment decisions.
2. To examine the relationship between herding behavior dimensions (investment sentiment, market volatility, information asymmetry, and past market returns) and investment decision-making.
3. To assess the impact of herding behavior dimensions on the investment decisions of retail investors.

Significance of the Study

This study makes several contributions. First, it adds to the behavioral finance literature by providing empirical evidence from a frontier market context that has been underrepresented in existing research (Mishra et al., 2021; Mahat, 2024). Second, it offers actionable insights for retail investors by identifying the specific behavioral drivers that compromise rational decision-making. Third, the findings hold regulatory and policy relevance, informing efforts by NEPSE and the Securities Board of Nepal (SEBON) to design more transparent and investor-friendly market structures. Finally, financial intermediaries and advisors may use these findings to develop better-informed client engagement and financial literacy programs.

Literature Review

Theoretical Foundation

The concept of herding behavior in financial markets is rooted in the broader field of behavioral finance, which emerged as a challenge to the Efficient Market Hypothesis (EMH) proposed by Fama (1970). The EMH holds that asset prices fully reflect all available information, rendering it impossible to consistently achieve returns in excess of market averages. Behavioral finance, by contrast, acknowledges that investors are subject to cognitive biases, emotional influences, and social pressures that lead to systematic deviations from rationality (Thaler, 1993; Shefrin, 2000).

Herding theory draws from several foundational frameworks. Keynes (1936) provided one of the earliest conceptual accounts of herding with his beauty contest analogy, suggesting that investors focus not on what they genuinely believe to be the best investment but on what they think other investors will choose. Bikhchandani, Hirshleifer, and Welch (1992) formalized this intuition through their model of information cascades, demonstrating that rational individuals can optimally choose to disregard their private signals and follow the publicly observable actions of others. This creates a cascade in which even small amounts of early public information can overwhelm the independent signals of many subsequent decision-makers.

Devenow and Welch (1996) distinguished between two broad types of herding: rational herding, which arises from information asymmetries and principal-agent relationships, and irrational herding, which is driven by psychological factors such as conformity bias, loss aversion, and fear of regret. Both forms are relevant to understanding retail investor behavior in developing markets.

Investment Sentiment and Herding

Investment sentiment refers to the overall mood or attitude of investors toward the market. Baker and Wurgler (2006) demonstrated that investor sentiment has a pervasive influence on stock prices, particularly for stocks that are difficult to arbitrage. When market sentiment is broadly positive, investors are more likely to interpret ambiguous signals favorably and to follow the crowd into purchases; when sentiment is negative, the reverse dynamic unfolds.

In the context of herding, sentiment amplifies conformity. Positive sentiment creates a self-reinforcing cycle in which rising prices attract more buyers, further elevating prices and confirming the positive outlook of early entrants. This dynamic is closely related to the concept of noise trading (Black, 1986), where uninformed investors trade on sentiment rather than fundamentals, pushing prices away from intrinsic values. Studies in Asian emerging markets, including those by Tan, Chiang, Mason, and Nelling (2008), have documented significant herding behavior correlated with market-wide sentiment measures.

Market Volatility and Herding

Market volatility, characterized by rapid and unpredictable price movements, is a well-established catalyst for herding behavior. During periods of high volatility, individual investors face heightened uncertainty and may rationally choose to look to the collective behavior of the market as a signal of prevailing sentiment (Christie & Huang, 1995). This phenomenon, sometimes termed "crisis herding," has been documented in a range of market contexts.

Chang, Cheng, and Khorana (2000) developed the cross-sectional absolute deviation (CSAD) method to test for herding in equity markets and found evidence of herding in emerging markets during volatile periods. Their findings suggest that in high-volatility environments, dispersion in individual stock returns decreases relative to what rational asset pricing models would predict, consistent with investors abandoning idiosyncratic strategies in favor of market consensus.

Economou, Kostakis, and Philippas (2011) further demonstrated that herding is more pronounced during market downturns, when fear and uncertainty are at their peak. In frontier markets such as Nepal, where circuit breakers and other volatility-dampening mechanisms may be less robust, the herding response to volatility is likely to be particularly pronounced.

Information Asymmetry and Herding

Information asymmetry, the unequal distribution of relevant market information among participants, is a foundational driver of herding in financial markets. When retail investors lack access to the same quality and quantity of information available to institutional investors or market insiders, they face what Akerlof (1970) termed a market for lemons problem: the adverse selection pressure of operating in a market where others are better informed.

