

Impact of Financial Literacy on Investment Decisions of Retail Investors

An Evidence-Based Study in the Indian Context

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Research design: Descriptive and analytical secondary-data study supported by official Indian evidence and peer-reviewed literature.

Academic integrity note: No primary responses, p-values or regression results are fabricated. Published findings are clearly attributed to their original studies.

Abstract

Financial literacy is increasingly important as retail investors gain easier access to equities, mutual funds and digital investment platforms. This study examines the relationship between financial literacy and investment decision-making among retail investors, with emphasis on India. A secondary-data analytical design is used, drawing on SEBI's Investor Survey 2025, Reserve Bank of India (RBI) evidence, OECD/INFE frameworks and peer-reviewed empirical studies. The evidence shows that financial literacy is broader than financial knowledge alone and includes attitudes, behaviour, skills and risk understanding. SEBI's 2025 survey covered more than 90,000 households and reported that 63% of households were aware of securities-market products, while only 9.5% were invested in them. Only 36% of investors were classified as having high or moderate securities-market knowledge. Prior empirical studies generally report a positive association between financial literacy and investment decision quality, participation, diversification and risk assessment, while behavioural biases and social influence can weaken this relationship. The study concludes that financial literacy can improve the quality of investment decisions, but education should be practical, continuous and linked to actual investment choices rather than delivered only as one-time information.

Keywords: Financial Literacy; Investment Decision-Making; Retail Investors; Risk Perception; Behavioural Finance; Financial Inclusion.

1. Introduction

Financial markets have become increasingly accessible to individual investors. Digital brokerage platforms, mobile applications, low-cost investment products and simplified account-opening processes have reduced several traditional barriers to participation. At the same time, greater accessibility has increased the need for investors to understand financial products, market risk, diversification, fees, inflation and the difference between short-term speculation and long-term investment. The central issue is therefore not only whether individuals can access investment products, but whether they possess the knowledge and judgement required to use them appropriately.

The OECD describes financial literacy as a combination of awareness, knowledge, skills, attitudes and behaviours necessary to make sound financial decisions and achieve individual financial well-being. This broader definition matters because investment decisions depend not only on what investors know but also on how they interpret risk, respond to uncertainty and translate knowledge into financial behaviour.

The Indian investment environment has changed substantially. Retail investors now encounter a wide range of products and information channels. This expansion creates opportunities for wealth creation but also increases exposure to misinformation, unsuitable products, excessive trading and behavioural biases.

1.1 Background of the Study

Financial literacy supports the ability to understand risk-return trade-offs, evaluate alternatives, compare costs, recognize diversification benefits and align investment choices with financial goals. Investors with limited financial capability may depend more heavily on informal advice, social influence or simplified online narratives.

1.2 Research Problem

The central research problem is whether financial literacy is associated with better investment decision-making among retail investors and how behavioural, social and demographic factors influence this relationship. **1.3 Importance of the Study**

- Retail investors: better risk assessment, diversification and long-term planning.
- Regulators: stronger investor-education and protection strategies.

- Financial institutions: clearer product information and suitability communication.
- Educational institutions: practical financial literacy within management education.
- Researchers: an integrated Indian evidence base for future primary studies.

2. Conceptual Understanding of Financial Literacy

Financial literacy should not be reduced to the ability to answer a few numerical questions. In the investment context, it is better understood as the ability to acquire, interpret and apply financial information to real decisions.

Dimension	Meaning in investment decisions	Examples
Financial knowledge	Understanding core financial concepts.	Inflation, compounding, interest, risk-return.
Risk literacy	Understanding uncertainty and potential loss.	Volatility, downside risk, risk tolerance.
Diversification knowledge	Understanding concentration and portfolio risk.	Asset allocation, spreading exposure.
Financial attitude	Preferences toward saving, risk and planning.	Long-term orientation, patience.
Financial behaviour	Applying knowledge in actual decisions.	Budgeting, disciplined investing, periodic review.
Digital financial literacy	Using digital financial services safely and effectively.	Information verification, platform security, fraud awareness.

2.1 Investment Decision-Making

Investment decision-making refers to the process through which an investor evaluates alternatives and selects financial products or strategies. Relevant decisions include asset selection, investment amount, risk level, diversification, investment horizon, timing and response to market information.

