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HOW DOES BEHAVIOURAL BIASES AND EMOTIONAL INTELLIGENCE INFLUENCE ON INDIVIDUAL INVESTMENT DECISIONS: MEDIATING ROLE OF RISK TOLERANCE

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Abstract

In the landscape of investment decision-making, the role of behavioral biases and emotional intelligence has garnered substantial attention. However, an overlooked facet in the extant literature pertains to the mediating influence of risk tolerance in this intricate relationship. This study endeavors to address this gap by investigating the interplay between behavioral biases, emotional intelligence, and investment decisions among individual investors in the Colombo Stock Exchange. The study population comprises both local and foreign investors, totaling 706,735. Employing a convenience sampling technique, a sample of 384 respondents was derived, and their insights were gathered through a 5-point Likert scale online survey. The analytical framework involved refining 359 responses for comprehensive analysis. Statistical analysis was conducted using SPSS and Smart PLS Version 4, employing the Partial Least Squares Structural Equation Modeling (PLS-SEM) technique. The results reveal a significant and positive impact of both behavioral biases and emotional intelligence on investment decision-making. Moreover, the study denotes a noteworthy positive influence of risk tolerance on investment decisions. Crucially, the mediation role of risk tolerance is substantiated, acting as a partial mediator between the relationship of behavioral biases and investment decision-making, as well as between emotional intelligence and investment decision-making. The implications of these findings shed light on the complex dynamics governing investment choices and underscore the significance of considering risk tolerance as a pivotal factor in understanding investor behavior. Consequently, this study contributes not only to the theoretical realm but also presents practical recommendations for investors, financial professionals, and market regulators alike.

Keywords: Behavioural Biases, Emotional Intelligence, Risk Tolerance, Investment Decision Making

1.0 Introduction

Investment decision-making remains one of the most extensively studied areas in finance, particularly in understanding the behaviour of individual investors operating under conditions of uncertainty. Traditional financial theories, including the Efficient Market Hypothesis (EMH) and Expected Utility Theory, assume that investors behave rationally and make decisions aimed at maximizing wealth. However, a growing body of behavioural finance literature

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demonstrates that investment decisions are often influenced by psychological, cognitive, and emotional factors that cause investors to deviate from rational behaviour (Shefrin, 2000; Kahneman & Tversky, 1979).

Recent developments in behavioural finance have further emphasized the importance of understanding the psychological mechanisms that shape investor behaviour. Ahiadu (2025) argues that adaptive market perspectives increasingly recognize the influence of emotions, bounded rationality, and market imperfections in investment decision making. Similarly, Aziz et al. (2024) found that behavioural biases significantly affect investment decisions among stock market investors, highlighting the continuing relevance of behavioural factors in contemporary financial markets. These findings suggest that investment decisions are not solely driven by objective financial information but are also influenced by investors' perceptions, emotions, and behavioural tendencies. Behavioural biases represent systematic deviations from rational judgment that arise when individuals rely on cognitive shortcuts or heuristics while making decisions under uncertainty (Raheja & Dhiman, 2020). Previous studies have identified several behavioural biases, including overconfidence, anchoring, representativeness, herding behaviour, and loss aversion, as significant determinants of investment decision-making (Waweru et al., 2008; Kengatharan & Kengatharan, 2014; Aziz et al., 2024). These biases often influence how investors interpret market information, evaluate investment opportunities, and respond to financial risks, leading to investment decisions that may differ from those predicted by traditional finance theories.

Alongside behavioural biases, emotional intelligence has emerged as an important psychological factor influencing investment behaviour. Emotional intelligence refers to an individual's ability to perceive, understand, regulate, and effectively utilize emotions in decision-making situations (Mayer & Salovey, 1997). Financial markets are characterized by uncertainty, volatility, and information asymmetry, making emotional regulation particularly important for investors. Ameriks et al. (2009) suggest that individuals with higher emotional intelligence tend to exhibit greater confidence and adaptability when facing financial uncertainty. More recent studies have similarly reported that emotionally intelligent investors are better able to manage emotional reactions and make more balanced investment decisions (Sharma, 2024; Kumari et al., 2022).

Furthermore, investment decisions are inherently associated with risk and uncertainty, making risk tolerance a critical component of investor behaviour. Risk tolerance reflects an individual's willingness to accept uncertainty and potential losses in pursuit of expected returns. Emerging evidence suggests that behavioural biases and emotional intelligence influence how investors perceive and respond to risk, which subsequently affects their investment choices (Ahmed et al., 2022; Singh et al., 2022). Consequently, risk tolerance may serve as an important psychological mechanism through which behavioural biases and emotional intelligence influence investment decision-making.

The Colombo Stock Exchange (CSE), as the primary capital market in Sri Lanka, has experienced increasing participation from individual investors over the past decade. Despite the growing interest in behavioural finance, empirical evidence regarding the integrated influence of behavioural biases, emotional intelligence, and risk tolerance on investment decisions remains limited in emerging market contexts. Existing studies have largely examined these factors independently, providing limited understanding of the mechanisms through which cognitive and emotional characteristics influence investment behaviour. Therefore, examining

the mediating role of risk tolerance offers an opportunity to advance the theoretical understanding of investor behaviour while providing practical insights for investors, financial advisors, regulators, and market educators. Accordingly, this study investigates the influence of behavioural biases and emotional intelligence on the investment decisions of individual investors in the Colombo Stock Exchange, while examining the mediating role of risk tolerance. By integrating behavioural, emotional, and risk-related factors within a single framework, the study contributes to the growing behavioural finance literature and enhances understanding of investor behaviour in an emerging market setting.

