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Research Article

Individual Behaviour Biases and Financial Literacy: An Analysis of Investment Decision-Making

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Abstract: Financial literacy can be defined as the ability of individuals to effectively understand, manage, and utilize financial resources to achieve better financial outcomes. It plays a significant role in enhancing individual financial well-being as well as contributing to broader economic development. Since individual investors form an important part of the financial ecosystem, this study explores the influence of financial literacy on their investment decision-making behaviour. The study is based on data collected from more than 200 individual investors from Hyderabad and Secunderabad and examines key dimensions of financial literacy, including knowledge of financial products, accessibility to financial services, money management practices, awareness of investment alternatives, and the ability to make informed investment decisions. Additionally, the research investigates various behavioural biases that investors may develop through personal experiences, investment exposure, and social influences. The findings indicate that practical financial skills have the strongest influence on investment behaviour, whereas basic awareness of financial products has comparatively less impact. The study emphasizes that behavioural biases can significantly affect investment choices and may influence the overall performance and returns of investors. Based on these insights, the research provides recommendations for policymakers and financial institutions to promote skill-oriented financial education and strengthen investors' decision-making capabilities.

Keywords: Financial Literacy, Behavior Bias, Investment, Investment Decisions, Financial Knowledge

INTRODUCTION

The financial services sector is a broad field integral to the economy covering areas such as banking, insurance and investment advisory. Its fundamental purpose is to support economic development by supplying both individuals and corporations with necessary capital tools for risk mitigation and a range of financial instruments. It empowers people to manage their money effectively plan for the future and confidently engage with the financial landscape including investments. Within this domain investment represents a core activity involving the commitment of capital with the aim of producing income or profit. Therefore, enhancing financial literacy is extremely important in equipping individuals to make sound investment choices. This entails educating the public on essential concepts such as risk-return, trade-offs, portfolio diversification and compound interest. By elevating financial understanding, society can encourage more strong financial planning, higher rates of savings and the development of more effective investment approaches.

Review of Literature

Gallery *et al.* [1] the study extends previous research by utilizing financial literacy metrics specifically designed to access decision making processes in retirement investment selection. There are several studies which try to understand the very important question as to whether the individual investors are well prepared for the task of their financial security in terms of retirement planning, etc. Lusardi and Mitchell, [2]; Capuano and Ramasay, [3] stated that financial literacy empowers individuals to utilize financial products optimally and make investments efficiently, thereby avoiding wasteful spending and superfluous costs. Financial Literate individual, often possessing higher disposable income and an enhanced ability to save, typically diversify their holdings across a broader range of financial products and demonstrate greater productivity in their investment stratergies – Cole and Fernando [4,5].

Financial Literacy and Investment Behavior

Investment behaviour, in contrast, represents the patterns of choices, attitudes, and actions demonstrated by individuals while allocating their financial resources. It includes decisions related to asset selection, portfolio structure, risk acceptance, diversification practices, and investment preferences across different options such as stocks, bonds, mutual funds, or real estate. Investment behaviour is influenced by several factors, including financial objectives, investment horizon, risk-taking ability, market conditions, and individual preferences. A strong foundation of financial knowledge is a critical element of financial literacy. It includes awareness and understanding of fundamental areas such as personal budgeting, savings management, debt control, and financial planning. In addition, knowledge of investment principles, including the relationship between risk and return, portfolio diversification, compounding benefits, and the impact of market fluctuations, is necessary for making rational and informed investment decisions. Effective financial management involves the systematic planning, allocation, and monitoring of financial resources to achieve both short-term and long-term goals. Regular saving practices are closely associated with financial literacy, as financially aware individuals understand the importance of maintaining emergency funds, planning for education expenses, preparing for retirement, and securing future financial needs. Aa per Dr. Naveen Prasadula Financial literacy enables individuals to assess various investment opportunities and select options that align with their financial goals and risk preferences. It helps investors understand the potential benefits and risks associated with different financial assets, thereby supporting more informed, calculated, and strategic investment choices. Risk management is another important dimension of financial literacy. Understanding personal risk tolerance allows investors to develop investment strategies that match their financial capacity and comfort level with market uncertainty. The manner in which investors identify, evaluate, and manage risks directly influences their investment behaviour and portfolio decisions. Long-term financial planning is also a significant indicator of financial capability. Goals such as retirement planning, wealth creation, and legacy management require investment decisions that are aligned with specific financial timelines and future objectives. Therefore, investment behaviour is often shaped by the individual's ability to plan and make decisions with a long-term perspective. Financially literate individuals also remain aware of economic trends, market developments, and changing financial conditions. Continuous monitoring of financial information supports adaptive and informed decision-making, as investment choices are often influenced by market movements and perceptions of future economic conditions. Financial literacy is a continuous learning process that evolves with changes in financial systems, technologies, and investment opportunities. Regular improvement in financial knowledge enhances investors' ability to identify emerging opportunities and adopt suitable investment strategies. Ultimately, investment behaviour reflects the practical application of an individual's financial literacy, as an investor's decisions, preferences, and actions represent their understanding, beliefs, and confidence in managing financial resources.

