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Financial Literacy and Investment Behaviour: A Study of Individual Investors in India's Stock Market

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Abstract

The objective of this research paper is to promote literacy in investment behavior among individual investors in the Indian stock market and enhance their understanding of the complex relationships, thereby increasing their awareness. After overviewing the existing literature, it was found that demographic factors, financial awareness, and use of technology are the important determinants influencing the decisions of individual investors in India. The findings revealed that tech-savvy Gen Z and young investors have a medium to high level of market knowledge. A large part of the population is still deprived of understanding advanced financial concepts such as intraday, bonds, futures and options, exchange-traded funds, etc. Young, educated, and wealthy individuals show good financial knowledge, but even today, Indian investors prefer safe investment options such as bank deposits, post office savings, investments in real estate, and, to some extent, mutual funds. Equity participation in India is still limited compared to developed countries. Studies show that financial literacy significantly increases individual investor confidence and market participation. The paper further points out the important challenges for various investor segments, such as low access to reliable data and bias in the system. Furthermore, investigators debate the above challenges and are compelled to promote financial literacy through tailor-made educational initiatives.

Keywords: Individual Investors, Financial Literacy, Financial Awareness, Investment Behaviour, Stock Market

Introduction

The Indian stock market has evolved significantly over the last few decades, developing into a dynamic and diverse environment, providing a plethora of investment avenues for retail investors. Thanks to the evolving trading platforms, regulatory reforms and growing access to financial products, the Indian stock market has become a pillar of economic growth and wealth creation. However, despite all the hype, the level of participation among retail investors in India can still be considered low globally. Moreover, it highlights the importance of financial literacy that affects the level of engagement in stock market by individuals.

Financial literacy, the knowledge and skills to effectively manage financial resources, is essential for empowering individuals to make informed investment decisions. This includes budgeting, risk assessment, portfolio diversification, and understanding market dynamics. An extensive body of empirical evidence demonstrates that increased levels of financial literacy yield superior investment return and mitigate individual investor from becoming a victim of financial fraud and making mistaken financial decisions that can decrease financial well-being. Stated differently, financial literacy helps individuals can better navigate the complexities of financial markets.

In the Indian context, the relationship between financial literacy and stock market participation is a unique interplay of socioeconomic dynamics, economic situation, legislative measures, and technological advances.

Cultural attitudes toward taking risks, generational wealth management practices, and varying levels of trust in formal financial systems can affect individual eligibility for stake in the stock market. Apart from that, the regulatory environment, which aims at providing investors adequate protection and stabilizing the stock market, plays an important role in building up trust in both the stock market and the bigger interests of participation. Technological advances have added another layer of complexity into the equation. Digital platforms and mobile applications have significantly widened access to stock markets for diversified socioeconomic backgrounds; however, proliferation of financial products now requires deep understanding about the risks and rewards of such products, thus making financial literacy more relevant.

Empirical research has shown how important this linkage is; for example, Arora and Marwaha (2013) and Vohra and Kaur (2016) have attested that financial literacy possesses a vital role in increasing stock market participation. Studies further clarify that these more financially aware individuals are more possible to indulge in equity markets and possibly maintain their investment over a long-term period. In addition, such individuals are in a better position to analyse the possible risk and return their investments can yield.

Long-term training and public awareness campaigns can lead to the improvement needed to boost financial literacy and an increased participation rate in the stock market amongst retail investors. Furthermore, different watchdog packages spread awareness, education and utilize that information to remove gaps between literacy and participation in equity markets. As financial markets take further development and become more dynamic, building up financial literacy will remain an underlying basis for enhancing participation, removing inequalities and achieving economic growth.

Literature Review

Sarkar and Sahu (2017) said that most investors having experience of more than five years mainly focus on short-term profits while possessing moderate awareness, relying more on financial knowledge than on social learning. Investment behaviour is significantly affected by demographic factors and awareness, while heuristics and market bias operate more powerfully compared to herding behaviour.

