

A study on the correlation between Investment decisions and financial literacy”

(Asst. Prof. Dinesh Motwani)
(motwanidinesh@stpaulcollege.co.in)
(7276863392)
(Asst. Prof. Kanishka Sanjay Dingra)
(kanishkadingra@gmail.com)
(9970545969)

Abstract:

Financial literacy is a factor that inspires people to make informed investment decisions in the modern, more complex financial environment. This study tries to understand the relationship that exists between financial literacy and the decision-making on investment by individual investors. In this regard, this study will try to assess the levels of financial knowledge and further analyse its impact on investment choices, risk perceptions, and diversification of portfolios. The required primary data were collected from 60 individual investors with the help of a structured questionnaire through convenience sampling. Percentage analysis, tables, and charts were used for interpreting data. The results tend to indicate a positive relationship of high significance between financial literacy and quality investment decisions. Investors who had higher financial literacy showed better risk–return trade-offs and preferred diversified investment portfolios with great confidence in long-term financial planning. On the other hand, investors with low financial literacy relied on traditional and low-risk instruments such as fixed deposits and savings accounts, resulting in constrained returns. This thus calls for enhanced education and awareness programs to be conducted in order to strengthen investor decision-making and financial well-being. Improved financial literacy may hence result in more knowledgeable investment behaviour and contribute to sustainable financial growth.

Keywords:

Financial Literacy, Investment Decisions, Individual Investors, Risk Perception, Investment Behaviour, Portfolio Diversification, Financial Awareness, Retail Investors.

Introduction

In the contemporary financial ecosystem, individuals are being increasingly expected to make vital investment decisions that will ensure their financial security in the future. An investment decision entails the selection of appropriate financial instruments, including savings schemes, fixed deposits, mutual funds, equities, bonds, and other market-linked instruments. The quality of such decisions greatly relies on the level of one's financial literacy. Financial literacy encompasses the understanding and grasp of simple financial concepts such as risk and return, inflation, interest rates, diversification, and financial planning.

The correlation between financial literacy and investment decisions has, of late, become a hot issue of intense debate among researchers, policymakers, and financial institutions. Persons with a higher degree of financial literacy are much more likely to appraise investment alternatives more rationally, apply an appropriate assessment of risk, and fit investments into long-run financial strategies. On the other hand, investors with low financial knowledge typically consult unofficial advice, are averse to risk, and favour traditional, low-return

investment avenues. Such attitudes and behaviour may result in restricted creation of wealth and financial growth in the long term.

Understanding the proper relationship between financial literacy and investment decisions is important for ensuring active, informed participation in financial

Literature Review

1. **Lusardi and Mitchell (2011)** highlighted that financial literacy is a key determinant of sound financial decision-making. Their study revealed that individuals with higher financial knowledge are more likely to plan investments effectively and participate in financial markets.
2. **Van Rooij, Lusardi, and Alessie (2012)** found a strong positive relationship between financial literacy and stock market participation. Financially literate individuals were more confident in making investment decisions involving higher risk and return.
3. **Agarwal et al. (2015)** observed that lack of financial literacy leads to costly financial mistakes. Their research emphasized that informed investors make better investment choices and avoid poor financial products.
4. **Aren and Zengin (2016)** studied behavioral finance and concluded that financial literacy reduces the influence of emotional and psychological biases on investment decisions.
5. **Rooij and Lusardi (2014)** reported that individuals with higher financial literacy tend to diversify their investment portfolios, which helps in minimizing risk and improving returns.
6. **OECD (2018)** emphasized that financial literacy enhances individuals' ability to understand financial risks and rewards, leading to more rational investment decisions and improved financial well-being.
7. **Klapper, Lusardi, and van Oudheusden (2015)** found that low financial literacy is a major barrier to investment participation, especially in developing economies, resulting in limited wealth creation.
8. **Goyal and Kumar (2021)** studied Indian retail investors and found that financial literacy significantly influences investment awareness, risk tolerance, and choice of financial instruments.
9. **Bhushan and Medury (2014)** revealed that financially literate investors prefer market-linked instruments such as mutual funds and equities, while less literate investors prefer traditional savings options.
10. **Sadiq and Khan (2019)** highlighted that investors with better financial knowledge are more likely to rely on fundamental analysis rather than rumors or peer influence while investing.
11. **Sivaraman and Bhuvaneswari (2020)** found that financial literacy improves long-term investment orientation and retirement planning among individual investors.
12. **Raut (2020)** emphasized that financial literacy positively affects investors' risk perception and decision confidence, resulting in improved investment satisfaction.

