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FINANCIAL LITERACY AND ITS IMPACT ON INVESTMENT BEHAVIOUR OF RETAIL INVESTORS IN INDIA

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Abstract

Financial literacy plays a significant role in shaping the financial decisions and investment behaviour of individuals, particularly in an increasingly complex and rapidly changing financial environment. In India, the growth of financial markets, digital investment platforms, mutual funds, systematic investment plans, and increased participation in the securities market has resulted in a substantial expansion of the retail investor base. However, greater access to financial products does not necessarily ensure informed and rational investment decisions. This study examines the influence of financial literacy on the investment behaviour of retail investors in India. The study focuses on key dimensions of financial literacy, including financial knowledge, financial attitude, financial awareness, risk understanding, investment planning, and financial decision-making skills, and examines their relationship with investment behaviour. Investment behaviour is considered in terms of investment preferences, risk tolerance, diversification, investment frequency, long-term orientation, and decision-making practices. The study also considers the role of behavioural factors such as overconfidence, herd behaviour, loss aversion, and emotional decision-making. Previous empirical evidence indicates that financially literate investors are more likely to make informed investment decisions and demonstrate greater awareness of risk and return. The research also suggests that financial literacy can help reduce the adverse influence of behaviour.

Keywords: Financial Literacy; Investment Behaviour; Retail Investors; Investment Decision-Making; Financial Awareness; Risk Tolerance; Behavioural Finance; Behavioural Biases; Financial Inclusion; Digital Financial Literacy; Investment Preferences; Portfolio Diversification; India.

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Introduction:

Financial literacy has emerged as an important determinant of financial well-being and informed investment decision-making. It refers to an individual's ability to understand and effectively use financial concepts such as saving, investment, risk and return, diversification, inflation, interest rates, and financial planning. As financial markets become increasingly sophisticated and digital financial services expand, individuals require adequate financial knowledge and decision-making skills to select appropriate investment avenues and manage financial risks. Recent literature identifies financial literacy as an important factor influencing investment decisions and financial behaviour among individual investors.

India has witnessed significant changes in the investment landscape in recent years. The expansion of mutual funds, equity markets, systematic investment plans, online trading platforms, mobile investment applications, and other digital financial services has made investment opportunities more accessible to retail investors. This increased accessibility has brought a larger number of individuals into financial markets. But access alone does not necessarily ensure informed investment behaviour. Investors must possess the knowledge and ability to evaluate financial products, understand risk–return relationships, diversify their portfolios, and make decisions consistent with their financial objectives.

The importance of financial education has also been recognised at the policy level in India. The National Strategy for Financial Education (NSFE) 2020–2025 emphasised financial education through a coordinated approach involving regulators and other stakeholders, with the objective of improving financial awareness and capability among different sections of the population.

Retail investors play an increasingly important role in India's financial markets. However, investment decisions are not determined by financial knowledge alone. Psychological and behavioural factors such as over-confidence, herd behaviour, anchoring, loss aversion, familiarity and emotional decision-making may influence investors' choices. Recent research on Indian retail investors demonstrates a positive relationship between financial literacy and investment decisions while also highlighting the role of behavioural biases in this relationship.

Empirical studies provide further support for the importance of financial literacy. A study of Indian investors found that financial literacy positively influences investment decisions and that financially literate investors are more likely to make informed choices. Similarly, research involving retail investors in India has shown that objective financial literacy can influence stock-market participation and investment behaviour. These findings suggest that improving financial literacy may help investors make more systematic and rational investment decisions.

At the same time, the rapid growth of digital investment platforms has created new challenges. Investors are increasingly exposed to large amounts of financial information through social media, online investment platforms and financial influencers. Consequently, the ability to distinguish reliable information from misleading or speculative advice has become an important component of effective financial decision-making. Recent research has therefore begun to examine digital financial literacy alongside conventional financial knowledge.

Against this background, the present study, 'Financial Literacy and its Impact on Investment Behaviour of Retail Investors in India,' seeks to examine the relationship between the level of financial literacy and the investment behaviour of retail investors. The study focuses on dimensions such as financial knowledge, financial awareness, financial attitude, risk perception and investment planning, and considers their influence on investment preferences, risk-taking, diversification and investment decision-making. Understanding this relationship is important for regulators, financial institutions, investment advisors and policymakers in developing effective investor-education programmes and strengthening responsible participation in India's financial markets.