The factors that interact with investment decisions were investigated by Mitra (2021) including gender, age, and earnings, all of which found direct correlation. Most investors, however, tend to prefer secure options like bank deposits, post-office savings,

and gold, and therefore very little is known about modern investment tools. The need for education was one of the conclusions of the study to bolster returns and economic growth.

As per Lavanya and Kettiramalingam (2024), A significant relationship between demographic variables and trading behaviour market awareness and techno-savvy-skills positively influenced risk appetite and investment returns . Online trading is markedly dominated by the young, educated, and tech-savvy individuals of Coimbatore-an indication of the need for dynamic educational programs to foster investor success.

Vohra and Kaur (2016) observed a standout awareness level proportion among the woman investor and the men investors while lack of awareness has been considered as a barrier to the stock market participation of the women. The study encourages SEBI to launch special educational and awareness programs for women.

Merkoulova and Veld (2022) While inertia, financial literacy, trust, and equity risk premium played significant roles in stock market participation, data showed that most of the non-investors (66%) were unwilling to invest, inertia being affected by age and gender.

Akhter and Sangmi, who in 2015 studied youth regarding their stock market knowledge, found it to be low to moderate with little variation across different academic disciplines. Their study, therefore, demands that financial education be directed to youth on various parameters so they may actively participate in the equity market.

According to Marwaha & Arora (2013), Financial Literacy is the cornerstone for enabling India incorporating individuals into its equity markets leading to wealth creation in the long run. Arora and Marwaha also noted moderate awareness of mutual funds and very little awareness of ULIPs, SIPs, and other instruments such as bonds, derivatives, and debentures. Investors in Punjab also showed the highest knowledge of diversification, market indices, and stock returns, while settlement periods, stock splits, and bond interest rates still were scarce in awareness. In the same vein, D.A.P. and Pandya (2018) found that most of the Indian investors are aware of only a few financial concepts such as risk, return and diversification, restricting their capacity to align investments with financial goals.

Subjective and objective financial literacy was cited by Sivaramakrishnan et al (2017). as the prime factor influencing one's intention to invest-objective literacy affecting behaviour as well. Perceptions such as regulatory perceptions, risk-avoidance, and hassle made a negative concept

"Attitude to Investment Behaviour," impacting intention negatively. Financial well-being directly impacted intention negatively but behaviour positively.

Both financial literacy and economic education were found to contribute to stock ownership in some Tunisian households, according to a study published by Mouna and Anis (2017). They found that individuals with low literacy were less likely to invest-basically, literacy stems from age, education level, and income.

This is, Bondia et al. (2019), while highlighting various socio-cultural determinants on an individual's decision of entering the stock market, brings out that there is a categorization of the stocks into a safe and risky class by Indian investors and thereby stock buying decisions are shaped through three phases, i.e., identification (recognition of opportunity based on goal-related information), rationalization (performance and fundamental analysis of options), and validation (people seeking confirmation from credible sources). Biases can act simultaneously as attention draw, sheer highlighting of opportunities, and hence rationalizing decisions.

Revand and Rani (2023) illustrated that the majority of the respondents have preferred safe forms of investments like bank deposits and mutual funds, investing every month for long-term goals such as retirement. Least preferred are exchange-traded funds (ETFs). Investment advice comes mostly from friends, with trends influenced by economic scenarios. However, with rising incomes, India's mobilization of savings has been slow, with significant differences in awareness and investment preferences for men and women.

Yadav et al. (2023) indicate that investors tend to prefer returns with less risk. Education and age have an effect on the investment decisions. Further, women are less informed about the options for investment when compared with men, while rural investors lack comprehensive knowledge of the available investment options. Most of these investors prefer safety in investment for their future needs, while equity participation is still very low.

Madhuri, Varalakshmi, and Kumar (2023) used ANOVA to determine that there exists a significant relationship between many variables, including income, motives, and expected returns, to attitudes regarding equity investment. Expected returns are a strong influence, while age and gender show weak, probably insignificant effects. Higher return expectations create positive attitudes toward equity investment.

