

Impact of Financial Literacy on Investment Decisions

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Abstract—The present study investigates how financial literacy influences the investment decisions of individual investors. In today's dynamic financial environment, individuals are required to independently navigate a wide range of complex financial instruments and investment opportunities. Financial literacy encompasses understanding fundamental financial concepts, evaluating risk effectively, and being aware of various investment options. This knowledge plays a significant role in guiding rational and informed investment behavior.

The main objective of this research is to determine whether financial literacy has a significant effect on investment decision-making and risk perception. The study follows a descriptive and analytical research design. Primary data were gathered from 50 respondents through a structured questionnaire designed using a Likert scale. For analysis, statistical techniques such as percentage analysis, mean, standard deviation, and Pearson correlation were applied.

The results indicate a strong positive association between financial literacy and investment decision behavior ($r = 0.64$, $p < 0.01$). Respondents with higher levels of financial literacy tend to adopt better diversification strategies, maintain balanced risk tolerance, and show greater involvement in growth-oriented investment avenues like mutual funds and equity markets.

The study concludes that improved financial literacy enhances the quality of investment decisions and promotes disciplined financial conduct. Therefore, strengthening financial education initiatives can contribute to individual financial security as well as broader economic progress.

Index Terms—Financial Literacy, Investment Behavior, Risk Assessment, Portfolio Diversification, Individual Investors.

I. INTRODUCTION

In the contemporary economic environment, financial decision-making has become increasingly sophisticated and demanding. Individuals are now presented with a broad spectrum of financial instruments, including equities, mutual funds, bonds,

insurance schemes, retirement plans, and various digital investment platforms. Although these options provide significant opportunities for wealth creation, they also require adequate financial understanding to prevent poor decision-making and mismanagement of risk.

Financial literacy serves as a fundamental factor in helping individuals assess financial alternatives effectively. It represents the combination of knowledge, skills, and confidence necessary to make sound financial choices. A financially knowledgeable individual is familiar with essential concepts such as inflation, compound interest, diversification, risk-return tradeoffs, and portfolio management. This awareness strengthens the ability to plan systematically, invest wisely, and manage financial resources in an efficient manner.

In several developing economies, financial inclusion has expanded considerably; however, the level of financial literacy remains inconsistent. Many individuals make investment decisions based on peer suggestions, speculation, or incomplete information rather than analytical evaluation. Such practices may result in inadequate portfolio diversification, excessive exposure to risk, or over-reliance on low-yield investment options.

For this reason, it becomes important to examine the connection between financial literacy and investment decision-making. Understanding whether individuals with higher financial knowledge make more rational and diversified investment choices can offer valuable insights for policymakers, academic institutions, and financial service providers.

1.1 Concept of Financial Literacy

Financial literacy is a multidimensional concept that includes several interconnected components:

1. Financial Knowledge – Awareness and understanding of fundamental financial principles

such as interest rates, inflation, and diversification.

2. Financial Awareness – Familiarity with various financial products, services, and market instruments.
3. Risk Perception – The capability to evaluate potential risks and expected returns associated with investment options.
4. Financial Attitude – An individual's approach toward saving, planning, budgeting, and disciplined investing.

Collectively, these elements determine how effectively a person can make informed investment decisions.

1.2 Investment Decision

An investment decision refers to the process of selecting appropriate financial instruments based on factors such as risk tolerance, expected returns, investment horizon, and personal financial objectives. Effective investment decisions require systematic analysis and informed judgment.

1.3 Need for the Study

Despite improvements in access to financial markets, disparities in financial literacy continue to exist. Many individuals participate in investment activities without fully understanding the associated risks and returns. This gap between access and knowledge may lead to inefficient allocation of funds and unsatisfactory financial outcomes.

Therefore, it is essential to empirically investigate whether higher levels of financial literacy contribute to improved investment decision-making behavior.

1.4 Statement of the Problem

Although financial markets have become more accessible, a significant portion of individuals lack adequate knowledge to evaluate investment alternatives effectively. Insufficient financial understanding may influence risk perception, asset allocation strategies, and overall portfolio performance. The present research seeks to determine whether financial literacy has a measurable impact on investment decision behavior.

1.5 Objectives of the Study

The study is conducted with the following objectives:

1. To measure the level of financial literacy among the selected respondents.

2. To analyze the relationship between financial literacy and investment decisions.
3. To examine the influence of financial literacy on risk perception.
4. To evaluate whether financially knowledgeable individuals exhibit diversified investment behavior.

