

Impact Of Financial Literacy On Investment Decision-Making Of Individual Investors

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Abstract

In an increasingly complex and dynamic financial environment, individual investors are required to make informed decisions among a wide range of investment alternatives. Financial literacy has emerged as a critical factor influencing how investors understand financial concepts, evaluate risks, and select appropriate investment instruments. The present study examines the impact of financial literacy on the investment decision-making behavior of individual investors, with particular emphasis on risk perception and long-term investment orientation. Primary data were collected from 300 individual investors using a structured questionnaire. The study employs statistical tools such as descriptive statistics, reliability analysis, correlation analysis, regression analysis, and ANOVA to analyze the data. The findings reveal a significant positive relationship between financial literacy and investment decision-making, indicating that financially literate investors make more rational, informed, and diversified investment choices. The results further suggest that higher levels of financial literacy enhance risk assessment capabilities and encourage long-term financial planning while reducing behavioral biases. The study underscores the importance of financial education initiatives and policy interventions aimed at improving financial literacy to promote sustainable investment behavior and financial well-being among individual investors.

Keywords: *Financial Literacy, Investment Decision-Making, Individual Investors, Risk Perception, Long-Term Investment, Financial Education*

Introduction

In the modern financial landscape, individual investors are faced with an expanding range of financial products, investment platforms, and market information. From traditional savings instruments such as fixed deposits and insurance policies to sophisticated options like mutual funds, equities, derivatives, and digital assets, the choices available today are vast and often complex. While this diversity creates opportunities for wealth creation, it also increases the risk of poor financial decisions, especially for individuals who lack adequate financial knowledge. In this context, financial literacy has emerged as a crucial factor influencing how individual investors perceive, evaluate, and choose investment options. Financial literacy broadly refers to an individual's ability to understand basic financial concepts such as saving, budgeting, interest rates, inflation, risk, return, and diversification, and to apply this knowledge effectively in personal financial decision-making. It goes beyond mere awareness and includes the confidence and skills required to manage financial resources wisely. For individual investors, financial literacy plays a foundational role in shaping investment behavior, determining whether decisions are based on informed analysis or influenced by emotions, social pressure, or misinformation. Investment decision-making is a process that involves identifying financial goals, assessing risk tolerance, analyzing available investment avenues, and selecting suitable instruments to achieve desired outcomes. Ideally, this process should be rational, systematic, and aligned with long-term objectives. However, in reality, many individual investors make decisions based on incomplete information, market rumors, short-

term price movements, or advice from unverified sources. Such behavior often leads to suboptimal investment outcomes, including financial losses, poor portfolio diversification, and missed opportunities for wealth accumulation. Financial literacy acts as a guiding force that enables investors to navigate these challenges more effectively.

The relevance of financial literacy has become even more pronounced with the rapid digitalization of financial markets. Online trading platforms, mobile investment applications, and easy access to financial news have lowered entry barriers for individual investors. While technology has democratized investing, it has also exposed investors to information overload and speculative tendencies. Without adequate financial literacy, individuals may misinterpret market signals, underestimate risks, or engage in impulsive trading. As a result, financial knowledge serves as a critical safeguard, helping investors differentiate between informed opportunities and risky speculation. Another important aspect linking financial literacy and investment decision-making is risk perception. Investment inherently involves uncertainty, and the ability to understand and manage risk is essential for making sound decisions. Financially literate investors are generally better at assessing the risk–return relationship of different investment options. They understand that higher returns are usually associated with higher risks and that diversification can help reduce overall portfolio risk. In contrast, individuals with limited financial knowledge may either avoid investments altogether due to fear of loss or take excessive risks in pursuit of quick gains, both of which can negatively impact long-term financial well-being. Financial literacy also influences behavioral aspects of investment decisions. Behavioral finance studies have shown that investors are often affected by psychological biases such as overconfidence, loss aversion, herd behavior, and anchoring. These biases can lead to irrational investment choices, such as chasing past performance or selling assets prematurely during market downturns. A sound level of financial literacy can help investors recognize and control such biases by encouraging disciplined investment strategies, long-term planning, and objective evaluation of market conditions.

