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Impact of Financial Literacy on Investment Behaviour of Individual Investors in India

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ABSTRACT

Financial literacy is an important capability for making informed decisions about saving, borrowing, investing and managing financial risk. In India, the expansion of banking access, mutual fund distribution, online trading platforms and digital financial services has increased the range of investment choices available to households. At the same time, access to financial products does not necessarily mean that individuals understand their costs, risks, liquidity characteristics or suitability for particular goals. This paper examines the relationship between financial literacy and the investment behaviour of individual investors in India. It considers financial knowledge, financial attitudes and financial behaviour, and discusses how these dimensions may shape preferences for bank deposits, equity shares, mutual funds, government securities, gold, insurance and pension products. The paper adopts a descriptive and analytical approach based on secondary sources, including peer-reviewed studies and publications from Indian and international institutions. Existing evidence suggests that financial literacy is associated with improved financial planning and more informed financial behaviour, although the relationship is also shaped by income, education, access to financial services, risk tolerance and behavioural biases. The paper concludes that financial education should combine conceptual knowledge with practical decision-making skills, investor protection awareness and accessible guidance. Since this paper is based on secondary material, it does not claim original survey findings or statistical tests. The hypotheses and empirical framework presented can guide a future primary study.

Keywords: Financial literacy; investment behaviour; individual investors; financial planning; risk perception; investment decisions; India.

I. INTRODUCTION

Investment decisions influence an individual's ability to preserve purchasing power, meet future financial goals and build wealth over time. Individuals allocate savings among a range of financial and physical assets, taking into account expected returns, risk, liquidity, tax treatment and investment horizon. These decisions are not made in a vacuum: they are shaped by financial knowledge, personal circumstances, family expectations, market conditions and psychological factors.

India's financial environment has changed significantly with the growth of formal banking, financial inclusion initiatives, mutual funds, demat accounts, online brokerage services and mobile-based financial applications. Individuals can now access products that were previously less familiar or less convenient to purchase. This development creates opportunities for participation and diversification, but it also increases the need to understand product features, market volatility, fees, fraud risks and regulatory protections.

Financial literacy is commonly understood as a combination of financial knowledge, skills, attitudes and behaviours that support sound financial decisions and financial well-being. The Reserve Bank of India's National Strategy for Financial Education 2020–2025 adopts a broad approach that includes knowledge, behaviour and attitudes, and identifies objectives such as active savings, participation in financial markets, safe use of digital financial services, risk management and retirement planning (RBI, 2021).

The central concern of this paper is whether and how financial literacy influences investment behaviour among individual investors in India. Financial knowledge may help people compare alternatives and understand risk-return trade-offs. Financial attitudes may influence

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willingness to save and plan for the future. Financial behaviour reflects whether individuals actually budget, save regularly, diversify and review their investments. However, literacy alone may not eliminate behavioural biases or overcome constraints such as low income, limited product access or lack of trust.

1.1 Background of the Study

The traditional Indian household portfolio has included bank deposits, gold, insurance-linked products, property and small-savings instruments. In recent years, mutual funds and direct equity investments have become more visible to retail investors. This shift makes it important to distinguish between merely participating in a financial market and making a suitable, informed investment decision. Investors need to understand that market-linked products can fluctuate in value and that past performance does not guarantee future returns.

Financial literacy can support the process by helping investors interpret basic concepts such as compound interest, inflation, diversification, risk and return, liquidity and time value of money. These concepts are relevant whether an individual chooses a fixed deposit, mutual fund, share, government security or pension product.

1.2 Statement of the Problem

Many individuals make investment decisions with incomplete information or rely heavily on informal advice, advertisements, social media content and recent market trends. Such practices may lead to unsuitable product selection, inadequate diversification, unrealistic return expectations or exposure to fraud. The problem is not simply whether investors have heard of different products; it is whether they understand the products sufficiently to assess their suitability for their financial goals and risk capacity. This study therefore examines the ways in which financial literacy may influence investment preferences, planning and risk management.

1.3 Significance of the Study

The study is relevant to individual investors, educators, financial institutions, regulators and policymakers. For investors, it highlights the importance of understanding financial products before committing savings. For educational institutions, it supports the inclusion of practical financial education in commerce and management curricula. For institutions and regulators, it emphasises the need for clear product disclosures, accessible investor education and safe digital financial services.

II. REVIEW OF LITERATURE

2.1 Lusardi and Mitchell (2014)

Lusardi and Mitchell reviewed the economic importance of financial literacy and the evidence connecting financial knowledge with household financial decisions. Their work discusses the role of knowledge in saving, borrowing and retirement planning, and highlights the importance of basic concepts such as interest compounding, inflation and risk diversification. Their review provides a foundational framework for treating financial knowledge as an important input into economic decision-making.