Need for the Study

This paper is the need of the society in various ways:

Facilitating Informed decision making: A primary motivation for this study is the critical role financial literacy plays in helping the investors take the informed investment choices. A proper knowledge of financial concepts related risk and available instruments empowers investors to select strategies that are in line with their specific objectives and personal appetite for risk.

Generating Behavioral Finance information: Analyzing investment behavior yields valuable information that are critical for both individual investors and economic policy makers. Such a study highlights the cognitive and emotional factors (Biases) such as risk aversion, overconfidence, loss aversion, etc. that shape financial choices. These findings can inform better personal strategies and more effective regulatory frameworks,

Promoting Market Engagement: Financial Literacy is instrumental in fostering wider and more active engagement in capital markets. As investor develop a clearer understanding of market mechanics, their confidence and propensity to invest increases. This heightened participation not only benefits individual wealth creation but also market liquidity and economic efficiency.

Enhancing Risk Management Capabilities: The research is further necessitated by the importance of financial literacy by cultivating effective risk management. Investors who understand risk profile of various assets are better positioned to evaluate and mitigate potential losses. This increased awareness is fundamental to building a well-balanced and diversified portfolio which is essential for long term financial resilience.

Mitigating Exposure to Financial Frauds: Financial literacy serves as critical defense mechanism against fraudulent financial practices and deceptive schemes. Investors equipped with a sound understanding of financial concepts and market red flags are significantly less susceptible to such fraud propositions and misrepresented opportunities. This protective knowledge is essential for preserving individual capital and developing trust in financial systems.

Informing Policy Development: Detailed investigations into the connection of financial literacy and investment conduct provide vital evidence to shape public policy. Such research evaluates the efficiency of current financial education initiatives and pinpoints specific knowledge gaps within the population. These insights are indispensable for making targeted evidence-based policies and policy measures designed to increase public financial capability on a systematic level.

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Objectives

- To assess the level of financial literacy among individual investors
- To investigate the relationship between key demographic variables and investors financial literacy
- To analyze the impact of investor's level of financial literacy on investment patterns and portfolio composition.

Scope of the Study

Specifically, it will analyze how investors knowledge, attitudes and practices influence financial decision making.

Furthermore, the study will assess the level of financial literacy investors possess relative to the specific investment alternatives (stock, mutual fund, real estate, etc.) they prefer. This comparative analysis is designed to identify potential gaps between investor education and their actual investment choices, thereby highlighting areas where financial knowledge may be insufficient for the selected assets.

Sources of Data

The direct data collection is done using the structured questionnaire circulated using online forms. And the indirect data is collected from various sources such as past papers, websites, etc.

RESULTS

Tools for Analysis

For the analytical framework the author has employed descriptive statistics, including charts, for better visualization. Furthermore, inferential statistical techniques such as ANOVA and Chi-Square Test has been utilized for testing and examining the significance of relationship between key variables.

Hypotheses

H_{01}: There is statistically significant difference in the level of financial literacy among investors who prefer different types of investments (Eg. Equity, Mutual Funds, Life Insurance, Bonds, etc.) (Figure 1).

H_{02}: There is statistically significant difference in the level of financial literacy among investors based on their performance on financial knowledge statements (Correctly identifying statements as True, False, or Responding 'Do not know') (Figure 2).

H_{03}: There is statistically significant difference in the tenure of Investment based on the gender of the investor.

Data Analysis

For H_{01} and H_{02} to find the relation between the level of financial literacy and the preferred type of investment and the relation between financial literacy based on the performance of the financial statement knowledge the ANOVA test was conducted (Table 1).

As the P-value is <0.05 the alternate hypothesis H_{10} and H_{20} – are accepted because it shows that there is a significant difference between the level of financial literacy and the type of investment preferred and also there exists a significantly strong relation between the level of the financial literacy of the investor and the performance based on the financial statement knowledge (Figure 3).

For H_{03} Chi-Square test was conducted to identify if there exist any affinity between the tenure of investment and the gender of the investor (Table 2).