In such an environment, it becomes individually rational for uninformed investors to observe and mimic the actions of those who appear to be better informed. Sias (2004) documented this dynamic in institutional investment, showing that institutions herd due in part to information-

based trading. Retail investors in frontier markets face even greater information deficits and are therefore more susceptible to cascading behavior.

In Nepal, where financial disclosure norms may be less stringent and where company-specific information is often hard to access and verify, information asymmetry is an especially important channel for herding behavior. Small investors operating with limited analytical capability are more likely to free-ride on the apparent informational advantage of others.

Past Market Returns and Herding

The influence of past market returns on investor behavior is one of the most well-documented phenomena in behavioral finance. Investors systematically extrapolate recent trends into the future, a cognitive bias described by Tversky and Kahneman (1974) under the representativeness heuristic. This leads to momentum-chasing behavior in which strong recent returns attract additional investment, perpetuating a trend.

Grinblatt, Titman, and Wermers (1995) documented momentum-following herding among mutual fund managers, while Barber and Odean (2000) showed that individual investors systematically engage in trend-chasing and underperform the market as a result. In NEPSE, where retail investors dominate market activity, the influence of past returns on current investment decisions is expected to be particularly significant. Rising markets may prompt increased participation driven by fear of missing out (FOMO), while declining markets may trigger panic selling that amplifies volatility further.

Empirical Evidence from Developing Markets

Substantial empirical evidence on herding has been generated from developing and emerging markets in Asia, which share several characteristics with Nepal's market environment. Chiang and Zheng (2010) found evidence of herding in many international markets during periods of market stress. Yousaf, Ali, and Shah (2018) documented herding behavior in the Pakistan Stock Exchange, a market with similar structural characteristics to NEPSE.

Within South Asia, Javaira and Hassan (2015) examined the Pakistan Stock Exchange and found significant herding, particularly during rising market conditions. Gondhi (2021) analyzed herding in the Indian stock market and found that retail investors showed stronger herding tendencies than institutional investors, consistent with the information asymmetry hypothesis.

Studies specifically focused on NEPSE are relatively limited. Shrestha (2019) documented the role of psychological biases, including herding, in the decision-making of Nepalese investors, finding that social norms and peer behavior were significant determinants of investment choices. The present study builds on this foundation by providing a more systematic and quantitative analysis of the herding phenomenon in NEPSE.

Conceptual Framework

Based on the theoretical and empirical review, this study proposes a conceptual framework in which herding behavior, operationalized through four dimensions, influences investment decisions:

Investment Sentiment → **Investment Decision**
Market Volatility → **Investment Decision**
Information Asymmetry → **Investment Decision**
Past Market Returns → **Investment Decision**

Each of these independent variables is expected to have a significant positive relationship with the dependent variable, investment decision, consistent with the behavioral finance literature reviewed above.

Research Methodology

Research Design

The study employed a causal comparative research design, which is appropriate for investigating the influence of identified independent variables on a dependent variable when the researcher cannot manipulate the variables directly. This design facilitates the examination of cause-and-effect relationships while preserving the naturalistic context of the research setting.

Population and Sampling

The target population comprised retail investors actively participating in NEPSE. A structured questionnaire was distributed to retail investors, and a total of 201 usable responses were collected. The sampling approach focused on investors who had made at least one stock transaction in the preceding twelve months, ensuring that respondents had sufficient practical experience with the market to provide meaningful responses about their decision-making processes.

Measurement Instrument

The research instrument was a structured questionnaire consisting of 25 Likert-scale items, each rated on a five-point scale ranging from 1 (Strongly Disagree) to 5 (Strongly Agree). The instrument was organized into five sections corresponding to the five constructs under investigation: Investment Sentiment (IS1–IS5), Market Volatility (MV6–MV10), Information Asymmetry (IA11–IA15), Past Market Returns (PMR16–PMR20), and Investment Decision (ID21–ID25).

Reliability Analysis

The reliability of each construct was assessed using Cronbach's Alpha coefficient, which measures the internal consistency of the items comprising each scale. All constructs achieved reliability levels exceeding the widely accepted threshold of 0.60 (Nunnally, 1978), with most surpassing the preferred threshold of 0.70, confirming the internal consistency of the measurement instrument.