2.2 Agarwal et al. (2015)

Agarwal and colleagues examined financial literacy and financial planning in India using information from participants in a financial advisory programme. Their study considered knowledge of interest rates, inflation and risk diversification and related these measures to financial planning and other financial tendencies. The authors reported that financial literacy was associated with better financial planning, while also observing variation across demographic and socioeconomic groups.

2.3 Lahiri and Biswas (2022)

Lahiri and Biswas studied whether financial literacy improves financial behaviour in India using the Financial Inclusion Insights survey conducted in 2018. Their analysis considered basic numeracy, interest rates, inflation and diversification, and examined outcomes relating to payment attitudes, savings attitudes and risk management. The study reported that improvements in financial literacy scores increased the likelihood of better financial behaviour and identified financial planning as a possible channel.

2.4 Bhandare et al. (2021)

Bhandare and colleagues investigated the impact of financial literacy models on individual financial behaviour in the Indian context. Their work contributes to the understanding of how different dimensions of literacy can be linked with practical financial outcomes and the need to consider more than knowledge alone.

2.5 OECD (2023)

The OECD/INFE 2023 International Survey of Adult Financial Literacy measures

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financial literacy through financial knowledge, financial behaviour and financial attitudes. It also considers financial inclusion, digital financial literacy and financial well-being. This multidimensional framework is useful for the present study because investment decisions are influenced by both what individuals know and how they behave.

2.6 Research Gap

The literature establishes an important relationship between financial literacy and financial decision-making. However, the relationship is not uniform across all investors or products. Further research can examine how literacy interacts with income, age, education, risk tolerance, investment experience and digital access in different Indian regions. There is also scope for localised studies comparing preferences for traditional products, such as deposits and gold, with market-linked products, such as mutual funds and equities. The present paper integrates these dimensions into a conceptual discussion and proposes hypotheses for future empirical testing.

III. OBJECTIVES OF THE STUDY

1. To explain the concept and dimensions of financial literacy in the context of individual investment decisions.
2. To examine the relationship between financial literacy and investment behaviour among individual investors in India.
3. To identify major investment avenues considered by individual investors.
4. To analyse the possible influence of financial knowledge, financial attitude and financial behaviour on investment planning.
5. To discuss the role of risk perception, demographic factors and behavioural biases in investment decisions.
6. To suggest measures for improving financial literacy and responsible investment behaviour.

IV. RESEARCH HYPOTHESES

The following hypotheses are proposed for testing in a future primary-data study:

- H01: There is no significant relationship between financial literacy and investment behaviour among individual investors in India.
- H11: There is a significant relationship between financial literacy and investment behaviour among individual investors in India.
- H02: Financial knowledge has no significant influence on investment planning.
- H12: Financial knowledge has a significant influence on investment planning.
- H03: Risk perception has no significant relationship with investment preferences.
- H13: Risk perception has a significant relationship with investment preferences.
- H04: Financial attitude has no significant influence on long-term financial planning.
- H14: Financial attitude has a significant influence on long-term financial planning.

These hypotheses have not been statistically tested in this secondary-data paper. Acceptance or rejection requires a defined sample, a validated questionnaire and appropriate statistical analysis.

V. RESEARCH METHODOLOGY

5.1 Research Design

The paper adopts a descriptive and analytical research design. It synthesises published research and institutional material to explain the potential relationship between financial literacy and investment behaviour.

5.2 Nature and Sources of Data

The study is based on secondary data. Sources include peer-reviewed journal articles, RBI publications, OECD reports and other relevant institutional material. The literature review is used to identify recurring themes and develop a conceptual framework. No new questionnaire responses have been collected for this draft.

5.3 Scope of the Study

The study focuses on individual investors in India and discusses investment avenues such as bank deposits, equity shares, mutual funds, government securities, gold, insurance and pension products. It considers the broad factors that may influence investment selection, including knowledge, attitude, behaviour, risk perception, income, age, education and investment experience.

5.4 Variables and Conceptual Framework

The principal independent construct is financial literacy, considered through financial knowledge, financial attitude and financial behaviour. The principal dependent construct is investment behaviour, reflected in product choice, diversification, investment regularity, planning horizon and review of investment decisions. Demographic and contextual factors—including age, income, education, occupation, access to financial services and investment experience—may act as control variables or influence the relationship.

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5.5 Limitations

- The paper relies on secondary sources and does not provide original primary survey results.
- The findings of reviewed studies may not be generalisable to every region or investor group in India.
- Financial products, regulations and market conditions change over time.
- Financial literacy is measured differently across studies, which may limit direct comparison.
- The paper does not establish causality between financial literacy and investment behaviour.