2.2 Behavioural Finance Perspective

Financial knowledge does not eliminate psychological influences. Herding can cause investors to follow the crowd; overconfidence can encourage excessive trading; familiarity can lead to concentrated portfolios; and loss aversion can cause investors to react disproportionately to losses. Therefore, a useful research model considers both financial literacy and behavioural influences.

2.3 Conceptual Relationship

Financial Literacy → knowledge + risk understanding + diversification + attitudes + behaviour → **Investment Decision-Making** → product selection + risk assessment + diversification + investment horizon + information evaluation.

3. Review of Literature – Foundational Studies

The literature has evolved from measuring financial knowledge toward examining how knowledge interacts with behaviour, social influence and financial-market participation.

Author / Year	Study focus	Key finding
Lusardi & Mitchell (2014)	Economic importance of financial literacy	Financial knowledge is a form of human capital connected with saving, investment and retirement decisions.
van Rooij, Lusardi & Alessie (2011)	Financial literacy and stock-market participation	Lower literacy was associated with lower stock participation; diversification knowledge was particularly important.
Fernandes, Lynch & Netemeyer (2014)	Financial education and downstream behaviour	Correlations between literacy and behaviour can be stronger than the measured causal effect of education interventions.
OECD/INFE (2023)	International financial literacy	Financial literacy is multidimensional and includes knowledge, behaviour and attitudes.
Raut (2020)	Indian individual investors	Financial literacy and social pressure were relevant to stock-investment intention and behaviour.

3.1 Literature Synthesis

The foundational literature supports a relationship between financial literacy and financial-market behaviour but also cautions against simplistic causality. Investors may know the correct principle but fail to apply it under emotional or social pressure.

3.2 Key Theoretical Insight

The strongest theoretical implication is that financial literacy can improve the quality of information processing. It may help investors understand why diversification matters, evaluate risk more accurately and avoid some forms of misinformation. However, decision quality also depends on attitudes, experience, social environment and behavioural discipline.

4. Review of Literature – Indian Evidence

Study	Sample / context	Main contribution
Raut (2020)	Indian individual investors across four states	A TPB-based model explained 36% of variance in stock-investment intention; social pressure was significant.
Kar & Patro (2024)	235 Indian participants	Examined financial literacy, social self-efficacy and socially responsible investment intention using PLS-SEM.
Agarwal, Rao & Nogueira (2025)	482 Indian retail investors	Reported a positive relationship between financial literacy and investment decisions; behavioural biases were important.
SEBI Investor Survey (2025)	90,000+ Indian households	Documented awareness, participation, knowledge, risk preference and demographic differences.
RBI Pan-India Survey	20,573 respondents	Measured financial knowledge, attitude and behaviour using an OECD/INFE-based framework.

4.1 Research Gap

- Many studies use geographically limited samples, limiting broad generalization.
- Financial literacy is sometimes measured mainly as knowledge rather than knowledge + attitude + behaviour.
- Digital investing creates new literacy requirements around online information and platform risk.
- Behavioural biases can weaken the effect of financial knowledge on actual decisions.
- There is value in connecting large official household evidence with investor-level empirical research.

4.2 Research Contribution

This paper integrates official Indian evidence with academic findings to provide a concise FM-oriented explanation of how financial literacy may influence retail investment decisions. It also separates documented evidence from claims that would require a new primary dataset.

5. Research Methodology

5.1 Research Design

The study uses a descriptive and analytical secondary-research design. It synthesizes peer-reviewed academic studies and official institutional evidence to examine how financial literacy is associated with retail investment decisions in India.

5.2 Nature and Sources of Data

- SEBI Investor Survey 2025.
- RBI Pan-India Financial Literacy and Inclusion Survey evidence.
- OECD/INFE financial-literacy frameworks.
- Peer-reviewed research on financial literacy, stock-market participation and investment behaviour.
- Published Indian studies using questionnaire-based empirical methods.

5.3 Sample Size and Sampling

No new respondent sample is claimed in the present paper. The main official evidence base is SEBI's survey of more than 90,000 households across urban and rural India. RBI evidence referenced in the paper is based on 20,573 respondents across 29 states and 5 Union Territories. Published academic studies retain their original sample sizes and are used as comparative evidence.

