CHAPTER 26

Behavioural and Financial Determinants of Retail Investors' Participation in Green Finance Initiatives

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ABSTRACT

This paper studies the behavioural and financial factors that influence retail investors' participation in green finance initiatives. Traditional financial theory suggests that investors take rational decisions mainly based on risk and return. In real situations, investors consider their emotions, values, and awareness about environmental issues while investing. The study is based on a descriptive review of existing literature and explains behavioural factors such as concern for the environment, social responsibility, overconfidence, herd behaviour, loss aversion and long-term thinking. It also looks at financial factors like income level, financial literacy, risk tolerance, expected returns, liquidity needs and investment horizon. Ethical values and concern for sustainability also affect their decisions. Higher financial literacy helps investors better understand green financial products and increases their confidence. The paper presents a simple framework showing how behavioural and financial factors together influence participation in green investments. The findings may help policymakers, financial educators and advisers promote awareness of sustainable finance among retail investors.

Keywords: Green finance; Retail investor behaviour; Behavioural finance; Sustainable investment; ESG investing.

1.0 Introduction

Green finance has gained significant importance in modern financial markets. It refers to financial activities and investments that promote environmental sustainability and support the transition to a low-carbon economy. Across the globe, governments and financial institutions are encouraging sustainable financial products such as green bonds and ESG-based funds. Retail investors contribute significantly to the growth of green finance by investing in such products. Their involvement strengthens sustainable markets and supports long-term economic stability.

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However, investment decisions are influenced by more than financial returns. Emotional factors, personal values, environmental awareness, and social responsibility also shape investor behaviour. At the same time, financial aspects like income level, financial literacy, risk preference, and investment horizon play a key role. This research focuses on analysing the combined impact of behavioural and financial factors on green investment decisions.

1.1 Purpose of the study

The main purpose of this study is to understand the behavioural and financial factors that influence retail investors' participation in green finance initiatives. Green finance focuses on investments that support environmental protection, renewable energy and sustainable development.

1.2 Background of the study

In recent years, sustainable and green finance investments have grown rapidly across the world. Governments and financial institutions are promoting green bonds, ESG funds and other sustainable financial products. These investments aim to reduce environmental damage and support a low-carbon economy. Retail investors are playing an increasingly important role in sustainability markets. Their participation helps mobilise private capital for green projects and supports long-term environmental goals.

1.3 Problem statement

Traditional financial theory assumes that investors make rational decisions based mainly on risk and return. However, in reality, investors are influenced by emotions, personal values, environmental awareness and financial knowledge. Because of this, participation in green finance does not always depend only on profit considerations.

1.4 Importance of behavioural and financial factors

Both behavioural factors (such as environmental concern, social responsibility and risk perception) and financial factors (such as income, financial literacy and risk tolerance) affect investment decisions. Understanding these factors is important to encourage greater participation in green finance initiatives.

1.5 Objectives of the study

- To identify behavioural factors influencing participation in green finance.
- To examine financial factors affecting sustainable investment decisions.
- To analyse how behavioural and financial factors together influence participation in green finance initiatives.

1.6 Significance of the study

This research explains how investors make decisions about green investments. It provides guidance to financial institutions and regulators to improve financial education and promote environmentally responsible investment practices.

2.0 Literature Review

Many studies explain that retail investors' decisions in green finance are affected by both behavioural and financial factors. Environmental concern, social responsibility and investor emotions influence participation in sustainable investments. At the same time, income level, financial literacy and risk tolerance also affect investment decisions. However, most research studies these factors separately, and limited research combines both to explain participation in green finance initiatives.