1.6 Significance of the Study

This research contributes to a better understanding of the role of financial education in shaping investment behavior. The findings may be useful for:

- Policymakers in designing structured financial awareness programs
- Educational institutions in incorporating financial education into academic curricula
- Financial institutions in encouraging responsible investment practices
- Individual investors aiming to enhance decision-making quality

1.7 Hypotheses of the Study

H0: Financial literacy does not have a significant impact on investment decisions.

H1: Financial literacy has a significant impact on investment decisions.

II. REVIEW OF LITERATURE

This chapter presents a comprehensive review of theoretical and empirical studies related to financial literacy and its impact on investment decision-making. The purpose of this review is to build a strong conceptual foundation for the present research by examining established theories, previous research findings, and scholarly discussions. It also helps in identifying research gaps that justify the need for the current study.

2.1 Theoretical Background

The association between financial literacy and investment behavior can be explained through various theoretical frameworks. These theories clarify how knowledge and education influence financial decision-making processes.

Human Capital Theory

Human Capital Theory proposes that education and acquired knowledge enhance an individual's

productivity and decision-making capability. Financial literacy can be considered an important component of human capital, as it improves a person's ability to analyze financial alternatives and interpret market information effectively. Individuals with higher financial knowledge are generally more competent in understanding economic changes, assessing financial risks, and making informed investment choices.

Behavioral Finance Theory

Behavioral Finance Theory challenges the traditional assumption that investors always act rationally. It suggests that psychological factors such as overconfidence, herd behavior, anchoring bias, and loss aversion often influence financial decisions. Financial literacy plays a vital role in minimizing these cognitive biases by strengthening analytical thinking and encouraging logical evaluation of investment opportunities. Individuals who possess better financial understanding are less likely to make emotionally driven investment decisions.

Modern Portfolio Theory

Modern Portfolio Theory emphasizes the principle of diversification to achieve an optimal balance between risk and return. According to this theory, investors can reduce overall risk by distributing investments across different asset classes. Financially literate individuals are more likely to understand diversification strategies, risk-return relationships, and asset allocation principles. This knowledge enables them to construct balanced portfolios aligned with their financial goals.

Together, these theoretical perspectives support the assumption that financial literacy positively influences structured and rational investment decision-making.

2.2 Review of Empirical Studies

Numerous empirical studies have examined the relationship between financial literacy and financial behavior, consistently highlighting its importance.

Research conducted by Lusardi and Mitchell (2014) demonstrated that individuals with greater financial knowledge are more inclined to participate in capital markets and engage in long-term financial planning activities.

Van Rooij et al. (2011) found that higher levels of financial literacy significantly increase stock market

participation and encourage better diversification practices among investors.

Grable (2000) concluded that financial knowledge positively affects risk tolerance and promotes structured risk-taking behavior.

The OECD (2016) report emphasized that financial education strengthens financial resilience and enhances decision-making capacity.

Although these studies establish a positive link between financial literacy and financial behavior, much of the existing research focuses on savings habits, retirement planning, or general market participation. Limited attention has been given to directly measuring the statistical impact of financial literacy on structured investment decision-making using localized primary data.

2.3 Research Gap

Despite the substantial body of literature on financial literacy, certain limitations remain that create the need for further investigation.

The primary research gaps identified are as follows:

- A majority of prior studies concentrate on savings behavior and retirement planning rather than systematic investment decision-making.
- Many researchers rely heavily on large-scale secondary datasets, with comparatively fewer studies utilizing localized primary data.
- Limited research has been conducted to quantify the statistical strength of the relationship between financial literacy and investment decision.
- There is insufficient exploration of how financial literacy affects diversification strategies and risk perception within small, focused sample groups.
- Context-specific empirical evidence based on selected respondent groups remains underdeveloped.

Considering these gaps, the present study undertakes correlation analysis using primary data collected from 50 respondents to examine whether financial literacy significantly influences investment decision behavior.

III. RESEARCH METHODOLOGY

This chapter outlines the methodological framework adopted to examine the relationship between financial literacy and investment decision-making. It explains the research design, data sources, sampling procedure, and statistical techniques applied for analysis.