1.1 Research Problem Identification and Justification

Behavioural finance literature has increasingly challenged the traditional assumption that investors behave rationally when making financial decisions. Instead, investment decisions are influenced by a range of psychological, emotional, and cognitive factors that often lead investors to deviate from rational decision-making processes (Shefrin, 2000; Bakar & Yi, 2016). Consequently, understanding the behavioural determinants of investment decisions has become a significant area of research within modern finance. A substantial body of empirical research has examined the influence of behavioural biases on investment decision-making. Studies conducted by Waweru et al. (2008), Kengatharan and Kengatharan (2014), Alquraan et al. (2016), and Keswani et al. (2019) reported that behavioural biases significantly affect investors' stock selection and investment behaviour. Similarly, Sri Lankan studies such as Gunathilaka (2014), Menike et al. (2015), Wijekumara and Madhushanka (2019), Somathilake (2020), and Dumohar et al. (2022) have explored factors influencing investment decisions among investors in the Colombo Stock Exchange. However, these studies primarily focused on either behavioural factors or investment determinants independently and provided limited attention to the interaction between cognitive and emotional factors in shaping investment behaviour.

More recently, researchers have emphasized the importance of emotional intelligence in financial decision-making. Emotional intelligence enables individuals to recognize, regulate, and effectively utilize emotions when making decisions under uncertainty (Mayer & Salovey, 1997). Empirical evidence suggests that emotionally intelligent investors are better equipped to manage stress, avoid impulsive reactions, and make more informed investment decisions (Ameriks et al., 2009; Ahmed et al., 2022; Sharma, 2024). Despite these findings, the integration of emotional intelligence with behavioural biases within a single explanatory framework remains relatively limited, particularly in emerging market contexts. Furthermore, investment decisions inherently involve risk, making risk tolerance a critical psychological characteristic influencing investor behaviour. Risk tolerance reflects an individual's willingness to accept uncertainty and potential losses in pursuit of expected returns. Previous studies have demonstrated that behavioural biases influence investors' perceptions of risk, while emotional intelligence affects individuals' ability to regulate emotional responses to uncertain situations (Loewenstein et al., 2001; Raheja & Dhiman, 2020). Consequently, risk tolerance may serve as an underlying mechanism through which behavioural biases and emotional intelligence influence investment decision-making. However, existing empirical findings regarding this mediating role remain fragmented and inconclusive.

A review of prior literature reveals three important research gaps. First, an empirical gap exists because most previous studies have examined behavioural biases, emotional intelligence, and risk tolerance as independent determinants of investment decisions rather than investigating

their integrated relationships within a single model (Ahmed et al., 2022; Aziz et al., 2024). Second, a theoretical gap exists regarding the mechanism through which behavioural and emotional factors influence investment decisions, as limited studies have examined risk tolerance as a mediating variable linking these psychological constructs to investment behaviour. Third, a contextual gap exists because evidence from emerging markets, particularly Sri Lanka and the Colombo Stock Exchange, remains relatively scarce despite the growing participation of individual investors in equity markets.

Addressing these gaps is important for both theory and practice. From a theoretical perspective, examining the mediating role of risk tolerance contributes to behavioural finance literature by providing a deeper understanding of the psychological processes underlying investment decision-making. From a practical perspective, understanding how behavioural biases, emotional intelligence, and risk tolerance jointly influence investment behaviour can assist investors, financial advisors, regulators, and financial educators in developing strategies to improve investment outcomes and promote more informed decision-making. Therefore, this study seeks to examine the influence of behavioural biases and emotional intelligence on the investment decisions of individual investors in the Colombo Stock Exchange while investigating the mediating role of risk tolerance. By integrating behavioural, emotional, and risk related dimensions into a unified framework, the study aims to extend existing behavioural finance literature and provide evidence from an important emerging market setting.

1.2 Research Question

How do behavioural biases and emotional intelligence influence the investment decisions of individual investors at the Colombo Stock Exchange, and to what extent does risk tolerance mediate these relationships?

1.3 Research Objective

The main objective of the study is to identify the impact of behavioral biases, emotional intelligence on investment decisions of individual investors at the Colombo Stock exchange, with the mediating role of risk tolerance.

2. Literature Review

2.1 Behavioural Finance Theory

Traditional financial theories such as the Efficient Market Hypothesis (EMH), Modern Portfolio Theory (MPT), and the Capital Asset Pricing Model (CAPM) are founded on the assumption that investors behave rationally and make decisions aimed at maximizing expected utility (Masomi & Ghayekhloo, 2011; Chandra & Kumar, 2012). These theories assume that investors possess complete information, process information objectively, and consistently select investment alternatives that optimize risk-adjusted returns. However, numerous market anomalies and empirical observations have challenged these assumptions, giving rise to the field of behavioural finance.

Behavioural finance integrates insights from psychology and finance to explain why investors frequently deviate from rational decision-making. Kahneman and Tversky's (1979) Prospect Theory represents one of the most influential theoretical foundations of behavioural finance.

Unlike Expected Utility Theory, Prospect Theory suggests that individuals evaluate gains and losses relative to a reference point and exhibit loss aversion, whereby losses are perceived more intensely than equivalent gains. Consequently, investors often display behaviours that contradict traditional financial predictions, particularly when faced with uncertainty and risk. Behavioural finance further suggests that investors rely on heuristics or mental shortcuts when processing information and making financial decisions (Kahneman & Tversky, 1974; Ritter, 2003). Although heuristics simplify complex decision-making situations, they may result in systematic biases that affect investment outcomes. Therefore, understanding these behavioural tendencies is essential for explaining investor behaviour in contemporary financial markets.