5.4 Data Analysis Tools

Tool	Purpose
Percentage analysis	Compare awareness, participation and demographic indicators.
Gap analysis	Identify differences between awareness, knowledge and participation.

Comparative tables	Synthesize findings across academic studies.
Graphical analysis	Present official survey indicators visually.
Interpretation of reported models	Explain published correlation, regression and SEM findings without creating new statistics.

6. Objectives and Hypotheses

6.1 Objectives of the Study

- To examine the relationship between financial literacy and retail investment decision-making.
- To identify major financial-literacy dimensions relevant to investment decisions.
- To examine evidence linking financial literacy with market participation, risk assessment and diversification.
- To assess the role of behavioural and social factors in investment decisions.
- To provide practical recommendations for investors, regulators and financial institutions.

6.2 Hypothesis

H₀: Financial literacy has no significant relationship with the investment decision-making of retail investors.

H₁: Financial literacy has a significant positive relationship with the investment decision-making of retail investors.

6.3 Variables of the Study

Variable	Role	Indicative measures
Financial literacy	Independent	Knowledge, risk understanding, diversification, attitudes, behaviour, digital capability.
Investment decision-making	Dependent	Product selection, risk assessment, diversification, investment horizon, information evaluation.
Behavioural factors	Contextual / possible moderator	Herding, overconfidence, familiarity, loss aversion, social influence.
Demographics	Control / segmentation	Age, education, income, occupation, experience, urban/rural status.

6.4 Methodological Integrity

Because the study is secondary in design, it does not claim a new p-value, regression coefficient or causal effect. The hypotheses are evaluated against the direction and significance reported in existing empirical research.

7. Data Analysis & Interpretation – Participation

7.1 Awareness versus Actual Participation

SEBI's Investor Survey 2025 reports that 63% of Indian households are aware of securities-market products, while only 9.5% are invested in such products. The difference is a useful indicator of the awareness–participation gap.

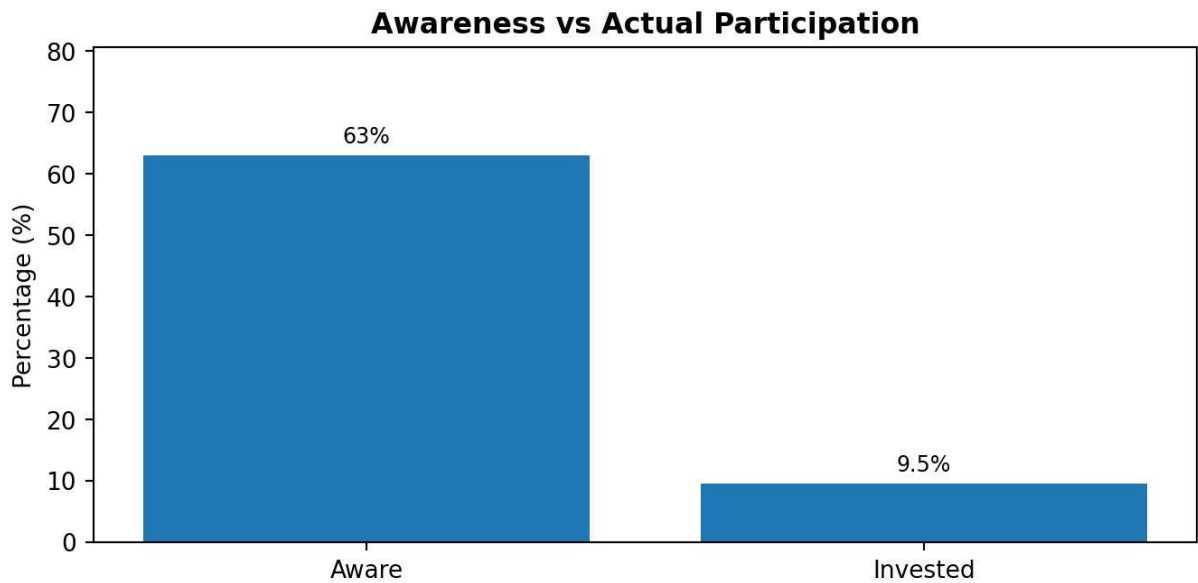


Figure 1. Awareness versus actual participation in securities-market products. Source: SEBI Investor Survey 2025.

