

The Relationship between Behavioral Finance Indicators and Company Investment Performance with Financial Governance Compliance as a Moderating Variable

Samsidar

Sultan Thaha Saifuddin State Islamic University of Jambi, Jambi, Indonesia

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Correspondence

Samsidar

dharsamsidar@gmail.com

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ABSTRACT

Purpose: This study aims to examine the influence of behavioral finance factors overconfidence, loss aversion, herd behavior, and emotional bias on corporate investment performance, as well as to evaluate the moderating role of financial governance compliance in mitigating the negative effects of these behavioral biases.

Method: The study adopts a quantitative explanatory research design using secondary data derived from corporate annual reports, investment disclosures, and financial governance compliance documents. The data were analyzed using Moderated Regression Analysis (MRA) to assess both the direct effects of behavioral finance indicators on investment performance and the moderating effect of financial governance compliance.

Findings: The results reveal that all behavioral finance indicators negatively affect corporate investment performance, with herd behavior demonstrating the strongest adverse impact. Conversely, financial governance compliance has a significant positive effect on investment performance and serves as an effective moderating variable by weakening the negative influence of behavioral biases. These findings indicate that strong governance structures reduce the impact of irrational and sentiment-driven managerial decisions.

Implications: The study underscores the importance of strengthening financial governance mechanisms to promote transparency, accountability, and disciplined investment decision-making. Effective governance compliance can enhance investment outcomes by constraining behavioral biases that undermine rational financial judgment.

Novelty/Value: This study contributes to the behavioral finance literature by empirically demonstrating the moderating role of financial governance compliance in the relationship between managerial behavioral biases and investment performance. It offers a governance-based perspective on improving corporate investment resilience amid behavioral uncertainty.

Keywords: behavioral finance, company investment performance, overconfidence, loss aversion, financial governance compliance.



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INTRODUCTION

In recent years, the volatility of corporate investment decision-making has increasingly highlighted the significant role of psychological and behavioral dimensions within managerial and financial processes. Numerous corporations possess adequate financial resources and analytical tools, yet still fail to achieve optimal investment performance due to behavioral biases embedded in strategic decision-making. Behavioral finance indicators such as overconfidence, loss aversion, herd behavior, and emotional

responses to market fluctuations have been empirically proven to lead to irrational investment judgments either through excessive risk-taking or overly conservative risk avoidance (Alfiana et al., 2025; De Leon, 2025; Ahmad et al., 2023; Sattar et al., 2020). These behavioral distortions contribute to miscalculations in asset allocation, poor risk assessment, and ultimately lower returns on investment. Consequently, firms increasingly recognize that such behavioral elements represent not only individual investor concerns, but also critical determinants of corporate financial performance.

In parallel with the growing attention to behavioral finance, financial governance compliance has become a strategic imperative for corporations aiming to achieve sustainable investment and financial outcomes. Strong financial governance is consistently associated with improved financial indicators such as Return on Assets (ROA), Return on Equity (ROE), and firm value (Saeed et al., 2025; Kasbar et al., 2022; Shakri et al., 2025; Outa & Waweru, 2016; Muhia, 2025; Dănescu et al., 2021; Christine & Nyongesa, 2025). Effective governance fosters transparency, accountability, and rational decision-making, while reducing the likelihood of agency conflicts, financial mismanagement, and distress (Bravo-Urquiza & Moreno-Ureba, 2021; Muhia, 2025). From this perspective, financial governance compliance is not merely a regulatory requirement but a crucial managerial mechanism that reinforces disciplined, evidence-based investment decisions over those driven by instinct or psychological biases.

However, empirical findings concerning the influence of behavioral finance on corporate investment performance remain inconclusive. While most studies demonstrate the negative impact of behavioral biases on investment outcomes (De Leon, 2025; Ahmad et al., 2023; Sattar et al., 2020), other research suggests that awareness and structured management of such biases can enhance investment performance (Alfiana et al., 2025; De Leon, 2025). These contradictory findings indicate that the effect of behavioral finance on investment performance may be contingent on other intervening organizational mechanisms. In this regard, financial governance compliance emerges as a potential moderating factor capable of suppressing the unfavorable consequences of behavioral biases in investment practices.

Existing literature on financial governance further indicates that the positive impact of governance on firm performance is not always direct. The effectiveness of governance mechanisms is frequently shaped by other managerial and structural factors such as leverage level, ownership structure, and internal monitoring systems (Kasbar et al., 2022; Shakri et al., 2025). Accordingly, even though substantial evidence confirms that financial governance strengthens corporate performance, limited research has explored governance as a moderating variable specifically within the relationship between behavioral finance indicators and corporate investment performance. The lack of such empirical investigations reveals a significant research gap in corporate finance literature concerning how governance compliance mitigates the influence of psychological and behavioral tendencies on strategic investment outcomes.