3.1 Research Design

The study is structured using a combination of descriptive and analytical research approaches. The descriptive component is utilized to assess the existing level of financial literacy among respondents, while the analytical component focuses on evaluating the association between financial literacy and investment decisions. This dual approach enables both measurement and interpretation of relationships between the selected variables.

3.2 Data Collection and Sources

The research is primarily based on firsthand data collected directly from participants. A systematically designed questionnaire was prepared to gather responses related to financial knowledge, awareness of financial instruments, perception of risk, financial attitude, and investment behavior. The questionnaire included statements measured on a Likert-scale format to capture the intensity of agreement or disagreement. In addition to primary data, supporting information was obtained from scholarly publications, research papers, academic journals, and institutional reports. These secondary sources were used to strengthen the theoretical foundation and contextual understanding of the subject.

3.3 Sample Size and Sampling Technique

The study was conducted with a sample of 50 respondents. Participants were selected through a convenience sampling method, where individuals who were readily accessible and actively engaged in financial decision-making were included. Although this sampling technique does not ensure full population representation, it provides practical and relevant insights for exploratory analysis within a limited scope.

3.4 Measurement of Variables

Two main variables were considered in this research:

- Independent Variable: Financial Literacy
- Dependent Variable: Investment Decision

Financial literacy was assessed through indicators such as understanding of financial concepts, awareness of investment options, evaluation of risk-return trade-offs, and financial attitude. Investment decision behavior was evaluated based on participants' preferences, diversification patterns, and risk tolerance levels.

3.5 Statistical Tools for Analysis

To interpret the collected data effectively, several statistical techniques were employed:

1. Percentage Analysis – Used to summarize demographic characteristics and response distribution.
2. Mean and Standard Deviation – Applied to measure central tendency and variability of financial literacy and investment behavior scores.
3. Pearson Correlation Coefficient – Utilized to determine the strength and direction of the relationship between financial literacy and investment decision.
4. Hypothesis Testing – Conducted using significance levels of 5% and 1% to evaluate whether the observed relationship is statistically meaningful.

These analytical tools enabled systematic evaluation of the proposed research hypothesis and facilitated objective interpretation of findings.

IV. CONCEPTUAL FRAMEWORK OF THE STUDY

A conceptual framework serves as a structured outline that explains the relationship between the key variables of a research study. It provides a logical foundation for understanding how different factors interact with each other and guides the process of hypothesis development and statistical testing.

In the present research, the conceptual framework is designed to examine how financial literacy influences investment decision-making behavior. The framework identifies financial literacy as the determining factor that shapes the quality and rationality of investment choices made by individuals.

4.1 Variables of the Study

The study is built upon two primary variables:

- Independent Variable: Financial Literacy
- Dependent Variable: Investment Decision

The independent variable represents the factor that is assumed to influence outcomes, while the dependent variable reflects the result or response affected by that factor.

4.2 Explanation of the Independent Variable

Financial literacy refers to an individual's understanding of essential financial principles and

their ability to apply that knowledge in real-life financial situations. It includes awareness of concepts such as:

- Risk and return relationship
- Diversification strategies
- Inflation and purchasing power
- Types of financial instruments
- Portfolio allocation techniques

A higher level of financial literacy strengthens analytical capability and enables individuals to evaluate financial alternatives with greater clarity and confidence.

4.3 Explanation of the Dependent Variable

Investment decision represents the process through which individuals choose financial instruments according to their risk tolerance, expected returns, investment duration, and financial objectives. Effective investment decisions are typically characterized by diversification, balanced risk-taking, and alignment with long-term financial goals.

Investment behavior reflects how individuals apply their financial knowledge in selecting and managing assets.

4.4 Relationship Between Variables

The framework assumes that financial literacy has a direct and positive impact on investment decision behavior. Individuals with stronger financial knowledge are more capable of assessing risks, comparing investment alternatives, and constructing diversified portfolios.

Improved financial understanding enhances rational thinking, reduces reliance on speculation or peer influence, and promotes systematic investment planning. As a result, a positive association between financial literacy and investment decision-making is expected.

4.5 Conceptual Model Representation

The theoretical relationship of the study can be illustrated as:

Financial Literacy → Investment Decision

This directional relationship indicates that financial literacy acts as a driving force influencing the nature and quality of investment decisions.