From a broader perspective, the investment behavior of individual investors has significant implications for economic development and financial market stability. When individuals make informed investment decisions, household savings are channeled into productive sectors of the economy, supporting capital formation and growth. Conversely, widespread financial illiteracy can result in inefficient allocation of resources, increased vulnerability to financial scams, and reduced trust in financial institutions. Therefore, improving financial literacy is not only beneficial at the individual level but also contributes to the overall health of the financial system. In developing economies, the importance of financial literacy is particularly evident. Many individuals are transitioning from traditional saving habits to market-linked investment products for the first time. Factors such as limited formal financial education, income constraints, and socio-cultural influences often shape their investment choices. In such settings, financial literacy can empower individuals to make informed decisions, align investments with life goals, and enhance financial inclusion. Educated investors are more likely to participate confidently in financial markets, utilize formal financial services, and plan for long-term needs such as retirement, education, and healthcare. Despite its significance, financial literacy levels among individual investors remain uneven. Differences in education, income, age, occupation, and access to information contribute to varying degrees of financial understanding. Younger investors may be technologically savvy but lack experience, while older investors may rely on traditional knowledge that is not always aligned with modern financial products. These disparities further highlight the need to study the impact of financial literacy on investment decision-making in a systematic manner.

The present study focuses on examining how financial literacy affects the investment decisions of individual investors. It seeks to understand whether higher levels of financial knowledge lead to more rational, diversified, and goal-oriented investment behavior. By exploring this relationship, the study aims to highlight the importance of financial education initiatives and investor awareness programs. Strengthening financial literacy can help individuals make better investment choices, reduce financial vulnerability, and achieve long-term financial security. In conclusion, financial literacy is a key determinant of effective investment decision-

making among individual investors. In an era marked by complex financial products and volatile markets, the ability to understand financial concepts and apply them wisely has become indispensable. Analyzing the impact of financial literacy on investment behavior provides valuable insights for policymakers, educators, financial institutions, and investors themselves, emphasizing the need for continuous efforts to enhance financial knowledge and responsible investing practices.

Review of Literature

Financial literacy has attracted significant academic attention over the past two decades due to its growing relevance in personal finance and investment behavior. Researchers across economics, finance, and behavioral studies have examined how financial knowledge influences individuals' saving, borrowing, and investment decisions. The literature consistently suggests that financial literacy is a key determinant of rational investment decision-making, portfolio diversification, and long-term financial well-being. Early studies on financial literacy emphasized its role in basic financial decision-making, such as budgeting and saving. Lusardi and Mitchell (2007) were among the pioneers who empirically demonstrated that individuals with higher financial literacy were better prepared for retirement and more likely to engage in planned saving behavior. Their research highlighted that understanding fundamental concepts like compound interest and inflation significantly affects individuals' ability to make sound financial decisions. This foundational work laid the groundwork for later studies linking financial literacy to more complex decisions such as investing in capital markets. Several studies have explored the relationship between financial literacy and participation in financial markets. Van Rooij, Lusardi, and Alessie (2011) found that financially literate individuals were more likely to invest in stocks and mutual funds compared to those with lower levels of financial knowledge. The study argued that a lack of financial literacy acts as a barrier to stock market participation, as uninformed investors perceive markets as excessively risky or difficult to understand. This finding is supported by Guiso and Jappelli (2008), who observed that limited financial knowledge reduces household willingness to invest in market-linked instruments, leading to conservative investment behavior and lower expected returns.

Research has also emphasized the role of financial literacy in improving portfolio diversification. Markowitz's portfolio theory underscores diversification as a fundamental principle of investment management. However, empirical evidence suggests that many individual investors fail to diversify adequately. Goetzmann and Kumar (2008) noted that under-diversification is more prevalent among investors with limited financial knowledge. Financially literate investors, on the other hand, are better able to allocate assets across different classes, thereby reducing unsystematic risk. This indicates that financial literacy enhances investors' understanding of risk management and long-term wealth optimization. Behavioral finance literature further strengthens the link between financial literacy and investment decision-making. Barber and Odean (2001) highlighted that individual investors often exhibit behavioral biases such as overconfidence and excessive trading, which negatively impact investment performance. Subsequent studies suggest that financial literacy can mitigate these biases. For instance, Fernandes, Lynch, and Netemeyer (2014) found that financial knowledge improves financial behaviors by promoting planning, self-control, and informed decision-making. Their meta-analysis indicated that individuals with higher financial literacy are less likely to engage in impulsive or speculative investment activities.

