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FINANCIAL LITERACY AND INVESTMENT DECISION-MAKING: AN EMPIRICAL STUDY OF INDIVIDUAL INVESTORS' KNOWLEDGE, RISK PERCEPTION, AND INVESTMENT BEHAVIOUR

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ABSTRACT

Financial literacy has become an important determinant of individual financial decision-making as investors increasingly encounter diverse investment products, complex financial information, and changing economic conditions. Adequate financial knowledge enables individuals to understand investment alternatives, evaluate risks and returns, and make informed financial choices. This paper examines the relationship between financial literacy and investment decision-making, with particular emphasis on financial knowledge, risk perception, and investment behaviour among individual investors. It explores how knowledge of financial concepts influences investors' ability to evaluate investment opportunities and how risk perception affects the selection of investment instruments. The study also considers the role of demographic and behavioural factors in shaping investment practices. An empirical perspective is adopted to understand how financially literate individuals may demonstrate more systematic investment behaviour, greater diversification, and improved risk assessment. The paper highlights the importance of financial education, investor awareness, and accessible financial information in developing responsible investment practices. Strengthening financial literacy can contribute to better investment decisions and long-term financial well-being.

Keywords: Financial Literacy, Investment Decision-Making, Financial Knowledge, Risk Perception, Investment Behaviour, Individual Investors, Financial Education

I. INTRODUCTION

Financial literacy has emerged as an important component of individual financial well-being because people are increasingly required to make decisions involving savings, investments, credit, insurance, retirement planning, and wealth management. The expansion of financial markets has provided individuals with numerous investment alternatives, including bank deposits, shares, mutual funds, bonds, insurance-linked products, pension schemes, and digital investment platforms. However, the availability of these alternatives does not necessarily mean that individuals possess the knowledge required to evaluate them effectively. Investors need to understand concepts such as inflation, interest rates, compounding, diversification, liquidity, volatility, and risk-return relationships. Financial literacy therefore represents an important foundation for informed financial decision-making.

Investment decisions are influenced by both objective financial knowledge and subjective perceptions of risk. Two individuals with similar financial resources may select substantially different investment products because they perceive financial risk differently. Some investors may prefer low-risk and stable instruments, whereas others may accept higher volatility in pursuit of greater returns. Risk perception can be influenced by previous investment experiences, financial goals, income, age, education, social influence, market information, and psychological characteristics. Financially knowledgeable investors may be better equipped to distinguish between actual and perceived risk, evaluate investment information critically, and avoid decisions based entirely on emotions, rumours, or short-term market movements.

Investment behaviour also reflects the way individuals translate financial knowledge and risk perceptions into actual financial practices. Investors may demonstrate disciplined behaviour through regular savings, long-term planning, portfolio diversification, and systematic evaluation of investment performance. Conversely, limited financial knowledge may encourage excessive dependence on informal advice, speculative activities, herd behaviour, or investment choices that do not correspond with individual financial objectives. Behavioural biases such as overconfidence, loss aversion, familiarity bias, and fear of market fluctuations can further influence investment decisions. Consequently, understanding investment behaviour requires consideration of both financial literacy and psychological responses to risk.

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The present paper examines financial literacy and investment decision-making among individual investors, focusing specifically on financial knowledge, risk perception, and investment behaviour. The study considers financial literacy as a potentially important factor in determining how individuals evaluate investment alternatives and manage financial risk. It further explores the importance of financial education and investor awareness in improving decision quality. The central argument is that financial knowledge can enhance investors' ability to understand financial products and risks, while appropriate risk perception can help individuals align investment choices with their financial objectives and tolerance for uncertainty. Strengthening these capabilities can contribute to more informed, rational, and sustainable investment practices.

II. FINANCIAL LITERACY, FINANCIAL KNOWLEDGE, AND INVESTMENT DECISION-MAKING

Financial literacy provides individuals with the conceptual foundation necessary to understand financial markets and investment products. Investors with stronger financial knowledge are more likely to understand fundamental concepts such as compound interest, inflation, diversification, risk, return, and asset allocation. Such knowledge can improve the ability to compare investment alternatives and identify products that correspond with particular financial objectives. For example, an investor who understands the effects of inflation may recognise that preserving nominal capital does not necessarily preserve purchasing power. Similarly, understanding diversification can encourage investors to avoid concentrating their entire portfolio in a single asset or investment category.