The study is particularly relevant because increasing participation in financial markets must be accompanied by the ability to make informed and responsible investment decisions. Strengthening financial literacy can potentially contribute to improved financial planning, better risk management, greater portfolio diversification and more sustainable long-term investment behaviour among Indian retail investors. Recent systematic literature also identifies financial literacy, financial inclusion, behavioural finance and digital financial literacy as important areas for understanding investment decisions among Indian retail investors.

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Review of Literature:

The literature on **financial literacy and investment behaviour of retail investors in India** has expanded considerably with the growth of capital markets, digital investment platforms and increasing participation of individual investors. Existing studies generally examine financial literacy through dimensions such as financial knowledge, financial attitude, financial behaviour, awareness and investment experience, while investment behaviour is reflected through investment choices, risk tolerance, diversification and decision-making. A recent systematic review notes that although considerable empirical research exists, findings remain fragmented across theoretical perspectives, geographical areas and methodologies, indicating scope for further integrated research on Indian retail investors.

Lusardi and Mitchell (2014)**,** established the broader theoretical importance of financial literacy by demonstrating that financial knowledge is an important component of economic decision-making. Their work positioned financial literacy as a human-capital factor that can influence saving, investment and retirement planning. This framework provides a foundation for examining whether financially knowledgeable individuals are more capable of making appropriate investment decisions.

Bellofatto, D'Hondt and De Winne (2018), examined the relationship between subjective financial literacy and retail investors' trading behaviour. Their findings indicated that investors reporting higher financial knowledge and experience tend to display relatively better investment behaviour, even after accounting for characteristics such as age, gender, education, portfolio value and trading experience.

Prasad, Kiran and Sharma (2021), investigated behavioural, socio-economic factors and financial literacy in relation to investment decisions among Indian retail investors, including differences associated with gender. The study used PLS-SEM to examine the relationships among these variables, demonstrating the importance of considering financial literacy together with behavioural and socio-economic characteristics rather than treating investment decisions as a function of financial knowledge alone.

Shroff, Paliwal and Dewasiri (2024)**,** specifically examined the impact of financial literacy on investment decisions in an emerging-market context using a sample of 384 Indian investors. The researchers developed a multidimensional measure of financial literacy and examined its relationship with investment decisions using regression techniques. The study found that financial literacy positively influences investment decisions and that financially literate investors are more likely to make informed investment choices.

Jain et al. (2023), and related behavioural-finance researchers have highlighted that financial literacy does not operate independently of psychological factors. Behavioural biases such as heuristics, framing effects, cognitive illusions and herding can influence investment decisions. Recent evidence suggests that behavioural biases may act as mechanisms through which financial literacy affects investment decisions.

A 2025 study on Indian retail investors examined the relationship between financial literacy, behavioural biases and investment decisions. The study argues that, despite the rapid expansion of India's retail investment market, there remains insufficient research examining how financial literacy interacts with behavioural biases. Its framework treats behavioural biases as mediating factors between financial literacy and investment decisions, providing a more comprehensive behavioural-finance perspective.

Shroff et al. (2025), further examined the antecedents of financial literacy among Indian investors. Using data from 384 investors, the study investigated financial literacy through the theoretical lenses of social cognitive theory, consumer socialization theory and the theory of planned behaviour. The findings indicate that demographic and socioeconomic characteristics, together with financial knowledge, behaviour and attitude, are associated with financial literacy levels. This suggests that financial literacy itself is shaped by multiple personal and social factors.

More recent research has extended the discussion from conventional financial literacy to digital financial literacy**.** A 2026 study of retail investors in India examined digital financial literacy, risk perception, investor confidence, access to digital platforms and financial planning behaviour. The findings reported significant positive relationships between these factors and investment decision quality, with digital financial literacy and financial planning behaviour emerging as important predictors.

Similarly, Sanyal et al. (2026), investigated behavioural biases among retail investors in Kolkata and examined the moderating roles of financial literacy and financial awareness. Based on data from 444 retail investors, the study found that over-confidence, anchoring, herd behaviour and loss aversion negatively influence investment decisions, whereas financial literacy and financial awareness positively influence decision-making and moderate the effects of behavioural biases.

A 2026 systematic literature review by Kumaraswamy and Tamizhjyothi synthesised research on financial literacy and investment decisions among Indian retail investors. The review identifies financial literacy, financial inclusion, behavioural finance, digital financial literacy and fintech as important dimensions of the contemporary research landscape. It also highlights continuing disparities in financial knowledge, financial capability and investment behaviour among Indian investors.

