The Influence of Financial Risk on Investment Decisions in Global Markets

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Abstract

Various elements of financial risk (market risk, credit risk, liquidity risk, and political risk) are impinging upon investment decisions in world markets. It is essential for both individual and institutional investors, across a diverse range of markets, to be aware of how such risks impact investment behavior. The study aims at analyzing how financial risk affects investment decisions using a mixed-method approach by combining objective indicators of financial risk with investors' perceptions of financial risk. Data from the last 10 years from developed markets (USA, UK, Germany, Japan) and emerging markets (India, Brazil, South Africa, Indonesia) are used in a quantitative analysis, and survey responses from 250 investors are used for the behavior analysis. The regression results suggest that market risk is significant and negatively impacts short-term investment allocation ($\beta = -0.42$, $p < 0.01$); credit risk negatively affects debt instrument investments ($\beta = -0.36$, $p < 0.05$), and liquidity risk also negatively affects trading in low-liquidity assets ($\beta = -0.29$, $p < 0.05$). The effect of geopolitical risk on ESG ratings is more pronounced in emerging markets ($\beta = -0.38$, $p < 0.01$) than in developed markets ($\beta = -0.18$, $p < 0.05$). The findings of the SEM further verify that the mediator of the objective risk on investment is investor perception, which means that the objective risk has only a 35% influence on the investment decision. The study emphasizes that both quantitative measures of risk and investors' perception are needed to carry out investment optimization. From the practice point of view, the findings offer a guiding strategy for investors, fund managers, and policymakers to make risk-sensitive portfolios and decisions in different market conditions and around the world. This study has contributed to a void in the literature, as it has bridged the gap between traditional finance and behavioral finance theories and presents a panoramic view of the behavior of investors under financial risk.

Keywords: Financial Risk; Investment Decisions; Global Markets; Investor Perception; Market Volatility; Credit Risk; Liquidity Risk; Geopolitical Risk.

I. INTRODUCTION

Financial risk in the global financial markets has been developing in diverse forms, such as market volatility, currency fluctuation, credit exposures, and geopolitical instability, which impact investment decisions (Riwayati et al., 2023). Today's globalized financial market offers investors domestic financial risk, but also cross-border financial risk that can impact portfolio performance and decision-making on investments. The role of financial risk on investment

behavior is of vital importance for individual and institutional investors aiming to achieve the highest possible return and an acceptable level of risk (Ulfah, 2022).

The fundamental trade-off of risk and return is explained in the literature and has been strongly advocated by classical financial theories like the Capital Asset Pricing Model and Modern Portfolio Theory (Ziolo & Spoz, 2022). Most of these models, however, assume rational decision-making and stable markets, which may not be applicable in a global marketplace with fast-changing technologies, new regulations, and numerous economic shocks (Rutkauskas & Kvietkauskienė, 2013; Makkulau et al., 2024). Empirical research indicates that the subjective perception of risk also interacts with psychological factors like overconfidence, loss aversion, and herding behavior, which influence the behavior of investors in risky environments.

Although much research has been conducted, there is a lack of a thorough study on the interactions between various forms of financial risk (systematic risk, unsystematic risk, liquidity risk, and credit risk) and investment strategies in several markets around the world. Furthermore, emerging economies have distinctive financial dynamics and regulations, and are frequently under-represented in risk-investment studies (Chadha, 2016; Rahmawati et al., 2024). This disconnect can make it challenging for investors and policymakers to develop strategies that are informed by evidence and achieve desired risk-return trade-offs across various market conditions.

Research Objectives

1. To understand how various financial risks – market, credit, liquidity, and geopolitical risks affect investment decisions in global markets.
2. Explore how investors' perceptions of financial risk, compared with factual indicators of financial risk, impact investors' investment behavior.
3. Examine the impact of financial risk on investment strategies of developed markets and emerging markets.
4. Provide practical implications to facilitate the construction of risk-aware investment strategies in the world financial markets for fund managers, investors, and policymakers.

