



Behavioral Biases and Financial Decision-Making of Individual Investors in Afghanistan: A Literature Review of Cognitive and Emotional Biases

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Abstract

This review examines cognitive and emotional biases that influence financial decision-making of individuals and considers their implications within Afghanistan's fragile market. It employed a literature review approach and drew on peer-reviewed scholarly literature from respected international journals. The reviewed literature of behavioral biases was organized into two broad categories: cognitive biases and emotional biases. The study examines how these biases influence trading behavior, asset allocation, diversification, and risk-taking behavior and other financial decisions and subsequently contextualizes them within the Afghanistan financial environment. The review indicates that overconfidence boosts the excessive risk-taking behavior in trading, while anchoring might cause investors to rely excessively on previously available information and respond slowly to new information. Mental accounting is a phenomenon that influences how people classify and evaluate financial resources, whereas loss aversion may lead individuals to place greater weight on losses than equivalent gains. Herding may encourage individuals to follow the decisions of others, particularly under uncertainty and limited information, while regret will discourage individuals from revising previous financial decisions. Economic uncertainty, limited market development, and informal financial practices in Afghanistan may increase the relevance of these behavioral inclinations in financial decision-making. Although behavioral biases have been widely studied in developed and emerging markets, evidence concerning fragile markets remains limited and fragmented. Afghanistan represents an underexplored context in behavioral finance, particularly how behavioral biases interact with financial decision-making under conditions of institutional and market fragility. The review highlights the need for context-specific empirical research and behavioral financial literacy programs to improve the decision-making of individual and household investors in Afghanistan.

Keywords: Behavioral Biases; Financial Decision-making; Fragile Market; Individual Investor; Afghanistan

1- INTRODUCTION

Understanding how individuals make financial decision is fundamental to understanding investor's behavior, market outcomes, and financial performance, particularly in fragile economies, where financial institutions and formal financial markets are not yet fully developed. Traditional finance theory is largely grounded in the assumptions of rational decision-making, which assumes that investors are rational in processing information and that the price of assets is complete information-based (Fama, 1970). However, market anomalies and financial crises, which have been tested several times, require a new explanatory framework to consider behavioral finance (Shiller, 2003). Behavioral finance is a branch of economics that considers the knowledge gained by psychologists regarding systematic failures in rational decision-making (Thaler, 2015). Current studies still indicate that behavioral biases have a significant influence on risk perception, asset prices, portfolio diversification, and long-term investment returns (Barberis and Thaler, 2003).

The theoretical foundation for this matter is the Prospect Theory, which explains that people consider profit and loss asymmetrically and that they are more vulnerable to loss compared to the same profit (Kahneman and Tversky, 1979). Expected utility theory is challenged through this framework, as it demonstrates that risk-prone decisions are influenced by framing and reference dependence instead of objective probabilities. Further studies

have found various cognitive biases, such as overconfidence, anchoring, mental accounting, and emotional biases, such as loss aversion, herding, and regret aversion (Shefrin, 2007). Recent empirical data published in major finance journals have proven that overconfidence encourages excessive trading and risk concentration (Daniel, Hirshleifer and Sun, 2020), anchoring slows the update of beliefs (Bordalo, Gennaioli, Ma as well as Shleifer, 2020), mental accounting is more likely to promote narrow framing and inefficient diversification (Barberis, & Huang, 2001), and herding is more active in volatile times (Bouri et al, 2019). All these findings point out that the distortion of behavior is persistent across markets.

Although the field of behavioral finance research has rapidly grown, most empirical studies on behavioral finance are based on developed financial systems or fairly organized emerging financial markets. Evidence of fragile economies, conflict-affected economies, and weak institutions is rare. The case of Afghanistan is particularly unique and highly unexplored. It is a financial environment typified by shallow capital markets, informal sources of investment, weak enforcement of rules, and macroeconomic insecurity. Investments are usually made in real estate, gold, foreign currency, and small-scale private enterprises, as opposed to diversified equity portfolios. In this situation, cognitive and emotional biases can be further increased by information asymmetry and poor feedback mechanisms (Gennaioli, Ma, and Shleifer, 2022).