Table 1: Reliability Statistics for All Constructs

Construct	Cronbach's Alpha	No. of Items	Assessment
Investment Sentiment	0.709	5	Acceptable
Market Volatility	0.726	5	Acceptable
Information Asymmetry	0.778	5	Good
Past Market Returns	0.665	5	Acceptable
Investment Decision	0.771	5	Acceptable

Data Analysis Techniques

Data analysis proceeded in three stages corresponding to the three research objectives. Descriptive statistics (mean and standard deviation) were computed for each item and each composite construct to address the first objective. Pearson correlation analysis was conducted to examine the bivariate relationships between the herding behavior dimensions and investment

decisions (Objective 2). Finally, multiple linear regression analysis was employed to assess the simultaneous impact of all four herding dimensions on investment decisions (Objective 3). The Variance Inflation Factor (VIF) was used to diagnose potential multicollinearity among predictors.

Results and Analysis

Objective 1: Descriptive Analysis of Herding Behavior and Investment Decisions

Investment Sentiment

Table 2 presents the descriptive statistics for the five investment sentiment items. Respondents generally reported moderate to high levels of agreement with statements measuring investment sentiment, with item means ranging from 3.45 to 4.09. Items IS3 (M = 4.03) and IS4 (M = 4.09) recorded the highest means, suggesting that investors strongly perceived the role of collective sentiment in shaping market trends. Item IS5 exhibited the lowest mean (M = 3.45) and the highest variability (SD = 1.11), indicating greater disagreement regarding certain aspects of sentiment-driven behavior.

Table 2: Descriptive Statistics – Investment Sentiment

Item	N	Minimum	Maximum	Mean	Std. Deviation
IS1	200	1.00	5.00	3.4650	1.03641
IS2	200	1.00	5.00	3.8400	0.95864
IS3	200	1.00	5.00	4.0251	0.78777
IS4	200	1.00	5.00	4.0854	0.81510
IS5	200	1.00	5.00	3.4500	1.10617

Market Volatility

Table 3 displays the descriptive statistics for market volatility items. The means ranged from 3.13 to 3.70, reflecting moderate perceptions of market volatility's influence on investment behavior. Item MV8 (M = 3.70) recorded the highest mean, while MV9 (M = 3.13, SD = 1.11) showed both the lowest mean and considerable variability, suggesting divergence in how investors assess the impact of volatility on their decisions.

Table 3: Descriptive Statistics – Market Volatility

Item	N	Minimum	Maximum	Mean	Std. Deviation
MV6	200	1.00	5.00	3.4300	1.02976
MV7	200	1.00	5.00	3.2050	1.07646
MV8	200	1.00	5.00	3.7000	0.91882
MV9	200	1.00	5.00	3.1300	1.10871
MV10	200	1.00	5.00	3.4100	1.03792

Information Asymmetry

The descriptive statistics for information asymmetry are presented in Table 4. Item means ranged from 2.93 to 3.48. Notably, item IA14 recorded the lowest mean (M = 2.93), indicating that fewer investors agreed with the corresponding statement. Item IA11 had the highest standard deviation (SD = 1.17), reflecting the greatest heterogeneity in responses. Overall, the moderate means suggest that information asymmetry is a recognized but variably experienced dimension of herding among NEPSE retail investors.

Table 4: Descriptive Statistics – Information Asymmetry

Item	N	Minimum	Maximum	Mean	Std. Deviation
IA11	200	1.00	5.00	3.4422	1.17440
IA12	200	1.00	5.00	3.4650	0.96093
IA13	200	1.00	5.00	3.4800	1.00731
IA14	200	1.00	5.00	2.9250	1.09791
IA15	200	1.00	5.00	3.2200	1.04742

Past Market Returns

Table 5 reports the descriptive statistics for past market returns. This construct had the highest mean values among all four herding dimensions, with item means ranging from 3.48 to 3.92. Item PMR16 ($M = 3.92$, $SD = 0.73$) recorded both the highest mean and the lowest standard deviation, indicating strong and consistent agreement that past market performance influences current investment decisions. The composite mean for this construct was 3.71, the highest among all predictors.