VI. CONCEPT AND DIMENSIONS OF FINANCIAL LITERACY

6.1 Financial Knowledge

Financial knowledge refers to understanding core financial concepts and applying them to real decisions. Relevant concepts include simple and compound interest, inflation, time value of money, risk and return, diversification, borrowing costs, taxation and the features of financial products. For example, understanding inflation helps an investor distinguish between nominal returns and changes in purchasing power.

6.2 Financial Attitude

Financial attitude concerns an individual's beliefs and orientation towards saving, spending, borrowing, risk and future planning. A person who values long-term security may be more likely to set financial goals and save regularly. Attitude does not guarantee action, but it can influence the intention to plan and invest.

6.3 Financial Behaviour

Financial behaviour is reflected in actual practices such as preparing a budget, maintaining emergency savings, paying bills on time, comparing financial products, investing regularly, diversifying appropriately and reviewing financial goals. It is important to distinguish knowledge from behaviour: an individual may understand diversification but still hold an overly concentrated portfolio.

6.4 Digital Financial Literacy

Digital financial literacy includes the ability to use digital financial services safely and evaluate information encountered online. Investors need to recognise fraudulent applications, phishing attempts, impersonation, misleading return claims and unauthorised advice. Digital convenience should be accompanied by secure practices and verification through official channels.

VII. INVESTMENT AVENUES AND THEIR RELEVANCE

7.1 Bank Fixed Deposits

Fixed deposits offer a stated rate of interest for a specified tenure, subject to the terms of the bank and deposit product. Investors should understand interest calculation, premature withdrawal conditions, taxation and the effect of inflation on real returns. Deposit insurance is subject to the applicable DICGC limit and rules; investors should not assume that every amount held with a bank is fully insured.

7.2 Equity Shares

Equity shares represent ownership in a company. Returns may arise from price appreciation and dividends, but share prices can decline and investors may lose capital. Financial literacy can help investors understand business fundamentals, valuation, volatility, diversification and the difference between investing and short-term speculation.

7.3 Mutual Funds

Mutual funds pool investors' money and invest according to a stated scheme objective. Categories include equity, debt, hybrid, index and exchange-traded funds. Investors should examine the scheme information document, riskometer, expense ratio, exit load, portfolio characteristics and investment horizon. A systematic investment plan is a method of investing periodically; it does not guarantee profit or protect against market losses.

7.4 Government Securities and Small-Savings Products

Government securities and eligible small-savings products may serve different objectives, including income, capital preservation or long-term savings. Their interest rates, maturity, liquidity, tax treatment and eligibility conditions differ. Investors should review the current official terms before investing.

7.5 Gold

Gold is a familiar asset in Indian households and may be held as jewellery, coins, bars or through financial products. The forms differ in making charges, storage, purity, liquidity, market risk and taxation. Financially informed decisions require comparison of the total cost and purpose of holding gold.

7.6 Insurance and Pension Products

Insurance primarily provides financial protection against specified risks, while pension products are

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designed to support retirement income. Some products combine insurance and investment features. Investors should understand charges, exclusions, surrender conditions, guarantees and market-linked risks, and should distinguish protection needs from investment goals.

VIII. FACTORS INFLUENCING INVESTMENT BEHAVIOUR

8.1 Age and Life Stage

Investment objectives and capacity to bear risk may change over an individual's life. A younger investor may have a longer investment horizon, while a person nearing retirement may prioritise liquidity and income stability. Age alone, however, is not a sufficient measure of risk tolerance.

8.2 Income and Wealth

Income affects the amount available for saving and investing. Individuals with limited disposable income may prioritise essential expenses, debt repayment and emergency savings. Higher income can increase the ability to diversify, but does not automatically lead to better financial decisions.

8.3 Education and Financial Experience

Formal education and investment experience may improve the ability to interpret financial information, but neither guarantees financial literacy. Practical financial education and access to reliable information remain important.

8.4 Risk Tolerance and Risk Capacity

Risk tolerance refers to an individual's willingness to accept uncertainty, while risk capacity concerns the financial ability to absorb losses. Suitable investment decisions should consider both, alongside the time horizon and purpose of the investment.

8.5 Behavioural Biases

Herd behaviour, overconfidence, loss aversion, anchoring and recency bias can affect investment decisions. For example, an investor may purchase an asset because it has recently risen in price or sell during a temporary decline due to fear. Financial literacy may help individuals recognise such tendencies, although education alone may not eliminate them.

8.6 Digital Platforms and Social Influence

Digital platforms can reduce transaction barriers and make investment information more accessible. At the same time, social media recommendations and unverified claims can encourage impulsive decisions. Investors should verify intermediaries and products through official regulatory and institutional sources.