This issue highlights an unexplored area in research. There is no sufficient literature review or empirical model of how behavioral biases determine the individual's decision-making process in the context of the socio-economic and institutional peculiarities of the Afghan economy. Economic uncertainty, limited information about market prices, informal financial networks, institutional factors, and social influences can influence the expression of cognitive and emotional biases in Afghanistan. However, review of existing literature from Afghanistan is limited. This highlights that one of the primary objectives is to combine the existing behavioral finance theories and international experiences along with institutional, economic and social features of the Afghan financial environment. This is contextual because financial-literacy interventions and policy recommendations geared toward a developed financial system might not be directly applicable to fragile financial settings.

Accordingly, this review has three objectives. It first draws on the recent cognitive, emotional and social biases of the individual in making financial decisions. Second, it critically analyses the impact of these biases on the financial behaviour in emerging and high uncertainty markets. Third, it situates these findings in the context of Afghanistan's fragile financial system and implications for further empirical studies, financial literacy, and policy development. The main goal of the study is to offer a comprehensive and context-driven analysis of behavioral biases that shape the financial decisions of individuals in Afghanistan. The overall objective of the study is to draw a synthesis between the well-known theories of behavioral finance and the institutional and socio-economic features of a fragile financial market to suggest possible further empirical research and conceptual foundations for designing context-specific financial-literacy and policy interventions.

2. LITERATURE REVIEW

2.1 Behavioral Biases and Investment Decision-Making in Fragile Markets in Afghanistan

A "Fragile market" refers to a financial system where political instability, currency fluctuation, and limited accessibility to formal financial instruments are at their peak and will lead the country to constrain market efficiency (Calvo and Mendoza, 2000). Recent studies in behavioral finance indicate substantial evidence that investors' decision-making is unsystematic and not in line with rational models, especially in emerging markets (Barberis, 2013). Conventional finance models presuppose efficiency in information and utility maximization, but empirical evidence and recent studies show that anomalies continue to occur that cannot be attributed to classical theory (Thaler, 2016). These anomalies are explained by the impact of psychological biases on the information processing and risk assessment by investors (Baker and Ricciardi, 2014).

One of the most reported bias in the literature published after 2010 is overconfidence. Research in the Review of Financial Studies demonstrates that excessive trading, underestimating risk, and producing lower net returns are all common results of overconfident investors (Barber and Odean, 2013). Such a bias is especially prominent in emerging markets, where informational asymmetry is more pronounced and regulatory control is weaker (Kumar & Goyal, 2015). Price expectations are also anchored, as investors base their expectations on previous prices or initial information despite a shift in the fundamentals of the market (Tversky and Kahneman, 1974; Kaustia, 2010).

Loss aversion and other forms of emotional bias are still being empirically supported in the most reputable journals. The Journal of Finance report confirms that investors are more responsive to losses than to gains, resulting in the disposition effect (Frydman and Camerer, 2016). Herding behavior is a common occurrence in new stock markets, which is exacerbated during times of uncertainty and volatility (Chiang and Zheng, 2010). According to

studies registered in the Web of Science, herding decreases market efficiency and increases price bubbles in less developed economies (Bouri et al., 2019).

Based on review of Scopus-indexed articles, the conclusions are that behavioral biases are more prominent in low-financial-literacy and institutional-fragility markets (Kumar and Goyal, 2015). As the financing system in Afghanistan is emerging and the country has fewer means to protect the rights of investors (World Bank, 2022), the same distortion of behavior will most probably impact decision-making.

The literature indicates that cognitive and emotional biases would influence investment outcomes in Afghanistan to a great extent. According to the behavioral finance literature published after 2010, there are cognitive and emotional biases that affect the decisions of investors (Baker and Ricciardi, 2014). Heuristic simplification leads to cognitive bias, and affective responses to gains and losses lead to emotional biases (Shefrin, 2010). Other research indicates that such bias influences the allocation of the portfolio and trading actions (Barberis, 2013). Excessive trading and underperformance are attributed to overconfidence (Barber and Odean, 2013). The anchoring and representativeness biases affect probability assessments, resulting in momentum trading and mispricing (Kaustia, 2010). Mental accounting influences the way investors place funds and determines their risk-taking behavior (Thaler, 2015).

Represented by emotional biases, including loss aversion, the unwillingness to incur a loss has been justified by experimental and market evidence (Frydman and Camerer, 2016). Herding behavior has been witnessed in Asian and Middle Eastern markets, especially during crises (Chiang and Zheng, 2010). According to the empirical synthesis, these biases are more pronounced in emerging markets because proper information is not readily available (Kumar and Goyal, 2015). These findings are applicable, considering that emerging South Asian economies have structural features similar to those of Afghanistan. In weak financial systems, behavioral distortions can have severe implications for investor confidence, risk tolerance, and capital allocation decisions.