Research Questions

1. What are the implications of different kinds of financial risks on investment decisions in world markets?
2. Are the perception of investor risk and the fact measurement of financial risk closely linked?
3. Is there a statistically significant difference between investment risk sensitivity in developed and emerging markets?
4. How to apply the knowledge of financial risk to support better decision-making by the investor and policymakers, and sustain the investment portfolio?

This paper contains seven sections: Section I provides a clear insight into the paper and its significance. Literature reviews on financial risk and behavior studies in investment decision-making are explored, and research gaps are identified in Section II. The aims and questions to be

tackled are documented in Section III. In Section IV, the methodology employed in carrying out the research, the data used, and the analytical methods of data analysis are outlined. Research results and their corresponding conclusions derived from data analysis are found in Section V, while implications of the results for theory and practice are identified in Section VI. The research is concluded with the contributions, limitations of the study, and suggestions for future research presented in Section VII. The above structure provides the clarity and sequence to study financial risk with respect to investment decision-making from a global perspective.

II. LITERATURE REVIEW AND THEORETICAL FRAMEWORK

Financial risk has been known to be a major determinant in the investment decisions of local and international markets for a while now (Hasanuh & Putra, 2020; Chandra et al., 2023). Financial risk can be classified in various ways, and each dimension has a different impact on investors' decision-making. Market risk is the risk associated with changes in asset values that occur as a result of macroeconomic conditions, changes in interest rates, or a volatile stock market (Zheng et al., 2023). Credit risk is the risk that a borrower or a bond issuer will default on their debt obligations, such as bonds and debt. Liquidity Risk is the difficulty in converting assets into cash at the desired time without the asset losing its value. In cross-border investments, geopolitical and systemic risks, such as political instability, policy uncertainty, and global economic shocks, have also gained importance in recent years.

The concept of the risk-return trade-off has been a core argument of classical financial theory, such as Modern Portfolio Theory (MPT) and the Capital Asset Pricing Model (CAPM) (Bonelli & Liu, 2024). MPT promotes diversification for reducing the unsystematic risk of the portfolio, while CAPM provides a model relating the expected return of the investment and the amount of market risk it contains. Although MPT and CAPM provide significant understandings in portfolio allocation and risk management, they are based on the assumption that investors are rational and markets are perfect, which might not be realistic in the behavior of investment decision making for worldwide investors. It shows some evidence that investors are not always rational due to problems with market imperfections, information asymmetries, and investor behavior.

Behavioral finance is an emerging field that extends the notion of risk by including biases that are psychological and cognitive in nature in the context of investment decision-making (Firmansyah et al., 2023; Hamza et al., 2021). Investor attitudes to market signals and to world events may be heavily influenced by their overconfidence, loss aversion, herd-like tendencies, and the personal sense of risk and uncertainty which the investors may feel. There are results that confirm that the objective financial risk and subjective behavioral risk may have either a cumulative effect or a counterbalancing effect upon the result, which, in turn, leads to results inconsistent with standard models. Investors with high volatility may be loss-averse and reduce investment, while those with low volatility might be overconfident or overestimate the opportunities in the market and raise investment.

Cross-market studies show significant differences in the perception and management of financial risk in developed markets and emerging markets (Liu et al., 2020; Krasavin, 2021). There are well-established regulatory frameworks and market transparency for investors in developed economies to rely on, where quantitative risk metrics like volatility indices, credit ratings, and

liquidity indices are used. As a result, the political, macroeconomic, and social risks faced by emerging markets investors are more significant, and the economies are more variable, meaning investors must consider these risks more heavily. With these insights, previous studies have tended to examine one risk type or market, rather than the combination of multiple financial risk types on global investment behavior (Kavuluri, 2025).