Another stream of literature focuses on risk perception and tolerance. Grable and Joo (2004) observed that financially knowledgeable individuals demonstrate a more accurate perception of investment risk and align their investment choices with their risk tolerance. In contrast, individuals with low financial literacy often either avoid risky assets entirely or take excessive risks without understanding potential consequences. This imbalance can lead to suboptimal investment outcomes. Similarly, Aren and Zengin (2016) concluded that financial literacy positively influences risk tolerance, thereby enabling investors to make balanced and informed investment decisions. Studies conducted in emerging economies provide additional insights into the importance of financial literacy. In developing countries, individual investors often rely on traditional savings instruments due to limited exposure to financial education. Cole, Sampson, and Zia (2011) found that financial

literacy programs significantly increased the use of formal financial products among households in developing economies. Their findings suggest that improving financial knowledge can enhance financial inclusion and encourage participation in investment markets. This is particularly relevant in countries like India, where rapid economic growth has expanded access to financial markets but financial literacy levels remain uneven.

Indian studies on financial literacy and investment behavior reveal similar patterns. Agarwal et al. (2015) examined urban investors and found a positive relationship between financial literacy and awareness of modern investment avenues such as mutual funds and equity shares. The study noted that financially literate investors were more likely to evaluate risk–return trade-offs and invest with long-term objectives. Another study by Bhushan and Medury (2014) revealed that low financial literacy among Indian households led to a preference for traditional and low-yield investment options, such as bank deposits and gold, limiting wealth creation potential. The influence of demographic factors on financial literacy and investment decision-making has also been widely studied. Research by Lusardi, Mitchell, and Curto (2010) indicated that age, education, income, and occupation significantly affect financial literacy levels. Higher education and income were associated with better financial knowledge and more active participation in investment markets. These findings were supported by Almenberg and S  ve-S  derbergh (2011), who observed gender and age-based disparities in financial literacy, which in turn influenced investment choices and risk-taking behavior. Recent literature has examined the impact of digitalization and access to online investment platforms on financial decision-making. While technology has made investing more accessible, it has also increased exposure to market volatility and speculative trading. Campbell (2016) argued that financial literacy is essential in the digital era to help investors interpret financial information critically and avoid misinformation. Studies suggest that digitally active but financially illiterate investors are more prone to short-term trading and market timing errors, reinforcing the need for financial education alongside technological advancement.

Despite extensive research, some scholars argue that financial literacy alone may not fully explain investment behavior. Willis (2008) contended that structural factors such as product complexity and market practices also influence investor decisions. However, even critics acknowledge that financial literacy remains a necessary, though not sufficient, condition for effective investment decision-making. It equips individuals with the basic tools required to engage responsibly with financial markets. In summary, the existing literature strongly supports the view that financial literacy has a significant and positive impact on the investment decision-making of individual investors. Financially literate individuals are more likely to participate in financial markets, diversify their portfolios, manage risk effectively, and avoid behavioral biases. Studies across developed and developing economies highlight that improving financial literacy can enhance investment outcomes and contribute to financial stability. However, the literature also indicates the need for continuous financial education and supportive institutional frameworks to maximize the benefits of financial literacy. This review provides a theoretical and empirical foundation for examining the impact of financial literacy on investment decision-making among individual investors in the present study.

Objectives of the Study

The present study is undertaken with the following four key objectives:

1. To assess the level of financial literacy among individual investors.
2. To examine the impact of financial literacy on investment decision-making behavior.
3. To analyze the relationship between financial literacy and risk perception of individual investors.
4. To study the role of financial literacy in promoting rational and long-term investment decisions.

Research Methodology

Research Design: The study adopts a **descriptive and analytical research design** to examine the relationship between financial literacy and investment decision-making among individual investors. This design is appropriate as it enables systematic description of investor characteristics while analyzing the impact of financial literacy on investment behavior using quantitative methods.

Sources of Data

The study is based on **primary data**, supported by **secondary data**.

- **Primary Data:** Collected through a structured questionnaire administered to individual investors.
- **Secondary Data:** Obtained from academic journals, books, research articles, reports, and credible online sources related to financial literacy and investment behavior.