2.2 Behavioral Drivers of Investor Decisions in Developing Economies

2.2.1 Cognitive Biases

Overconfidence Bias:

It is generally recognized that overconfidence is a key cognitive bias in the decision-making process of financial investment. Daniel and Hirshleifer (2015) found that overconfident investors overestimate the accuracy of their knowledge, information, forecasting ability, and ability to control market result information. Recent theoretical and empirical studies also suggest that overconfidence causes investors to overvalue their personal values and underestimate collective values, thus creating foreseeable trends in asset prices (Daniel, Hirshleifer, & Sun, 2020). Moreover, Evidence from large-scale trading data shows that overconfident investors greatly overtrade compared to rational standards, which significantly reduces risk-adjusted returns after transaction fees and market frictions (Barber & Odean, 2013; Broihanne, Merli, & Roger, 2021).

According to more recent data, overconfidence is associated with a higher exposure to speculative assets and idiosyncratic risk, particularly during bull markets, when prior gains reinforce attribute bias (Chuang, & Susmel 2011).

Behavioral asset pricing models also suggest that overconfident beliefs may increase market instability, as investors overvalue the precision of their signals and actively participate in the market based on noisy information (Daniel et al., 2020). Recent empirical evidence indicates that overconfidence is relevant to investor behavior in emerging-market settings. Studies from India and Saudi Arabia, for example, find significant effects of overconfidence on investor behavior and market outcomes, suggesting that this cognitive bias can play an important role in emerging stock markets (Kumar & Prince, 2022; Aljifri, 2023). As a whole, modern research has also indicated that the effects of overconfidence go beyond the performance of individual investors and are even reflected in overall market inefficiencies. The attitude is a challenge to the rational investor theory of the modern financial market and, by the way, to the idea of rational investor behavior, which encourages over-trading, under-diversification, and mispricing by skewing probability judgments and risk perceptions.

Anchoring Bias

Anchoring bias is a mental tendency of investors to rely excessively on an initial reference point when making a judgment despite having updated information that is relevant to the judgment. Although it was originally formulated in the field of behavioral psychology, anchoring is an important concept in behavioral finance, as it can be used to explain the deviations from rational belief updating (Tversky and Kahneman, 1974). Recent empirical evidence suggests that investors base their future return predictions on salient price anchors, such as past purchase

prices, past highs, or 52-week highs. To illustrate, a study in the Journal of Financial Economics indicates that reference-dependent expectations based on past prices affect the decision to trade and slow the process of absorbing new information in prices (Andries & Haddad, 2020). Because investors underreact to news that deviates from their initial anchor, such behavioral rigidity increases the predictability of returns and momentum effects.

Moreover, another study concludes that anchoring combines with the limited attention of investors to focus on readily apparent price indicators and ignores fundamental indicators (Bordalo, Gennaioli, Ma, and Shleifer, 2020). This is the mechanism of selective adjustment, which explains why asset prices can drift slowly to fundamental values, as opposed to adjusting instantaneously. Anchoring has also been validated in experimental and field-based studies published after 2020, confirming that anchoring affects both retail and institutional investors, and the bias may persist even among financially sophisticated investors (D'Acunto et al., 2020). Anchoring is demonstrated to be more intense in cases of low market transparency and high uncertainty of information and undermines informational efficiency (Cen et al, 2021).

Overall, the literature indicates that anchoring can distort expectation formation and delay the incorporation of information into asset prices and abnormal phenomena, such as momentum and post-earnings announcement drift. By limiting the alterations made in beliefs concerning reference points that are obsolete, anchoring continues to present a stumbling block to the complete effectiveness of financial markets.

Mental Accounting

Mental accounting refers to the psychological process by which people categorize, judge, and monitor financial performance across individual mental accounts instead of combining it into a pattern of overall wealth (Thaler, 2015). In modern behavioral finance, this bias is closely related to reference dependence and narrow framing, where investors do not consider the overall performance of a portfolio but consider it based on gains and losses relative to particular types of performance. Recent work in the Review of Financial Studies indicates that investors simply psychologically distinguish income streams (including dividends, capital gains, and salary income), which drives the powering-down of different consumption and reinvestment behavior patterns, in contrast with the behavioral patterns predicted by the standard portfolio theory (Barberis, & Huang, 2001).

