

Financial Literacy and Investment Decisions

A Secondary-Research Review of Financial Knowledge, Behavioral Factors and Investment Choices in India

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Abstract

Financial literacy has become increasingly important as individuals face a wider range of savings and investment products, digital investment platforms and market information. This paper examines the relationship between financial literacy and investment decisions, with particular emphasis on the Indian context. The study adopts a secondary-research design and synthesizes evidence from peer-reviewed academic studies, reports of Indian financial regulators and international financial-literacy research. Financial literacy is examined as a multidimensional construct comprising financial knowledge, financial awareness, financial attitudes, financial behaviour, risk understanding and long-term planning ability. The review indicates that financially literate individuals are generally better positioned to compare investment alternatives, understand risk and return, diversify portfolios, plan for long-term objectives and resist purely emotion-driven decisions. Indian evidence also indicates that socioeconomic characteristics such as education, income, gender, age, location and sources of financial information are associated with differences in financial literacy and investment choices. Recent regulatory evidence further indicates that market participation is increasing while substantial gaps remain in securities-market knowledge. Behavioural biases such as herding, overconfidence, framing and heuristic decision-making can weaken the positive effect of knowledge when investors act on social influence or unreliable information. The paper argues that financial literacy should therefore move beyond awareness campaigns toward practical, goal-based and behaviour-oriented financial education. The study concludes with implications for regulators, educational institutions, employers, financial institutions and individual investors.

Keywords: Financial Literacy; Investment Decisions; Financial Behaviour; Investor Awareness; Behavioural Biases; India

1. Introduction

Financial decisions influence household wealth, financial security and the ability to achieve long-term economic goals. Individuals routinely make decisions concerning savings, bank deposits, insurance, mutual funds, equities, bonds, pension products, gold and real estate. The increasing availability of digital investment platforms has made access to financial products easier, but accessibility does not necessarily mean that investors possess the knowledge required to select suitable products. Financial literacy is therefore an important foundation for responsible investment decision-making.

Financial literacy may be broadly understood as the combination of knowledge, skills, attitudes and

behaviours that enables individuals to make informed financial choices and improve financial well-being. The Reserve Bank of India and other Indian financial-sector stakeholders have treated financial literacy as an important component of financial inclusion. India's National Strategy for Financial Education (NSFE) 2020–2025 emphasized the development of appropriate knowledge, skills, attitudes and behaviours so that people can manage money better and plan for the future (RBI, 2021).

Investment decisions are not determined by knowledge alone. Investors are also influenced by income, financial goals, risk tolerance, investment experience, family and peer influence, media exposure and behavioural biases. The availability of

social-media investment content and online financial influencers has added another layer of complexity. An investor may have access to information but still make unsuitable decisions if the information is misunderstood or if emotions dominate rational analysis.

The importance of this issue is particularly visible in India because participation in financial markets has expanded rapidly. SEBI's Investor Survey 2025 provides evidence of growing awareness of securities products while also identifying gaps in practical securities-market knowledge. The survey's Investor Knowledge Quotient indicates that only 36% of investors had moderate-to-high securities-market knowledge under the survey's classification, demonstrating that market participation can coexist with significant knowledge limitations (SEBI, 2026).

Against this background, the present paper reviews the relationship between financial literacy and investment decisions in India. Rather than creating or reporting unverified primary data, the study uses secondary evidence from academic literature and authoritative institutional sources.

1.1 Problem Statement

The expansion of financial products has increased the responsibility placed on individual investors. Low or incomplete financial literacy can lead to difficulty in understanding inflation, compounding, diversification, risk-return trade-offs, fees, liquidity and investment time horizons. At the same time, behavioural biases and social influence may cause investors to follow market trends or informal recommendations without adequate evaluation. The central problem addressed by this study is therefore whether, and through what mechanisms, financial literacy contributes to better investment decisions among individuals, particularly retail investors in India.

1.2 Objectives of the Study

- To explain the concept and major dimensions of financial literacy.
- To examine the relationship between financial literacy and individual investment decisions.

- To identify financial and behavioural factors that influence investment choices.
- To review evidence concerning financial literacy and investment behaviour in India.
- To examine the role of financial education in improving investment decision quality.
- To suggest practical measures for regulators, educators, employers, financial institutions and investors.