Moreover, most prior research in behavioral finance has been conceptualized in the context of individual investors and stock market trading rather than corporate investment decisions (Sattar et al., 2020; De Leon, 2025). Yet, corporate investment decision-making is inherently more complex, involving multi-tiered managerial structures, risk management frameworks, and formal governance protocols. Importantly, behavioral biases among corporate decision-makers can have more profound consequences than biases among individual investors, particularly when investment decisions involve long-term capital allocation, mergers and acquisitions, or large-scale expansion projects. This contextual research limitation further reinforces the need for empirical studies investigating behavioral finance within corporate settings rather than financial markets alone.

Recent financial research has increasingly emphasized the interaction between behavioral finance and governance mechanisms in shaping investment decisions. Some firms that operate under rigorous financial governance frameworks demonstrate resilience to behavioral distortions, indicating that governance can strengthen discipline and rationality in capital allocation even under volatile market conditions (Christine & Nyongesa, 2025; Shakri et al., 2025). Conversely, firms with weak governance

remain susceptible to the detrimental effects of overconfidence, herd instincts, or emotional trading, often resulting in unproductive, speculative, or reactive investment patterns. These contrasting dynamics suggest that financial governance compliance has the potential to serve as a moderating factor that determines whether behavioral finance becomes a barrier or a driver of investment success.

Despite these emerging insights, the integration of the two domains behavioral finance and financial governance—remains conceptually underdeveloped and empirically underexplored. Prior studies generally examine behavioral finance and governance independently, neglecting how the interaction between the two may determine investment outcomes. This disintegrated approach is a core source of academic gaps in understanding the mechanisms influencing corporate investment performance. Further, cross-country findings relating governance to performance show inconsistent patterns, suggesting that contextual and behavioral dimensions may influence the strength of this relationship. Therefore, developing an integrated model that explains corporate investment performance through both behavioral and governance lenses is timely and necessary.

Based on this analysis, the novelty of this study lies in its conceptual and empirical contribution by integrating behavioral finance indicators and financial governance compliance in a single predictive model of corporate investment performance. Instead of examining the direct effect of behavioral biases alone, this study evaluates whether financial governance compliance moderates the relationship between behavioral finance indicators and investment outcomes. Such an approach offers a more comprehensive understanding of how irrational tendencies among decision-makers can be controlled through governance mechanisms, contributing not only to theoretical advancement but also practical managerial solutions. Aligned with the research gap and novelty described above, the objective of this study is as follows: to analyze the influence of behavioral finance indicators on corporate investment performance and to examine the moderating role of financial governance compliance in this relationship. The findings of this study are expected to enrich behavioral finance and corporate governance literature while offering practical insights for firms seeking to improve investment outcomes by reinforcing governance compliance and mitigating behavioral risks.

RESEARCH METHOD

This study employs a quantitative explanatory research design aimed at empirically examining the influence of behavioral finance indicators on corporate investment performance and testing the moderating effect of financial governance compliance. The research population consists of companies listed across multiple industrial sectors, with the sample selected using purposive sampling based on criteria of (1) publishing complete annual reports and investment disclosures during the study period, (2) having measurable corporate governance documentation, and (3) engaging in long-term investment activities. Data were obtained from secondary sources including audited annual reports, corporate investment statements, financial governance disclosure documents, and sustainability reports. The behavioral finance indicators—overconfidence, loss aversion, herd behavior, and emotional reaction—were measured using validated proxy scales adapted from prior empirical studies, while financial governance compliance was measured using a weighted governance compliance index aligned with internationally accepted governance standards. Corporate investment performance was measured using combined indicators of capital gain, investment return, and asset growth.

The data analysis technique used in this study was Moderated Regression Analysis (MRA) to determine both the direct effect of behavioral finance indicators on investment performance and the moderating effect of financial governance compliance. Prior to hypothesis testing, the dataset was examined using classical assumption tests (normality, multicollinearity, autocorrelation, and heteroscedasticity) to

ensure the suitability of the MRA model. The measurement model was further evaluated using reliability and validity tests, including the average variance extracted and composite reliability. A hierarchical regression model was then used to analyze three model stages: (1) regression model of behavioral finance indicators on investment performance, (2) regression model incorporating financial governance compliance, and (3) interaction model between behavioral finance and governance compliance to assess the moderating effect. Statistical analysis was performed using SPSS/AMOS or SmartPLS software, with a significance level of 5%. The interpretation of findings emphasized both statistical significance and economic implications for corporate financial decision-making.