There are several recent works that indicate that mental accounting effects on asset allocation arise from the tendency of people to mentally categorize their financial resources into multiple accounts or portfolios. Investors can therefore choose to divide their investments into different safe and speculative compartments even if they could achieve higher risk-adjusted returns with an integrated portfolio optimization (Bordalo, Gennaioli & Shleifer, 2021). Mental compartmentalization may lead to under-diversification and could account for the preference for dividend-paying stocks by investors, who may view dividends as cash they can spend and capital gains as cash they can save (Hartzmark & Solomon, 2019). This behaviour defies the practical assumption that dividend irrelevance holds true, as it is shown that investors can give different psychological interpretations to the same return. Furthermore, when making decisions about how to allocate investment funds, narrow framing can make people more risk averse, as the decision is made on an individual basis instead of within a portfolio of investments (Bordalo et al., 2021). Further, from an empirical standpoint, the segregated performance assessment of an investment may affect trading behavior and the way investors make decisions (Gennaioli, Ma, & Shleifer, 2022). Evidence from Afghanistan also shows mental accounting labelling affects the way households use remittance funds for specific expenditures, and that households tend to budget remittances separately from other funding sources (Ibrahimi, Rasikh & Nawabi, 2026). The findings, taken together, indicate that mental accounting can influence both investment decisions and the manner in which households manage, appraise, and utilize financial resources.

Overall, modern literature implies that mental accounting is a possible methodical error in wealth assimilation, which promotes inefficient portfolio development and undermines the advantage of diversification. Investors leave the rational expected utility maximization when they split financial results into unrealistic classes and subject themselves to unnecessary financial inefficiency.

2.2.2 Emotional Biases

Loss Aversion

Loss aversion is refers to the tendency of individuals to experience the psychological impact of losses more strongly than the corresponding pleasure associated with equal gains (Barberis, 2013). The idea underpinning prospect theory is central to the theory and offers a valuable account of how people might deviate from the expected utility paradigm when assessing risky financial decisions. Loss averse investors could be especially hesitant to sell losers, which can lead to the disposition effect, defined as investors' tendency to sell winners when they are less

emotionally attached and hold on to losers when they are more emotionally attached (Frydman & Jin, 2021). These activities may impact on portfolio management by postponing the exit of less successful investments and eventually lower the efficiency of the investment decisions.

Loss aversion is also connected to the reference points used to evaluate financial outcomes used by investors. A drop in asset values below an investor's reference level (e.g., cost of acquisition) can change subsequent risk-taking behavior (Barberis et al., 2021). In a prospect-theoretic perspective, investors might be more willing to take of additional risk if they think they are in the loss domain to make up for any losses. This imbalance in risk aversion may be responsible for delayed portfolio rebalancing of portfolios and sticking with mediocre investments. Experimental evidence also suggests that losses can evoke stronger psychological reactions than comparable gains, which suggests behavioral support for the importance of loss aversion in the financial decision-making process (Frydman & Jin, 2021).

Loss aversion can gain greater significance in times of increased macroeconomic uncertainty and stress in the financial markets. In that case, greater sensitivity toward potential losses can enhance defensive investment, and investors whose losses are already realized can reverse to higher-risk investment behavior in an effort to regain their wealth (Bordalo et al., 2021). So, the behavioral implications of loss aversion are in part related to investor reference points, the nature of wealth changes and the market context. In general, the literature suggests that loss aversion has a typical impact on how investors assess gains and losses, which leads to skewed risk-taking, loss aversion, delayed portfolio adjustment, and a tendency to undermine the predictions of rational choice models. Therefore, loss aversion is a significant behavioral factor to take into consideration when explaining the investment choice of individuals, as well as the persistence of financial-market trends/anomalies.

Herding Bias

Herding is the behaviour of investors who rely on the actions of others while disregarding their own information or analysis or independent research, especially when conditions are uncertain (Banerjee, 1992). Though initial theoretical underpinnings focused on the role of informational cascades and reputational issues (Bikhchandani & Sharma, 2001), recent empirical studies offer greater support of its existence in contemporary financial markets. Research published in the *Journal of Banking and Finance* after 2020 has documented considerable herding in emerging and frontier equity markets (especially when markets are experiencing heightened volatility and macroeconomic pressure) (Vo & Phan, 2019). Such results indicate that as uncertainty increases, investors move toward common trades, and the cross-sectional return distribution narrows.

