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Enhancing Investment Decisions Through the Prism of Financial Literacy: An In-depth Review

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Abstract: *This study aims to analyze and synthesize current research on financial literacy and its impact on investment decision-making. It extends the literature on personal finance by incorporating recent studies on financial literacy, the interplay between financial literacy and financial management behavior, and the concept of financial inclusion. Reviewing existing literature underscores the pervasive lack of fundamental knowledge, skills, and attitudes necessary for optimal personal finance decision-making, even in economically advanced nations. Consequently, since the mid-20th century, efforts to enhance financial literacy and promote personal finance education have gained prominence in industrialized and high-income countries.*

While comprehensive studies are limited, recent scholarly and governmental attention to developing nations underscores the increasing global relevance of financial literacy and prudent financial behaviors for national socioeconomic well-being. Studies from economically challenged and emerging nations have revealed low levels of financial literacy, with correlations found between low literacy scores and demographics such as gender, age, employment status, education level, income, and rural residency. However, some demographic factors were found to be less influential. This research emphasizes the importance of expanding financial literacy initiatives across diverse population groups and addressing factors that influence financial literacy levels.

Keywords: *Financial literacy, Investment decision-making, Personal finance, financial management behavior, financial inclusion, Socioeconomic health, Demographics, Developing nations, Education, Income, Rural residency.*

Introduction: In today's dynamic financial landscape, individuals are increasingly confronted with complex financial decisions from a young age. Early missteps in financial management can lead to substantial financial setbacks, particularly for the younger generation facing significant debts like credit card balances or student loans. These financial commitments can hinder their ability to accumulate wealth effectively. Therefore, there is a pressing need for scholarly inquiry into the financial acumen of the younger demographic. Understanding the factors that facilitate or impede the acquisition of financial knowledge is paramount for policymakers seeking to design effective interventions.

Lack of financial literacy can lead to unintended financial errors, suboptimal financial practices, and vulnerability to sudden economic shifts. Negotiating this financial terrain requires individuals to comprehend and navigate concepts such as inflation, diverse asset portfolios, risk management, and the power of compound interest. Thus, a broad spectrum of analytical skills and comprehensive knowledge is essential to avoid costly mistakes.

Furthermore, individuals today bear greater responsibility for managing their financial well-being throughout their lifetimes. The strain on social welfare systems and retirement funds has intensified due to increased life expectancy. Globally, traditional employer-backed pension plans are giving way to private retirement savings schemes, shifting the onus of retirement planning from organizations to individuals. Additionally, there is a noticeable shift in the job market dynamics, with a widening wage gap between those with higher education qualifications and those without. Concurrently, rapid technological advancements are reshaping financial markets, introducing intricate financial instruments, and fostering the growth of the financial technology (fintech) sector. This transformation affects how individuals access financial guidance, select investments, and conduct transactions.

In this context, assessing individuals' levels of financial literacy and understanding the extent to which their financial decisions are influenced by this knowledge is critical. It sheds light on the challenges and opportunities presented by the evolving financial landscape, guiding efforts to enhance financial education and decision-making capabilities.

Defining Financial Literacy:

The concept of financial literacy has been delineated by numerous scholars and organizations in diverse ways, mirroring the norm in various research domains. This section delves into the extent of existing conceptual and operational definitions of financial literacy.

<u>According to PACFL's Definition:</u> The President's Advisory Council on Financial Literacy (PACFL, 2008), convened to enhance financial literacy across all demographics, has articulated the definition of financial education and financial literacy as follows:

- Financial literacy: the ability to apply knowledge and skills in managing finances effectively for sustained financial well-being.
- Financial education: the process through which individuals acquire a deeper understanding of financial concepts, products, and services, empowering them to make informed decisions, steer clear of pitfalls, access support resources, and take proactive measures to bolster both short-term and long-term financial stability.

Literature Review:

In the realm of financial literacy, Hilgert, Beverley, and Hogarth (2003) laid the groundwork by highlighting financial knowledge's pivotal role. This foundational aspect, as defined by FINRA (2003), encompasses investors' grasp of market principles, financial instruments, organizational structures, and regulatory frameworks.

Moore (2003) delves deeper into the multifaceted nature of financial literacy, stressing competence and practical application. He argues that financial literacy evolves through experience and active integration of knowledge, leading to increased sophistication over time.

The National Council on Economic Education (NCEE) (2005) broadens the scope, adding basic economic principles and understanding of the U.S. economy to the mix. This underscores the interconnectedness of economic and financial literacy. Mandell (2007) extends the definition to include evaluating complex financial instruments for long-term well-being, emphasizing informed decision-making.

