Bridging Policy-Participation Gap in Green Finance: Financial Literacy, Trust, Behavioural Biases Shaping Sustainable Investment Decisions Globally

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Abstract: Green finance is becoming a strategic tool for sustainable development, climate protection and eco-friendly investments. To date, governments and financial regulators around the world have enacted numerous policies for green finance, such as green bonds, environmental, social, and governance disclosure frameworks, sustainable investment policies, and climate-related financial policies. Despite these efforts, the level of investor involvement in green financial products is not uniform, and especially limited in developing countries like India. Past research suggests that policy measures alone will not necessarily result in sustainable investment behaviour, as other factors such as financial literacy, trust, transparency, perceived risk, and behavioural biases also play a role in investor decision making. The study suggests a conceptual model that connects environmental awareness of green finance policy to financial literacy, institutional trust, transparency, and behavioral attributes to sustainable investment decision-making. A thorough literature review reveals some research gaps in understanding investor behavior in relation to policy-based sustainability programs. The results should offer guidance to policymakers, financial institutions and regulators to develop effective green finance policies to boost investor trust and participation.Finally, the study adds to the current debate on sustainable finance, filling the gap between the formulation of policies and the uptake of green financial products by investors.
Keywords: Green Finance Policy, Investor Behaviour, Behavioral Finance, Sustainable Investing and Mixed-Method Research

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Introduction:

Sustainable economic development, environmental degradation and climate change are all now at the heart of policy and investment decision making. Green finance, a pivotal instrument for raising funds for environmentally friendly initiatives and fostering economic development, proves effective in this regard. International organisations like the United Nations Environment Programme (UNEP), the World Bank, the Organisation for Economic Co-operation and Development (OECD) and the International Monetary Fund (IMF) have highlighted the need to embed sustainability aspects within financial systems. Green finance includes financial products and services that promote environmental goals such as green bonds, sustainable mutual funds, ESG investments, climate financing and renewable energy funding. Wang et al. (2023) argued that green finance is an important way to realize the carbon neutrality and sustainable development goals. Likewise, Zhang and Liu (2024) found that supportive regulatory measures can play a crucial role in the development of sustainable investment markets. New research has shown that investors have recently been more interested in ESG. Kumar and Sharma (2023) discovered that environmental, social and governance (ESG) aspects are increasingly being taken into account by investors in making investment decisions. But the shift to sustainable investing is still uneven, based on a range of behavioural and institutional obstacles.
Likewise, Mishra et al. (2023) highlighted the importance of trust and transparency in ESG disclosures for enhancing investor confidence. According to Patel and Verma (2024), The psychological effect on

investors is another factor investigated in the behavioral finance literature, suggesting that investors are skeptical of the claims of green investment products and have weak expectations of financial returns (Nguyen et al., 2024). This is also evident in international cases in which the policy proved effective or less effective, depending on the awareness of and trust in the investors. While the policy landscape has been enhanced in India through various initiatives, such as SEBI's ESG disclosure requirements, sovereign green bonds, and sustainable finance frameworks, there is still a low number of participants in green financial instruments when compared to developed economies. Previous studies tend to be either studies of policy mechanisms or of investment performance, and have relatively little interest in perceptions and behavioral reactions by investors. Thus, grasping investors' perception and reaction to green finance policies becomes crucial to ramp up the sustainable investment adoption. The current study seeks to tackle this issue by analyzing the interaction between policy awareness, financial literacy, trust, transparency and behavioral biases to influence investor behavior. The results will come with concrete recommendations on how to improve the effectiveness of green finance policies and facilitate sustainable financing.

Review of literature:

Kumar and Sharma (2023) The study explored the awareness of ESG among retail investors of India, and revealed that financial literacy plays a crucial role in sustainable investment decisions. Knowledge of ESG was associated with an increased willingness to invest in environmental financial products among investors with a higher level of knowledge. Singh and Gupta (2024) The study examined the association of green finance awareness and investment behaviour in India. The results indicated that there is a positive relationship between investor participation in green bonds and sustainable mutual funds, and policy awareness.

Reddy and Kumar (2023) The researchers discovered that behavioural biases act as a moderator between sustainability awareness and the investment choice of Indian investors. Patel and Shah (2024) This study pointed out that there was an increasing demand for ESG investment products from young investors and that investor education was required. Narayanan and Bhat (2023) The authors studied the Sustainable Finance initiatives in India and found that the investor involvement is positively affected by regulatory support. The study has shown that environmental consciousness can have a strong impact on green investment intentions for investors in cities. Mehta and Rao (2022) The results showed that financial institutions are playing a critical role in the awareness of the sustainable investment. Sinha and Roy (2023) The research results showed that green bond investments are positively related to LTIO.