1.3 Research Questions

- What are the major dimensions of financial literacy relevant to investment decisions?
- How does financial literacy influence investment choice, risk perception and portfolio diversification?
- What behavioural and socioeconomic factors strengthen or weaken the effect of financial literacy?
 - What measures can improve financial literacy and investment decision-making in India?

1.4 Scope of the Study

The paper focuses primarily on individual and retail investors and examines financial literacy in relation to investment decisions. It considers traditional and market-linked financial products, including bank deposits, mutual funds, equities, bonds, insurance-linked products, gold and real estate. The geographical emphasis is India, supported by selected international evidence for conceptual comparison. The paper does not provide personalized investment advice and does not claim that financial literacy alone determines investment outcomes.

2. Conceptual Background

2.1 Meaning of Financial Literacy

Financial literacy is more than knowing definitions of financial products. It includes the ability to apply financial knowledge in real-life decisions. Important concepts include interest and compound interest, inflation, risk and return, diversification, liquidity, taxation, fees, debt management, insurance and retirement planning. The OECD/INFE framework treats financial literacy as involving financial knowledge, behaviour and attitudes, while also examining financial inclusion and financial well-being (OECD, 2023).

2.2 Dimensions of Financial Literacy

Dimension	Meaning	Relevance to Investment Decisions
Financial knowledge	Understanding interest, inflation, risk, return, diversification and financial products.	Helps investors compare alternatives and interpret investment information.
Financial awareness	Awareness of available products, regulation, costs, risks and reliable information sources.	Reduces dependence on informal or misleading recommendations.
Financial attitude	Orientation toward saving, planning, delayed gratification and risk.	Influences willingness to plan and remain invested for suitable horizons.
Financial behaviour	Actual practices such as budgeting, saving, diversification and monitoring investments.	Converts knowledge into disciplined financial action.
Risk literacy	Ability to understand probability, volatility, loss potential and risk-return trade-offs.	Supports suitable asset allocation and prevents treating high returns as risk-free.
Digital financial literacy	Ability to safely use digital financial services and evaluate online financial information.	Important because investment access increasingly occurs through digital platforms.

2.3 Investment Decisions

An investment decision involves selecting an asset or portfolio after considering objectives, expected return, risk, liquidity, investment horizon and personal financial circumstances. A rational investment process generally begins with goal identification, assessment of financial capacity and risk tolerance, selection of an appropriate asset allocation, diversification, periodic review and disciplined execution. Financial literacy supports each stage by improving the investor's ability to understand relevant information.

2.4 Theoretical Link Between Financial Literacy and Investment Decisions

The relationship can be represented through a simple conceptual chain: Financial Knowledge → Financial Awareness and Risk Understanding → Financial Attitudes and Behaviour → Investment Decision Quality. Knowledge can improve an investor's ability to recognize risk and compare products. Awareness can reduce information asymmetry. Positive financial attitudes can

encourage long-term planning. Behavioural discipline can translate knowledge into actual decisions. However, behavioural biases may intervene between knowledge and action, meaning that a financially knowledgeable investor can still make poor decisions under emotional or social pressure.

3. Literature Review

The literature generally supports the proposition that financial literacy is associated with better financial planning and investment choices, although the strength and nature of the relationship vary across populations and measures of literacy. Rooij, Lusardi and Alessie (2011) established an influential framework connecting financial literacy with stock-market participation. Their work distinguished basic financial knowledge from more advanced knowledge and showed that financial literacy is relevant to participation in sophisticated financial markets. The study helped establish the importance of financial knowledge in explaining household investment behaviour.

Rao and Kumar (2015) examined financial literacy and financial planning in India and reported that financial literacy was associated with better financial planning. Their evidence also indicated that education, gender and investor characteristics were related to differences in financial literacy. This suggests that literacy is shaped by socioeconomic conditions and is not evenly distributed across the population.

Agarwal and colleagues' broader research tradition on financial literacy and financial inclusion has emphasized that literacy affects the ability to use formal financial products appropriately. In India, the policy focus has increasingly connected financial education with financial inclusion and financial well-being.

A recent India-focused study by Shroff (2024) examined 384 investors and reported that financial literacy positively influenced investment decisions. The study developed a multidimensional measure of financial literacy and used regression-based analysis to investigate the relationship. Its findings reinforce the proposition that higher financial literacy is associated with a greater likelihood of informed investment decisions.