Interpretation: Awareness is much broader than actual participation. The gap may reflect perceived risk, product complexity, financial capability, income constraints, trust and access. Therefore, increasing awareness alone may not be sufficient to improve investment participation.

7.2 Why the Gap Matters

A retail investor may know that equities or mutual funds exist but still lack the confidence or knowledge to select a suitable product. Financial education should therefore move from simple product awareness toward practical decision skills.

8. Data Analysis – Investor Knowledge

SEBI's Investor Survey 2025 reports that only 36% of investors have high or moderate knowledge of securities-market products. Approximately 64% are therefore classified in the low-knowledge category.

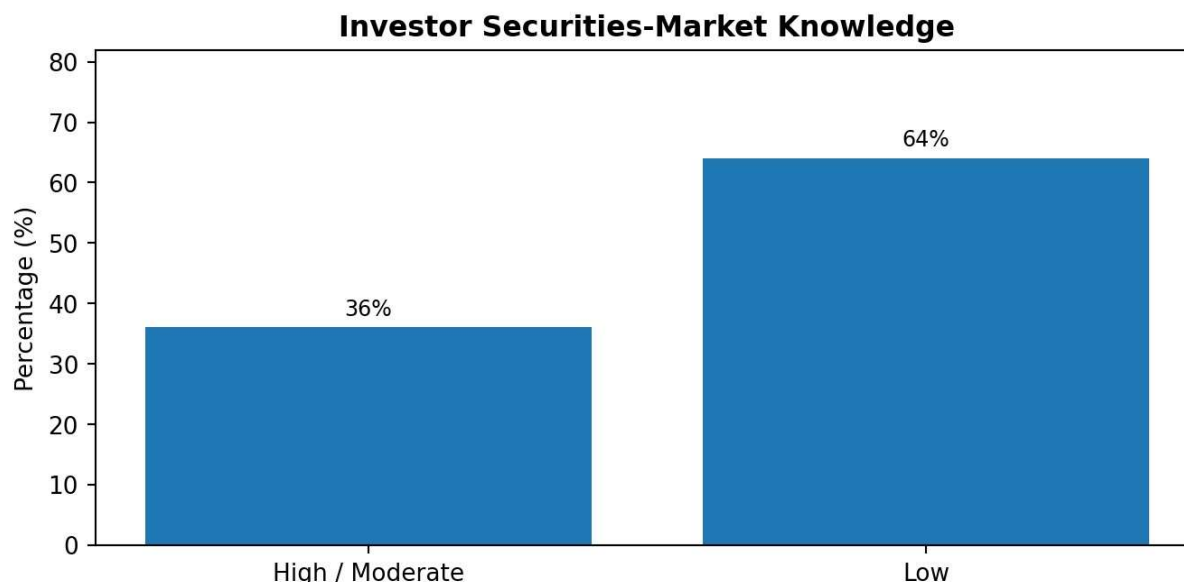


Figure 2. Investor securities-market knowledge profile. Source: SEBI Investor Survey 2025.

Interpretation: Participation in financial markets does not automatically imply adequate market knowledge. A large low-knowledge segment can be vulnerable to misinformation, unsuitable products, social influence and poor risk assessment.

8.1 Implication for Investor Education

- Explain risk and downside scenarios rather than focusing only on potential returns.
- Teach diversification using practical portfolio examples.
- Show how fees, inflation and time horizon affect outcomes.
- Teach investors how to verify information and recognize misleading claims.

9. Data Analysis – Risk Preference

SEBI's survey indicates that around 80% of Indian households prioritize capital preservation. This provides important context for investment education because retail investors may value downside protection and financial stability more than aggressive return maximization.