Objectives:

The study titled ‘Financial Literacy and its Impact on Investment Behaviour of Retail Investors in India’ is undertaken with the following objectives:

1. To assess the level of financial literacy among retail investors in India with reference to financial knowledge, financial awareness, financial attitude and financial behaviour.
2. To examine the impact of financial literacy on the investment behaviour of retail investors in India.
3. To identify the major investment avenues preferred by retail investors and examine their relationship with the level of financial literacy.
4. To analyse the influence of financial literacy on investors’ risk perception and risk-taking behaviour.
5. To examine the relationship between financial literacy and investment decision-making, particularly with respect to investment planning, portfolio diversification and long-term investment orientation.
6. To study the influence of behavioural factors and biases such as overconfidence, herding, anchoring, loss aversion and emotional decision-making on the investment behaviour of retail investors.
7. To examine whether demographic and socio-economic characteristics such as age, gender, education, income and investment experience influence the financial literacy and investment behaviour of retail investors.
8. To assess the role of digital financial literacy in shaping the investment behaviour of retail investors in the increasingly digital Indian financial market.

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9. To suggest appropriate measures for improving financial literacy and responsible investment behaviour among retail investors in India.

Research Design

The present study adopts a descriptive, analytical and exploratory research design based exclusively on secondary data. The study seeks to examine the relationship between financial literacy and the investment behaviour of retail investors in India by analysing information available from published reports, official databases, research studies and other credible secondary sources.

As no primary survey is conducted, the study relies on existing statistical information relating to financial literacy, financial awareness, investment preferences, securities-market participation, risk perception and investment behaviour.

Nature and Sources of Data

The study is based entirely on secondary data collected from authentic and reliable sources.

The major sources include:

- Securities and Exchange Board of India (SEBI) – Investor Survey reports, investor awareness and securities-market participation data.
- Reserve Bank of India (RBI) – financial literacy, financial inclusion and household financial information.
- National Centre for Financial Education (NCFE) – financial literacy and financial education information.
- National Statistical Office (NSO) and Government of India publications.
- Association of Mutual Funds in India (AMFI) – mutual fund and SIP-related statistics.
- Stock exchanges and depositories – information relating to retail participation and investor accounts.
- Research articles published in peer-reviewed journals.
- Reports and publications of international organisations such as the OECD, World Bank and IMF, wherever relevant.
- Books, working papers, institutional reports and credible financial databases.

SEBI's Investor Survey 2025 is particularly useful for the present study because SEBI has made both the main report and respondent-level data available for research purposes.

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Study Period

The study may cover the period **2015–2025**, subject to the availability and comparability of secondary data. This period is appropriate for examining changes in financial literacy and retail-investor participation during a period of rapid expansion in India's digital financial ecosystem.

Where recent data are available, information for 2025–26 may also be incorporated to provide the latest perspective.

Variables of the Study

The major variables considered in the study are: Independent Variable – Financial Literacy

Financial literacy is examined through:

- Financial knowledge
- Financial awareness
- Understanding of risk and return
- Understanding of inflation and interest
- Knowledge of financial products
- Investment awareness
- Financial planning
- Digital financial literacy

The RBI's financial-literacy framework is particularly useful because its measurement incorporates financial knowledge, financial attitude and financial behaviour**.** The RBI's pan-India survey also assessed concepts such as interest, compounding, inflation, risk-return relationships and diversification.

Analysis and Discussion

For a secondary-data-based article**,** the analysis should primarily use evidence from SEBI, RBI and other institutional sources rather than presenting invented survey statistics. The following section is suitable for your article **‘**Financial Literacy and Its Impact on Investment Behaviour of Retail Investors in India.’ SEBI's Investor Survey 2025 is especially useful because it provides nationally representative information on investor awareness, participation and behaviour, along with respondent-level data.

Financial Literacy and Investment Behaviour of Retail Investors

Financial literacy is an important factor influencing the quality of investment decisions. Financially literate investors are expected to possess a better understanding of risk and return, diversification, inflation, interest rates and different financial

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products. The Reserve Bank of India's financial literacy framework measures financial literacy through three broad dimensions—financial knowledge, financial attitude and financial behaviour. Its pan-India survey assessed concepts such as interest, compound interest, inflation, risk and return, and diversification.

The available evidence indicates that an increase in access to financial products does not necessarily imply a corresponding increase in financial understanding. This distinction is particularly important in India's rapidly expanding retail investment market. SEBI's Investor Survey 2025 shows that traditional savings instruments continue to have a strong position among Indian households, while market-linked products are increasingly gaining attention. The survey also highlights the importance of trust, awareness and the ability to understand financial products in encouraging participation in securities markets.