Another recent study on Indian retail investors by Kumar and co-authors (2025) examined the interaction between financial literacy and behavioural biases. The study argues that literacy is important because heuristics, framing, cognitive illusions and herding can affect investment decisions. This perspective is important because investment quality cannot be explained by knowledge alone.

International evidence also supports the importance of basic financial competencies. The OECD/INFE 2023 survey covered 39 countries and economies and examined financial knowledge, behaviour and attitudes. The report identified weaknesses in areas such as simple and compound interest and applying inflation concepts in real-life contexts. These concepts are directly relevant to evaluating investment returns and maintaining purchasing power (OECD, 2023).

Indian regulatory evidence provides a complementary perspective. The SEBI Investor Survey 2025 found substantial differences in

investor knowledge. Its Investor Knowledge Quotient classified investors according to market familiarity and their understanding of inflation and purchasing power. The survey reported that only 36% of investors fell into the moderate-to-high knowledge category, while around half of investors were classified as low knowledge. This indicates that increased participation in securities markets does not automatically imply adequate financial literacy (SEBI, 2026).

3.1 Research Gap

Existing studies provide substantial evidence that financial literacy is related to investment behaviour, but several gaps remain. First, financial literacy is measured differently across studies, ranging from basic numeracy to broader multidimensional constructs. Second, many studies focus on a single city, region or investor segment, limiting generalizability. Third, behavioural biases, digital financial literacy and social-media influence are increasingly relevant but are not consistently incorporated into older financial-literacy models. Fourth, there is a need to connect financial knowledge with actual investment behaviour rather than relying only on self-reported confidence. These gaps support continued research using standardized measures and longitudinal or mixed-method approaches.

4. Research Methodology

4.1 Research Design

This paper adopts a descriptive and analytical secondary-research design. It is structured as a review article rather than as a primary survey study. No fabricated questionnaire responses, sample sizes, correlation coefficients or regression results are reported. The purpose is to synthesize established evidence and identify patterns relevant to the relationship between financial literacy and investment decisions.

4.2 Sources of Data

Secondary information was drawn from peer-reviewed research articles, academic publications, official publications of the Reserve Bank of India

(RBI) and Securities and Exchange Board of India (SEBI), and international research from the OECD/INFE. Priority was given to authoritative and recent sources, while foundational studies were included to establish the theoretical background.

4.3 Review Approach

The review followed four stages: (1) identification of literature relating to financial literacy and

4.4 Conceptual Framework

investment behaviour; (2) classification of evidence into financial knowledge, behaviour, attitudes, risk perception and behavioural biases; (3) comparison of findings across Indian and international studies; and (4) synthesis of implications for investment decision-making and financial education. The analysis is thematic rather than a formal statistical meta-analysis.

Independent / Enabling Factors	Mediating Factors	Investment Decision Outcomes
Financial knowledge	Risk perception	Product selection
Financial awareness	Financial attitude	Diversification
Digital financial literacy	Financial behaviour	Investment horizon
Education and experience	Confidence / decision discipline	Risk-adjusted decision quality
Income and financial capacity	Behavioural-bias resistance	Goal alignment

The framework proposes that financial literacy has a direct positive influence on investment decision quality, while risk perception, financial behaviour and behavioural-bias resistance act as important mechanisms. Demographic and socioeconomic characteristics can influence both literacy and investment choices.

5. Results and Discussion

5.1 Major Findings from the Secondary Evidence

Finding	Evidence / Interpretation
Financial literacy is positively associated with informed investment decisions.	Indian studies report that financially literate investors are more likely to make informed choices and participate in investment products appropriately.
Basic financial concepts remain important.	Understanding inflation, compounding and risk-return relationships is essential for evaluating real investment outcomes.
Knowledge does not guarantee rational behaviour.	Herding, overconfidence, framing and other behavioural biases can cause poor decisions even when investors possess financial knowledge.
Financial literacy varies across socioeconomic groups.	Education, income, gender, age, residence and information sources can be associated with different levels of literacy.

Market participation can exceed market knowledge.	SEBI's 2025 survey indicates that substantial numbers of investors have low or moderate securities-market knowledge despite growing awareness and participation.
Digital literacy is increasingly important.	Online investment access increases convenience but also increases exposure to misinformation, scams, unsuitable recommendations and social-media influence.