Lusardi and Mitchell (2007c) stress understanding basic economic concepts for prudent saving and investment decisions, while Lusardi and Tufano (2008) add debt literacy to the mix, focusing on informed debt decisions. ANZ Bank (2008), cited in Schagen (2007), emphasizes informed judgment and effective decision-making in financial resource management, highlighting the multifaceted nature of financial literacy.

As financial landscapes evolve, so do the challenges. Lusardi, Mitchell, and Oggero (2018) note shifts in financial tools, increased debt among older Americans, and greater individual financial responsibility.

The impact of financial literacy on behavior is significant. Financially literate individuals exhibit better borrowing habits, savings behavior, and investment acumen, leading to wealth accumulation (Lusardi and Mitchell, 2014). Studies also link financial literacy to retirement planning success (Mitchell and Lusardi, 2015) and better handling of unexpected expenses (Hasler, Lusardi, and Oggero, 2018).

Conversely, low financial literacy correlates with unwise debt behavior and poor financial decisions (Moore, 2003; Lusardi and Tufano, 2015). Young individuals, especially millennials, face challenges with student loans due to limited knowledge (Lusardi, Oggero, and de Bassa Scheresberg, 2016), while fintech influences financial behavior (Lusardi, Avery, and de Bassa Scheresberg, 2018).

Research Methodology:

The research methodology involves a descriptive study and secondary research. A collection of high-quality research papers from working papers, conferences, journals, and theses was gathered to examine financial literacy based on prior literature. The search criteria were refined based on the study's focus, resulting in a substantial volume of literature for each keyword under investigation.

Objectives:

- To review and summarize recent research on financial literacy and related topics.
- To identify and analyze the various factors or pillars that contribute to financial literacy.

Analysis and Discussion:

From a global perspective excluding India

Chen and Volpe (1998) delved into the financial literacy of 924 college students from 13 US campuses to expand on previous research. They explored how financial literacy correlated with factors like gender, age, nationality, race, income, work experience, academic field, and academic standing. The study revealed notable differences in financial literacy across subgroups based on academic discipline, academic standing, and work experience. Students with less work experience, non-business majors, and those from lower socioeconomic backgrounds showed lower financial literacy levels. Women had lower literacy rates than men, and international students were less financially literate than domestic students.

Volpe et al. (2002) highlighted the heightened need for financial knowledge among internet investors compared to traditional investors due to potential misinformation and manipulation. They analyzed the investment literacy of 530 online investors, considering variables such as age, income, gender, education, and prior online trading experience. The study uncovered significant variations in financial literacy levels based on gender, age, income, education, and experience. Older participants outperformed younger ones but had lower financial literacy than men. Online traders exhibited higher knowledge levels, as did investors with higher incomes.

Mirshekary and Saudagaran (2005) studied the utilization of information from annual reports by different financial statement users and the importance of various information sources in investment decisions. They surveyed seven user groups in Tehran, finding that annual reports were the most crucial information source, followed by oral information and daily share prices. Conversely, stockbrokers' advice, rumors, and advice from acquaintances ranked lower in significance. Iranian investors heavily relied on annual reports for decision-making.

Australia's national study on adult financial literacy in 2005 by ACNielsen Research revealed that lower education levels, unemployment or low-skilled employment, low income, being single, and extreme age groups were associated with lower financial literacy. However, there was an overall improvement in financial literacy among Australians in 2005.

In Singapore, the Money SENSE Financial Education Steering Committee's 2005 study assessed Singaporeans' financial awareness and management abilities, showing a positive outlook on investing, basic financial planning, and money management among Singaporeans.

Volpe and Chen (2006) surveyed 212 benefit administrators in US companies to identify key personal finance concerns for working adults and assess their understanding. They found that topics like investing and estate planning were deemed less significant, with mutual fund details and costs considered least important, yet working adults had limited knowledge in these areas.

Al-Tamimi (2006) surveyed individual investors in the UAE to understand their investment behavior's influencing factors, finding that corporate earnings, stock marketability, past stock performance, government holdings, and financial market development were most impactful. Surprisingly, religious motivations and family opinions had minimal influence. However, the study did not explore the link between investment decisions and financial literacy.

Maditinos et al. (2007) studied Greek investors across various categories, finding that intuition and experience were the primary factors guiding investment decisions, followed by fundamental analysis and global market activity, while factors like market noise and portfolio analysis were less influential.

Table 2. Financial literacy scores, normalised to 100

In alphabetical order.