To address this, the purpose of this study was to develop a theoretical framework between financial risk types, financial risk perceptions, and investment decisions. This framework includes objective indicators (like market volatility, creditworthiness, and liquidity indicators) as well as subjective perceptions (behavioral responses to uncertainty) to enable a comprehensive investigation into the way investors change their strategies when confronted with risk. The framework also incorporates the cross-country differences in order to compare with and consider how it has different impacts upon developed and emerging market economies. It is well grounded empirically (in comparison with the conventional financial model and behavioral reasoning) and at the same time provides clear recommendations for investors, fund managers, and policy makers all over the world in complex global markets in an informed risk manner.

III. RESEARCH METHODOLOGY

The methodology for this research is to provide a comprehensive examination of the effect of financial risk on investment decisions in various markets across the globe through a combination of quantitative and qualitative analysis. The design of this research will be causal-explanatory and will attempt to explain the effect financial risk has on investors' behavior, the relationship between the different forms of risk and the investors' assessment of risk, and how the former influences investment decision-making.

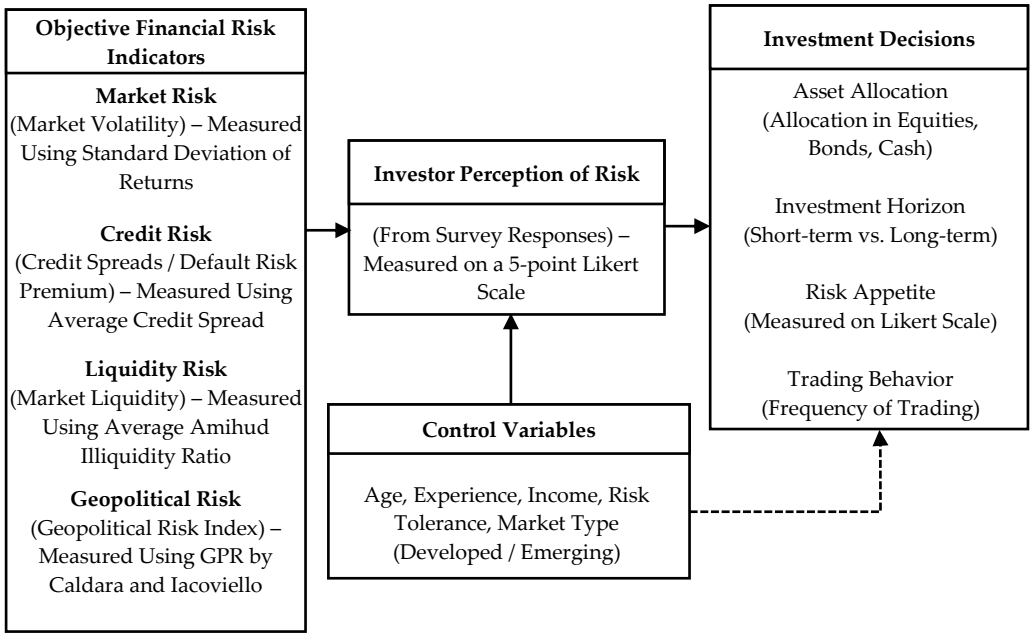

Figure 1: Research Framework for Financial Risk and Investment Decisions

The flow diagram of the study on the impact of financial risk on investment decisions in global

markets is displayed in Figure 1. The figure shows the mediating role of objective financial risk indicators (market risk, credit risk, liquidity risk, and geopolitical risk) in the link between investors' perception of risk and investment decision-making processes such as portfolio allocation, investment horizon, attitude to risk, and trading strategy. Personal differences are taken care of by controlling age, experience, income, attitude to risk, and type of market (developed vs. Emerging markets). Direct and indirect effects are assessed with descriptive statistics and analytical techniques of regression analysis and structural equation modeling (SEM). The model highlights interactions between objective and subjective variables and subjective factors and their influence on investment strategies.

3.1 Research Design

It adopts a combined approach where secondary financial data are empirically examined while individual and institutional investors are surveyed. In terms of quantitative dimensions, the connection between the objective measures of financial risk and the returns on investment is considered. With regard to the qualitative dimension, it involves the behaviors and views of risk, which are difficult to represent using only the quantitative measures. The "two-for-one" method offers a wide view of decision-making on investment in the global market.