2.2 Behavioural Biases and Investment Decision-Making

Behavioural biases refer to systematic deviations from rational judgment caused by cognitive limitations, psychological tendencies, and heuristic driven decision processes. Previous research identifies several common behavioural biases influencing investment decisions, including overconfidence, herding, anchoring, representativeness, and loss aversion (Waweru et al., 2008; Keswani et al., 2019). Overconfidence bias causes investors to overestimate their knowledge, forecasting ability, and investment skills, often resulting in excessive trading and increased risk taking behaviour. Representativeness bias leads investors to form judgments based on recent trends or limited information, causing them to overlook broader market realities. Anchoring bias occurs when investors rely excessively on initial information or reference points when evaluating investment opportunities. Similarly, herding behaviour encourages investors to imitate the actions of others rather than relying on their own analysis, while loss aversion causes investors to avoid realizing losses even when doing so would be financially beneficial. Empirical evidence generally supports the influence of behavioural biases on investment decisions. Waweru et al. (2008), Alquraan et al. (2016), Keswani et al. (2019), and Jain et al. (2023) reported significant relationships between behavioural biases and investor decision-making. Similarly, studies conducted within the Sri Lankan context found that behavioural factors significantly influence investment decisions among Colombo Stock Exchange investors (Kengatharan & Kengatharan, 2014; Menike et al., 2015; Dumohar et al., 2022). However, findings are not entirely consistent across studies. While some researchers report strong effects of herding behaviour and overconfidence, others find weaker or context-dependent relationships influenced by market conditions, investor experience, and cultural characteristics. These inconsistencies suggest that additional psychological mechanisms may influence how behavioural biases translate into investment decisions.

2.3 Emotional Intelligence and Investment Decision-Making

Beyond cognitive biases, emotional factors play a significant role in financial decision-making. Emotional Intelligence (EI), introduced by Mayer and Salovey (1993, 1997), refers to an individual's ability to perceive, understand, regulate, and utilize emotions effectively. Goleman (2006) further conceptualized emotional intelligence through dimensions such as self-awareness, self-management, social awareness, and relationship management. Financial markets are inherently characterized by uncertainty, volatility, and information asymmetry. Consequently, investors frequently experience emotions such as fear, anxiety, regret, and excitement when making investment decisions. Investors with higher levels of emotional intelligence are generally better able to regulate these emotions and make more balanced investment decisions. Empirical studies provide evidence supporting the role of emotional intelligence in investment behaviour. Ameriks et al. (2009) found that emotionally intelligent

individuals display more effective financial decision-making and greater adaptability in uncertain investment environments. Similarly, Quinn and Wilemon (2009), Tanvir et al. (2016), and Kumari et al. (2022) reported that emotional intelligence positively influences investment decision quality by reducing impulsive behaviour and improving emotional regulation. Despite growing interest in emotional intelligence, most studies have examined its direct influence on investment decisions, with limited attention given to the underlying mechanisms through which emotional intelligence affects investor behaviour.

2.4 Risk Tolerance and Investment Decision-Making

Risk tolerance is widely recognized as one of the most important determinants of investor behaviour. It refers to an individual's willingness to accept uncertainty and potential losses in pursuit of expected returns (Bodie et al., 2014). Investors are commonly categorized as risk-averse, risk-neutral, or risk-seeking depending on their attitudes toward financial risk. Previous studies suggest that risk tolerance is influenced by both individual characteristics and external environmental factors. Demographic variables such as age, gender, income level, education, and investment experience have been found to influence risk tolerance levels (Falahati & Paim, 2012; Hoffmann et al., 2013; Thennakoon & Liyanage, 2023). Investors with higher risk tolerance are generally more willing to invest in high-risk, high-return financial assets, whereas risk-averse investors tend to prefer safer investment alternatives. Empirical evidence consistently demonstrates a significant relationship between risk tolerance and investment decision-making. Nguyen et al. (2016) reported that risk tolerance significantly influences portfolio selection and investment behaviour. Similarly, Singh et al. (2022) found that differences in risk tolerance contribute substantially to variations in investment choices among individual investors. More importantly, behavioural finance theory suggests that risk tolerance may function as an intervening psychological mechanism linking behavioural biases and emotional intelligence with investment decisions. Behavioural biases influence how investors perceive and evaluate financial risk, while emotional intelligence affects individuals' ability to regulate emotions associated with uncertainty and potential losses. These psychological characteristics subsequently influence an individual's willingness to accept risk, which ultimately shapes investment behaviour (Loewenstein et al., 2001; Raheja & Dhiman, 2020). Therefore, risk tolerance may not merely act as an independent predictor of investment decisions but may serve as a mediating mechanism through which behavioural biases and emotional intelligence influence investor behaviour. Despite this theoretical proposition, empirical evidence examining the mediating role of risk tolerance remains limited, particularly within emerging market contexts such as Sri Lanka.

2.5 Synthesis of Literature and Research Gap

A review of the existing literature reveals several important gaps. First, previous studies have predominantly examined behavioural biases, emotional intelligence, and risk tolerance as independent determinants of investment decisions rather than investigating their integrated relationships within a single theoretical framework. Second, although behavioural biases and emotional intelligence have been individually linked to investment decision-making, limited empirical evidence exists regarding the mechanism through which these factors influence investment behaviour. Specifically, the mediating role of risk tolerance remains underexplored. Third, prior findings regarding the influence of behavioural biases are not entirely consistent across different contexts, suggesting the need for further investigation into factors that may explain these variations. Finally, empirical evidence from emerging markets, particularly Sri

Lanka and the Colombo Stock Exchange, remains relatively limited compared with developed markets. Accordingly, the present study addresses these empirical, theoretical, and contextual gaps by examining the influence of behavioural biases and emotional intelligence on investment decisions while investigating the mediating role of risk tolerance among individual investors in the Colombo Stock Exchange.