Table 5: Descriptive Statistics – Past Market Returns

Item	N	Minimum	Maximum	Mean	Std. Deviation
PMR16	200	1.00	5.00	3.9150	0.72830
PMR17	200	1.00	5.00	3.4750	0.99212
PMR18	200	1.00	5.00	3.7050	0.96051
PMR19	200	1.00	5.00	3.6650	0.84042
PMR20	200	1.00	5.00	3.8050	0.78745

Investment Decision

The descriptive statistics for the dependent variable, investment decision, are shown in Table 6. Item means ranged from 2.91 to 3.80. Items ID21 ($M = 2.91$) and ID22 ($M = 3.05$) recorded the lowest means, indicating lower agreement with specific herding-driven decision statements. Items ID24 ($M = 3.80$) and ID25 ($M = 3.71$) recorded the highest means, suggesting stronger consensus that certain aspects of group-influenced decision-making are present among retail investors.

Table 6: Descriptive Statistics – Investment Decision

Item	N	Minimum	Maximum	Mean	Std. Deviation
ID21	200	1.00	5.00	2.9100	1.06658
ID22	200	1.00	5.00	3.0450	1.00400
ID23	200	1.00	5.00	3.4250	0.95863
ID24	200	1.00	5.00	3.8000	0.91333
ID25	200	1.00	5.00	3.7100	0.83027

Composite Construct Means

Table 7 summarizes the composite means and standard deviations for all five constructs. Investment Sentiment ($M = 3.77$) and Past Market Returns ($M = 3.71$) registered the highest composite means among the independent variables, while Information Asymmetry ($M = 3.31$) recorded the lowest. The composite mean for Investment Decision was 3.38.

Table 7: Descriptive Statistics – Composite Construct Scores

Construct	N	Mean	Std. Deviation
Investment Sentiment	200	3.7723	0.64405
Market Volatility	200	3.3750	0.71592

Information Asymmetry	200	3.3060	0.77054
Past Market Returns	200	3.7130	0.56696
Investment Decision	200	3.3780	0.69218

Objective 2: Correlation Analysis

Table 8 presents the Pearson correlation matrix for all five constructs. All bivariate correlations were statistically significant at the 0.01 level (two-tailed), confirming that each herding behavior dimension is meaningfully associated with the investment decision variable and with each other.

Table 8: Pearson Correlation Matrix

Variable	InvestorS	MarketV	InformationA	Pastmarket	Investmentb
Investment Sentiment	1	.372**	.506**	.357**	.414**
Market Volatility	.372**	1	.473**	.433**	.481**
Information Asymmetry	.506**	.473**	1	.507**	.491**
Past Market Returns	.357**	.433**	.507**	1	.434**
Investment Decision	.414**	.481**	.491**	.434**	1

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

The strongest correlation with Investment Decision was observed for Information Asymmetry ($r = .491$, $p < .001$), followed by Market Volatility ($r = .481$, $p < .001$), Past Market Returns ($r = .434$, $p < .001$), and Investment Sentiment ($r = .414$, $p < .001$). These results indicate moderate positive relationships, confirming that all four herding dimensions are relevant predictors of investment decisions.

Among the predictor variables, the strongest inter-predictor correlation was between Information Asymmetry and Past Market Returns ($r = .507$) and between Information Asymmetry and Investment Sentiment ($r = .506$), suggesting some degree of overlap among the constructs. However, as the subsequent multicollinearity diagnostics confirm, these intercorrelations were not severe enough to compromise the integrity of the regression analysis.

Objective 3: Multiple Regression Analysis

Multiple linear regression analysis was conducted with Investment Decision as the dependent variable and Investment Sentiment, Market Volatility, Information Asymmetry, and Past Market Returns as the independent variables.

Model Summary

Table 9 presents the model summary. The regression model yielded an R of .600 and an R Square of .360, indicating that the four herding behavior dimensions collectively explained 36.0% of the variance in retail investors' investment decisions. The Adjusted R Square of .347 confirms that this explanatory power holds after adjusting for the number of predictors. The Durbin-Watson statistic of 1.787 falls within the acceptable range (1.5–2.5), indicating that residuals are not significantly autocorrelated and the ordinary least squares assumptions are adequately satisfied.

Table 9: Model Summary

Model	R	R Square	Adj. R Square	Std. Error	Durbin-Watson
1	.600a	.360	.347	.55937	1.787

a. Predictors: (Constant), Past Market Returns, Investment Sentiment, Market Volatility, Information Asymmetry.

b. Dependent Variable: Investment Decision.

ANOVA

The ANOVA results presented in Table 10 confirm the overall statistical significance of the regression model ($F(4, 195) = 27.427, p < .001$). The regression sum of squares was 34.328, considerably exceeding the residual sum of squares of 61.015, demonstrating that the model explains a meaningful and statistically significant portion of variation in the dependent variable.