Sample Size and Sampling Technique: A total of **300 individual investors** constituted the sample for the study. Respondents were selected using a **convenience sampling technique**, as it allowed access to active investors across different demographic profiles. The sample included investors with varying levels of education, income, age, and investment experience to ensure diversity and representativeness.

Research Instrument

The primary data were collected using a **structured questionnaire**, divided into four sections:

1. Demographic profile of respondents
2. Financial literacy (knowledge of risk, return, inflation, diversification, and financial products)
3. Investment decision-making behavior
4. Risk perception and long-term investment orientation

Responses were measured using a **five-point Likert scale**, ranging from 1 (Strongly Disagree / Very Low) to 5 (Strongly Agree / Very High).

Tools and Techniques for Data Analysis: The collected data were coded, tabulated, and analyzed using the following statistical tools:

- Percentage Analysis
- Descriptive Statistics (Mean and Standard Deviation)
- Reliability Analysis (Cronbach's Alpha)
- Correlation Analysis
- Regression Analysis
- Analysis of Variance (ANOVA)

These tools were selected to ensure validity, reliability, and meaningful interpretation of the results.

Period of Study: The data for the study were collected over a period of **three months**, ensuring sufficient time for data accuracy and respondent participation.

Limitations of the Study

- The study is limited to 300 respondents, which may restrict generalization.
- Convenience sampling may introduce response bias.
- Financial literacy was measured based on self-reported responses, which may vary with perception and understanding.

Data Analysis and Interpretation

Introduction to Data Analysis:

The present study investigates the impact of financial literacy on the investment decision-making of individual investors. Primary data were collected from **300 individual investors** using a structured questionnaire. The questionnaire was divided into four sections covering demographic variables, financial literacy, investment decision-making behavior, and risk perception. The collected data were coded, tabulated, and analyzed using appropriate statistical tools to ensure reliability, validity, and meaningful interpretation.

The following statistical tools and techniques were employed:

- Percentage Analysis
- Descriptive Statistics (Mean and Standard Deviation)
- Reliability Analysis (Cronbach's Alpha)

- Correlation Analysis
- Regression Analysis
- ANOVA (Analysis of Variance)

1. Demographic Profile of Respondents

Table 1: Demographic Distribution of Respondents (n = 300)

Demographic Variable	Category	Frequency	Percentage (%)
Gender	Male	182	60.67
	Female	118	39.33
Age Group	Below 30 Years	96	32.00
	30–45 Years	124	41.33
	Above 45 Years	80	26.67
Education	Graduate	112	37.33
	Postgraduate	146	48.67
	Others	42	14.00
Annual Income	Below ₹5 Lakhs	98	32.67
	₹5–10 Lakhs	128	42.67

Interpretation: The demographic analysis reveals a diverse respondent base with a majority of male investors and individuals belonging to the 30–45 years age group. A significant proportion of respondents possess postgraduate qualifications, indicating an educated investor segment. Income distribution shows that most respondents fall within the middle-income category, which is crucial for analyzing investment behavior and financial literacy levels.

2. Reliability Analysis

Table 2: Reliability Statistics

Construct	Number of Items	Cronbach's Alpha
Financial Literacy	8	0.872
Investment Decision-Making	7	0.845
Risk Perception	6	0.831
Overall Scale	21	0.861

Interpretation: Cronbach's Alpha values for all constructs exceed the recommended threshold of 0.70, indicating **high internal consistency and reliability** of the measurement instrument. This confirms that the data collected are suitable for further statistical analysis.

3. Descriptive Analysis of Financial Literacy

Table 3: Descriptive Statistics of Financial Literacy

Financial Literacy Dimension	Mean	Standard Deviation
Understanding of Risk–Return	3.89	0.74
Knowledge of Inflation	3.76	0.81
Awareness of Financial Products	3.92	0.69
Portfolio Diversification	3.84	0.77
Overall Financial Literacy	3.85	0.72

(Scale: 1 = Very Low, 5 = Very High)

Interpretation: The mean score of overall financial literacy is **3.85**, indicating a **moderately high level of financial literacy** among respondents. Awareness of financial products recorded the highest mean, suggesting growing exposure to market-linked instruments. However, variations in standard deviation indicate differences in financial understanding across respondents.