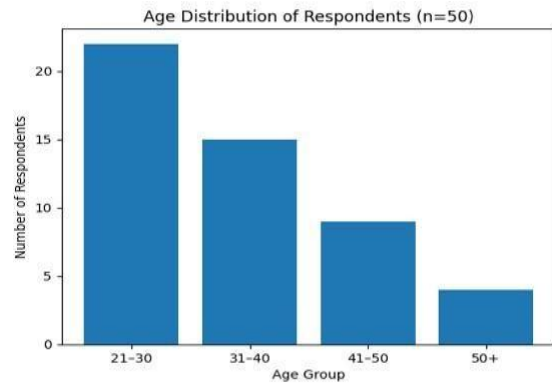
V. DATA ANALYSIS AND INTERPRETATION

This chapter presents statistical analysis of primary data collected from 50 respondents. The purpose is to examine the relationship between financial literacy and investment decision.

5.1 Demographic Profile of Respondents

Age Distribution

Age Group	Frequency	Percentage
21-30	22	44%
31-40	15	30%
41-50	9	18%
50+	4	8%



Interpretation

The majority of respondents (44%) belong to the 21–30 age group. This age group typically represents early career professionals who are beginning to actively manage savings and investments. The second largest group (30%) falls within 31–40 years, representing individuals likely to have higher income stability and greater investment exposure.

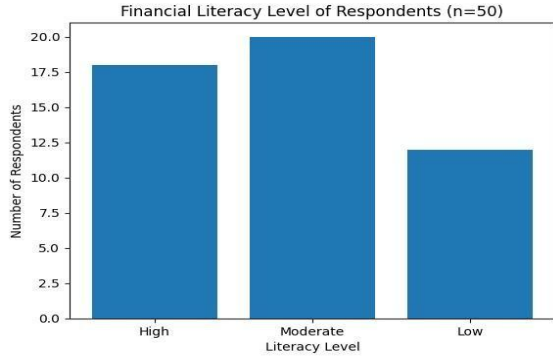
This distribution indicates that the sample largely consists of economically active individuals who are directly engaged in financial decision, making the data relevant for analyzing investment behavior.

5.2 Level of Financial Literacy

Literacy Level	Frequency	Percentage
High	18	36%
Moderate	20	40%
Low	12	24%

Mean Score = 3.72

Standard Deviation = 0.58



Interpretation

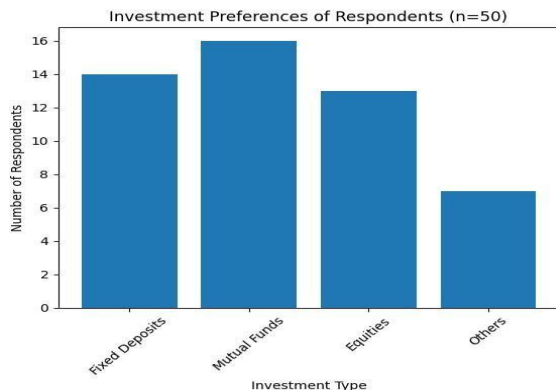
- The mean score of 3.72 indicates that overall financial literacy among respondents is moderate to high. A relatively low standard deviation (0.58) suggests that responses are fairly consistent and not widely dispersed.
- 36% respondents demonstrate high literacy levels. These individuals show better understanding of inflation, diversification, risk-return trade-offs, and market instruments. Meanwhile, 24% respondents fall in the low literacy category, indicating potential vulnerability to poor financial decisions.
- This distribution confirms that financial awareness exists but is not uniformly strong across all individuals.

5.3 Investment Preferences

Investment Instrument	Percentage
Fixed Deposits	28%
Mutual Funds	32%
Equities	26%
Others	14%

Mean Investment Score = 3.61

Standard Deviation = 0.66



Interpretation

- Mutual funds represent the most preferred investment instrument (32%), followed closely by fixed deposits (28%). Equity investment participation stands at 26%.
- Interestingly, respondents with higher financial literacy demonstrate greater preference toward mutual funds and equities, while low-literacy respondents prefer fixed deposits.
- This suggests that financial literacy influences willingness to accept calculated risk in pursuit of higher returns. Financially literate individuals understand diversification and long-term growth potential, leading to more balanced portfolios.

5.4 Risk Perception Analysis

61% of high-literacy respondents reported moderate-to-high risk tolerance. Only 25% of low-literacy respondents demonstrated similar tolerance levels.