Retail Investor Participation in Financial Markets

India has experienced a substantial expansion in retail participation in financial markets. Digital onboarding, mobile investment platforms, simplified account-opening procedures and increased availability of financial information have reduced some of the traditional barriers to market participation.

However, participation should not be interpreted as evidence of adequate financial literacy. SEBI's Investor Survey 2025 identifies a continuing gap between participation and understanding. According to the survey findings, only around 36% of current investors possess moderate or high knowledge of securities markets**,** while a substantial proportion relies on informal sources such as friends, family and social media for investment recommendations.

This finding has important implications. Retail investors may have easy access to financial products but may not always possess the analytical ability required to evaluate investment alternatives. Consequently, financial inclusion and market participation need to be accompanied by effective financial education and investor awareness. Relationship between Financial Literacy and Investment Decision-Making

The literature generally indicates a positive association between financial literacy and investment decision-making. A recent study of Indian retail investors found a significant positive relationship between financial literacy and investment decisions. The study further demonstrated that financial literacy can reduce the influence of

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several behavioural biases on investment decisions.

Financially literate investors are more likely to understand the relationship between risk and return and to evaluate investment alternatives on the basis of their financial objectives. They are also better positioned to distinguish between short-term market fluctuations and long-term investment opportunities.

The implication is that financial literacy may contribute to more disciplined investment behaviour. Investors with greater financial knowledge are more likely to consider diversification, investment horizon and risk tolerance before making investment decisions rather than relying exclusively on market rumours or recommendations from acquaintances.

Risk Perception and Investment Behaviour

Risk perception is an important component of retail investment behaviour. SEBI's Investor Survey 2025 indicates that many Indian households continue to prefer relatively risk-free returns. Nearly eight out of ten respondents reportedly expressed a preference for risk-free returns, with limited product knowledge and perceived complexity of market-linked investments identified as important factors.

This suggests that inadequate financial literacy may contribute to conservative investment behaviour. Investors who do not adequately understand market-linked products may prefer fixed deposits, insurance, gold and real estate because these instruments are more familiar to them.

However, excessive preference for low-risk products may also affect long-term wealth creation. Therefore, financial literacy programmes should not encourage investors simply to take more risk; rather, they should help investors understand appropriate risk, risk diversification and the relationship between risk and expected return.

Financial Literacy and Portfolio Diversification

Diversification is one of the fundamental principles of investment management. Financially literate investors are more likely to understand that concentrating investments in a single asset or financial product can increase portfolio risk.

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The RBI's financial-literacy framework explicitly includes risk-return relationships and diversification within financial knowledge.

From an investment-behaviour perspective, better knowledge of diversification can encourage investors to allocate their savings across different asset classes according to their risk tolerance and investment objectives. Thus, financial literacy may contribute not only to the choice of investment products but also to the manner in which investors construct and manage their portfolios.

Influence of Behavioural Biases

Financial knowledge alone does not completely eliminate irrational investment behaviour. Retail investors can be influenced by psychological biases such as over-confidence, anchoring, herding, loss aversion, familiarity and the disposition effect.

Recent research involving Indian retail investors found that behavioural biases have a significant role in investment decision-making. The study reported a positive relationship between financial literacy and investment decisions and found evidence that financial literacy can reduce the influence of behavioural biases. In particular, higher financial literacy was associated with lower tendencies toward herding, familiarity bias, over-confidence and self-attribution.

More recent Indian evidence also distinguishes financial literacy from financial awareness**.** A 2026 study of 444 retail investors found that behavioural biases negatively affected investment decisions, while financial literacy and financial awareness positively influenced decision-making. The study further reported that financial awareness significantly moderated the effects of the behavioural biases examined.

These findings indicate that improving investment behaviour requires more than providing technical financial information. Investors also need the ability to recognise emotional reactions and cognitive biases that may influence their decisions.

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Digital Financial Literacy and Investment Behaviour

Digitalisation has significantly transformed the Indian investment environment. Online trading platforms, mobile applications and digital financial services have made investment products more accessible to ordinary households.

This development creates both opportunities and risks. Digital platforms reduce transaction costs and improve access to information, but they may also expose investors to misleading information, social-media recommendations, fraudulent schemes and impulsive trading decisions.

SEBI's recent survey highlights the need for digital literacy and credible sources of financial guidance as mobile-first investing expands.

Therefore, contemporary financial literacy should increasingly include **digital** financial literacy - the ability to evaluate digital financial information, identify reliable sources, understand online investment risks and use digital investment platforms responsibly.