Further support is found in another study, which states that herding is most pronounced during periods of crisis, when fear and uncertainty about fundamentals undermine the reliability of personal signals (Bouri et al, 2021). Such correlated trading behavior may cause asset price bubbles and contribute to sudden corrections when mass sentiment shifts. The empirical investigations of post-2020 dynamics using high-frequency and cross-country data show that herding is especially strong in markets with lower institutional development, low transparency, and Information asymmetry (BenSaïda, Litimi, & Abdallah, 2022).

The behavioural reasons focus on the idea that investors will anticipate or pursue market trends and directions due to social learning, reputational gain, and the fear of performing worse than others (Hirshleifer & Teoh, 2003). Experimentally, individuals also find psychological gratification in conforming to group behaviour when such conformity reduces expected returns (Bouri et al., 2021). In general, modern literature has concluded that herding behaviour can increase systematic risk by amplifying feedback mechanisms between prices and investor sentiment. Herding causes inefficiency in the market and leads to over-volatility, especially in immature financial markets, by weakening the role of independent information processing and increasing the speed of the collective trading waves (Chang, Cheng, & Khorana, 2000).

Regret Aversion

Regret aversion refers to the tendency of investors to avoid decisions that may lead to future regret, especially when the outcome prove worse than those of alternative decisions (Zeelenberg & Pieters, 2007). When making financial decisions, the expected regret might sway investors' risk-taking and decision-making, because they may feel the need to prevent the psychological repercussions of confirming a poorly performing investment decision. Recent empirical evidence indicates that investors with higher regret sensitivity are more likely to hold on to losses, thereby strengthening the disposition effect (Frydman & Camerer, 2016). Such reluctance may suggests an attempt to avoid the emotional consequences of unsuccessful financial decisions rather than a rational reassessment of fundamentals.

The findings of post-2020 again show that portfolio rebalancing decisions depend on expected regret, especially in turbulent environments (Gennaioli, Ma, and Shleifer, 2022). Where there is high uncertainty, investors would choose safer or status quo alternatives to reduce the risk of future self-blame. Experimental studies show that regret-averse individuals minimise their exposure to risk after receiving negative feedback, despite the absence of objective changes in probability (Frydman & Camerer, 2016). Such a change of behavior tends to result in inefficient diversification and over-conservatism. Regret aversion is also strongly related to status quo bias since both may affect the willingness to leave one's initial decisions. Regret is a counterfactual feeling: as well as considering the events that happened to them investors also consider those that might have happened if they had taken another course of action (Barberis, 2013). Realizing that such counterfactual comparisons are possible can make investors less likely to take a risk that could lead to future self-blame. This process could lead investors to hold on to their investments, especially if the risks associated with switching to different investments are unclear. The impact can be enhanced when the economy and financial market is unstable, and uncertainty raises the probability of making a bad decision (Wangzhou et al., 2022).

In general, the body of literature suggests that regret aversion may impact investment decisions by making them more sensitive to the emotional effects of bad outcomes. The bias may lead investors to avoid making choices that would later incur regret, which limits rational updating, slows down potential changes in trading, and helps to maintain the status quo investment decision environment. From this perspective, regret aversion is a behavioral concept that plays a critical role in the understanding of risk taking, portfolio change and irrationalities in investment decision making, especially when uncertainty is involved, and during times of financial stress.

2.3 Behavioral Biases in the context of Afghanistan

The institutional and financial systems in Afghanistan differ markedly from the developed financial architectures that typically underpin standard decision-making models. While conventional financial models assume that households and investors can make decisions based on comprehensive portfolio information in Afghanistan, limited financial-market depth, lack of access to diversified investment instruments, institutional weaknesses, macroeconomic uncertainty, and informal economic arrangements can limit this ability (OECD, 2019; IMF, 2016). In such an atmosphere, people might heavily depend on information that's easily accessible, personal experience, social networks and simplified decision-making rules when assessing financial options. These conditions do not necessarily mean that the individuals are irrational, but might magnify the effect of behavioral factors where formal information and professional financial advice is scarce, and effective feedback mechanisms are limited. When investors get limited, objective feedback on the quality of their financial decisions, overconfidence may prove especially relevant. Investors might believe that positive investment returns are due to their own knowledge or skill, and underestimate the impact of market conditions, uncertainty or luck. This self-attribution may lead to an overconfidence in prediction and/or increase risk-taking. Overconfidence is related to higher trading volume, lower diversification, and higher exposure to idiosyncratic risk in the behavioral-finance literature (Daniel et al., 2020; Bianchi, 2021). Evidence from Afghanistan also provides an emerging empirical basis for considering these mechanisms. The study of SMEs in Afghanistan, (Ibrahimi and Adil, 2026) concluded that overconfidence was positively related to the financial performance while anchoring, loss aversion and herding behavior were negatively related to the financial performance, and that financial literacy significantly mitigated the adverse effects of these behavioral biases. This is especially significant, given that these results indicate that the impact of behavioral biases is not necessarily the same across financial settings and may vary based on the nature of the financial setting and the financial attributes of the decision maker.