Table 10: ANOVA

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	34.328	4	8.582	27.427	.000b
Residual	61.015	195	0.313		
Total	95.343	199			

Regression Coefficients and Multicollinearity

Table 11 presents the unstandardized and standardized regression coefficients for each predictor, along with collinearity statistics.

Table 11: Regression Coefficients

Variable	B	Std. Error	Beta	t	Sig.	Tolerance	VIF
(Constant)	0.561	0.307		1.828	.069		
Investment Sentiment	0.167	0.073	0.156	2.300	.023	0.715	1.399
Market Volatility	0.245	0.066	0.253	3.721	.000	0.710	1.408
Information Asymmetry	0.189	0.067	0.211	2.812	.005	0.583	1.715
Past Market Returns	0.198	0.084	0.162	2.343	.020	0.688	1.453

All four predictors were statistically significant at the 5% level. Market Volatility had the largest standardized coefficient ($\beta = .253, t = 3.721, p < .001$), identifying it as the strongest predictor of investment decisions in this model. This was followed by Information Asymmetry ($\beta = .211, t = 2.812, p = .005$), Past Market Returns ($\beta = .162, t = 2.343, p = .020$), and Investment Sentiment ($\beta = .156, t = 2.300, p = .023$).

Multicollinearity diagnostics yielded Tolerance values ranging from 0.583 to 0.715 and VIF values between 1.399 and 1.715. All values fall well within acceptable limits (Tolerance > 0.10; VIF < 10), indicating that multicollinearity does not pose a threat to the validity of the regression estimates (Hair et al., 2010).

The regression equation can be expressed as:

$$\text{Investment Decision} = 0.561 + 0.167(IS) + 0.245(MV) + 0.189(IA) + 0.198(PMR)$$

This equation indicates that a one-unit increase in Market Volatility is associated with the greatest increase in herd-influenced investment decisions (0.245 units), followed by Past

Market Returns (0.198 units), Information Asymmetry (0.189 units), and Investment Sentiment (0.167 units), holding all other variables constant.

Discussion

The findings of this study provide compelling empirical evidence for the role of herding behavior in shaping the investment decisions of retail investors in NEPSE. The significant and positive influence of all four herding dimensions, investment sentiment, market volatility, information asymmetry, and past market returns, is consistent with the theoretical predictions of behavioral finance and with empirical findings from comparable markets.

The emergence of Market Volatility as the strongest predictor of investment decision ($\beta = .253$) aligns with theoretical arguments that uncertainty amplifies the human tendency to seek guidance from the collective. When price movements are rapid and unpredictable, individual investors with limited analytical capacity find it rational to look to the behavior of others as a proxy for market wisdom. This finding is consistent with Christie and Huang (1995) and Chang et al. (2000), who documented heightened herding during volatile market conditions.

Information Asymmetry emerged as the second strongest predictor ($\beta = .211$), reflecting the structural reality of NEPSE as a market where high-quality, timely financial information is not uniformly accessible to all participants. Retail investors, operating under informational disadvantage, tend to infer information from the observable trading patterns of others, generating cascading behavior. This result corroborates the information cascade models of Bikhchandani et al. (1992) and the empirical findings of Sias (2004) regarding information-driven herding.

Past Market Returns ($\beta = .162$) also significantly influenced investment decisions, reflecting the representativeness bias documented by Tversky and Kahneman (1974). Investors in NEPSE appear to extrapolate from recent market performance to form expectations about future returns, leading to trend-chasing behavior. This finding aligns with Barber and Odean (2000), who demonstrated that individual investors disproportionately follow recent winners and avoid recent losers.

Investment Sentiment, while the weakest predictor in the regression model ($\beta = .156$), nonetheless had a statistically significant relationship with investment decisions. The moderate mean score for Investment Sentiment ($M = 3.77$) suggests that investors are generally aware of the emotional dimensions of market participation but may vary in how directly they allow sentiment to override analytical judgment. Baker and Wurgler's (2006) finding that sentiment most strongly affects difficult-to-value stocks may partially explain the relatively smaller coefficient in the Nepalese context, where the market is dominated by banking stocks with more transparent fundamentals.