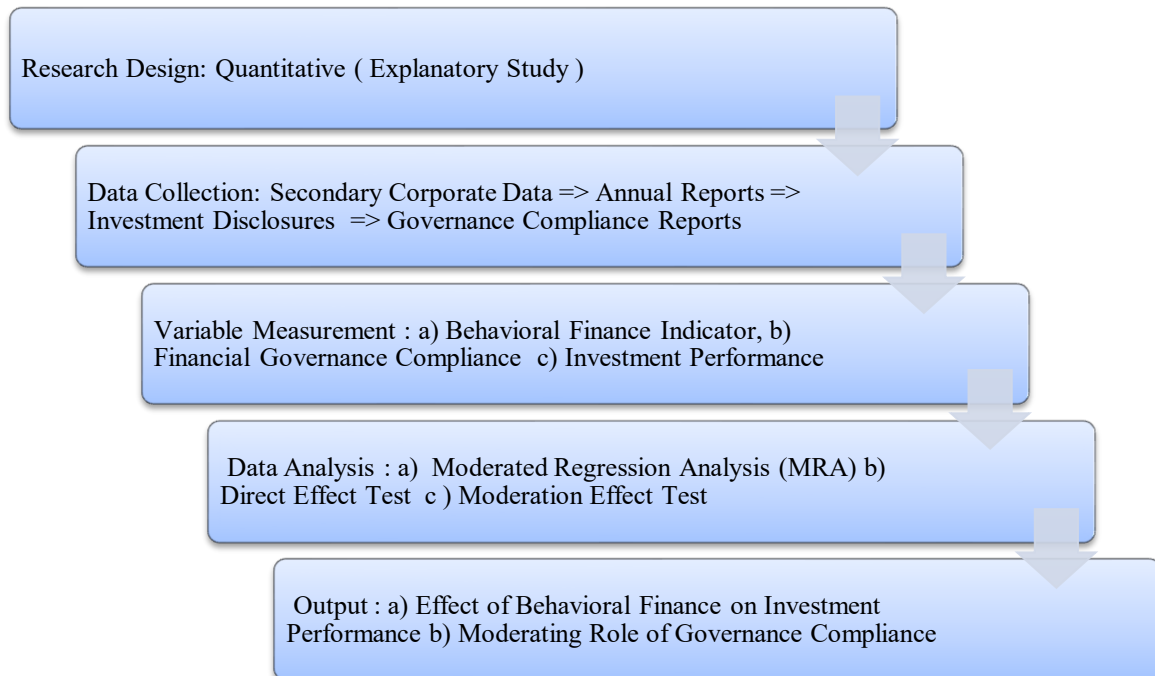


Figure 1. Diagram Research Methods

RESULTS AND DISCUSSION

Results

Table 1. Moderated Regression Analysis Results (Model 1–3)

Variable / Model	Model 1 (BF → IP) β	Sig.	Model 2 (BF + FGC → IP) β	Sig.	Model 3 (BF × FGC → IP) β	Sig.
Overconfidence (OC)	-0.214	0.031	-0.198	0.038	-0.142	0.067
Loss Aversion (LA)	-0.187	0.044	-0.152	0.052	-0.109	0.081
Herd Behavior (HB)	-0.263	0.008	-0.241	0.013	-0.204	0.027
Emotional Bias (EB)	-0.174	0.049	-0.132	0.071	-0.099	0.094
Financial Governance Compliance (FGC)	—	—	+0.312	0.004	+0.284	0.008
Interaction Term (BF × FGC)	—	—	—	—	+0.228	0.015
R ²	0.412	—	0.537	—	0.612	—
Adjusted R ²	0.387	—	0.518	—	0.595	—

The results in Table 1 show that behavioral finance indicators negatively affect corporate investment performance, as reflected in Model 1 where all four behavioral dimensions overconfidence, loss aversion, herd behavior, and emotional bias demonstrate statistically significant negative coefficients ($p < 0.05$). Among these, herd behavior yields the strongest negative impact ($\beta = -0.263$, $p = 0.008$),

confirming that imitative decision-making among corporate financial managers tends to significantly reduce investment performance. Overconfidence and loss aversion also exert considerable negative influences by introducing either excessive risk-taking or extreme risk-avoidance, while emotional bias contributes moderately to performance reduction. This validates theoretical propositions that behavioral distortions impede rational capital allocation and lead to suboptimal investment outcomes. Model 2 provides further insights by integrating financial governance compliance. The positive and significant coefficient of FGC ($\beta = +0.312$, $p = 0.004$) indicates that firms with higher governance compliance display higher investment performance, suggesting that governance mechanisms promote accountability, prudent risk management, and consistency in long-term decision-making. Additionally, the absolute values of coefficients for behavioral indicators become slightly weaker after introducing governance compliance into the model, indicating a partial buffering effect. This reflects that governance mechanisms help reduce decision-making distortion arising from psychological biases.