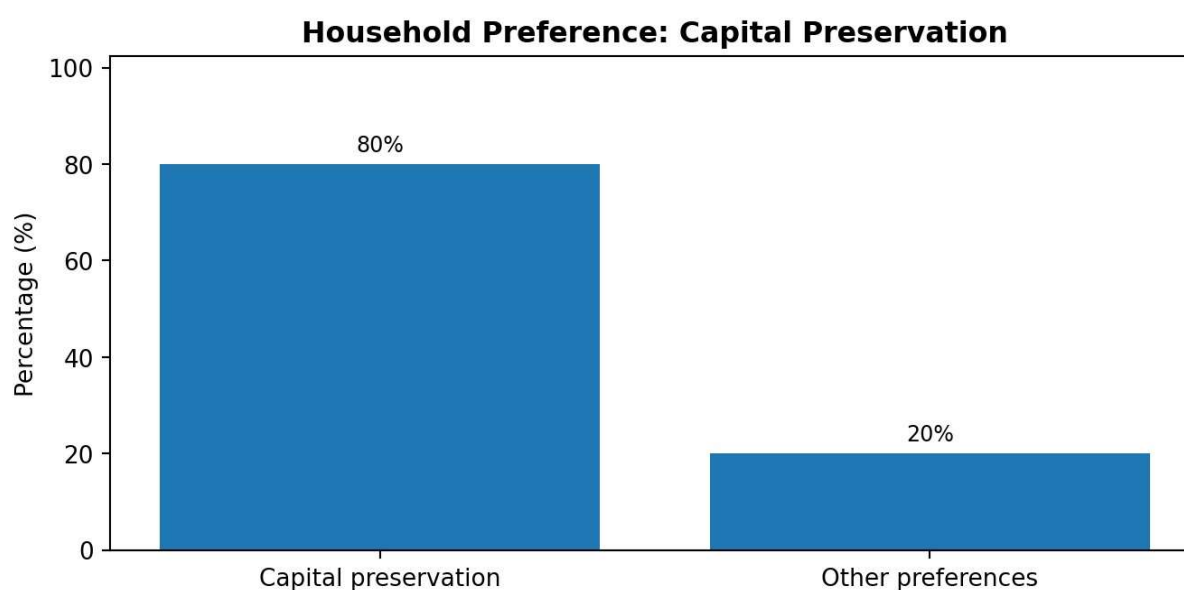


Figure 3. Household preference for capital preservation. Source: SEBI Investor Survey 2025.

Interpretation: Investment recommendations should be aligned with risk capacity and financial goals. Financial literacy should help investors distinguish between risk tolerance, risk capacity and expected return.

9.1 Practical Financial-Management Implication

For an FM perspective, the key issue is suitability. A financially literate investor should evaluate expected return together with volatility, liquidity, time horizon, concentration risk and the possibility of permanent capital loss.

10. Data Analysis – Urban and Rural Participation

SEBI reports securities-market household penetration of 15% in urban areas compared with 6% in rural areas.