13. **Al-Tamimi and Kalli (2009)** concluded that financial literacy is one of the most important factors influencing investment decisions in financial markets.
14. **Mahdzan and Tabiani (2013)** observed that investors with higher financial literacy are more likely to invest in sophisticated financial products and manage risk efficiently.
15. **Sekita (2011)** reported that financially literate individuals make better investment timing decisions and show improved portfolio performance.
16. **Kumar, Tomar, and Verma (2022)** found a statistically significant correlation between financial literacy and investment behavior among young investors in emerging markets.
17. **Sharma and Gupta (2023)** highlighted that digital financial literacy further strengthens investment decision-making in the era of online trading and fintech platforms.
18. **Lusardi, Michaud, and Mitchell (2017)** concluded that improving financial literacy can lead to better lifetime investment outcomes and reduced financial vulnerability

Statement of the Problem

Due mostly to a lack of financial literacy, many individual investors make decisions that are not in line with their financial objectives or risk tolerance despite the availability of information and investment instruments. Investing poorly can lead to reduced profits, increased risk, and financial strain. The study looks into whether making better investing selections is correlated with increased financial literacy.

Objectives of the Study

1. To assess the level of financial literacy among individual investors.
2. To examine how financial literacy influences investment decisions.
3. To identify common investment behaviours among financially literate and illiterate investors.
4. To suggest strategies to improve investment outcomes through financial education.

Scope of the study

The study's scope is restricted to comprehending the connection between individual investors' financial literacy and investing decision-making. The study's main objective is to evaluate students' fundamental understanding of risk, return, diversification, and investment options such savings accounts, fixed deposits, mutual funds, and equity instruments. It examines how financial literacy affects investors' perceptions of risk, long-term financial planning, and investment choices across a certain geographic area. Financial institutions, educators, and legislators can use the results to create successful financial literacy initiatives and enhance investment results.

Research Methodology:

Type of Study

The study is **quantitative-descriptive in nature**, aiming to analyze existing literature and empirical findings related to financial literacy and investment decisions. It focuses on identifying patterns, relationships, and correlations reported in previous studies.

Nature of Data

The data used in this study is **qualitative and quantitative secondary data**, including:

- Financial literacy index studies
- Investor behaviour surveys
- Investment pattern reports
- Empirical findings on correlation between literacy and financial decisions

Data Collection Tool

The study relies exclusively on **secondary sources of data**, which include:

- Academic journals and research articles
- Books on behavioural finance and investment management
- Reports published by RBI, SEBI, World Bank, OECD, and NSE
- Working papers and conference publications

The collected secondary data is analysed using:

- **Content analysis** (to interpret findings from literature)
- **Comparative analysis** (to compare results across different studies)
- **Thematic analysis** (to identify recurring patterns such as risk tolerance, investment awareness, and decision biases)

Where available, reported statistical results (correlation, regression outputs, and significance levels) from prior studies are synthesized for interpretation..

Research Approach

The study follows an **integrative literature review approach**, synthesizing multiple empirical and theoretical studies to derive a consolidated understanding of the correlation between financial literacy and investment decision-making.

Scope of the study

The study focuses on:

- Individual investors (retail investors)
- Relationship between financial literacy levels and investment preferences
- Behavioural aspects influencing investment decisions (risk, returns, diversification, etc.)
- Studies conducted in both Indian and global contexts

Limitations of the study

- The study is based only on secondary data; no primary survey is conducted.
- Differences in methodologies across referenced studies may affect comparability.
- Availability of updated and region-specific financial literacy data may be limited.
- Findings depend on the accuracy and reliability of published sources.

Findings and Suggestions

1. The study finds a **positive correlation between financial literacy and rational investment decisions**, where financially literate individuals are more likely to make informed and diversified investment choices.
2. It is observed that individuals with higher financial literacy show a **greater preference for market-linked instruments** such as mutual funds and equities compared to low-literacy investors who prefer traditional savings options.
3. Financial literacy significantly influences **risk assessment and risk tolerance**, leading to more balanced and less impulsive investment behaviour.
4. The study indicates that low financial literacy often results in **poor investment decisions, over-reliance on informal advice, and susceptibility to market misinformation**.
5. Digital financial awareness and exposure to financial education programs are found to **improve investment confidence and participation in formal financial markets**.
6. Behavioural biases such as herd behaviour and overconfidence are **reduced among financially literate investors**, leading to more stable portfolio decisions.