The high composite mean for Past Market Returns ($M = 3.71$) and the low variability of PMR16 ($SD = 0.73$) suggest a near-universal tendency among NEPSE investors to look backward at market performance when making forward-looking investment decisions. This recency bias is a well-documented manifestation of herding and underscores the need for improved investor education about the limitations of using historical returns as predictors of future performance. The correlation matrix revealed that Information Asymmetry had the highest correlations with both the dependent variable ($r = .491$) and with other predictors ($r = .506$ with Investment

Sentiment and $r = .507$ with Past Market Returns). This suggests that information deficits are not only directly influential on investment decisions but also interact with, and potentially exacerbate, the influence of sentiment and past returns. Addressing information asymmetry through enhanced disclosure requirements and investor education could therefore have a broad dampening effect on herding behavior.

Overall, the regression model explained 36.0% of the variance in investment decisions, a substantial portion given that the model is limited to behavioral dimensions of herding and does not include firm-specific or macroeconomic control variables. The inclusion of such variables in future research could yield an even more comprehensive explanation of investment decision-making in NEPSE.

Conclusion and Recommendations

Conclusion

This study investigated the effect of herding behavior on stock market investment decisions among retail investors in the Nepal Stock Exchange (NEPSE). Drawing on a sample of 201 retail investors and employing descriptive statistics, Pearson correlation, and multiple regression analysis, the study found that all four dimensions of herding behavior, investment sentiment, market volatility, information asymmetry, and past market returns, exert a statistically significant positive influence on investment decisions.

Market Volatility was identified as the most influential predictor, followed by Information Asymmetry, Past Market Returns, and Investment Sentiment. Together, these four variables explained 36.0% of the variance in investment decision-making, confirming that herding behavior constitutes a substantial and measurable force in the NEPSE market environment.

The reliability analysis confirmed the internal consistency of all measurement constructs (all Cronbach's Alpha values ≥ 0.665), lending confidence to the validity of the findings. The absence of significant multicollinearity among predictors further supports the robustness of the regression results.

These findings have important implications. They confirm that NEPSE retail investors do not consistently behave as rational, independent agents as classical finance theory would predict, but instead are meaningfully influenced by social learning, emotional contagion, information deficits, and recency bias. Acknowledging these behavioral realities is a necessary first step toward building a more mature and efficient Nepalese capital market.

Recommendations

Based on the findings, the following recommendations are offered:

1. Financial literacy campaigns should be intensified. SEBON and NEPSE should prioritize investor education initiatives that specifically address cognitive biases such as herding, representativeness, and overconfidence. Educational content should be practically oriented, helping investors recognize these biases in their own decision-making.
2. Disclosure and transparency standards should be strengthened. The significant role of information asymmetry in driving herding behavior underscores the need for improved financial disclosure norms in Nepal. Mandatory and timely publication of company financial statements, dividend announcements, and corporate governance reports can

reduce the information advantage currently enjoyed by institutional insiders over retail investors.

3. Volatility management mechanisms should be reviewed. Given the strong influence of market volatility on herding behavior, regulators should evaluate the adequacy of existing circuit breaker and price limit mechanisms. Appropriately calibrated volatility controls could help dampen panic-driven herding during market downturns.
4. Investors should develop systematic investment frameworks. Individual investors are encouraged to adopt disciplined investment strategies based on fundamental analysis rather than market trends and peer behavior. Systematic approaches such as dollar-cost averaging and portfolio diversification can mitigate the behavioral tendencies identified in this study.
5. Financial institutions should integrate behavioral insights. Brokerage firms, investment advisors, and fund managers operating in NEPSE should integrate awareness of behavioral biases into their client advisory services, developing products and communication strategies that help clients make more deliberate and less emotionally reactive investment decisions.

Limitations and Future Research

The study is subject to several limitations. The sample, while adequate, was drawn using a non-probability method and may not fully represent the entire population of NEPSE retail investors. The self-report nature of the questionnaire introduces the possibility of social desirability bias. Additionally, the study is cross-sectional and thus cannot establish causality in a strict temporal sense.

Future research could address these limitations by employing longitudinal designs, probability sampling, and panel data methods. The incorporation of objective market data, such as trading volume, price return volatility indices, and cross-sectional return dispersions, alongside survey data would enable a richer triangulation of herding behavior. Extensions to other asset classes (bonds, mutual funds, commodities) and comparisons across investor segments (institutional versus retail) would also enrich the understanding of herding dynamics in Nepal's evolving capital market.

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Data availability

All data will be provided with a reasonable request to the corresponding author.

Declarations

Ethics approval and consent to participate

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Consent for publication

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Competing interests

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