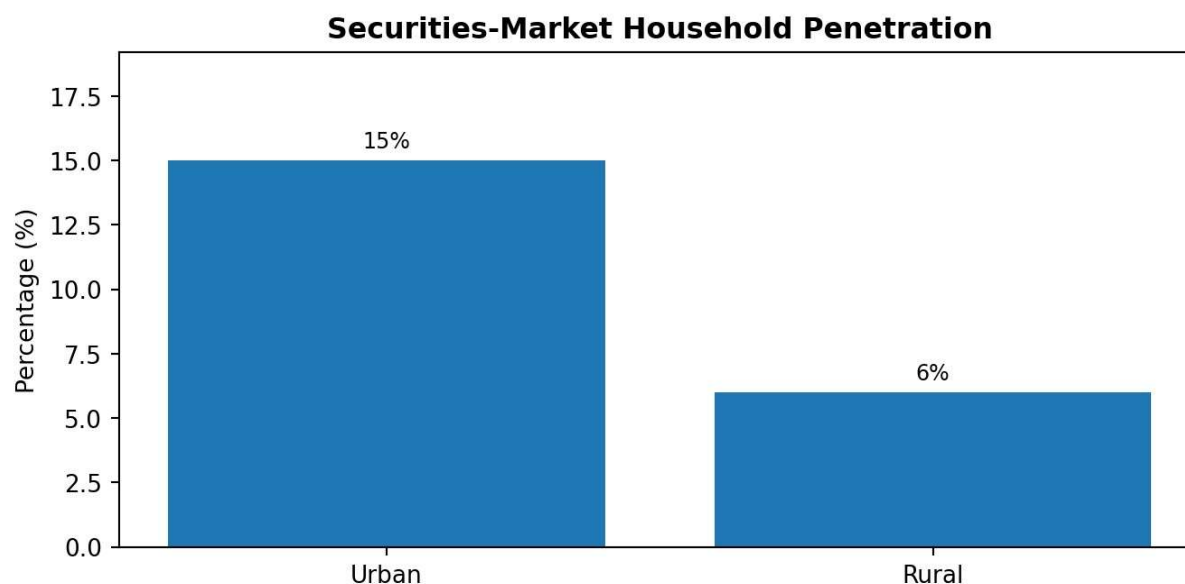


Figure 4. Urban versus rural securities-market household penetration. Source: SEBI Investor Survey 2025.

Interpretation: The urban–rural difference should not be interpreted as proof that financial literacy alone causes higher participation. Income, education, financial infrastructure, digital access, information availability and investment opportunities may operate together.

10.1 Policy Implication

Investor education should be accessible in regional languages and through mobile-first formats. Financial inclusion is more sustainable when access to products is accompanied by the capability to understand them.

11. Data Analysis – Geographic Pattern

The SEBI survey reports differences in securities-market household penetration across states. Selected values are presented below.

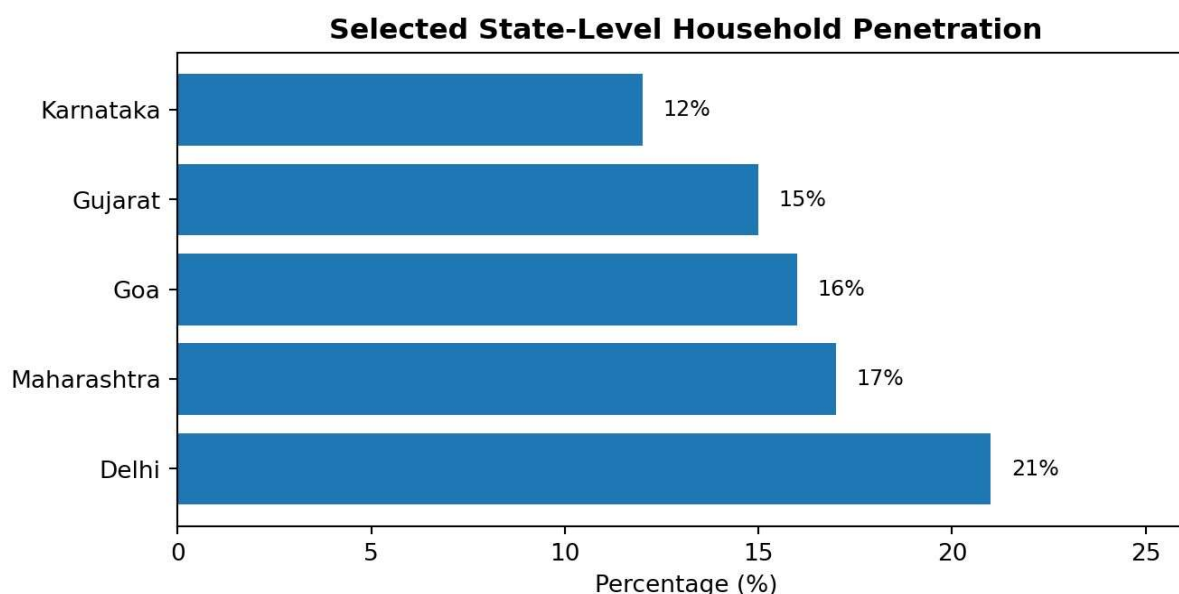


Figure 5. Selected state-level household penetration. Source: SEBI Investor Survey 2025.

Maharashtra is among the higher-participation states in the selected comparison. Such differences may reflect financial-market infrastructure, income levels, awareness, education, employment structure and proximity to financial services.

11.1 Caution in Interpretation

State-level association should not be treated as a causal estimate of financial literacy. A proper causal test would require respondent-level observations and controls for multiple socio-economic variables.

12. Data Analysis – RBI Financial Literacy Evidence

The RBI's Pan-India Financial Literacy and Inclusion Survey used an OECD/INFE-based framework covering financial knowledge, financial attitude and financial behaviour. The reported evidence is based on 20,573 respondents across 29 states and 5 Union Territories.

