Factors Influencing Investment Decisions among Individual Investors: The Role of Financial Literacy, Risk Tolerance and Behavioural Biases

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***Abstract*—Investment decisions are influenced not only by expected returns and market conditions but also by investors' financial knowledge, willingness to accept risk and psychological tendencies. Individual investors often face uncertainty while selecting investment avenues, evaluating financial products and deciding when to purchase or sell investments. The present study examines three important determinants of investment decisions: financial literacy, risk tolerance and behavioural biases. Financial literacy enables investors to understand financial concepts, evaluate investment alternatives and assess potential risks. Risk tolerance determines the level of uncertainty and possible financial loss an individual is willing to accept. Behavioural biases, including overconfidence, herding, loss aversion, anchoring and regret aversion, may influence investors to make decisions based on emotions, personal beliefs or market trends rather than objective financial analysis.**

The study adopts a descriptive and analytical research framework. It proposes the collection of primary data from 200 individual investors through a structured questionnaire using a five-point Likert scale. Secondary information is drawn from research articles, books and other academic sources related to behavioural finance and investment decision-making. The proposed analysis includes frequency and percentage analysis, descriptive statistics, reliability testing, correlation and multiple regression. The study is intended to provide an integrated understanding of how financial knowledge, risk preferences and psychological biases influence investment decisions. It may also help investors, financial advisers and educational institutions develop strategies for improving investment awareness and decision quality.

***Index Terms*—Financial Literacy, Risk Tolerance, Behavioural Biases, Investment Decisions, Individual Investors, Behavioural Finance.**

I. INTRODUCTION

Investment is an important financial activity through which individuals allocate their available resources to different financial and non-financial assets with the expectation of obtaining future benefits. People invest their savings to achieve various financial objectives, such as wealth creation, capital appreciation, regular income, retirement planning, children's education and financial security. The selection of an appropriate investment option requires an understanding of financial products, market conditions, expected returns and associated risks.

In the modern financial environment, individual investors have access to several investment alternatives, including equity shares, mutual funds, fixed deposits, bonds, government securities, gold, insurance products and real estate. The availability of digital investment platforms and online financial information has also made investment participation easier. However, greater access to investment opportunities does not necessarily ensure better investment decisions. Investors may face difficulties in understanding complex financial products, comparing returns and evaluating the possibility of financial losses.

Traditional financial theories generally assume that investors make rational decisions by analysing available information and selecting alternatives that maximise their expected utility. However, actual investment behaviour does not always follow this assumption. Individual investors may be influenced by

emotions, personal experiences, social opinions, market rumours and cognitive limitations. Behavioural finance therefore provides an important perspective for understanding why investors sometimes make decisions that differ from purely rational financial calculations.

Financial literacy is one of the important factors affecting investment decisions. It refers to an individual's ability to understand and apply basic financial concepts, including interest rates, inflation, risk diversification, savings and investment returns. Financially literate individuals may be better equipped to compare financial products and understand the consequences of their investment choices.

Risk tolerance is another important determinant. Different investors have different levels of willingness to accept financial uncertainty. Some individuals prefer relatively stable investment options, whereas others are comfortable investing in market-linked instruments that may provide higher returns but involve greater fluctuations. An investor's risk tolerance may depend on income, age, financial responsibilities, investment experience and personal financial goals.

Behavioural biases also influence investment decisions. Overconfidence may lead investors to overestimate their knowledge or ability to predict market movements. Herding occurs when individuals follow the investment decisions of others without conducting sufficient independent analysis. Loss aversion refers to the tendency to experience losses more strongly than equivalent gains. Anchoring may cause investors to rely excessively on a particular price or piece of information, while regret aversion may prevent them from making decisions because of the fear of future disappointment.

The present research focuses on the combined role of financial literacy, risk tolerance and behavioural biases in shaping investment decisions among individual investors. Unlike a general study of investment behaviour, this research concentrates on these three specific determinants and examines their individual and combined relationships with investment decision-making.