3.0 Methodology

The study employs a quantitative explanatory research design grounded in the positivist paradigm. Data were collected through a structured online questionnaire distributed to individual equity investors of the Colombo Stock Exchange. Using a deductive approach, the study develops and tests hypotheses based on established behavioural finance and emotional intelligence theories. Data were analysed using descriptive statistics and Partial Least Squares Structural Equation Modeling (Smart PLS-SEM) to assess reliability, validity, model fit, and both direct and mediating relationships among emotional intelligence, risk tolerance, and investment decision-making.

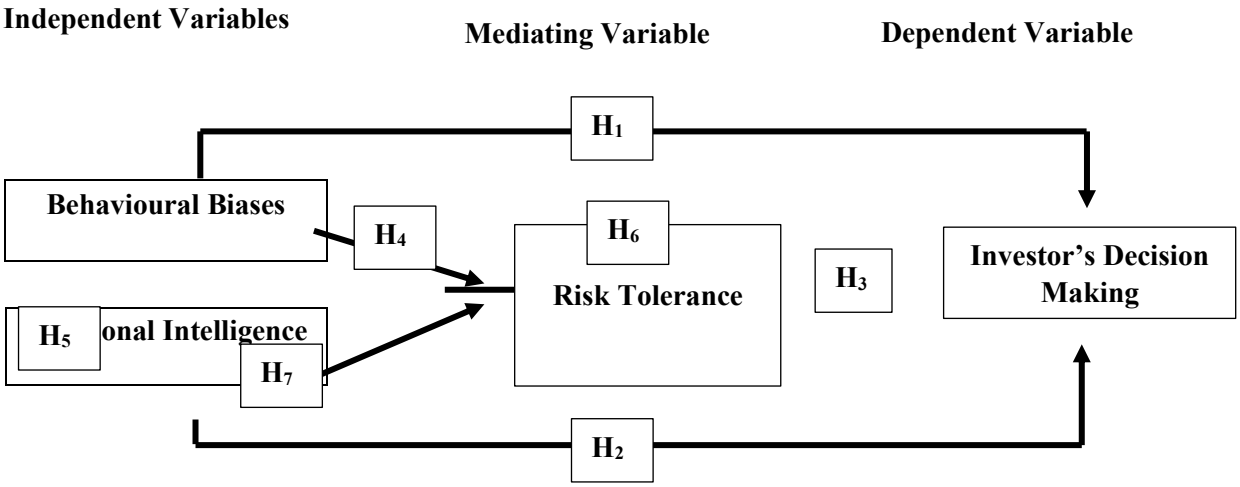


Figure 01: Conceptual Framework of the study
Source : Author Complied (2025)

3.1 Population and Sampling

The population of this study comprises individual investors who actively trade equities and other financial instruments listed on the Colombo Stock Exchange (CSE). According to the Colombo Stock Exchange (2024), there were approximately 706,735 local individual investors, representing the target population for this research. The minimum sample size was determined using the Krejcie and Morgan (1970) sample size determination table. For a population exceeding 700,000 individuals, the recommended minimum sample size is 384 respondents. Accordingly, a total of 384 responses were collected. Due to the absence of an accessible sampling frame containing the contact details of all CSE investors, a non-probability convenience sampling technique was employed. The online questionnaire was distributed through investor networks, social media platforms, and investment-related groups to reach active individual investors. Although convenience sampling limits the generalizability of findings, efforts were made to obtain responses from investors with diverse demographic and investment characteristics, including variations in age, gender, educational attainment, income level, investment experience, and portfolio size. Following data screening procedures,

responses containing missing values and identified outliers were removed. As a result, 359 valid responses were retained for the final analysis.

3.2 Data Collection and Measurement

Primary data were collected through a structured online questionnaire administered using Google Forms. The questionnaire consisted of four sections designed to measure behavioural biases, emotional intelligence, risk tolerance, and investment decision-making. Behavioural biases were operationalized through items reflecting key cognitive and behavioural tendencies identified in behavioural finance literature, while emotional intelligence, risk tolerance, and investment decision-making were measured using established scales adapted from prior studies. All measurement items were assessed using a five-point Likert scale ranging from 1 = Strongly Disagree to 5 = Strongly Agree. The use of a standardized Likert scale facilitated the collection of reliable and comparable quantitative data while capturing respondents' perceptions, attitudes, and behavioural tendencies related to investment decision-making.

Table 01 : Operationalization of the Variables

Variable	Dimension	Measurement Scale	Source
Behavioural Biases	Overconfidence, Herding, Anchoring, Representativeness, and Loss aversion	Likert scale	(Rajeswaran, 2020), (Sukamulja & Senoputri, 2019) Kengatharan & Kengatharan (2014)
Emotional Intelligence	Self-Awareness Self-Regulation Motivation Empathy Social Skills	Likert scale	(Golmen, 2006), (Tanvir & Safyan, 2016)
Risk Tolerance	Risk Tolerance	Likert scale	(Kanagasabai & Aggarawal, 2020) (Mubaraq et al., 2021)
Investment Decision Making	Investment Decision Making	Likert scale	(Keswani, Dhingra, & Wadhwa, 2019)

Source : Survey Data (2025)

3.3 Research Hypotheses

H_1: There is an impact of Behavioral biases on the Investment Decisions of Individual Equity Investors.