9. DISCUSSION

The reviewed literature supports the view that financial literacy is associated with improved financial planning and financial behaviour. Agarwal et al. (2015) report an association between literacy and financial planning among participants in an Indian financial advisory programme. Lahiri and Biswas (2022) also find that higher financial literacy is associated with a greater likelihood of better financial behaviour in their analysis of Indian survey data. These studies support the relevance of financial knowledge, but they do not imply that knowledge is the only determinant of investment outcomes.

A useful interpretation is that financial literacy can improve the quality of the decision process. It can help investors ask relevant questions, compare product costs, understand uncertainty and align investments with goals. However, the final decision is also shaped by the availability of suitable products, household cash flows, financial obligations, trust, advice quality and market conditions.

The multidimensional approach adopted by the RBI and OECD is therefore appropriate. Financial knowledge, attitude and behaviour should be considered together. Programmes that only teach definitions may have limited impact if they do not help people apply concepts to budgeting, savings, risk assessment, digital safety and long-term planning.

IX. FINDINGS FROM THE SECONDARY REVIEW

7. Financial literacy is a relevant factor in financial planning and informed investment decisions.
8. Understanding interest, inflation, risk and diversification provides a foundation for comparing investment alternatives.
9. Financial attitude and actual financial behaviour are important complements to financial knowledge.
10. Risk tolerance, risk capacity, income, age, education and investment experience can influence investment choices.
11. Digital access can increase participation, but it also creates a need for digital financial literacy and fraud awareness.
12. Behavioural biases may affect decisions even when investors possess some financial knowledge.

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13. Financial education is likely to be more useful when it is practical, continuous and connected to real financial goals.

These are thematic findings from the literature reviewed. They are not results from a new survey conducted by the author and should not be represented as such.

X. SUGGESTIONS AND RECOMMENDATIONS

11.1 Integrate Financial Education into Academic Programmes

Schools, colleges and universities should include practical modules on budgeting, savings, compound interest, inflation, credit, investment risk, diversification, insurance and retirement planning. Commerce and management students can benefit from case studies and simulated investment exercises.

11.2 Promote Investor Awareness

Banks, regulators, educational institutions and financial organisations should conduct regular investor awareness programmes. Such programmes should explain product features, costs, risks, grievance redressal and how to verify authorised intermediaries.

11.3 Encourage Goal-Based Planning

Individuals should identify financial goals, estimate the time horizon and assess their ability to bear risk before selecting products. Investment decisions should be reviewed periodically and should not be based solely on recent returns.

11.4 Improve Digital Safety

Investors should use official applications and websites, protect passwords and one-time passwords, avoid sharing confidential credentials and verify claims of guaranteed or unusually high returns. Suspicious activity should be reported through the appropriate official channels.

11.5 Strengthen Access to Reliable Guidance

Financial institutions and public agencies should make product information understandable and accessible in regional languages. Where personalised advice is needed, investors should check the qualifications and regulatory status of the adviser.

11.6 Encourage Responsible Diversification

Investors should avoid excessive concentration in a single company, sector or asset class. Diversification should be based on financial goals, risk capacity and product characteristics rather than on a belief that it removes all risk.

XI. CONCLUSION

Financial literacy is an important foundation for responsible investment behaviour and household financial well-being. India's expanding financial ecosystem has made a wider range of investment products accessible to individual investors. However, access alone cannot ensure that products are selected appropriately. Investors need to understand the relationship between risk and return, the impact of inflation, the benefits and limits of diversification, product costs, liquidity and the suitability of investments for their financial goals.

The secondary literature reviewed in this paper indicates that financial literacy is associated with better financial planning and financial behaviour. At the same time, investment choices are influenced by personal circumstances, risk perception, behavioural biases and access to reliable information. Financial education should therefore combine knowledge with practical skills, safe digital behaviour and clear information about investor rights.

The paper concludes that sustained financial literacy initiatives can support more informed investment participation in India. A future empirical study using primary data from individual investors could test the proposed hypotheses and examine whether the relationship differs by age, income, education, occupation and investment experience.

XII. SCOPE FOR FUTURE RESEARCH

Future research may use a structured questionnaire administered to individual investors in Bhopal or other selected regions. A sample should be selected using a clearly stated sampling method, and the questionnaire should measure financial knowledge, attitude, behaviour, risk tolerance and investment preferences. A sample size such as 200 respondents may be considered if justified by the study design and available resources; it should not be reported as completed unless data are actually collected.

After data collection, researchers may use descriptive statistics, reliability analysis, correlation, chi-square tests, t-tests, ANOVA or regression, depending on the research questions and measurement scales. The results should report the actual sample profile, missing data, test statistics, significance levels and limitations. No statistical result should be fabricated or inferred from secondary literature.

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DECLARATION

This paper has been prepared for academic purposes using secondary sources and published literature. The sources consulted have been acknowledged in the reference list. The paper does not claim original primary survey data or statistical results. Any future empirical analysis will be based on independently collected and verifiable data.