Moreover, the mental accounting framework provides important information about the financial environment of the Afghan household, as many households tend to allocate their resources according to the source of the funds or the purpose of the expenditure and not to the overall level of wealth (Thaler, 2015). While the economic value of the funds is the same, its psychological segmentation leads to families handling their regular income, business capital and savings separately under different, non-fungible mental categories. This behavior creates a "narrow framing" effect, which causes people to make individual financial decisions without considering their impact on the household's balance sheet, or its risk profile. This mechanism is more relevant with respect to the remittance-receiving households. Remittances are an important source of income in Afghanistan, but the recipients often treat them as additional windfalls or allocate them to non-fungible tasks such as meeting subsistence needs, current debt repayment or precautionary saving for future needs, rather than investment. Mental accounting illustrates why, although two families with the same total wealth may save the same amount, they may have different savings and investment propensities.

In situations where official financial information and trustworthy market insights are limited, herding behaviour is especially noteworthy. Market uncertainty and volatility always reinforce herding tendencies in environments with high information asymmetry and limited institutional development (Bouri et al., 2021). Afghan investors and households cope with these restrictions through interpersonal networks, such as the family, peers and local traders, who serve as information sources. The more frequently the financial decisions of trusted associates are repeated, the greater the sense of safety and profit, which leads to self-reinforcing demand for certain assets. The behavioral danger with social signals is that investors frequently ignore their own risk tolerances, personal financial limitations and unique situations when they follow the herd. These conditions may interact with other types of behavioral biases. Loss aversion may be especially significant if households view financial losses as a threat to their economic security, particularly in the face of macroeconomic uncertainty. Investors might have the urge to avoid taking any losses and may choose to keep substandard assets in their portfolio in the expectation of them improving their gains (Barberis, 2013; Barberis et al., 2021). This might further be exacerbated by regret aversion, which causes people to hesitate from changing their financial choices once they have already taken them, due to the possibility of experiencing psychological discomfort when the different choice turns out to be better (Frydman & Camerer, 2016). These biases can help to keep the financial decisions in place and discourage portfolio reshuffle in such an uncertain world with few investment options.

The overall Afghan financial landscape offers a valuable backdrop to the analysis of behavior and its impact on the financial decision-making of Afghan households. Mental accounting, herding, overconfidence, loss aversion, and regret aversion could be influenced by the institutional setting, the availability of a diverse range of financial products and services, information asymmetry, macroeconomic uncertainty, remittance dependence, and interpersonal networks. Importantly, these contextual factors should not be considered as direct causes of behavioral bias but rather as context in which behavioral tendencies are likely to play a bigger role in financial decision-making. In this context, mental accounting and herding behaviour are very relevant since they are directly related to the way households allocate finances and to the reaction to the financial decisions made by others. It is, therefore, useful to consider these two biases in examining differences in the saving and investment decisions of households in Afghanistan in a contextually grounded way.