H_2: Emotional intelligence impacts the investment decisions of individual equity investors.

H_3: Risk tolerance impacts the investment decisions of individual equity investors.

H_4: Behavioural biases impact the risk tolerance of individual equity investors.

H_5: Emotional intelligence impacts the risk tolerance of individual equity investors.

H_6: Risk tolerance mediates the relationship between behavioural biases and the Investment Decisions of Individual Equity Investors.

H_7: Risk tolerance mediates the relationship between emotional intelligence and the Investment Decisions of Individual Equity Investors.

4. Results and Finding

4.1 Demographic Analysis

The sample is largely male (84.6%) and mostly married (58.9%). Most investors are young adults, with the majority (63.3%) between 26 - 35 years. A significant proportion is salaried employees (75.5%), indicating stable income earners dominate market participation. The findings also show that most investors (69%) have less than five years of experience, suggesting a relatively new investor base in the CSE. In terms of income, the majority fall within the lower-to-middle income categories, with 43.2% earning below Rs. 100,000 and 27.6% between Rs. 100,000 - 200,000. Overall, the demographic profile reflects a young, male-dominated, salaried, and moderately experienced group of retail investors.

4.2 Indicator Reliability using Factor Loadings

Factor Loading represents "the degree of each item's correlation with a principal component." Stevens (2002) mentioned that higher the sample size, lower factor loadings can be statistically meaningful. The item loadings assessed the indicator reliability. Loading factor should be greater than 0.7. However, loading factor between 0.6-0.7 is also still acceptable (Yana et al., 2015).

Table 4.12: Factor Loading Analysis

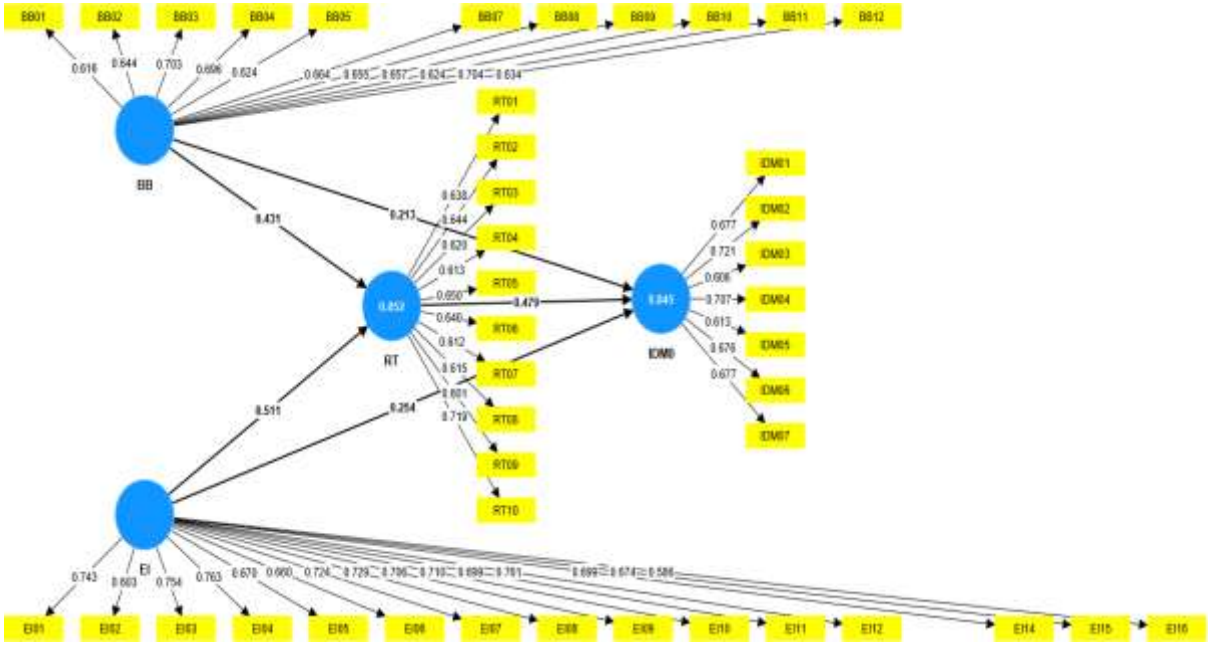


Figure 2: Measurement Model Assessment PLS Algorithm
Source: Survey Data (2025)

4.3 Reliability of Measurement Instrument

Table 02: Assessment of Reliability

Variable	Cronbach's alpha	Composite reliability (rho_a)	Composite reliability (rho_c)
Behavioural Biases	0.868	0.870	0.893
Emotional Intelligence	0.925	0.928	0.935
Investment Decision Making	0.794	0.797	0.850
Risk Tolerance	0.836	0.84	0.871

Source: Survey Data (2025)

Table 02 shows that all four psychological constructs demonstrate strong reliability. Behavioural Biases, Emotional Intelligence, and Risk Tolerance report high Cronbach's alpha values (0.868, 0.925, and 0.836), indicating excellent internal consistency. Investment Decision Making has a slightly lower alpha of 0.794, but still remains within the acceptable range. Additionally, the composite reliability values for all constructs are high, confirming that the measurement scales used in the study are reliable and valid.

4.4 Convergent Validity

Convergent validity refers to the degree to which items of a construct are correlated with each other (Malhorta & Birks, 2007). When AVE value is 0.5 or above it ensures that the constructs are adequately convergent (Hair et al., 2014). In the current study, all constructs have an AVE value greater than the required minimum threshold of 0.50 as illustrated in below table 03.