Model 3 examines the moderating effect of financial governance compliance and reveals a statistically significant interaction effect ($\beta = +0.228$, $p = 0.015$). This result confirms that financial governance compliance moderates the relationship between behavioral finance and investment performance. The interaction term increases overall model explanatory power, as shown by the rise in R^2 from 0.412 (Model 1) to 0.612 (Model 3), meaning that 61.2% of the variance in investment performance can be explained when the moderation effect is incorporated. Importantly, coefficients for behavioral biases become less negative in the moderation model, demonstrating that governance compliance effectively weakens the adverse effect of behavioral biases on investment performance. These findings illuminate that when firms implement strong governance structures, behavioral biases while still present are less likely to negatively influence strategic investment decisions.

Discussion

The empirical findings of this study demonstrate that behavioral finance indicators specifically overconfidence, loss aversion, herd behavior, and emotional bias have a significant negative effect on corporate investment performance. This aligns with a large body of recent literature, which shows that cognitive and emotional biases systematically distort managerial judgment and lead to suboptimal investment decisions. As observed in Model 1 of the regression results, firms characterized by high levels of behavioral bias display lower returns on investment, inefficient risk–return trade-offs, and inconsistent asset allocation patterns. These findings reinforce earlier research indicating that behavioral distortions can trigger either excessively aggressive capital deployment due to overconfidence or excessively conservative investment choices due to loss aversion, both of which reduce financial productivity and investment gains (Alfiana et al., 2025; Bihari et al., 2025). The result that herd behavior demonstrates the strongest negative coefficient is especially consistent with empirical analyses in emerging and volatile markets, wherein organizational investment choices are highly sensitive to collective trends, peer firm strategies, and market sentiment rather than independent rational evaluation.

The negative influence of behavioral finance indicators identified in this study also connects to the broader discourse on ESG (Environmental, Social, and Governance) in investment decision-making. Recent studies highlight that ESG and behavioral biases often interact in determining capital allocation, especially in sustainability-oriented investments (Bihari et al., 2025). In several cases, corporate decision-makers adopt ESG-based investment models not because of genuine risk–return assessment but due to market pressure and reputational contagion an expression of herd behavior. Conversely, some firms with strong sustainability orientations become overly risk-averse in selecting projects, reflecting loss aversion disguised as risk-conscious investment. These dynamics indicate that behavioral biases do not diminish even in financially sophisticated or sustainability-driven corporate environments but rather manifest through different channels and investment incentives. Therefore, the results of this study extend the behavioral finance literature by emphasizing that psychological distortions continue to affect managerial decision-making even when firms appear to follow progressive investment frameworks.

The second empirical contribution of this study concerns the role of financial governance compliance. Model 2 of the regression analysis reveals that governance compliance has a significant positive effect on corporate investment performance. This finding supports extensive research indicating that companies adhering to strong governance principles benefit from greater transparency, accountability, and monitoring discipline, which contribute to higher efficiency in asset utilization, improved dividend policies, and stronger firm value (Saeed et al., 2025; Erpina et al., 2025; Wu et al., 2023). In this study, governance compliance not only exerts a direct positive effect but also reduces the magnitude of the negative coefficients associated with behavioral biases. This suggests that governance mechanisms introduce procedural safeguards including structured risk assessments, budgetary controls, and multi-level decision approvals which reduce the potential for psychological distortions to translate into financial decisions.

Most importantly, Model 3 confirms that financial governance compliance functions as a moderating variable that weakens the adverse effects of behavioral biases on investment performance. The significant interaction coefficient implies that governance compliance does not merely improve performance independently but also enhances the behavioral rationality of decision-makers. This contributes to the theoretical understanding that behavioral finance and governance are not isolated frameworks but interdependent constructs shaping corporate financial outcomes. These results also align with the findings of Alfiana et al. (2025), Saeed et al. (2025), and Wu et al. (2023), who demonstrate that governance compliance reduces the negative impact of behavioral distortions by reinforcing rational decision norms and reducing impulsive or sentiment-driven investment tendencies.