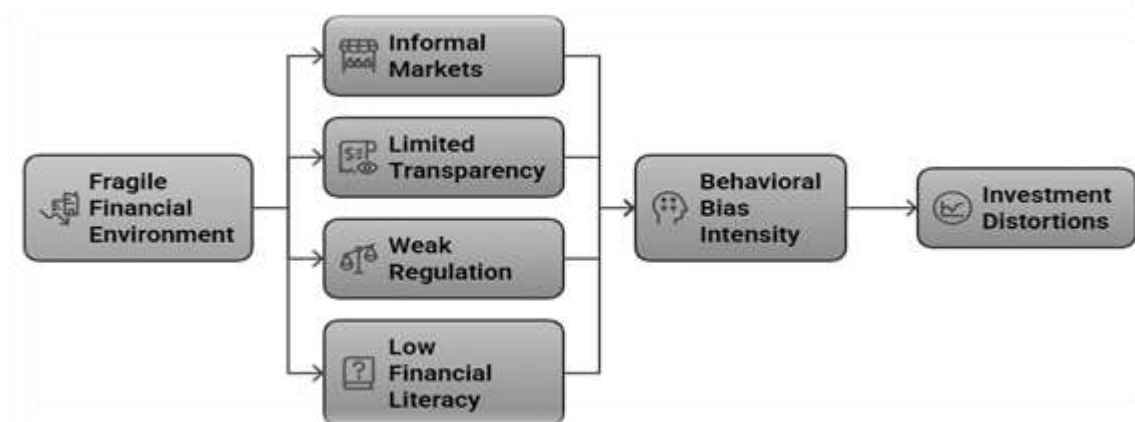


Figure1: Contextual Amplification Model (Afghanistan-Specific)

Figure1 illustrates the structural impact of Afghanistan's fragile financial environment on behavioural biases and, by extension, on investment decision-making. According to the model, informal market structure, widespread opacity, weak regulation, and low financial literacy contribute to substantial environmental uncertainty, as seen by extreme information asymmetry and negligible investor protection. In this environment, investors rely on emotional instinct and social cues rather than objective financial research. These structural restrictions don't only coexist with behavioral biases; they actively increase them. The lack of consistent performance feedback promotes overconfidence; opaque market signals cause herding behavior; macroeconomic instability heightens loss aversion; and poor financial literacy reinforces mental accounting.

The cumulative impact of these intensified biases is evident in investment biases, such as under-diversification, undue loss realisation, speculative clustering, and inefficient asset allocation. Ultimately, the model extends the traditional theory by incorporating institutional fragility into the behavioral finance model and, as such, will show that in a context such as Afghanistan, investor irrationality is not solely supported by the structural fragility of the financial system but is, in part, a psychological phenomenon too.

3. RESEARCH GAPS AND DIRECTIONS FOR FUTURE RESEARCH:

Although behavioural finance has generated substantial empirical evidence on cognitive and emotional biases on financial decision-making, the literature remains concentrated in developed financial systems and relatively ordered emerging markets. Much of the recent empirical literature is based on data from formal financial markets, by relatively high liquidity, market transparency, provide investment security, and are highly regulated. These conditions differ substantial from those found in fragile financial environment such as Afghanistan. Consequently, it remains uncertain whether existing behavioural finance findings can be generalised to such contexts. Based on the literature reviewed several research gaps are predicted and need to be explored by researchers in the context of Afghanistan.

Geographical and Contextual gap: While a large amount of literature exists on behavioral biases and financial decision making in developed and emerging markets, the literature for Afghanistan is still limited. For example, empirical evidence of systematic biases, like overconfidence, anchoring, mental accounting, loss aversion, herding, and regret is still sparse. Future research should investigate if these biases are more prevalent, stronger and more consequential in contexts of political turmoil, macroeconomic uncertainty, less information for markets and less institutional development.

Scope Gap: The extant study focused only on a few behavioural biases (herding behaviour, mental accounting, regret aversion, anchoring, loss aversion, and overconfidence) in the context of Afghanistan; there are many more biases to investigate and assess their impacts across various fields in Afghanistan.

Household-level research Gap: Household-level research that considers behavioural biases is less global, and in Afghanistan it is almost non-existent. So there is a vast research area in the field of household financial decision-making, including spending, saving, lending/borrowing, investment, and many other aspects.

Islamic Finance sector: Since Afghanistan is an Islamic country and many prefer to conduct finance in accordance with Islamic Sharia law, studying these financial decisions from the perspective of behavioural finance would yield valuable insights. Researchers can study them through framing effect, ambiguity bias, and so forth.

Entrepreneurship and Start-ups: Afghanistan needs to develop entrepreneurship, SMEs, and MSMEs, but many investors remain reluctant to invest in these sectors. Behavioural finance can address this question by researching and collecting investors' ideas on this topic.

Structural market gap: The current research generally operates under the assumption of trading in formal equity markets, where transaction data are available. However, Afghan investors primarily focus on informal assets such as real estate, gold, foreign currency, and small private businesses. The behaviours are likely to differ across these asset classes, but there is seldom a body of current theoretical and empirical frameworks that address informal or poorly developed financial systems.