Table 03 : Assessment of Convergent Validity

Variable	Average variance extracted (AVE)
Behavioural Biases	0.492
Emotional Intelligence	0.497
Investment Decision Making	0.532
Risk Tolerance	0.504

Source: Survey Data (2025)

Although the AVE values for Behavioural Biases (0.492) and Emotional Intelligence (0.497) were below or marginally below the recommended threshold of 0.50, their Composite Reliability values were high, exceeding 0.70. Following Fornell and Larcker (1981), convergent validity may still be considered acceptable when AVE is below 0.50 but composite reliability is satisfactory.

4.5 Discriminant Validity

Discriminant validity demonstrates the low correlations between constructs (Hair et al., 2014; Malhorta & Birks, 2007). In the present study, discriminant validity was evaluated by HTMT ratio, comparing threshold below of 0.9 (Henseler et al., 2015)

Table 04: Assessment of Discriminant Validity

Variable	Behavioural Biases	Emotional Intelligence	Investment Decision Making	Risk Tolerance
Behavioural Biases				
Emotional Intelligence	0.891			
Investment Decision Making	0.181	0.174		
Risk Tolerance	0.894	0.861	0.725	

Source: Survey Data (2025)

According to the above table 04, all the variables indicated heterotrait-monotrait (HTMT) ratio below 0.9. Thus, the measurement model's discriminant validity met all criteria since none of the variables did not exceed 0.9 HTMT ratio.

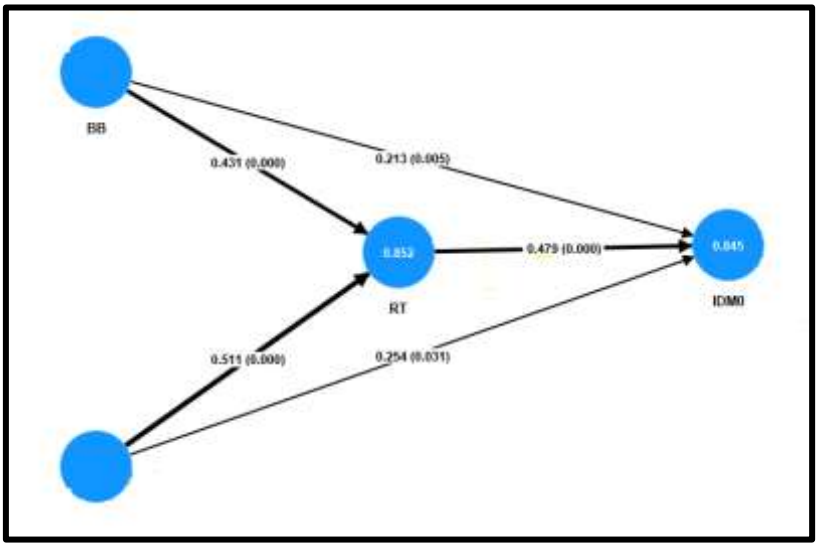
4.6 Descriptive Statistics of the Variables

Table 05: Descriptive Statistics

Variable	Sample items	Mean	Std. Deviation
Behavioural Biases	359	3.530	0.801
Emotional Intelligence	359	3.598	0.779
Investment Decision Making	359	3.618	0.714
Risk Tolerance	359	3.601	0.713

Source : Survey Data (2025)

Table 05 summarizes the responses of 359 CSE investors and shows that all four variables fall within moderate levels. Investors demonstrate moderate behavioural biases (mean 3.53) and slightly higher emotional intelligence (mean 3.60). Their investment decision-making is relatively consistent (mean 3.62), and they also display moderate risk tolerance (mean 3.60).



Overall, these results provide a useful snapshot of investor behaviour and form a strong basis for examining how emotional intelligence and risk tolerance influence investment decisions.

Figure 03 : Coefficient of Determination (R2) with mediation Variable - Structural Equation Model (Bootstrapping)
Source: Survey Data (2025)

Although the structural model produced relatively high explanatory power for Risk Tolerance ($R^2 = 0.852$) and Investment Decision-Making ($R^2 = 0.845$), additional diagnostic assessments were conducted to evaluate the robustness of the findings. First, multicollinearity was assessed using Variance Inflation Factor (VIF) values, and all values were found to be below the recommended threshold, indicating that multicollinearity was not a concern. Second, common method bias was examined using the full collinearity assessment approach proposed by Kock (2015). The results suggested that common method variance was unlikely to significantly influence the findings. Furthermore, discriminant validity was established through both the Fornell-Larcker criterion and HTMT ratios, confirming that the constructs represented conceptually distinct dimensions. Therefore, the high R^2 values may be attributed to the strong explanatory power of behavioural biases, emotional intelligence, and risk tolerance in explaining investment decision-making rather than methodological artefacts.