Interpretation

- This finding highlights the direct relationship between knowledge and risk assessment. Financial literacy reduces irrational fear of market volatility and improves confidence in investment decision.
- Individuals lacking financial knowledge often equate risk solely with potential loss, whereas financially informed individuals evaluate risk in terms of probability and expected return.
- Thus, financial literacy improves rational risk evaluation rather than promoting reckless risk-taking.

5.5 Correlation Analysis

Pearson Correlation Coefficient (r) = 0.64 p-value = 0.000 (< 0.01 level)

Interpretation

- The correlation coefficient of 0.64 indicates a strong positive relationship between financial literacy and investment decision.
- This means that as financial literacy increases, quality and rationality of investment decisions also improve.

- The p-value (0.000) indicates statistical significance at 1% level, meaning the probability of this relationship occurring by chance is extremely low.

Hypothesis Testing

- Since $p < 0.01$, the null hypothesis is rejected.
- Therefore, it is concluded that financial literacy has a statistically significant positive impact on investment decision.

VI. FINDINGS AND RECOMMENDATIONS

6.1 Findings

Primary data collected from 50 respondents has been analyzed to identify the impact of financial literacy on investment decision behavior. The descriptive results show that the overall financial literacy level of participants is moderate to high (Mean = 3.72). This indicates that most respondents possess basic knowledge of financial concepts such as inflation, compounding, diversification, and risk-return trade-offs.

The major findings of the study are summarized below:

- 36% of respondents fall under the high financial literacy category.
- Individuals with higher literacy levels show stronger preference for mutual funds and equities.
- Respondents with lower literacy levels generally prefer fixed deposits due to safety concerns.
- Financially knowledgeable individuals demonstrate moderate to high risk tolerance.
- The correlation between financial literacy and investment decision is strong and positive ($r = 0.64$).
- The relationship is statistically significant at the 1% level ($p < 0.01$).

These results confirm that financial literacy contributes positively to diversification practices and rational risk evaluation in investment decisions.

6.2 Recommendations

Based on the results of the study, the following suggestions are proposed:

1. Educational Recommendations

- Financial literacy programs should be incorporated into higher education curricula.
- Colleges and institutions should organize practical workshops related to investment planning and financial management.

2. Institutional Recommendations

- Banks and financial organizations should conduct awareness campaigns to improve investor knowledge.
- Simple and clear advisory information should be made accessible through digital platforms.

3. Policy-Level Recommendations

- Government authorities should expand nationwide financial literacy initiatives.
- Regulatory bodies should strengthen investor protection through educational programs.

4. Individual-Level Recommendations

- Investors should continuously update their financial knowledge to improve decision quality.
 - Proper portfolio diversification strategies should be followed to manage investment risk effectively.

VII. DISCUSSION

The findings of this research support the theoretical understanding of financial behavior and investment decision-making. Financial literacy enhances the ability to analyze financial information, leading to more rational investment choices.

The correlation coefficient (0.64) indicates a meaningful relationship, suggesting that financial knowledge plays an important role in shaping investment patterns. However, it is also recognized that investment decisions are influenced by multiple factors, including income level, financial objectives, economic conditions, and psychological characteristics.

The results are consistent with behavioral finance principles, which state that education helps reduce biases such as herd behavior and emotional decision-making. Financially informed individuals are more likely to rely on systematic analysis rather than speculation.

Additionally, the study shows that financial literacy promotes diversification. Investors with better understanding distribute their funds across different asset classes instead of concentrating in a single investment option.

Thus, financial literacy acts as both a safeguard against poor financial choices and a driver of structured wealth creation.

VIII. CONCLUSION

The study examined the influence of financial literacy on investment decision among 50 respondents using descriptive and analytical methods. The statistical findings confirm a strong positive relationship between financial literacy and investment behavior.

Individuals with higher financial literacy demonstrate improved understanding of risk-return dynamics, greater participation in growth-oriented instruments, and better portfolio diversification practices. The rejection of the null hypothesis establishes that financial literacy significantly affects investment decisions.

The research highlights that financial knowledge is a practical determinant of financial wellbeing rather than merely theoretical awareness. Strengthening financial education at institutional and policy levels can enhance individual financial stability and support long-term economic development.

In summary, financial literacy plays a crucial role in promoting informed and rational investment behavior.

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