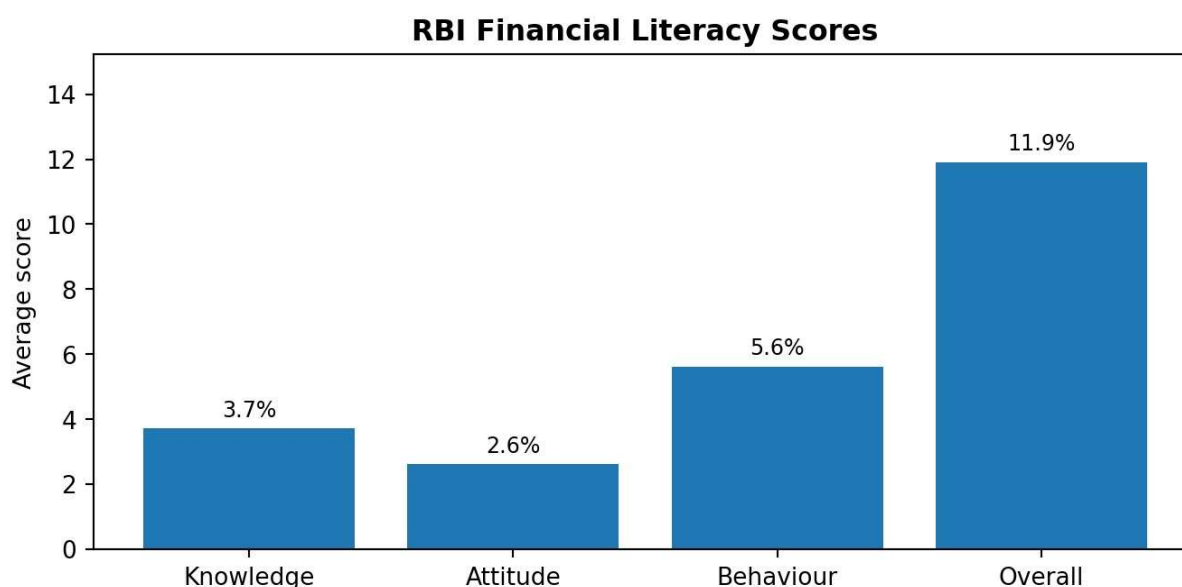


Figure 6. RBI financial-literacy component scores. Source: RBI Annual Report, Pan-India Financial Literacy and Inclusion Survey.

Interpretation: The RBI framework reinforces the multidimensional nature of literacy. Investment capability is not simply a test of numerical knowledge; attitudes and behaviour are also relevant to financial outcomes.

13. Empirical Evidence and Discussion

13.1 Agarwal, Rao and Nogueira (2025)

The Indian retail-investor study used 482 completed responses from active investors with at least one year of market experience. The authors reported a significant positive direct effect of financial literacy on investment decisions and found that behavioural biases were important in the relationship.

13.2 Raut (2020)

Raut's Indian study examined individual investors using a theory-of-planned-behaviour framework. The model explained 36% of the variance in stock-investment intention. Social pressure was important, illustrating that investment decisions are not purely knowledge-driven.

13.3 van Rooij, Lusardi and Alessie (2011)

The study found that individuals with lower financial literacy were less likely to participate in the stock market. Knowledge of diversification was especially relevant, supporting the importance of applied financial knowledge.

13.4 Fernandes, Lynch and Netemeyer (2014)

The meta-analysis provides an important caution: financial education interventions can have smaller behavioural effects than simple cross-sectional correlations. This means education should be practical, timely and linked to actual financial decisions.

Overall Discussion

Across these studies, the direction of evidence is broadly consistent with a positive association between financial literacy and investment decision quality, while psychological and social factors remain important.