Behavioural factors like environmental concern and ethics influence investors to choose socially responsible investments. John R. Nofsinger (2014) explained that investors who care about environmental and social issues are more likely to choose socially responsible investments. His study shows that personal values strongly influence portfolio choices. Lewis & Mackenzie (2000) found that ethical awareness plays an important role in investment decision-making. Investors who are socially conscious prefer companies that follow responsible practices. Social responsibility is an important behavioural factor that influences investors to prefer companies with strong environmental performance and ethical values. Derwall et al. (2005) showed that companies with strong environmental performance attract more investor interest. Their findings suggest that good sustainability performance can positively affect investment decisions.

Meir Statman (2000) discussed value-based investing and socially responsible portfolios. He explained that many investors consider moral and social values along with financial returns. Overconfidence is a behavioural bias where investors believe they can outperform the market, often leading to excessive trading and risky decisions. Barber and Odean (2001) found that overconfident investors trade more frequently and often believe they can outperform the market. This bias may lead to poor or risky investment decisions. Herd behaviour is a behavioural factor where investors follow others' actions instead of making independent investment decisions.

Abhijit V. Banerjee (1992) explained that individuals often follow others' actions instead of making independent decisions. This herd behaviour can influence investment patterns in financial markets. Hong et al. (2004) studied social interaction and found that people are more likely to invest when others around them also participate. Social influence increases stock market participation. Loss aversion is a behavioural bias where investors fear losses more than they value gains, influencing their risk-taking and investment decisions. Kahneman and Tversky (1979) developed Prospect Theory, which explains that investors fear losses more than they value gains. This loss aversion affects risk-taking and investment choices. Long-term orientation is a behavioural factor where investors with stable income and a future-focused approach are more likely to participate in financial markets. Guiso et al. (2008) found that wealth and income influence stock market participation. Investors with stable income and long-term focus are more likely to invest in financial markets. Income level is an important financial factor, as higher income and wealth increase the likelihood of participating in investment markets. Guiso et al. (2008) showed that higher income and wealth increase the likelihood of participating in investment markets. Financial stability improves investment capability. Financial literacy is a key financial factor that influences investment decisions, as knowledgeable investors make more informed and confident choices. Lusardi and Mitchell (2007) demonstrated that financial literacy significantly affects investment decisions. Investors with better knowledge make more informed and confident choices. Risk tolerance is an important financial factor that determines whether investors participate in risky assets like stocks.

John Y. Campbell (2006) studied household finance and found that risk tolerance determines participation in risky assets like stocks. Individuals with higher risk tolerance invest more in equity markets. Expected return is a key financial factor that influences investment decisions, as investors base their choices on anticipated returns.

Eugene F. Fama (1970) introduced the Efficient Market Hypothesis, explaining that investors form return expectations based on available information. Expected returns influence investment decisions. Liquidity needs and investment horizon are important financial factors that influence portfolio selection and risk-taking decisions. Bodie, Kane, and Marcus explained that liquidity needs and time horizon are important in portfolio selection. Investors with short-term needs prefer liquid assets, while long-term investors can take higher risks. Sustainable investing behaviour shows that companies with strong ESG performance can also achieve good financial results. Friede et al. (2015) conducted a meta-analysis showing a positive relationship between ESG performance and financial performance. Their findings support the idea that sustainable investing can be financially beneficial. UNEP Finance Initiative promotes the integration of ESG factors into financial decision-making. It highlights the importance of sustainability in global financial markets. Global Sustainable Investment Alliance (GSIA Reports) indicate that global participation in sustainable investments is steadily increasing. Retail investors are showing growing interest in green and ESG-based products.

2.1 Research gap

Many studies focus separately on behavioural finance or sustainable investing. However, limited research combines both psychological and financial determinants to explain retail investors' participation in green finance. Few studies explain how behavioural biases and financial capacity interact together to influence retail investors' decisions in sustainable investments. Therefore, this study addresses the gap by developing a combined conceptual model of behavioural and financial determinants influencing retail participation in green finance initiatives.