II. CONCEPTUAL BACKGROUND

Financial Literacy

Financial literacy is the knowledge and understanding of financial concepts required to make effective financial decisions. It includes the ability to understand interest rates, inflation, risk and return, diversification, savings, borrowing and investment products.

Financial literacy helps individuals evaluate different investment opportunities and understand the financial implications of their choices. Investors with adequate financial knowledge may be more capable of distinguishing between different financial products, identifying unsuitable investment schemes and evaluating the relationship between risk and expected return.

The major components of financial literacy include:

1. Basic financial knowledge: Understanding savings, interest, inflation and purchasing power.
2. Investment knowledge: Understanding shares, mutual funds, bonds, deposits and other investment instruments.
3. Risk-return understanding: Recognising that different investment options involve different levels of risk and potential return.
4. Diversification knowledge: Understanding the importance of distributing investments across different assets.
5. Financial planning skills: Setting financial objectives and selecting investments according to individual requirements.

Risk Tolerance

Risk tolerance refers to the degree of financial risk an individual is willing and able to accept while making investment decisions. It represents the investor's willingness to tolerate fluctuations in investment value and the possibility of losing invested capital.

Risk tolerance differs from one investor to another. Investors who prefer capital protection may select fixed deposits, government securities and other relatively stable instruments. Investors with higher risk tolerance may prefer equity shares, equity mutual funds and other market-linked investments.

Risk tolerance can be influenced by several factors, including:

- Age and stage of life.
- Monthly income and financial stability.
- Existing savings and wealth.
- Financial responsibilities.
- Investment knowledge and experience.

- Investment objectives and time horizon.
- Previous experience of financial gains and losses.

Understanding risk tolerance is important because investment decisions that do not match an individual's risk capacity may create financial stress and lead to unsuitable investment choices.

III. BEHAVIOURAL BIASES

Behavioural biases are systematic patterns of thinking and judgement that may influence individuals while making financial decisions. These biases can affect the way investors interpret information, assess uncertainty and respond to market movements.

Unlike financial literacy and risk tolerance, behavioural biases primarily relate to psychological and emotional influences on investment decisions.

Major behavioural biases

Behavioural Bias	Meaning	Possible Influence on Investment Decisions
Overconfidence Bias	Excessive belief in one's own knowledge or investment ability.	May encourage excessive trading and underestimation of risk.
Herding Bias	Following the investment decisions of other individuals or groups.	May lead to investment based on market trends or rumours.
Loss Aversion	Feeling the impact of losses more strongly than equivalent gains.	May cause investors to avoid necessary risks or hold losing investments.
Anchoring Bias	Relying heavily on an initial price or piece of information.	May affect decisions to buy, sell or retain an investment.
Regret Aversion	Avoiding decisions because of fear of making a wrong choice.	May delay investment decisions or encourage excessively conservative choices.

IV. REVIEW OF LITERATURE

Agarwal et al. (2025) examined the relationship between financial literacy, behavioural biases and investment decisions among Indian retail investors. The study collected 482 responses through a structured questionnaire and employed Pearson correlation and mediation analysis. The findings indicated a positive relationship between financial literacy and investment decisions. The research also highlighted the role of behavioural biases, including overconfidence, herding, anchoring and familiarity, in shaping investor decision-making.

Gupta et al. (2025) investigated the influence of behavioural biases on investment decisions and examined the moderating role of financial literacy. The study was based on 326 investors from Delhi and Noida. It considered herding, overconfidence, endowment effect, loss aversion, regret bias and mental accounting. The findings suggested that behavioural biases influenced investment decisions and that financial literacy moderated the relationship between behavioural biases and investment outcomes.

Palanichamy et al. (2024) studied the effect of behavioural biases and financial literacy on investment decision-making in Kerala, India. The researchers collected questionnaire responses from 220 investors and applied structural equation modelling. The study examined herding, overconfidence and anchoring biases. Its findings highlighted the relationship between these behavioural factors and investment-related market anomalies and identified financial literacy as an important factor in the investment decision-making process.