5.2 Financial Literacy and Product Selection

Financially literate investors are more capable of matching products to objectives. For example, a short-term liquidity requirement may not be compatible with a highly volatile asset, while a long-term retirement objective may require a different strategy. Financial literacy helps investors recognize that product selection should be based on purpose, risk capacity, time horizon, liquidity and diversification rather than simply on advertised returns.

The Indian literature also indicates that financial literacy can influence participation in both traditional and market-linked assets. This does not mean that financially literate individuals will always choose equities or other higher-risk products. Rather, literacy can improve the quality of the matching process between the investor's circumstances and the characteristics of the product.

5.3 Risk Perception and Diversification

Risk literacy is a central component of investment decision quality. Investors need to distinguish between guaranteed and market-linked returns, understand volatility, and recognize that diversification can reduce concentration risk but cannot eliminate all investment risk. A financially literate investor is more likely to consider the relationship between expected return and risk rather than selecting an asset solely because its historical return was high.

Diversification is particularly important because individual investors may become concentrated in familiar companies, sectors, local property or gold. Financial education should therefore explain not only the definition of diversification but also its practical application across assets and risk categories.

5.4 Inflation and Real Returns

Understanding inflation is fundamental to investment decisions. A nominal return does not necessarily represent an increase in purchasing power. If an investment earns a return below inflation, the investor's real purchasing power may decline. SEBI's Investor Knowledge Quotient uses an inflation-versus-return scenario to assess this practical understanding, highlighting the importance of applying financial concepts rather than merely recognizing terminology (SEBI, 2026).

5.5 Behavioural Biases

Financial decisions can be affected by cognitive and emotional biases. Herding occurs when investors follow the actions of others rather than independently evaluating information.

Overconfidence can cause excessive trading or underestimation of risk. Anchoring can make investors overly dependent on a previous price or reference point. Framing can cause different decisions depending on how the same information is presented. Loss aversion may encourage investors to hold losing investments for too long or avoid suitable investments because of fear of losses. Financial literacy can reduce some of these effects by improving analytical capability, but it cannot eliminate behavioural bias. Consequently, effective financial education should include practical decision rules, scenario-based learning and awareness of emotional triggers. This is more useful than purely theoretical instruction.

5.6 Role of Digital Financial Literacy

Digital investment platforms have reduced transaction barriers and expanded access to information. However, digital convenience creates

new risks. Investors may encounter unverified recommendations, misleading performance claims, impersonation, fraudulent schemes or pressure to make rapid decisions. Digital financial literacy should therefore include verification of regulated entities, understanding of product disclosures, protection of personal credentials and the ability to distinguish education from promotion.

5.7 Discussion of Indian Policy Context

India has developed a substantial institutional framework for financial education. The NSFE 2020–2025 promoted a multi-stakeholder approach involving financial regulators, educational institutions, financial intermediaries and other stakeholders. The strategy emphasized content, capacity, communication, community and collaboration. RBI has also emphasized financial literacy as an important element of financial inclusion and financial well-being.

SEBI's recent investor-awareness work further demonstrates the continuing policy need. The 2025 Investor Survey shows that awareness of financial products and actual securities-market knowledge are not identical. Therefore, future programs should measure practical knowledge and decision-making ability, not simply whether individuals have heard of investment products.

6. Implications of the Study

6.1 Implications for Individual Investors

- Define the financial goal and investment horizon before selecting a product.
- Understand inflation, compounding, risk, return, liquidity and diversification.
- Verify information through regulated and reliable sources before investing.
- Avoid making decisions solely because friends, social-media personalities or market trends recommend an investment.
- Review portfolio concentration and ensure that risk is consistent with financial capacity and objectives.
 - Maintain an emergency fund and adequate insurance before taking substantial investment risk.

6.2 Implications for Educational Institutions

Financial education should be practical, continuous and connected to real-life decisions. Colleges and universities can include modules on budgeting, inflation, compounding, taxation, insurance, mutual funds, securities markets, fraud awareness and retirement planning. Case studies and simulations can be more effective than definitions alone because they allow students to experience the consequences of alternative choices.