3.0 Research Methodology

This study is descriptive and conceptual in nature. It is based on secondary data from journals, books, and official reports related to behavioural and green finance. No primary data were collected. The selected studies analysed using thematic analysis to identify important behavioural and financial factors. These factors were grouped and compared to understand their impact on retail investors' participation in green finance. Based on these findings, a conceptual framework was constructed to explain retail investors' participation in green finance.

4.0 Data Analysis

This study adopts a conceptual analysis to explain the relationship between behavioural and financial determinants and retail investors' participation in green finance initiatives. Instead of using statistical tools, the analysis focuses on understanding how different factors logically influence investment decisions. Green investment decisions are not based only on financial returns; they are also shaped by psychological attitudes, personal values and financial capability.

Behavioural factors play an important role in shaping investors' intentions. For example, investors with strong environmental concern are more likely to support sustainable projects because they value environmental protection. Social responsibility and ethical motivation encourage individuals to align their financial decisions with their personal beliefs. Behavioural factors can sometimes limit investment decisions. Due to loss aversion, investors may hesitate to invest in green products that seem risky or new. Similarly, herd behaviour may influence investors to participate only when green investments become popular in the market. Long-term orientation supports green investing because many sustainable projects generate returns over a longer period.

Financial factors also significantly affect participation. Financial literacy improves understanding of green bonds, ESG funds and other sustainable financial instruments. Investors with higher financial knowledge feel more confident in evaluating risks and returns. Income level determines the ability to allocate funds for green investments. Risk tolerance influences whether investors are willing to invest in innovative or equity-based green products. Liquidity needs and investment horizon further shape decisions, as some green projects require long-term commitment.

Table 1: Factors Influencing Green Investment

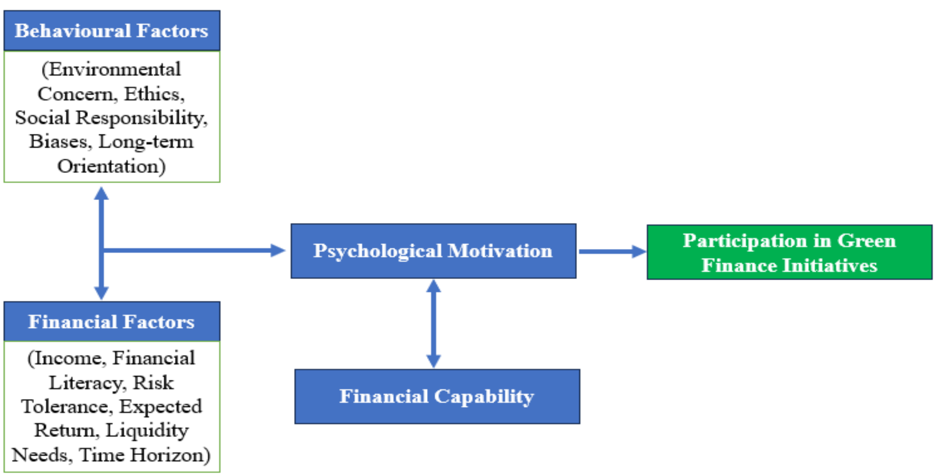
Factor	Influence on Green Investment
Environmental concern	Increases willingness to invest sustainably
Loss aversion	Reduces participation in unfamiliar green products
Financial literacy	Improves understanding and confidence
Risk tolerance	Determines participation in higher-risk green assets

The conceptual model of this study explains that retail investors' participation in green finance initiatives depends on two major groups of factors: behavioural factors and financial factors. Both are equally important and work together to influence investment decisions. Behavioural factors include environmental concern, social responsibility, ethical values, long-term thinking and behavioural biases such as loss aversion or herd behaviour. These factors create motivation, intention and positive attitude towards sustainable investments. They answer the question: *"Why should I invest in green finance?"*

Financial factors include income level, financial literacy, risk tolerance, expected return, liquidity needs and investment horizon. These factors provide the ability, knowledge and confidence to invest. They answer the question: *"Can I invest, and is it financially suitable for me?"*

If an investor has strong environmental concern but lacks financial literacy or sufficient income, participation in green finance may remain limited. On the other hand, an investor may have good financial knowledge and income, but without environmental awareness, they may prefer conventional investments. Therefore, actual participation occurs only when both motivation and financial capability are present.