Financial literacy (21=100); Knowledge (7=100), Behaviour (9=100), Attitude (5=100)

	Financial Literacy Score	Financial Knowledge	Financial Behaviour	Financial Attitude
Austria	68.5	76.0	66.3	61.9
Bulgaria	58.5	56.9	59.3	57.6
Colombia	53.5	54.9	53.2	52.0
Croatia	58.6	63.4	55.5	55.6
Czech Republic	62.0	64.9	59.1	62.9
Estonia	63.5	70.7	58.8	62.1
Georgia	57.6	62.5	56.3	50.0
Germany	66.1	73.7	62.9	61.2
Hong Kong, China	71.1	88.2	64.8	58.3
Hungary	58.8	65.6	49.9	65.1
Indonesia	63.5	53.2	69.7	66.8
Italy	53.0	56.1	46.3	61.0
Korea	62.1	65.7	59.8	61.3
Malaysia	59.7	52.3	68.1	54.9
Moldova	59.8	55.6	60.6	61.4
Montenegro	54.5	56.7	52.3	52.8
Peru	57.6	58.0	56.5	58.9
Poland	62.1	71.1	60.6	52.4
Portugal	62.3	56.8	65.2	64.9
North Macedonia	56.1	56.1	56.2	56.1
Romania	53.4	48.3	55.7	54.7
Russia	59.6	68.7	54.6	56.0
Slovenia	70.0	68.7	69.6	72.5
France *		68.0		
Malta **	48.9	32.0	57.9	56.5
Thailand ***		56.0		77.3
Average ^	60.5	62.8	59.2	59.2
OECD-11 ^^	62.0	65.8	59.2	61.6

From the perspective of India

In India, according to a 2019 report by the National Centre for Financial Education (NCFE), the following key findings were observed:

- The overall financial literacy rate in India stands at 27%, which is a 7% increase from the 2013 survey.
- Goa, Chandigarh, and Delhi are the top three states in terms of financial literacy.
- The West, North East, North, and South zones have higher financial literacy rates than the national average of 27%.
- Financial literacy rates are 33% in urban areas and 24% in rural areas.
- Among financially literate individuals, 29% are male and 21% are female.

- Lower-income and education levels correlate with lower financial literacy.
- The general category exhibits the highest level of financial knowledge.

Comparing India to 14 nations in the OECD INFE research, India scored 4.2 in financial knowledge, lower than the average of 5.2. This is reflected in the relatively low percentage of respondents with extensive financial knowledge (24%) compared to other nations. For instance, even South Africa, with the lowest average score, had nearly one-third of proficient respondents. In Hungary, rated highest, 69% were highly knowledgeable. Other nations also had more than 40% highly knowledgeable respondents.

In a study on investment behavior among middle-class households in Nagpur by Aparna Sanudra and M.A. Burghate (2012), life insurance plans were the second-most popular investment choice at 41%, after bank deposits. Public provident funds and post office saving deposits followed. Only 18% invested primarily for tax benefits, with most seeking high returns and liquidity. The majority preferred bank savings and insurance, showing consistent investment preferences across age groups.

Another study on investor behavior in Mumbai by Brahmabhatt, P.S. Raghu Kumari, and Shamira Malekar (2012) revealed that despite losses, most investors favored stock markets over other options. They prioritized savings and security but sought higher interest rates with low risk in a short period. Many had higher education and consulted multiple sources, including friends and relatives, before making investment decisions.

Interpretation and Findings:

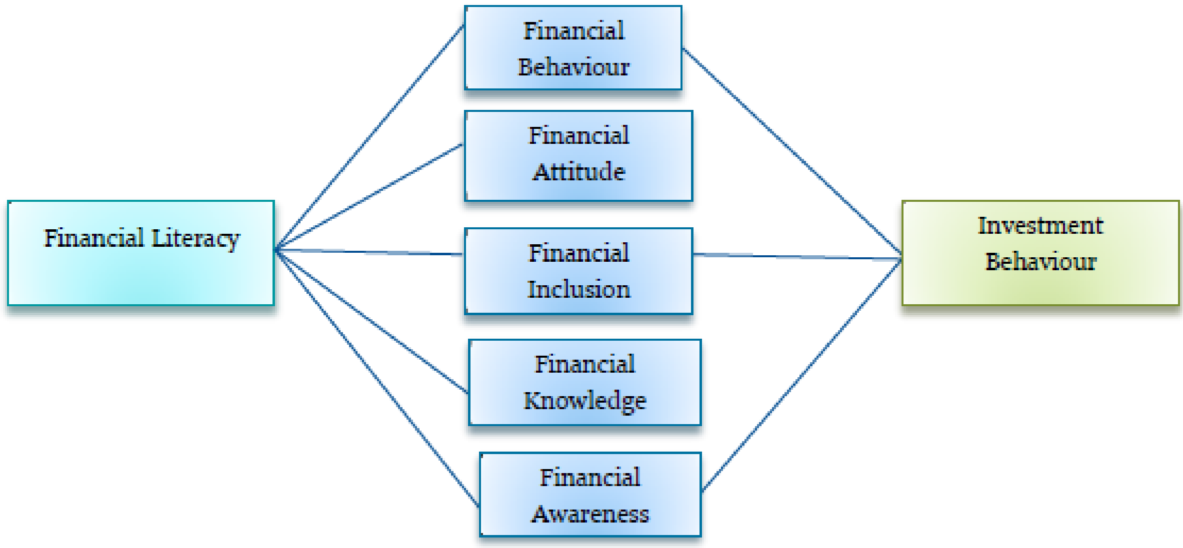
<u>Discoveries regarding various aspects of financial literacy and their impact on investment decision-making</u>