6.3 Implications for Regulators

Regulators can strengthen investor education by using simple language, regional-language content, interactive tools and scenario-based assessments. Financial-literacy programs should measure actual comprehension and decision capability. Special attention is required for first-time investors and individuals obtaining investment information primarily through digital and social-media channels.

6.4 Implications for Employers and Financial Institutions

Employers can provide workplace financial-education programs covering salary planning, emergency funds, retirement, insurance and investment basics. Financial institutions can improve product disclosures by presenting costs, risks, liquidity restrictions and suitability considerations clearly. The objective should be informed choice rather than product promotion.

7. Recommendations

- Develop standardized financial-literacy assessments that test practical application rather than terminology alone.
 - Integrate financial education into higher education and workplace learning.
- Increase digital financial-literacy programs addressing misinformation, scams and unregulated advice.
- Use real-life scenarios involving inflation, compounding, diversification and risk-return trade-offs.

- Promote goal-based investment planning rather than return-chasing behaviour.
- Strengthen investor education in regional languages and for underserved populations.
- Encourage investors to use regulated intermediaries and verify investment information before acting.
- Conduct more longitudinal research to determine whether financial education produces lasting changes in investment behaviour.

8. Limitations of the Study

The principal limitation is that the paper uses secondary evidence and does not collect original survey responses. Therefore, it cannot estimate the financial-literacy level of a specific local population or establish a new causal relationship using primary statistical data. Existing studies also use different definitions and measurement scales, which makes direct comparison difficult. In addition, investment behaviour changes with market conditions, technology and regulation. Future research should use primary data, validated financial-literacy scales and appropriate statistical models such as correlation, multiple regression or structural equation modelling.

9. Scope for Future Research

Future researchers can conduct a primary survey among retail investors in a defined geographical area, such as a district, city or state, and measure financial knowledge, financial attitude, financial behaviour, risk tolerance, digital literacy and investment decisions. A structured Likert-scale questionnaire can be combined with objective financial-literacy questions. Hypotheses can then be tested using correlation and regression analysis. Future studies should also examine the mediating role of behavioural biases and the effects of financial influencers and social-media investment content.

10. Conclusion

Financial literacy is an important foundation for sound investment decision-making, but it is not the

only determinant of investor behaviour. The reviewed evidence indicates that knowledge of financial concepts, awareness of products and risks, positive financial attitudes and disciplined financial behaviour can improve the quality of investment choices. In India, academic research generally supports a positive association between financial literacy and investment decisions, while recent regulatory evidence demonstrates that substantial knowledge gaps remain among investors.

The central implication is that financial education should move from simple awareness toward practical decision capability. Investors need to understand inflation, compounding, diversification, risk, liquidity and time horizon and must also recognize the behavioural biases that can distort decisions. Digital financial literacy is now equally important because the growth of online investing has increased both access and exposure to unreliable information.

A financially literate investor does not necessarily achieve the highest return. Rather, the financially literate investor is better equipped to make decisions that are consistent with financial goals, risk capacity and time horizon. Strengthening this capability can contribute to household financial resilience, responsible participation in financial markets and broader financial well-being. Continued cooperation among regulators, educational institutions, employers, financial institutions and individuals is therefore essential for building a more financially informed investor population in India.

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Appendix A: Suggested Primary Survey Framework for Future Research

The following framework is provided only as a future-research instrument and is not presented as collected data. Researchers conducting a primary study may use a five-point Likert scale (1 = strongly disagree to 5 = strongly agree) together with objective financial-literacy questions.

Construct	Example Indicators
Financial knowledge	Understands inflation; understands compound interest; understands risk-return relationship; understands diversification.
Financial awareness	Knows regulated investment channels; compares product costs; checks product information before investing.
Financial attitude	Prefers long-term planning; values regular saving; avoids unnecessary financial risk.
Financial behaviour	Maintains a budget; invests regularly; reviews portfolio; diversifies investments.
Behavioural bias	Follows others' investment choices; reacts emotionally to market movements; is overconfident in personal predictions.
Investment decision quality	Goal alignment; appropriate risk level; diversification; long-term orientation; informed product selection.

Formatting note: This manuscript has been prepared in Times New Roman, 12-point body text, 1.5 line spacing, and 1-inch margins. The title is 16-point bold and section headings are 12-point bold, consistent with the supplied conference guidelines.