4.7 Hypotheses Testing

Table 06: Hypotheses Testing

Hypotheses	Direct Relationships	Sample mean (M)	Standard deviation (STDEV)	Path coefficient	P values
Hypothesis One	Behavioural Biases -> Investment Decision Making	0.218	0.076	0.213	0.005
Hypothesis Two	Emotional Intelligence -> Investment Decision Making	0.255	0.118	0.254	0.031
Hypothesis Three	Risk Tolerance -> Investment Decision Making	0.476	0.08	0.479	0.000
Hypothesis Four	Behavioural Biases -> Risk Tolerance	0.431	0.069	0.431	0.000
Hypothesis Five	Emotional intelligence -> Risk Tolerance	0.513	0.069	0.511	0.000

Source : Survey Data (2025)

Based on Hair et al. (2016), path coefficients above 0.1 indicate meaningful relationships. All paths in this study exceeded this threshold and were statistically significant ($p < 0.05$), confirming support for each hypothesis. Behavioural biases showed a positive effect on investment decision-making ($\beta = 0.213$, $p = 0.005$), supporting H_1. Emotional intelligence also positively influenced investment decisions ($\beta = 0.254$, $p = 0.031$), confirming H_2. Risk

tolerance had the strongest direct effect on investment decisions (β = 0.479, p = 0.000), validating H_3. Regarding the mediating variable, behavioural biases positively affected risk tolerance (β = 0.431, p = 0.000), supporting H_4, while emotional intelligence demonstrated an even stronger positive impact on risk tolerance (β = 0.511, p = 0.000), confirming H_5.

Table 07: Hypotheses Testing-Mediation Effect I

Mediation Effects - Hypothesis Six	Direct Effect (DE) -Path Coefficient	Indirect effect (IE) - Path coefficient	Total effect (TE) - Path Coefficient	VAF = (IE/TE)	P Values	Nature of Mediation
Behavioural Biases -> Risk Tolerance -> Investment Decision Making	0.213	0.206	0.419	49%	0.000	Partial mediation (20% - 80%)

Source: Survey Data (2025)

The indirect path from behavioural biases to investment decisions through risk tolerance was significant (β = 0.206, p = 0.000), confirming that risk tolerance mediates this relationship. Thus, H6 was accepted. The Variance Accounted For (VAF) was 49.1%**,** indicating partial mediation, as values between 20% and 80% reflect typical partial mediation (Sarstedt et al., 2017). This means behavioural biases influence investment decisions both directly and indirectly through risk tolerance.

Table 08: Hypotheses Testing-Mediation Effect II

Mediation Effects - Hypothesis Seven	Direct Effect (DE) -Path Coefficient	Indirect effect (IE) - Path coefficient t	Total effect (TE) - Path Coefficient	VAF = (IE/TE)	P Values	Nature of Mediation
Emotional Intelligence -> Risk Tolerance -> Investment Decision Making	0.245	0.254	0.499	50.9%	0.000	Partial mediation (20% - 80%)

Source : Survey Data (2025)

The indirect effect of emotional intelligence on investment decisions through risk tolerance was significant (β = 0.245, p = 0.000), confirming the mediation proposed in H_7. The VAF value of 50.9% indicates partial mediation, as ratios between 20% and 80% represent typical

partial mediation (Sarstedt et al., 2017). This suggests that emotional intelligence influences investment decisions both directly and indirectly through risk tolerance.

5. Discussion

5. Discussion of Findings

The findings of this study provide important insights into the behavioural and psychological factors influencing investment decision-making among individual investors in the Colombo Stock Exchange. The results demonstrate that behavioural biases, emotional intelligence, and risk tolerance significantly influence investment decisions, highlighting the importance of cognitive, emotional, and risk-related factors in investor behaviour.

The significant positive effect of behavioural biases on investment decision-making supports the central premise of behavioural finance theory that investors do not always behave rationally when making financial decisions. Traditional financial theories assume that investors objectively evaluate all available information and make decisions that maximize expected utility. However, behavioural finance argues that investors frequently rely on cognitive shortcuts and heuristics when processing complex financial information (Kahneman & Tversky, 1974; Ritter, 2003). Consequently, behavioural biases such as overconfidence, anchoring, representativeness, herding, and loss aversion influence how investors interpret information, perceive opportunities, and respond to market uncertainty. The findings are consistent with Prospect Theory, which suggests that individuals evaluate gains and losses differently and often make decisions based on subjective perceptions rather than objective probabilities (Kahneman & Tversky, 1979). Therefore, the significant influence of behavioural biases suggests that investment decisions in the Colombo Stock Exchange are shaped not only by economic fundamentals but also by investors' psychological tendencies and behavioural predispositions. This finding is consistent with previous studies conducted by Waweru et al. (2008), Kengatharan and Kengatharan (2014), Ranaweera and Kawshala (2022), and Rawat (2023).

The results further indicate that emotional intelligence positively influences investment decision-making. This finding suggests that emotionally intelligent investors are better able to recognize, understand, and regulate their emotions when confronted with uncertain and volatile market conditions. According to Mayer and Salovey (1997), emotional intelligence enables individuals to manage emotional responses effectively and utilize emotions constructively during decision-making processes. In financial markets, investors are frequently exposed to emotions such as fear, anxiety, regret, and excitement, all of which can influence investment behaviour. Investors with higher emotional intelligence are more capable of controlling impulsive reactions and maintaining rational judgment during periods of market turbulence. Consequently, emotional intelligence contributes to more disciplined and consistent investment decisions. This finding supports the arguments of Ameriks et al. (2009), Arora and Kumari (2020), and Kumari et al. (2022), who reported that emotionally intelligent investors tend to make more effective financial decisions and demonstrate greater resilience when facing financial uncertainty.

Risk tolerance was found to be the strongest predictor of investment decision-making. This finding emphasizes the importance of investors' willingness to accept uncertainty and potential losses when making investment choices. According to Bodie et al. (2014), risk tolerance

reflects an individual's attitude toward financial risk and significantly influences investment preferences and portfolio selection. Investors with higher risk tolerance are generally more willing to invest in risky financial assets with higher expected returns, whereas risk-averse investors tend to prefer safer investment alternatives. The significant relationship identified in this study suggests that differences in risk tolerance play a critical role in explaining variations in investment behaviour among individual investors. This finding is consistent with the studies of Nguyen et al. (2016), Kanagasabai and Achchuthan (2020), and Singh et al. (2022).