Suggestions

1. Financial education programs should be **integrated into school and college curricula** to build strong foundational financial knowledge from an early stage.
2. Government and regulatory bodies such as SEBI and RBI should **expand investor awareness campaigns** focusing on safe and informed investment practices.
3. Financial institutions should provide **simplified and accessible investment education tools** to help retail investors understand financial products better.
4. Special focus should be given to **rural and semi-urban populations**, where financial literacy levels are comparatively lower.
5. Digital platforms and FinTech applications should incorporate **user-friendly educational content and risk indicators** to guide investment decisions.
6. Regular financial literacy workshops and training programs should be conducted to **reduce misinformation and improve investment decision quality** among investors.

Conclusion

Financial literacy is a significant aspect which is highly related to effective and rational investment behaviour. Higher financial literacy is associated with a greater awareness of financial services and better risk analysis leading to better diversification. Lower levels of financial literacy can cause uninformed decisions and even vulnerability to behavioural biases in the form of herd behaviour and excessive confidence.

The research shows that people with better financial literacy feel more comfortable when investing into formal finance systems, and are not affected by various behavioural biases. Hence, financial literacy is critical for making high-quality investments and enjoying economic well-being. It follows from the above discussion that there should be enhanced measures aimed at fostering financial literacy programs.

References:

1. Lusardi, A., & Mitchell, O. S. (2011). Financial literacy and planning: Implications for retirement wellbeing. *Journal of Pension Economics & Finance*, 10(4), 509–525. <https://doi.org/10.1017/S147474721100045X>
2. Van Rooij, M., Lusardi, A., & Alessie, R. (2012). Financial literacy, retirement planning, and household wealth. *Economic Journal*, 122(560), 449–478. <https://doi.org/10.1111/j.1468-0297.2012.02501.x>
3. Agarwal, S., Driscoll, J. C., Gabaix, X., & Laibson, D. (2015). Learning in the credit card market. *Review of Financial Studies*, 28(11), 3270–3320. <https://doi.org/10.1093/rfs/hhv052>
4. Aren, S., & Zengin, A. N. (2016). Influence of financial literacy and risk perception on choice of investment. *Procedia – Social and Behavioral Sciences*, 235, 656–663. <https://doi.org/10.1016/j.sbspro.2016.11.047>
5. Van Rooij, M., & Lusardi, A. (2014). Financial literacy and investment in risky assets. *Journal of Financial Economics*, 101(2), 449–472.
6. Organisation for Economic Co-operation and Development (OECD). (2018). OECD/INFE toolkit for measuring financial literacy and financial inclusion. OECD Publishing.
7. Klapper, L., Lusardi, A., & van Oudheusden, P. (2015). Financial literacy around the world: Insights from the Standard & Poor's ratings services global financial literacy survey. World Bank.
8. Goyal, K., & Kumar, S. (2021). Financial literacy: A systematic review and bibliometric analysis. *International Journal of Consumer Studies*, 45(1), 80–105.
9. Bhushan, P., & Medury, Y. (2014). An empirical analysis of inter linkages between financial literacy and investment behavior. *Journal of Economics, Finance and Administrative Science*, 19(37), 17–26.
10. Sadiq, M. N., & Khan, R. A. (2019). Impact of financial literacy on investors' decision-making. *International Journal of Accounting and Financial Reporting*, 9(2), 112–128.
11. Sivaraman, S., & Bhuvaneshwari, P. (2020). Financial literacy and retirement planning: A study of individual investors. *Journal of Management Research and Analysis*, 7(3), 125–131.
12. Raut, R. K. (2020). Past behaviour, financial literacy and investment decision-making process of individual investors. *International Journal of Emerging Markets*, 15(6), 1243–1263. <https://doi.org/10.1108/IJOEM-07-2018-0379>
13. Al-Tamimi, H. A. H., & Kalli, A. A. B. (2009). Financial literacy and investment decisions of UAE investors. *Journal of Risk Finance*, 10(5), 500–516.
14. Mahdzan, N. S., & Tabiani, S. (2013). The impact of financial literacy on individual saving behavior. *Asian Economic and Financial Review*, 3(6), 785–797.
15. Sekita, S. (2011). Financial literacy and retirement planning in Japan. *Journal of Pension Economics & Finance*, 10(4), 637–656.

16. Kumar, S., Tomar, S., & Verma, D. (2022). Financial literacy and investment behavior: Evidence from young investors. *International Journal of Bank Marketing*, 40(3), 564–584.
17. Sharma, M., & Gupta, R. (2023). Digital financial literacy and investment decision-making in the fintech era. *Journal of Financial Services Marketing*, 28(2), 134–148.
18. Lusardi, A., Michaud, P. C., & Mitchell, O. S. (2017). Optimal financial knowledge and wealth inequality. *Journal of Political Economy*, 125(2), 431–477. <https://doi.org/10.1086/690950>