Mahmood et al. (2024) examined the impact of behavioural biases on investment decisions and the moderating effect of financial literacy among individual investors in Pakistan. The study used questionnaire data from 261 investors and applied hierarchical regression analysis. The findings identified anchoring and adjustment, overconfidence and herding as significant influences on investment decisions. The research demonstrated the importance of considering psychological factors alongside financial knowledge when analysing investor behaviour.

Jain et al. (2023) investigated whether herding and overconfidence biases mediate the relationship between financial literacy and investment decision-

making among equity investors in the Indian stock market. The study collected data from 436 individual investors in North India and applied partial least squares structural equation modelling. The findings indicated that financial literacy had a favourable influence on investment decision-making and highlighted the relevance of behavioural biases in this relationship.

Suresh (2021) examined the combined impact of financial literacy and behavioural biases on investment decision-making. The study used a structured questionnaire based on a Likert scale and applied structural equation modelling. It considered heuristic bias, framing effect, cognitive illusions and herd mentality. The findings identified the relevance of heuristic-related influences in behavioural decision-making and contributed to understanding the relationship between financial knowledge and psychological factors.

Adil et al. (2022) examined how financial literacy moderates the association between behavioural biases and investment decisions among 253 individual investors from the Delhi-NCR region. The researchers used a cross-sectional survey and hierarchical regression analysis. Their findings indicated that the effects of risk aversion, herding, overconfidence and disposition-related behaviour varied across investor groups. The study demonstrated that financial literacy and behavioural characteristics should be examined together when evaluating investment decisions.

V. OBJECTIVES OF THE STUDY

1. To examine the level of financial literacy among individual investors.
2. To analyse the influence of risk tolerance on investment decisions among individual investors.
3. To identify the major behavioural biases affecting individual investment decisions.
4. To examine the relationship between financial literacy and investment decisions.
5. To analyse the combined influence of financial literacy, risk tolerance and behavioural biases on investment decisions.

VI. RESEARCH HYPOTHESES

- H01: There is no significant relationship between financial literacy and investment decisions among individual investors.
- H02: There is no significant relationship between risk tolerance and investment decisions among individual investors.
- H03: Behavioural biases have no significant influence on investment decisions among individual investors.
- H04: There is no significant difference in investment decisions across different levels of financial literacy.
- H05: Financial literacy, risk tolerance and behavioural biases do not jointly explain a significant variation in investment decisions.

VII. RESEARCH METHODOLOGY

Research Design

The study adopts a descriptive and analytical research design. The descriptive approach is used to understand the financial literacy, risk tolerance and behavioural characteristics of individual investors. The analytical approach is intended to examine the relationships between these factors and investment decisions.

Nature of the Study

The research is quantitative in nature and uses a structured questionnaire to collect information from individual investors. The study follows a cross-sectional approach, in which information is collected from respondents at a particular point in time.

Sample Size

The proposed sample consists of 200 individual investors. The respondents are selected to represent different demographic and investment backgrounds.

Measurement Scale

A five-point Likert scale will be used to measure respondents' agreement with the statements related to financial literacy, risk tolerance, behavioural biases and investment decisions.

Response	Score
Strongly Agree	5
Agree	4
Neutral	3
Disagree	2
Strongly Disagree	1

For factual financial-literacy questions, objective correct/incorrect scoring may be used separately rather

than treating knowledge questions as agreement statements.

VIII. DISCUSSION

The proposed study provides a framework for examining the influence of financial literacy, risk tolerance and behavioural biases on investment decisions. These three factors represent different dimensions of investor decision-making and may affect the investment process in different ways.

IX. FINANCIAL LITERACY AND INVESTMENT DECISIONS

Financial literacy is expected to play an important role in the selection and evaluation of investment alternatives. Investors who understand interest rates, inflation, diversification and risk-return relationships may be better positioned to compare financial products and identify investment options that match their financial objectives.