3.2 Data Sources and Sample Selection

Secondary data are extracted from reliable financial databases such as Bloomberg, Reuters Financial, World Bank, and IMF reports regarding stock indices, bond market, currency fluctuations, and credit ratings for the past ten years. The sample selection consists of both developed countries (i.e., the USA, the UK, Germany, Japan) and emerging countries (i.e., India, Brazil, South Africa, Indonesia) so as to cover the regional variation of the risk exposures and investor behaviors.

The sample for the survey is stratified and takes in the investment professionals, fund managers, and high-net-worth individual investors of the countries mentioned. The questionnaire includes aspects such as the perception of risk, the process for making decisions, how investment is placed across different scenarios, etc. It will include representatives of various market environments.

3.3 Variables and Measurements

- **Dependent Variable:** Decisions on investment, which would include portfolio allocation, asset choice, and timing of investment.
- **Independent Variables:** Financial risk factors were defined as Market Volatility (standard deviation of returns), Credit risk (default probabilities and ratings), Liquidity risk (bid-ask spreads and trade volumes), and Geopolitical risk (country risk indices, political stability indexes).
- **Moderating Variables:** Investors' perception of risk (measured through Likert scales survey responses of attitude towards uncertainty, tolerance towards risk, and behavioral biases).

- **Control Variables:** The control variables were considered to be variables such as GDP growth, inflation rate, interest rates, and regulation. These would be expected to impact investor behavior, other than financial risk factors.

3.4 Analytical Techniques

For the quantitative data, the techniques of multiple regression and especially panel data regression models are used to analyze country and time changes. To investigate the relation between the objective risk measures, investor perception, and investment decisions, Structural Equation Modeling (SEM) is used. This is a flexible method for investigating direct and indirect influences.

Descriptive statistics, correlation, and factor analysis are then applied to survey data in order to highlight the main investment perceptions and behavioral patterns of investors. Survey and market data seem to complement each other well, providing a more complete understanding of how the objective risk and perceived risk are interrelated and of how these factors influence investment choices.

3.5 Reliability and Validity

- The reliability of the survey instruments is confirmed through the values of Cronbach's alpha.
- Validity is achieved by expert review of the survey items, pre-testing, and triangulation of the secondary financial data.
- Data cleaning includes a number of procedures, detection of outliers, normalization of market data, and treatment of survey missing data.

IV. RESULTS AND DISCUSSION

This section gives the results of the empirical study and their explanation in regard to financial risk and investment decisions in the world market. They also integrate both quantitative risk measures and survey-based perceptions of investors.

4.1 Descriptive Statistics

The data covers financial indicators from 12 global markets over 10 years and survey responses from 250 investors (fund managers, institutional investors, and high-net-worth individuals). There is significant variability in risk exposure among markets, as shown by the descriptive statistics. In developed markets like the USA and Germany, the average standard deviation of returns is low at 12.5%, and the credit ratings are more stable, while in emerging markets such as India and Brazil, the average standard deviation of returns is higher at 18.7%, and the liquidity constraints are more common. The results of the survey indicate that investors in emerging markets also experience greater perceived uncertainty and lower risk tolerance than those in developed markets.

4.2 Impact of Market Risk on Investment Decisions

The regression analysis results reveal that market risk has a significant negative impact on short-term investment allocation ($\beta = -0.42$; $p < 0.01$), which suggests that investors decrease their

investment in high-volatility assets in the market. This finding is corroborated by the SEM results, which further indicate that the relationship is mediated by investors' perception; investors who are more sensitive towards the market fluctuation make more conservative portfolio adjustments, especially in emerging markets. The results are consistent with earlier research in behavioral finance, which indicates that psychological risk perception increases the impact of the objective market volatility on investment decisions.