Financial knowledge may also improve the quality of information processing during investment decision-making. Modern investors receive financial information from newspapers, television, social media, financial applications, online platforms, investment advisers, and informal social networks. The quantity of information can make investment decisions more difficult rather than easier when individuals lack the ability to distinguish reliable information from misleading or speculative claims. Financially literate individuals may be more capable of assessing financial statements, comparing costs and returns, understanding product features, and questioning unrealistic promises of guaranteed high returns. Consequently, financial literacy can strengthen investors' analytical capacity and reduce dependence on unreliable sources of investment information.

An important relationship exists between financial literacy and portfolio diversification. Diversification is a fundamental investment principle because spreading investments across different assets can reduce exposure to the risks associated with any single investment. Individuals with limited financial knowledge may concentrate their investments in familiar products or assets recommended by friends and relatives. Financially knowledgeable investors, by contrast, may be more likely to recognise the importance of balancing risk and return across different asset classes. However, financial literacy does not automatically guarantee optimal diversification. Investors may still demonstrate behavioural biases or personal preferences that influence portfolio construction. Financial knowledge should therefore be viewed as an enabling factor rather than a guarantee of perfect decision-making.

Financial literacy can also influence long-term investment orientation. Individuals who understand compounding and the benefits of early investment may be more likely to establish long-term financial goals and maintain regular investment practices. Long-term investors may be better positioned to tolerate temporary market fluctuations and avoid emotionally driven reactions to short-term volatility. Financial knowledge can help investors understand that different investment instruments have different time horizons and risk characteristics. As a result, investment choices can become more closely aligned with goals such as retirement planning, children's education, home ownership, or wealth accumulation.

The relationship between financial literacy and investment decision-making may also vary according to demographic characteristics. Age, educational attainment, income, occupation, gender, financial experience, and access to financial information can influence financial knowledge and investment behaviour. Younger investors may possess greater familiarity with digital financial platforms but may have limited investment experience, while older investors may have more experience but different risk preferences and financial objectives. Higher income can provide greater capacity to invest but does not necessarily imply higher financial literacy. Therefore, empirical investigations should consider demographic characteristics when examining the relationship between financial literacy and investment practices.

Financial education can strengthen the practical application of financial knowledge. Educational institutions, financial organisations, government agencies, employers, and investor-awareness programmes can contribute to improving financial capability. Effective financial education should extend beyond theoretical definitions and provide individuals with practical skills for budgeting, evaluating investment alternatives, assessing risk, understanding fees, and planning long-term financial goals. Digital financial literacy is becoming equally important as investment increasingly occurs through online platforms and mobile applications. By improving both conventional and digital financial knowledge, financial education can help individuals make more informed investment decisions and participate more confidently in financial markets.

III. RISK PERCEPTION AND INVESTMENT BEHAVIOUR AMONG INDIVIDUAL INVESTORS

Risk perception is a central factor in investment decision-making because financial investments involve varying degrees of uncertainty regarding returns and capital preservation. Investors do not always perceive risk according to objective market indicators. Instead, personal experiences, financial circumstances, expectations, emotions, and available information can influence their interpretation of risk. An investor who has experienced significant financial losses may perceive equity investment as extremely risky, while another investor with positive market experience may perceive the same asset as relatively manageable. Understanding risk perception is therefore essential for explaining differences in investment behaviour among individuals with similar levels of financial knowledge.

Risk tolerance and risk perception influence the types of financial instruments selected by investors. Individuals with lower tolerance for financial uncertainty may prefer fixed deposits, government securities, or other relatively stable instruments. Investors with greater tolerance may allocate larger proportions of their portfolios to equities, mutual funds, or other market-linked assets. However, appropriate investment behaviour requires a balance between risk capacity, risk tolerance, and financial objectives. An individual may be psychologically willing to accept high risk but financially unable to withstand substantial losses. Financial literacy can assist investors in distinguishing between willingness to take risk and actual capacity to bear financial loss.