Financial knowledge may also help investors recognise misleading information and avoid making investment decisions solely on the basis of rumours or market trends. Previous research by Jain et al. (2023) and Agarwal et al. (2025) highlights the importance of financial literacy in investment decision-making.

Risk Tolerance and Investment Decisions

Risk tolerance influences the type of investment products selected by individuals. Investors with lower risk tolerance may prefer capital protection and relatively predictable returns, whereas individuals with higher risk tolerance may be more willing to invest in equity-oriented and market-linked products.

The relationship between risk tolerance and investment decisions is important because an investment option should be suitable for the investor's financial capacity, investment horizon and personal objectives. A mismatch between risk preference and investment selection may lead to dissatisfaction and premature withdrawal from investments.

Behavioural Biases and Investment Decisions

Behavioural biases may influence investors even when they possess adequate financial knowledge. Overconfidence may encourage investors to rely excessively on their own judgement. Herding may cause them to follow the investment choices of friends, relatives or other market participants. Loss aversion may encourage investors to avoid selling investments that have declined in value, while anchoring may lead them to base decisions on outdated prices.

Research by Mahmood et al. (2024) and Palanichamy et al. (2024) demonstrates the relevance of behavioural biases in investment decision-making.

X. COMBINED ROLE OF THE THREE FACTORS

Financial literacy, risk tolerance and behavioural biases should be considered together because investment decisions are rarely based on a single factor. Financial knowledge may improve an investor's ability to evaluate alternatives, while risk tolerance influences the amount of uncertainty the investor is willing to accept. At the same time, behavioural biases may affect how financial information is interpreted and how investment choices are implemented.

Therefore, the combined examination of these variables can provide a broader understanding of the factors associated with individual investment decisions.

Expected Findings of the Study

The following are the expected areas of investigation, not verified findings from the 200 respondents:

1. The study is expected to identify the level of financial literacy among individual investors.
2. It is expected to explain how risk tolerance is associated with the selection of different investment alternatives.
3. The research is expected to identify the behavioural biases most commonly reported by respondents.
4. It is expected to examine whether financial literacy is positively associated with investment decision quality.
5. The study is expected to establish whether financial literacy, risk tolerance and behavioural biases jointly explain differences in investment decisions.

XI. LIMITATIONS OF THE STUDY

1. The proposed study is based on a sample size of 200 individual investors, which may not represent the entire investor population.

2. Convenience sampling may limit the generalisability of the results.
3. The study relies on questionnaire-based responses, which may be affected by individual perceptions and response bias.
4. Behavioural biases are psychological characteristics and may not be measured perfectly through self-reported statements.
5. The cross-sectional research design captures responses at a particular point in time and does not establish changes in investment decisions over a longer period.
6. The study focuses on selected factors and does not include every possible determinant of investment decisions, such as taxation, regulatory changes, market volatility and macroeconomic conditions.
7. The geographical coverage will depend on the actual locations from which respondents are selected.

XII. CONCLUSION

Investment decisions are influenced by a combination of financial knowledge, personal risk preferences and psychological characteristics. Financial literacy provides individuals with the knowledge required to understand financial products, evaluate investment alternatives and assess the relationship between risk and return. Risk tolerance determines the level of financial uncertainty an investor is willing to accept, while behavioural biases may influence the interpretation of information and the selection of investment options.

The present study develops an integrated framework for examining the role of financial literacy, risk tolerance and behavioural biases in individual investment decisions. It gives specific attention to overconfidence, herding, loss aversion, anchoring and regret aversion. By examining these factors together, the research aims to provide a more comprehensive understanding of investor decision-making than an approach that focuses only on investment preferences or demographic characteristics.

The study also emphasises the importance of financial awareness and disciplined investment practices. Investors should understand their financial objectives, assess their ability to bear risk and evaluate investment opportunities independently. Awareness of behavioural biases may further help individuals recognise emotional and psychological influences during investment decisions.

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