Objective

The objective of this study is to analyse the financial literacy of individual investors in India and explore the relationship between financial literacy and investment behaviour. The study will also explore the demographics and socio-economic factors that influence financial literacy and investment decisions. The study shall also make recommendations about ways and means through which financial literacy may be enhanced and investments increased based on the findings.

Methods

The study is based on a qualitative research design using content analysis method. Going through journals, articles, research papers, regulatory publications and magazine. A thorough literature review synthesizing results from previous studies was conducted on financial literacy and investment behaviour. The study also gains insights from recent market trends and policy developments to give a contextual understanding of the Indian stock market.

Results

Financial Literacy: The study showed that financial literacy plays a important role in allowing individual investors to make well-versed investment decisions. Some investors, like younger, techie and Gen Z individuals, validate moderate to high levels of market knowledge, a significant portion of the population still lacks understanding of advanced financial concepts like ETF, ULIPs, Delivery, Intraday, Bonds, Mutual funds, ETF, F&O etc. According to different studies it has been concluded that unequal distribution of financial literacy is visible across categories like demographics with younger, educated, and richer individuals showing good financial knowledge.

Investment Behaviour Trends: Investors in India prefer safer investment options such as bank deposits, post-office savings, gold, and mutual fund to some extent and moderate preference for mutual fund. Equity market participation is still limited because of demographic factors, risk appetite, and financial awareness. Young investors with moderate market knowledge have the tendencies for online trading. Gender disparities have been noted, whereby a lesser percentage of women participate due to their limited knowledge. Decision-making is significantly influenced by heuristic, biases, and market sentiment.

Challenges

Low Awareness: Most of individual investors lack fundamental and technical understanding of investment principles like diversification, risk, return, Moving Averages, RSI, and MACD and candlestick charts.

Behavioural Biases: Investor decisions have negative influences from heuristic and herding biases
Inertia: Many of the non-investors are not interested in trading in stocks owing to their perception of trading being complicated or of not having enough trust.

Disparities Based on Gender: Women and rural investors suffer huge disadvantages in terms of access and financial knowledge.

Limited Education: Shortcomings in the financial education programs inhibit confidence and capacity among potential investors.

Opportunities

Technological Adoption: Online trading platforms have empowered the democratisation of stock market access through mobile apps.

Customized Educational Programs: The ambition comes in the guise of an array of targeted educational campaigns focusing on women, youth, and rural investors.

Regulatory Support: Other supportive measures for expansion came through SEBI and other allied body for conducting investor awareness initiatives.

Economic growth: Enhanced financial knowledge and improved participation in investments foster economic development and wealth creation.

Conclusions

Financial literacy plays a significant role in deciding or shaping the investment behaviour of individual investors in the Indian stock market. It has been observed that a large segment of the population is able to understand advanced investment tools, but a substantial portion still possesses limited or low knowledge regarding financial awareness. Such disparities in accessing tools, along with behavioural biases and an overall low trust in financial systems, hinder participation in the stock market. This study unearths a latent strategy calling for synergistic action to promote financial literacy, hence addressing systemic challenges to equity market participation.

Recommendations

1. Design a targeted educational program on advanced financial concepts for special groups of youth, women and rural people to make it easier for them to grasp financial education
2. The use of digital platforms for financial education and trading and investment must be promoted to create a user-friendly interface and make resources easily accessible
3. Regulators, including SEBI, RBI, IRDA, PFRDA, and MCA, must conduct awareness campaigns and protection initiatives to build investor confidence.

4. The government should actively promote participation through activities like workshops, incentives, and other means that promote long-term investment by ensuring equity markets are highlighted as beneficial for investors.

5. Programmes should be initiated to educate investors about their biases and help them make rational goal-based investment decisions

6. Financial literacy modules should be included in school, college and university curriculum to create a strong base for informed financial behaviour and to provide better knowledge to the coming generation.

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Conflicts of interest

There are no conflicts of interest.

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