Micro-level decision-making gap: The current literature mainly emphasises individual investors but fails to highlight households as decision-making units, in which financial budgeting may be subject to negotiation. As in Afghanistan, a joint household authority structure, intergenerational pressure, and gender roles often influence financial decision-making. The relationship between behavioural bias and intra-household relationships has not been empirically studied.

Temporal dynamics gap: The literature on behavioural finance relies on cross-sectional survey data in most of its investigations and offers little insight into the long-term dynamics of biases under economic constraints. Behavioural responses can be enhanced or dynamically adjusted in weak economies characterised by frequent shocks, price volatility, and exchange rate fluctuations. They are currently lacking longitudinal and panel-based evidence.

Interaction between informal social networks and behavioural bias Gap: In Afghanistan, most financial decisions commonly take into account kinship ties, community leaders, and networks of trust, but not advisory mechanisms. The exaggeration of herding behaviour due to the dense network of social activities has not been explicitly modelled in Afghanistan.

Gap in financial literacy heterogeneity: Most studies conducted around the globe recognise the moderating effect of financial literacy, yet very few examine how literacy levels and religious financial values interact to shape the level of bias in Afghanistan.

Macroeconomic uncertainty multiplier gap exists: The combined impact of political instability, sanctions, lack of access to banking, and fluctuating exchange rates on behavioural distortions has not been theoretically or practically developed in Afghanistan. Informal behavioural finance models rarely treat macro-institutional fragility as a structural moderator.

Policy and measurement gap: No validated behavioural tools have been adapted to the Afghan context, and there is insufficient evidence to inform financial literacy interventions or regulatory measures.

Addressing the above gaps is necessary to develop context-specific behavioural models that most accurately reflect the realities of Afghanistan's fragile financial environment. It would lead to more resilient, context-specific insights that would allow policymakers, financial institutions, and regulators to formulate evidence-based policies that promote sustainable growth of the financial sector and strengthen Afghanistan's long-term economic sustainability.

4. CONCLUSION

This review covered the literature on cognitive, emotional and social behavioral biases in financial decisions with a particular attention to the underexplored context of Afghanistan. As summarized in the literature reviewed, cognitive biases can affect the way individuals interact with the information, make financial decisions, allocate resources, and build their portfolios. The literature reviewed suggests a number of biases that may affect how people process information, evaluate financial alternatives, allocate financial resources, and assemble portfolios. Likewise, a preference for loss aversion, herd behavior and regret may have an impact on risk-taking, the impact on losses, conforming to other decision makers, and changing past decisions with respect to finances. Together, these results provide evidence that the rational and fully-informed decision-making model is insufficient to account for the nature of financial choices.

Two key strengths of the review are its contextual interpretation of existing evidence by behavioral finance, and its focus on the financial fragility in Afghanistan. The level of formal market development, financial information, institutional capacity, access to financial services and economic stability are all significantly different between Afghanistan and developed and established emerging financial markets. These conditions can influence how the behavioral biases are manifested, and can add to the use of past experiences, informal information, social networks, and simplified decision-making approaches. Economic and exchange-rate uncertainty can enhance the salience of anchoring and loss aversion, for instance, and dependence on the informal network might amplify the impact of social influence and herding. Mental accounting can also be more significant if a household has more than one purpose specific or informal account for managing its finances. These contextual interpretations, however, should not be taken for granted to be applicable to Afghan households and investors in general.

The review also highlights some key avenues for future investigations. There is limited empirical evidence on the presence of behavioral biases in Afghanistan, especially at the household level and for informal assets and financial activities. To consider the isolated and combined effect of behavioral biases, future studies should use valid and contextually relevant measurement tools, sound quantitative and qualitative research methods, and, as much as possible, longitudinal designs. The link between behavioral propensities, financial literacy, informal social networks, the household decision-making process, and macroeconomic uncertainty should also be paid greater attention. Behavioral insights can be applied to the context of financial-literacy programmes, investor education, consumer protection and development programmes for the financial sector in Afghanistan from a practical point of view. This should be done within the context of the need, not directly from the well-established financial markets. By raising individuals' awareness of common behavioral biases, they can help understand systematic decision-making errors, and make more informed financial decisions. To sum up, it is very important that the understanding of fragile financial system is not only an academic research field but also a need to create financial education and investment practices and policies more suitable for Afghanistan.

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CONFLICT OF INTEREST

The author states that this paper does not have any conflicts of interest in its publication. The study was conducted as an independent study, and no relationships between its research, analysis, and conclusions and any financial or personal connections were taken into account.

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