Gupta and Iyer (2024) The authors noted that investors like to invest in products that are green, if they are provided with credible sustainability reporting systems. Banerjee and Sen (2023) This research highlighted the need to be consistent with the policy to build the confidence of investors in green finance measures. International Studies Wang et al. (2023) They found that policy frameworks that are effective promote the development of green financial markets in developing economies. Nguyen et al. (2024) The study found that the level of trust in institutions has a positive moderating effect on the investor's response to green finance policies. . Smith and Brown (2023) The researchers highlighted transparency in sustainability reporting as one of the key determinants in investors' confidence. Johnson et al. (2024) This study emphasized the importance of ESG performance for investing choices of institutional investors.

Lee and Park (2023) Financial literacy has been found to be the driver towards increasing investors' understanding of sustainable financial products. Garcia and Torres (2024) The authors noted behavioural biases have a large impact on green investment decision-making processes. Wilson et al. (2023) The report showed that investors' attitudes towards investment risks lower their participation in eco-friendly funds. Chen and Huang (2024) The results showed that the government incentives have positive effects on increasing the willingness of investors to invest in green bonds. The study highlighted by Miller and Anderson (2023) underscored the need to apply concepts from behavioural finance to sustainable investment policies.

Problem Statement:

There is a need for significant investment in environmentally responsible projects for the transition towards sustainable economic development. To support this, governments, regulators and financial institutions have enacted a range of green finance policies such as disclosure frameworks, green bonds, sustainable investment funds and financial regulations relating to climate change. However, the investments in green financial products are low and inconsistent, especially in emerging markets like India. Inadequate linkage of policy formulation and investor behaviour is one of the major obstacles. Although policymakers think that regulatory backing and financial instruments will automatically foster sustainable investments, investors may consider green financial products according to various criteria such as financial literacy, confidence, perceived risk, transparency and expected return. This means that the desired effects of green finance policies are not necessarily achieved on the ground.

The majority of the existing research is centered on the effectiveness of green finance policies, ESG performance or sustainability reporting. There is, however, little research that has examined the perceptions, interpretation and reactions of investors to these policies. Moreover, overconfidence, loss aversion, ambiguity aversion and skepticism in the sustainability claims may play an important role in the investment decision. The problem is made more complex because of the lack of attention to greenwashing, inadequate disclosure rules, and limited knowledge of sustainable investment opportunities.

Research that studies the relationship between investor behavior and the awareness of green finance policies in India is still at a nascent stage. The majority of available studies do not consider the behavioral or institutional aspects of sustainable investment adoption, which are important, but rather take either a policy or finance perspective. Furthermore, there are not many studies that use mixed methods that capture both quantitative relationships and qualitative insights. Thus, a holistic framework is needed to clarify the interplay between these factors, namely, policy awareness, financial literacy, trust, transparency, and behavioural biases on investor participation in green financial products. Solving this problem can help close the gap between implementing green finance policies and investor action.

Research Gap:

The literature on green finance policies has examined the subject through the prism of investor behavior, either in terms of the impact of policies or the behavior itself. Therefore, no work to date has adopted an integrated approach where it analyzes both the green finance policies and investor behavior within a single analytical structure. Also, most studies are focused either on developed economies or emerging markets. The case of India remains unexplored. Secondly, while developing an understanding of risk perception, trust, overconfidence, loss aversion and sustainable investment decisions, the existing studies have not adopted quantitative methods in conjunction with mixed-method approaches to understand the nuances of the statistical relationships among key factors affecting sustainable investment decisions.

Most studies to date have analysed the impact of green finance policies without examining behavioural insights and the role of behavioural finance variables in this regard. Against this background, the proposed study aims to develop a comprehensive mixed-methods study that analyses how various green finance policies (regulatory, policy, and behavioural) influence individual-level sustainable investment decisions through policy awareness, financial literacy, institutional trust, transparency, and behavioural biases.

Expected Outcome

The present work is expected to contribute towards developing a complete conceptual and empirical structure linking green finance policies and investor behavior through key factors affecting their sustainable investment decisions. This work is expected to advance knowledge of the academic literature on both policy practice and theory for integrating behavioral finance and sustainable finance and provide evidence-based recommendations for policymakers and regulators to design impactful green finance initiatives and for financial institutions to formulate effective practical strategies to improve investor awareness, increase participation in the green investment markets by doing this supporting the sustainable economic development objective.

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