Country	S.No	Study	Identified Factors	Impact on Investment
India	1	(Singh, Chetna,2019)	• financial knowledge • financial behavior • financial attitude	Yes
	2	(Chowdhary, Tarun K.)	• Financial Education	Yes
	3	(Popat, Disha Ashokkumar,2019)	• Financial attitude • Financial behavior • financial awareness • financial knowledge	Yes
	4	(Sangeeta Gupta,2017)	• Financial Knowledge	Yes
	5	*Gangwar, Rachna and Singh, Ritvik (2018*	• financial knowledge	No
	6	(Karan Gupta,2018)	• Financial Awareness • Financial	Yes

			Knowledge	
	7	(Selvamohana K,2018)	• Financial knowledge	Yes
	8	(Pradeep Gupta,2019)	• Financial knowledge • Financial Attitude • Financial Behavior	Yes
	9	(Susana D,2019)	• Financial Behavior	Yes
	10	(P, Shanmugha Priya,2017)	• Financial Attitude • Financial Behavior • Financial Knowledge	Yes
Developing Countries	1	(Kamer Karakurum-Ozdemir1 · Melike Kokkizil2 · Gokce Uysal3,2018)	• Financial Education • financial inclusion	Not mentioned
	2	(Ghirmai Kefela)	• Financial Education	Not mentioned
	3	(Javed Iqbal Bhabha,2014)	• Financial Knowledge	Yes
	4	(A Firli1,2017)	• Personal Socio demographic characteristics • Financial Training • Financial Attitude • Financial Behaviour • Financial Knowledge	Not mentioned
	5	(Girum Abebea , Biruk Teklea , and Yukichi Mano,2018)	• Financial Knowledge	Yes

Research Gap of the Study:

The survey reveals that most research on financial literacy is concentrated in developed nations or conducted by international organizations studying financial literacy across various global economies. Limited studies have focused on emerging countries like India. There is a need for further investigation into the reasons behind lower financial literacy levels among women in India and other nations. Additionally, exploring government initiatives aimed at measuring or reducing financial illiteracy could be beneficial.



Conclusion:

After examining various studies, we have identified Financial Education, Financial Inclusion, Financial Behavior, Financial Attitude, and Financial Knowledge as the key pillars or factors of financial literacy that directly or indirectly influence an individual's level of financial understanding and decision-making. Our analysis indicates that women tend to have lower financial literacy levels compared to men in India and other developing nations. Moreover, there is a correlation between increasing income and higher financial literacy, as seen in consistent findings across different research works. This suggests a link between access to financial education and/or the quality of education with income levels, emphasizing the importance of not just years of education but also its quality.

The research reveals that many individuals struggle with understanding fundamental financial concepts such as interest calculations, the impact of inflation, and risk management through diversified investments. This points to a significant lack of financial literacy among respondents in India. Studies consistently highlight that inadequate comprehension of financial product benefits and limited accessibility to financial information contribute to India's lower financial literacy levels.

Furthermore, our investigation uncovers connections between socio-demographic factors like gender, age, education, income, urban or rural residence, ethnicity, and employment status with financial literacy. Specifically, individuals with lower financial literacy scores are more likely to be female, young or old, less educated, underemployed, living in rural areas, and lacking experience in complex financial markets. This underscores the need for tailored educational strategies to enhance financial literacy across different demographic groups.

Additionally, it's crucial to contextualize financial education by considering psychological, and sociological factors, and addressing specific challenges within the financial landscape and economic systems where individuals manage their finances.

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