Figure 1: Green Finance Participation Flowchart Diagram



The flowchart explains how retail investors participate in green finance initiatives based on two main groups of factors: behavioural factors and financial factors. First, behavioural factors such as environmental concern, ethics, social responsibility, personal biases, and long-term orientation create psychological motivation. This means that when investors care about the environment and future sustainability, they develop an intention or desire to invest in green financial products.

Second, financial factors such as income level, financial literacy, risk tolerance, expected return, liquidity needs, and investment time horizon create financial capability. This means investors must have enough money, knowledge, and risk-taking ability to actually invest.

The flowchart shows that:

- Behavioural Factors → create Psychological Motivation
- Financial Factors → create Financial Capability
- When both motivation and capability are present → Investors Participate in Green Finance Initiatives

In simple words, an investor may want to invest in green products (motivation), but without enough income or financial knowledge (capability), participation may not happen. Similarly, having money and knowledge without environmental concern may also reduce green investment. Green finance participation happens when both psychological motivation and financial capability work together.

5.0 Findings / Results

The study shows that environmental awareness plays an important role in encouraging retail investors to participate in green finance initiatives. Investors who care about environmental protection and sustainability are more likely to choose green investment options. It is also found that financial literacy increases confidence in making green investment decisions. Investors who understand financial products and market concepts feel more comfortable investing in sustainable assets.

However, behavioural biases, such as loss aversion and herd behaviour, may slow down the adoption of new or unfamiliar green financial products. Investors may hesitate if they perceive higher risk or uncertainty. The findings further indicate that ethical values and social responsibility influence long-term sustainable investment decisions. Investors with strong moral values tend to support environmentally friendly projects.

The results suggest that both psychological motivation (behavioural factors) and financial capability (financial factors) together determine participation in green finance initiatives. Green investment is more likely when investors have both the desire and the ability to invest.

6.0 Conclusion and Implications

The study concludes that retail investors are not purely profit-oriented; they also consider sustainability and ethical values while making investment decisions. Environmental concern and social responsibility significantly influence their willingness to participate in green finance initiatives. At the same time, financial factors such as income, financial literacy, and risk tolerance also play an important role. Therefore, participation in green finance is determined by the combined effect of behavioural motivation and financial capability. The findings have important implications. For investors, increasing awareness about green financial products can improve informed decision-making. For financial advisors, understanding clients' behavioural preferences and financial capacity can help provide more tailored and suitable guidance. For policymakers, promoting green finance education and awareness programs can encourage greater retail participation and support sustainable economic development.

7.0 Recommendations

Based on the findings of the study, several practical recommendations can be suggested to improve retail investors' participation in green finance initiatives. First, there is a strong need for investor awareness programmes focused specifically on green finance. Workshops, seminars, webinars, and digital campaigns can help investors understand the importance of sustainable investments and their long-term benefits. Increasing awareness will strengthen psychological motivation and reduce hesitation toward green financial products.

Second, financial institutions and regulators should provide simplified explanations of ESG and green investment products. Many retail investors avoid such products because they find them complex or difficult to understand. Clear, simple, and transparent communication about risk, return, and environmental impact can increase trust and participation.

Third, financial literacy training programmes should be promoted at educational institutions and community levels. Improving financial knowledge will enhance investors' confidence, decision-making ability, and understanding of green financial instruments. Higher financial literacy directly supports financial capability.

Fourth, financial advisors should adopt behaviour-based advisory services. Advisors must consider clients' environmental values, risk tolerance, biases, and long-term goals while recommending green investments. Personalized guidance can bridge the gap between motivation and action.

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