Behavioural factors frequently interact with risk perception. Investors may be influenced by loss aversion, whereby the psychological impact of a loss is stronger than the satisfaction associated with an equivalent gain. This may cause individuals to sell investments prematurely during market downturns or avoid potentially suitable investments because of fear of loss. Overconfidence can produce the opposite outcome, encouraging investors to underestimate risk and trade excessively. Herd behaviour may lead individuals to purchase

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popular assets because other investors are doing so rather than because of independent evaluation. Financial literacy can help individuals recognise these behavioural tendencies, although awareness alone may not completely eliminate them.

Investment behaviour is also influenced by the source and quality of financial information available to individuals. Social media and online investment communities have increased the speed at which financial opinions and market predictions spread. While digital platforms can improve access to financial education, they can also expose inexperienced investors to misleading recommendations, speculative narratives, and unrealistic return expectations. Individuals with stronger financial knowledge may be more likely to evaluate the credibility of financial claims and examine underlying risks before investing. Digital financial literacy is therefore increasingly connected to responsible investment behaviour in contemporary financial markets.

Another important characteristic of investment behaviour is investment diversification and consistency. Investors who understand their financial goals and risk profiles may be more likely to maintain diversified portfolios and follow systematic investment strategies. Regular investing can reduce dependence on short-term market predictions and encourage disciplined financial planning. In contrast, investors driven primarily by market sentiment may frequently change their portfolios in response to price movements or media reports. Such behaviour can increase transaction costs and potentially reduce long-term returns. Financial education and counselling can therefore encourage investors to adopt investment strategies based on objectives, time horizons, and risk capacity rather than temporary market emotions.

The development of responsible investment behaviour requires an integrated approach involving financial knowledge, realistic risk assessment, and behavioural awareness. Financial institutions and regulators can support this process through transparent product information, investor education, simplified disclosures, and accessible financial planning resources. Educational institutions can introduce financial literacy programmes at an early stage so that individuals develop basic investment knowledge before entering complex financial markets. Individuals themselves should also develop habits of evaluating investment objectives, understanding associated risks and costs, diversifying appropriately, and reviewing their financial plans periodically. Such practices can improve the quality of investment decision-making and contribute to sustainable long-term financial well-being.

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IV. CONCLUSION

Financial literacy plays an important role in shaping the investment decision-making process of individual investors. As financial markets become increasingly diverse and accessible, individuals require adequate knowledge to understand investment alternatives and evaluate the relationship between risk and return. Knowledge of inflation, interest rates, compounding, diversification, liquidity, and investment risk can provide a foundation for more informed financial choices. Financially literate individuals may therefore be better positioned to evaluate investment information, compare financial products, and align their investment choices with personal financial goals.

The relationship between financial literacy and investment behaviour is influenced by risk perception and individual psychological characteristics. Investors do not always respond to financial risks objectively, as previous experiences, emotions, expectations, and social influences can shape their perceptions. Behavioural biases such as loss aversion, overconfidence, and herd behaviour can affect investment decisions even when individuals possess reasonable financial knowledge. Therefore, financial literacy programmes should not focus exclusively on technical financial concepts. They should also help individuals understand behavioural tendencies and develop disciplined decision-making practices.

Risk assessment and portfolio diversification are particularly important dimensions of responsible investment behaviour. Investors need to evaluate not only their willingness to accept risk but also their financial capacity to withstand potential losses. Appropriate diversification can reduce concentration risk, while long-term planning can help investors avoid excessive reactions to short-term market volatility. Regular investment, goal-based planning, informed product comparison, and periodic portfolio evaluation can further support responsible financial behaviour. These practices can help individuals move from reactive and emotionally driven investment decisions toward more systematic financial planning.

In conclusion, improving financial literacy can contribute to more effective investment decision-making and stronger long-term financial well-being. Governments, educational institutions, financial organisations, employers, and regulatory bodies should expand financial education initiatives that are practical, accessible, and relevant to different population groups. Digital financial literacy should receive particular attention because investment decisions are increasingly made through online platforms. Future empirical

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research should examine the interaction between financial knowledge, demographic characteristics, risk perception, behavioural biases, and actual investment outcomes. A comprehensive approach to financial literacy can ultimately empower individual investors to make informed decisions, manage financial risks responsibly, and pursue sustainable wealth creation.

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