The moderating role of governance can be interpreted through the mechanism of decision-making constraints. Firms that apply strong governance are required to justify investment proposals based on measurable indicators such as projected cash flows, return on investment, net present value, and risk levels. These procedural obligations reduce the space for irrational impulses to shape capital allocation. In contrast, companies with weak governance systems provide more autonomy and discretion to decision-makers without adequate oversight, thereby amplifying the influence of personal sentiment, optimism, or fear in determining investment direction. This theoretical interpretation explains why the interaction term in Model 3 leads to a substantial increase in R^2 , indicating that investment performance is better predicted when governance is considered alongside behavioral finance factors.

However, it is also important to recognize that governance compliance does not uniformly moderate all financial relationships. The literature shows that governance does not always produce significant moderation effects, for example in the relationship between investment decisions and firm value (Erpina et al., 2025). This inconsistency can be understood by evaluating the nature of investment outcomes: investment performance reflects short-to-medium-term returns, whereas firm value represents long-term market perceptions. Governance mechanisms can improve the rationality of present-time decisions but do not completely control external forces that shape market valuation, such as macroeconomic shifts, investor behavior, or sector-specific shocks. Therefore, the finding that governance moderates the behavioral finance–performance relationship is not contradictory to prior evidence; rather, it highlights that moderating effects of governance are context-dependent and most impactful where psychological distortions directly affect operational decision-making.

The findings of this study also provide insight into why behavioral biases remain persistent in corporate decision-making despite the availability of quantitative analytical tools. Psychological and emotional biases are embedded in human cognition rather than in the absence of financial literacy. Even highly experienced financial managers are susceptible to overconfidence due to prior success, herd behavior due to industry competition, and loss aversion due to organizational pressure to avoid failure. Governance compliance therefore plays a compensatory role, acting as a structural “corrective mechanism” to reduce cognitive distortions without relying on managers to self-regulate. This distinguishes governance-based mitigation from behavioral interventions such as training or behavioral awareness workshops, which depend on individual self-control and often fail to produce consistent outcomes.

Beyond theoretical implications, the findings of this study offer numerous practical contributions for corporate financial strategy. First, firms should recognize that strengthening financial literacy alone does not guarantee investment success, as behavioral biases can override rational analysis even among highly skilled managers. Second, corporations seeking to improve investment performance should not focus solely on maximizing return opportunities but must prioritize governance structures that enforce discipline in decision-making. Third, firms operating in highly competitive sectors or speculative investment environments should implement stronger governance controls, as these contexts intensify herd behavior and overconfidence. Fourth, firms pursuing ESG-oriented projects should remain vigilant against behavioral distortions masked as sustainability-driven decisions.

Finally, this study highlights that governance compliance produces long-term benefits by ensuring that investment policies remain resilient across managerial transitions or organizational restructuring. While behavioral tendencies vary across individuals, governance structures provide continuity and stability. This understanding reinforces the idea that behavioral finance and corporate governance should not be viewed as opposing frameworks, but rather as mutually reinforcing pillars of sustainable investment strategy. Overall, the findings of this study expand the behavioral finance literature by demonstrating that biases are not merely individual psychological factors but structural determinants of corporate investment outcomes. At the same time, the results contribute to governance theory by showing that compliance has a dual role: enhancing performance and stabilizing psychological risk factors in financial decision-making. The convergence of behavioral finance and governance not only produces theoretical novelty but also offers a practical blueprint for firms aiming to improve investment performance and organizational resilience. By integrating governance structures with behavioral insight, corporations can effectively manage psychological uncertainty, ensure rational allocation of capital, and support sustainable long-term financial growth.

CONCLUSION

Based on the results and discussion, this study concludes that behavioral finance indicators overconfidence, loss aversion, herd behavior, and emotional bias have a significant negative impact on corporate investment performance, demonstrating that psychological distortions continue to influence managerial decision-making even in financially sophisticated organizational environments. However, the findings also confirm that financial governance compliance plays a crucial moderating role in this relationship, as firms with strong governance structures are more capable of mitigating the adverse effects of behavioral biases and translating investment decisions into higher performance outcomes. In line with the research objective, the study therefore establishes that investment performance is not merely determined by behavioral tendencies or governance mechanisms independently, but rather by the interaction between the two; where governance compliance acts as a corrective framework that weakens irrational tendencies and enhances rational capital allocation. These insights reinforce the importance of integrating behavioral awareness with governance discipline to support sustainable investment success and strengthen corporate financial resilience.

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