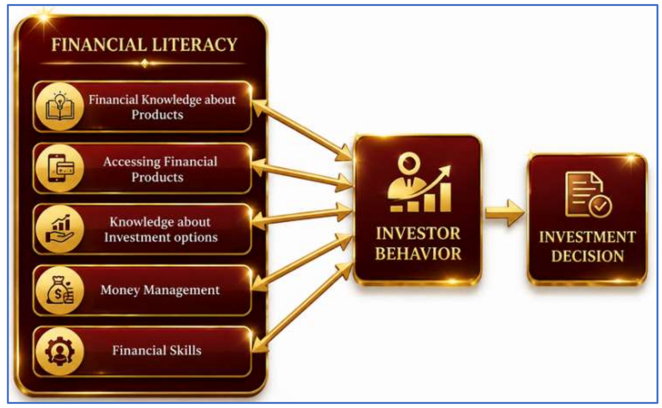

Figure 1: Financial Literacy

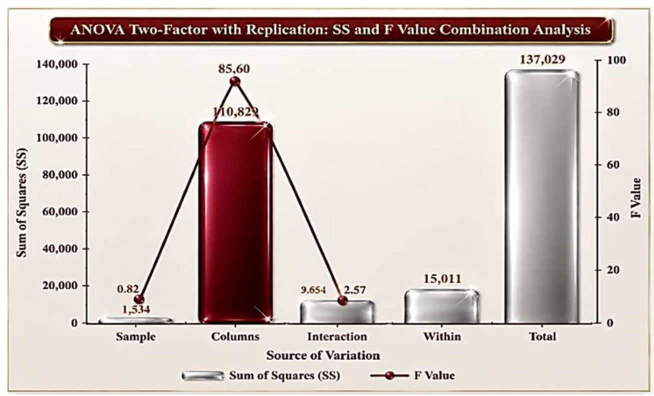

Figure 2: A NOVA Two Factors with Replication

Figure 3: Tenure of Investment by Gender

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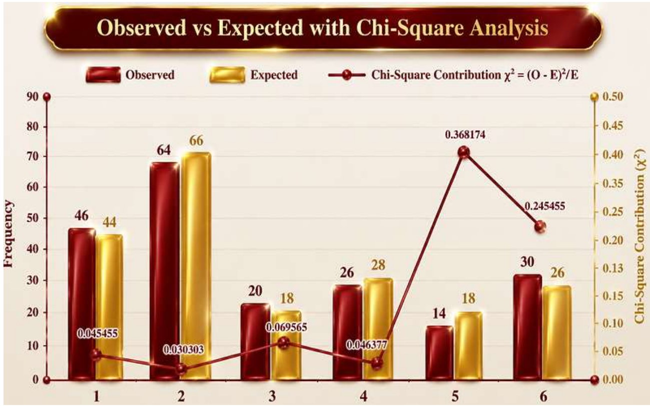

Figure 4: Observed vs Expected with Chi-Square Analysis

Table 1: ANOVA – Two-Factor with Replication

Source of Variation	SS	df	MS	F	P-Value
Sample	1533.67	3	511.222	0.81734	0.49698
Columns	110829	2	55414.7	85.5966	8.30E-12
Interaction	9654.17	6	1069.03	2.5725	0.04556
Within	15011.3	24	625.472	—	—
Total	137029	35	—	—	—

Table 2: Affinity Between the Tenure of Investment and the Gender of the Investor

Gender	Upto 1 year (Short Term)	1 - 3 Years (Medium Term)	Above 3 Years (Long Term)	Grand Total
Male	44	18	18	80
Female	66	28	26	120
Grand Total	110	46	44	200

Table 3: Observed vs Expected with Chi-Square Difference

Observed	Expected	Difference (O - E)	$(O - E)^2$	$\chi^2 = (O - E)^2/E$
46	44	2	4	0.045455
64	66	-2	4	0.030303
20	18	2	4	0.069565
26	28	-2	4	0.046377
14	18	-4	16	0.368174
30	26	4	16	0.245455

$X^2 = 0.805336$

Here as the value of X^2 is greater than the static value of the same hence we can say that the H_{30} hypothesis is rejected and can accept the null hypothesis H_{03} stating that there is no statistically significant difference between the gender of the investor and the tenure of the investment (Table 3 and Figure 4).

DISCUSSION

Based on the result of data analysis, which shows a statistically significant relationship between financial literacy and both investment preference and performance, it is evident that improving financial literacy can lead to more informed and effective investment decisions. The acceptance of the alternate hypothesis confirms that investors with higher levels of financial literacy tend to prefer more structured and suitable investment options and demonstrate better performance due to their understanding of finances. Therefore, it is recommended that policy makers and financial institutions design targeted financial education programs that go beyond basic product awareness and focus on strengthening practical skills such as financial statement analysis and investment evaluation. Additionally, incorporating financial literacy training into educational curricula and workspace learning initiatives can help individuals make better long-term investment choices. This kind of training and knowledge sharing would be more beneficial for the youth as they would just start their investment planning and the good early start to them would not only benefit the young investors but also would help in the development of the markets. Even those who are not from the finance background needs to have the basics of financial literacy to mitigate the distortions caused by the biases in their investments. Such measures would not only enhance individual investment outcomes but also contribute to broader financial stability and economic growth.

CONCLUSION

The study highlights that investment decision-making is influenced by both individual behavioural biases and the level of financial literacy possessed by investors. While financial knowledge helps individuals evaluate investment alternatives, manage risks, and make rational decisions, behavioural biases often affect judgement and lead to deviations from logical financial choices. Factors such as overconfidence, loss aversion, herd behaviour, and emotional influence can significantly shape investment preferences and outcomes. The findings suggest that financially literate investors are more capable of understanding financial products, assessing investment opportunities, and adopting informed decision-making practices. However, improving financial literacy alone may not completely eliminate behavioural biases, as psychological factors continue to influence investor behaviour. Therefore, developing financial awareness along with behavioural understanding is essential for promoting effective investment decisions. A balanced approach combining financial education and bias management can help investors achieve better financial planning and long-term wealth creation.

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