14. Comparative Evidence Matrix

Research evidence	What it tells us	Practical implication
SEBI 2025 awareness vs participation	Awareness is much higher than actual investment participation.	Move investor education beyond product awareness.
SEBI 2025 knowledge profile	A majority of investors are in the low-knowledge category.	Focus on practical market knowledge and risk assessment.
SEBI 2025 capital preservation	Households show a strong preference for preserving capital.	Explain suitability and downside risk.
SEBI 2025 urban vs rural	Participation varies geographically.	Use regional and mobile-first education.
Agarwal et al. (2025)	Financial literacy positively relates to investment decisions; biases matter.	Combine literacy with behavioural awareness.
Raut (2020)	Social pressure affects investment intention.	Teach investors to evaluate independent evidence.
van Rooij et al. (2011)	Low literacy is associated with lower stock participation.	Teach diversification and market basics.
Fernandes et al. (2014)	Education effects can be modest.	Use continuous, decision-linked education.

14.1 Overall Pattern

The evidence supports a clear pattern: financial literacy is useful but not sufficient by itself. Better investment decisions require knowledge plus behavioural discipline, reliable information, suitable products and alignment with financial goals.

15. Findings and Hypothesis Assessment

15.1 Major Findings

- Financial literacy is multidimensional and includes knowledge, attitudes, behaviour and risk understanding.
- Indian evidence shows a substantial gap between awareness of securities products and actual participation.
- A large proportion of surveyed investors have low securities-market knowledge.
- Higher financial literacy is generally associated with better investment decision quality in the reviewed empirical literature.
- Behavioural biases such as herding, overconfidence and familiarity can weaken rational decision-making.
- Urban–rural and state-level differences indicate that access and socio-economic conditions interact with financial capability.
- Digital investment access increases the importance of digital financial literacy and information verification.
- Investor education is more likely to be useful when it is continuous and connected to actual decisions.

15.2 Hypothesis Assessment

Hypothesis	Assessment
H ₁ : Financial literacy has no significant relationship with investment decision-making.	Not supported by the overall direction of the reviewed empirical evidence.
H ₂ : Financial literacy has a significant positive relationship with investment decision-making.	Broadly supported by reviewed empirical studies, subject to the limitations of secondary-data synthesis.

Important: This is an evidence-based assessment, not a newly estimated statistical test. A new p-value would require original respondent-level data.

16. Suggestions, Conclusion and Limitations

16.1 Suggestions / Recommendations

- Teach practical concepts: risk-return, diversification, inflation, compounding, fees and investment horizon.
- Promote regulated and reliable information sources instead of relying solely on social-media recommendations.
- Use regional-language, mobile-first investor education for smaller cities and rural areas.
- Financial platforms should provide clear risk disclosures and scenario-based tools for complex products.
- MBA and undergraduate curricula should include practical personal-finance and investment simulations.
- Investor education should address behavioural biases, not only financial terminology.

16.2 Conclusion

The study concludes that financial literacy is an important factor associated with retail investment decision-making. Investors who understand financial concepts, risk and diversification are better positioned to evaluate alternatives and make informed choices. However, financial literacy alone does not determine investment outcomes. Behavioural biases, social influence, market experience and digital environments continue to shape investor behaviour. The most effective approach is therefore to combine financial knowledge with practical decision tools, transparent information and behavioural awareness.

16.3 Limitations

- Secondary-data design does not provide a new respondent-level causal test.
- Published studies differ in sample, geography, variables and statistical methods.

- Household-level official evidence and individual-investor studies are not directly identical.
- The study does not pool effect sizes through a formal meta-analysis.
- Financial literacy and investor behaviour evolve with technology and market conditions.

17. References / Bibliography & Appendix

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Appendix – Suggested Primary Survey Instrument

If the college requires primary data, the following items can be administered to retail investors. They are not used to fabricate the results of this secondary study. Use a 5-point Likert scale: 1 = Strongly Disagree to 5 = Strongly Agree.

Financial literacy	Investment decision-making
I understand inflation and purchasing power.	I consider financial goals before investing.
I understand compound interest.	I assess my risk tolerance before investing.
I understand risk-return trade-offs.	I consider diversification in my portfolio.
I understand diversification.	I compare alternatives before investing.
I can distinguish major investment products.	I avoid decisions based only on social-media recommendations.
I can evaluate risk, return and cost.	I review reliable information before major investments.

Final quality check: spelling, sentence formation, terminology consistency, hypothesis notation, chart captions and academic wording have been standardized. Decorative repetition has been avoided; visuals are used only where they strengthen the research argument.

END OF RESEARCH PAPER