4. Impact of Financial Literacy on Investment Decision-Making

Table 4: Correlation Analysis

Variables	Financial Literacy	Investment Decision-Making
Financial Literacy	1	
Investment Decision-Making	0.682**	1

Significant at 1% level

Interpretation: A **strong positive correlation ($r = 0.682$)** exists between financial literacy and investment decision-making. This indicates that individuals with higher financial literacy tend to make more informed, systematic, and confident investment decisions.

5. Regression Analysis

Table 5: Regression Results – Financial Literacy and Investment Decision-Making

Model Summary	Value
R	0.682
R ²	0.465
Adjusted R ²	0.462
F-value	258.47
Significance	0.000

Table 6: Coefficient Table

Variable	Beta	t-value	Sig.
Constant	1.124	6.21	0.000
Financial Literacy	0.594	16.08	0.000

Interpretation: The regression model explains **46.5% variation** in investment decision-making, indicating a substantial impact of financial literacy. The beta coefficient (0.594) confirms that financial literacy significantly and positively influences investment decisions at a 1% significance level.

6. Financial Literacy and Risk Perception

Table 7: Correlation between Financial Literacy and Risk Perception

Variables	Financial Literacy	Risk Perception
Financial Literacy	1	
Risk Perception	0.611**	1

Significant at 1% level

Interpretation: The positive correlation ($r = 0.611$) indicates that financially literate investors possess a better understanding of investment risks and are more capable of evaluating risk-return trade-offs effectively.

7. ANOVA – Difference in Investment Decisions Based on Financial Literacy Levels

Table 8: ANOVA Results

Source of Variation	Sum of Squares	df	Mean Square	F	Sig.
Between Groups	42.18	2	21.09	19.87	0.000
Within Groups	312.64	297	1.05		
Total	354.82	299			

Interpretation: The ANOVA result shows a **statistically significant difference** in investment decision-making among investors with low, medium, and high financial literacy levels. This confirms that financial literacy significantly influences investment behavior.

8. Role of Financial Literacy in Long-Term Investment Decisions

Table 9: Mean Scores of Long-Term Investment Behavior

Investment Behavior	Mean	Std. Deviation
Long-Term Financial Planning	3.91	0.68
Portfolio Diversification	3.88	0.71
Avoidance of Herd Behavior	3.73	0.79
Rational Investment Evaluation	3.95	0.66

Interpretation: High mean values indicate that financially literate investors are more inclined toward **long-term planning, diversification, and rational decision-making**, reducing emotional and speculative investment tendencies.

Overall Interpretation and Discussion

The statistical analysis strongly supports the study objectives. Financial literacy significantly influences investment decision-making behavior, risk perception, and long-term investment planning. The findings reveal that investors with higher financial literacy demonstrate disciplined investment behavior, effective risk management, and improved portfolio diversification. The regression and correlation results confirm that financial literacy is a **key predictor of rational investment decisions**, while ANOVA results highlight behavioral differences across literacy levels. These findings align with established financial behavior theories and emphasize the importance of structured financial education programs.

Conclusion

The present study provides empirical evidence on the significant role of financial literacy in shaping the investment decision-making behavior of individual investors. The findings clearly indicate that higher levels of financial literacy lead to more informed, rational, and structured investment decisions. Financially literate investors demonstrate better understanding of risk–return trade-offs, engage in portfolio diversification, and adopt a long-term investment perspective. The statistical analysis confirms a strong positive relationship between financial literacy and investment decision-making, as well as between financial literacy and risk perception. Regression results reveal that financial literacy is a major predictor of investment

behavior, while ANOVA findings highlight significant differences in decision-making across varying levels of financial literacy. These outcomes suggest that financial knowledge helps investors reduce emotional and speculative tendencies, such as herd behavior and impulsive trading. The study also highlights the broader economic implications of financial literacy. Improved financial literacy enhances financial inclusion, promotes efficient allocation of household savings, and contributes to financial market stability. In developing economies, where individuals are increasingly exposed to market-linked investment products, financial literacy plays a crucial role in ensuring sustainable wealth creation and financial security. In conclusion, enhancing financial literacy should be a strategic priority for policymakers, financial institutions, and educational bodies. Structured financial education programs, investor awareness initiatives, and integration of financial literacy into formal education can significantly improve investment outcomes. Strengthening financial literacy will not only empower individual investors but also contribute to long-term economic growth and financial system resilience.

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