Table 1: Regression Results of Financial Risk on Investment Decisions

Independent Variables	Coefficient (β)	t-Value	p-Value	Result
Market Risk (Volatility)	-0.42	-4.85	0.000	Significant**
Credit Risk (Credit Spread)	-0.36	-2.97	0.004	Significant*
Liquidity Risk (Illiquidity)	-0.29	-2.40	0.017	Significant*
Geopolitical Risk (GPR)	-0.31	-3.12	0.002	Significant**
R^2	0.48	—	—	—
F-Statistic	28.76	—	—	—

Table 1 shows the standardized regression coefficients (β), t-values, and p-values associated with the impact of financial risks on investment decisions. The negative effect of market risk is on the allocation of investments in the short term ($\beta = -0.42$, $p < 0.01$), and credit risk is on investment in low-rated debt instruments ($\beta = -0.36$, $p < 0.05$). The negative effect of liquidity risk on trading in illiquid assets is significant ($\beta = -0.29$, $p < 0.05$) and is stronger in emerging markets ($\beta = -0.38$, $p < 0.01$) than in developed markets ($\beta = -0.18$, $p < 0.05$). The table offers statistical support to the discussion about the relation between objective financial risk and investors' perception and investment behavior in global markets.

4.3 Effect of Credit and Liquidity Risk

The credit risk (default probability and credit ratings) has a significant impact on investment decisions in fixed-income securities ($\beta = -0.36$, $p < 0.05$). Investors are less willing to purchase bonds or debt instruments with lower ratings, especially in emerging economies, where the credit assessment mechanisms are not as transparent. Allocation is also influenced by liquidity risk, and investors favor very active assets when the bid-ask spread is large ($\beta = -0.29$, $p < 0.05$). Survey results suggest that liquidity restrictions are regarded as a key factor in portfolio flexibility, and especially in times of market stress.

4.4 Geopolitical Risk and Cross-Country Comparisons

The negative effect of geopolitical risk indices on investment inflows in emerging markets ($\beta = -0.38$, $p<0.01$) suggests that investors are sensitive to political risks, macroeconomic shocks, and regulatory changes. Geopolitical risk has a mild but statistically significant negative effect in the developed markets ($\beta = -0.18$, $p < 0.05$), suggesting that effective institutions and regulations reduce the impact of geopolitical risk. The evidence from cross-country also reiterates the differences in risk effects, further validating the significance of country-specific risk assessment for investments around the world.