More importantly, the study reveals that risk tolerance partially mediates the relationships between behavioural biases and investment decision-making, as well as between emotional intelligence and investment decision-making. This finding provides a significant theoretical contribution to behavioural finance literature. The results suggest that behavioural biases and emotional intelligence influence investment decisions not only directly but also indirectly through investors' willingness to accept risk. Behavioural biases affect how investors perceive and evaluate risk, often leading to distorted assessments of investment opportunities and potential outcomes (Loewenstein et al., 2001; Raheja & Dhiman, 2020). Similarly, emotionally intelligent investors are better able to regulate emotions associated with uncertainty and potential losses, enabling them to develop a greater tolerance for risk. Consequently, risk tolerance functions as a psychological mechanism that translates cognitive and emotional characteristics into actual investment behaviour. This finding supports previous research indicating that risk tolerance serves as a key link between psychological traits and investment decisions (Ahmed et al., 2022; Sharma, 2024). The partial mediation effect observed in the study further suggests that risk tolerance does not fully explain the relationships between behavioural biases, emotional intelligence, and investment decision-making. Instead, both direct and indirect pathways exist. This indicates that investment behaviour is a multidimensional phenomenon shaped by the combined influence of cognitive biases, emotional competencies, and risk preferences. Therefore, the findings support a more integrated behavioural finance perspective that recognizes the simultaneous influence of cognition, emotion, and risk perception in explaining investor decision-making. Overall, the study extends behavioural finance literature by providing empirical evidence that behavioural biases and emotional intelligence jointly influence investment decision-making through both direct and indirect effects via risk tolerance. Furthermore, by focusing on investors in the Colombo Stock Exchange, the study contributes to the limited body of behavioural finance research in emerging markets and provides a deeper understanding of the psychological mechanisms underlying investment behaviour.

6. Conclusion

This study examined the influence of behavioural biases and emotional intelligence on the investment decision-making of individual investors in the Colombo Stock Exchange, with particular emphasis on the mediating role of risk tolerance. Drawing upon behavioural finance theory and employing Partial Least Squares Structural Equation Modelling (PLS-SEM), the findings provide robust empirical evidence that cognitive, emotional, and risk-related factors play significant roles in shaping investor behaviour. The results confirmed that behavioural biases and emotional intelligence significantly influence investment decision-making, demonstrating that investors do not always behave as fully rational actors. Instead, investment decisions are influenced by cognitive shortcuts, psychological tendencies, and emotional competencies. Risk tolerance emerged as the strongest direct predictor of investment decision-making, highlighting its critical role in determining how investors respond to uncertainty,

volatility, and potential financial losses. Furthermore, risk tolerance was found to partially mediate the relationships between behavioural biases and investment decision-making, as well as between emotional intelligence and investment decision-making. These findings suggest that investors' psychological and emotional characteristics influence their willingness to accept risk, which subsequently affects their investment choices. From a theoretical perspective, the study contributes to behavioural finance literature by demonstrating that behavioural biases and emotional intelligence influence investment decisions through both direct and indirect pathways via risk tolerance. The findings support the argument that investment behaviour is a multidimensional phenomenon shaped by the interaction of cognitive, emotional, and risk-related factors. By examining these relationships within a unified framework, the study extends existing behavioural finance knowledge and provides empirical evidence from an emerging market context.

The study also offers several important practical implications. For individual investors, the findings highlight the importance of developing greater awareness of behavioural biases and strengthening emotional regulation skills when making investment decisions. Investors who recognize the influence of overconfidence, herding, anchoring, and other behavioural tendencies may be better positioned to make more objective and informed investment choices. Similarly, improving emotional intelligence may help investors manage fear, anxiety, and impulsive reactions during periods of market volatility. For financial advisors and wealth management professionals, the findings suggest that investment recommendations should not be based solely on financial objectives and demographic characteristics. Greater attention should be given to assessing investors' emotional characteristics, behavioural tendencies, and risk tolerance profiles before formulating investment strategies. Incorporating behavioural and emotional assessments into client advisory processes may improve portfolio suitability and investor satisfaction. For regulators and market institutions such as the Colombo Stock Exchange and the Securities and Exchange Commission of Sri Lanka, the findings emphasize the need to strengthen investor education programmes that focus not only on financial literacy but also on behavioural finance and risk awareness. Educational initiatives that help investors identify common behavioural biases and understand the role of emotions in investment decisions may contribute to more rational participation in the capital market and reduce behavioural-driven market inefficiencies. Furthermore, universities, professional accounting and finance bodies, and financial education providers should consider incorporating behavioural finance, emotional intelligence, and risk management concepts into financial education and investor training programmes. Such initiatives would help develop more informed, emotionally resilient, and risk-aware investors capable of making better long-term investment decisions. Despite its contributions, the study is subject to certain limitations. The use of a cross-sectional research design limits the ability to establish causal relationships among the variables. In addition, the use of convenience sampling may restrict the generalizability of the findings beyond the sample investigated. Future research may employ longitudinal designs, probability sampling techniques, and additional behavioural constructs to further enhance understanding of investor behaviour in emerging financial markets. Overall, the study provides valuable insights into the psychological mechanisms underlying investment decision-making and underscores the importance of behavioural biases, emotional intelligence, and risk tolerance in shaping investor behaviour within the Colombo Stock Exchange.

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