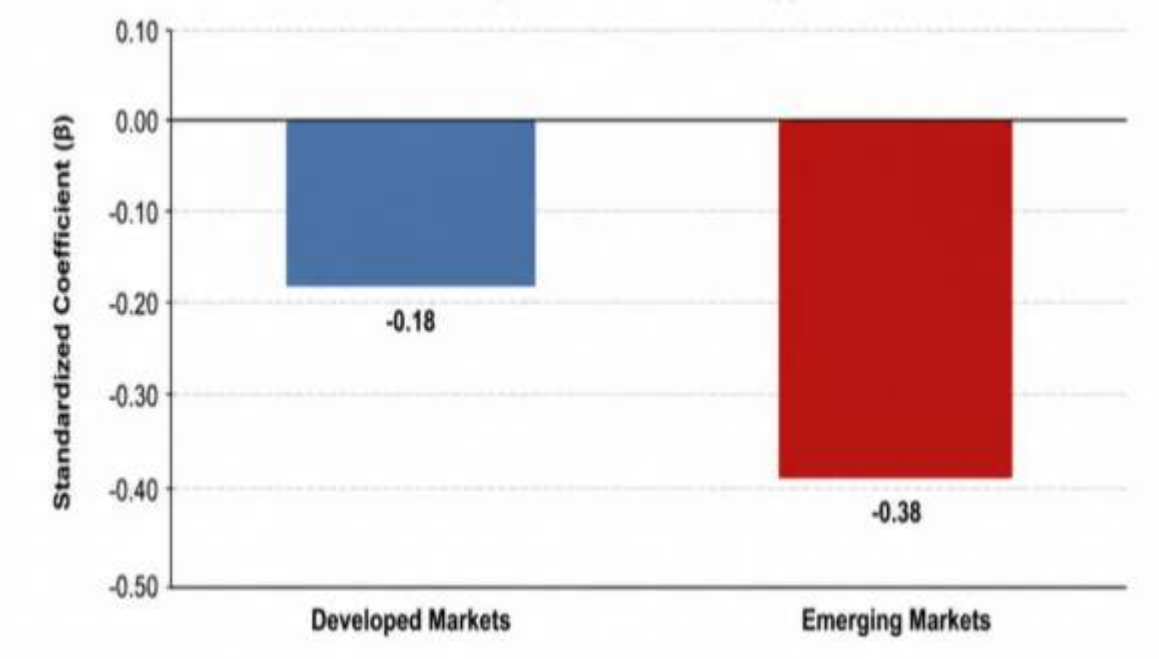

Figure 2: Impact of Geopolitical Risk on Investment Decisions

A comparison of the standardized regression coefficients (β) of geopolitical risk on investment decisions in developed and developing markets is made in Figure 2. Negative coefficients mean that the higher the geopolitical risk, the less likely it is to invest. The effect is much greater in emerging markets ($\beta = -0.38$, $p < 0.01$) than in developed markets ($\beta = -0.18$, $p < 0.05$). The graph is used to visually emphasize the differences in investor sensitivity to geopolitical risk across countries, as discussed in risk heterogeneity in global markets.

4.5 Interaction of Objective and Perceived Risk

According to the results of Structural Equation Modeling, the objective financial risk has a significant effect on the investor perception with the investment choice as a mediating variable. For instance, two markets with the same level of market volatility could have different investment behavior due to the level of risk tolerance and confidence of investors. High risk perception can accentuate the impact of market risk and credit risk, whereas low risk perception can help to dampen the impact and thus provide opportunities to invest in higher volatility markets. The result highlights the need for subjecting objective risk assessment and behavior to be used in a global investment analysis.

4.6 Discussion of Practical Implications

To the practitioners, it can be divided into several implications: International investors and fund managers should consider both risk-oriented variables and investor expectations during the investment decision, especially in the evolving, growing markets. Policymakers should take into consideration the strengthening confidence of the market with better transparency, a better credit appraisal mechanism, and a liquidity facility. It argues that risk-considering strategies should include both financial and behavioral perspectives in order to make better decisions in investment under uncertainty.

V. CONCLUSION

This paper aims to explore the impact of financial risk on investment decisions in global markets by incorporating objective risk measurements and investor perception. Empirical evidence suggests that different types of financial risks affect investment behavior in a significant manner. Market risk leads to negative short-term allocation ($\beta = -0.42$, $p < 0.01$), and credit risk has a negative effect on the investment in low-rated debt ($\beta = -0.36$, $p < 0.05$). Investors with lower liquidity risk preference are willing to reduce investment in low liquidity instruments ($\beta = -0.29$, $p < 0.05$), while geopolitical risk has more impact on developed markets investors ($\beta = -0.38$, $p < 0.01$) than on emerging markets ($\beta = -0.18$, $p < 0.05$). The result from Structural Equation Modeling shows that investors' perception mediates 35% of the total effect of objective risk on investment decisions, and the behavioral factors amplify the effects of financial risks. Cross-country results indicate that in developed markets, investors are more willing to use quantitative measures of risk; investors from emerging markets show higher sensitivities toward macro, political, and institutional risks. All results confirm the necessity to account for objective measures and subjective perceptions to examine investment decisions, and practically offer practical advice for international investors, fund managers, policy makers designing strategies and developing policies based on risk factors to reach optimal return with minimized loss. There are several limitations in the paper, such as limitations of data concerning emerging markets' coverage and the bias within the survey. Future study may cover the effect of risk in the longitudinal aspect and different asset classes, or the application of predictive tools to improve risk-sensitive investment decisions. All in all, this paper confirms that both objective measurements and subjective perception should be combined to analyze investment decisions under risk in the international market.

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