Discussion of Major Findings

The secondary evidence reviewed in the study leads to the following broad observations:

First, financial literacy is positively associated with better investment decision-making. Investors who understand basic financial concepts are better equipped to evaluate investment alternatives and risks.

Second, financial awareness and financial literacy should be treated as related but distinct concepts. Awareness helps investors recognise financial products and opportunities, whereas literacy provides the knowledge and skills necessary to evaluate them.

Third, behavioural biases continue to affect retail investors even when financial information is increasingly available. Over-confidence, herding, anchoring and loss aversion can lead investors away from rational investment decisions.

Fourth, the growth of digital investment platforms makes financial literacy

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increasingly important. Easy access to trading and investment products can increase participation, but it can also increase exposure to unreliable information and impulsive decision-making.

Fifth, traditional investment preferences remain strong among Indian households. The continued preference for relatively safe and familiar instruments suggests that perceived risk, lack of product knowledge and trust remain important determinants of investment behaviour.

Overall Interpretation

The analysis indicates that financial literacy has an important relationship with the investment behaviour of retail investors in India. The growth of financial-market participation has created greater opportunities for households to invest in market-linked instruments, but participation without adequate knowledge can expose investors to inappropriate investment choices.

The evidence suggests that financial literacy can improve investors' ability to evaluate risk and return, diversify their portfolios and make decisions based on financial objectives rather than emotions or social influence. At the same time, behavioural biases remain significant and demonstrate that financial knowledge by itself is not sufficient to ensure rational investment behaviour.

Accordingly, financial education programmes in India should adopt a broader approach encompassing financial knowledge, financial awareness, behavioural finance, risk management, digital financial literacy and investor protection**.** Such an integrated approach can help retail investors move from mere participation in financial markets towards informed, responsible and sustainable investment behaviour.

Conclusion

The present study**,** ‘Financial Literacy and Its Impact on Investment Behaviour of Retail Investors in India,’ examined the relationship between financial literacy and the investment behaviour of retail investors using secondary sources. The analysis indicates that financial literacy is an important factor in improving the quality of investment decisions. Financially literate investors are better positioned to understand risk and return, evaluate financial products, diversify their portfolios and make investment decisions consistent with their financial objectives. Recent Indian evidence also reports a positive relationship between financial literacy and investment decisions.

The findings further indicate that financial knowledge alone is not sufficient to ensure rational investment behaviour. Retail investors may continue to be influenced by behavioural factors such as overconfidence, herding, anchoring, loss aversion and other psychological biases. Recent research in India shows that these biases can negatively affect investment decisions, while financial literacy and financial awareness can help reduce their adverse influence.

The increasing participation of Indian households in securities markets makes financial literacy particularly important. SEBI's Investor Survey 2025 provides extensive evidence on investor awareness and participation and makes both the survey report and respondent data available for research purposes. The continuing expansion of digital investment platforms has further increased the need for digital financial literacy, enabling investors to assess online financial information, understand investment risks and distinguish reliable information from misleading recommendations.

The study therefore concludes that strengthening financial literacy should be viewed as an important component of India's investor-development and financial-inclusion agenda. Financial education should move beyond basic awareness of financial products and incorporate risk management, portfolio diversification, long-term financial planning, behavioural finance, digital financial literacy and investor protection.

For policymakers, regulators and financial institutions, the priority should be to develop investor-education programmes that are simple, accessible and targeted to different demographic and socioeconomic groups. Financial advisers and educational institutions can also play an important role in developing the analytical and behavioural skills required for responsible investing.

Overall, higher financial literacy is likely to contribute to more informed, disciplined and responsible investment behaviour among Indian retail investors, although financial knowledge should be complemented by financial awareness and behavioural interventions. The evidence supports a shift from merely increasing participation in financial markets towards ensuring that participation is informed, risk-aware and sustainable. This approach can contribute not only to better individual financial outcomes but also to the development of a more resilient and inclusive Indian financial market.

Key Implications

1. Enhance financial literacy: Financial education should cover practical investment concepts rather than only theoretical knowledge.
2. Strengthen digital financial literacy: Investors need skills to evaluate online investment information and digital financial products.
3. Address behavioural biases: Investor education should explicitly address over-confidence, herding, anchoring and loss aversion.
4. Promote diversification: Investors should be encouraged to understand risk diversification and asset allocation.
5. Improve investor awareness: Reliable and accessible information from regulators and financial institutions should be strengthened.
6. Encourage long-term investment planning: Financial literacy programmes should promote goal-based and disciplined investment rather than speculative behaviour.
7. Target financially vulnerable groups: Investor education should take account of differences in education, income, age, location and investment experience.

In conclusion, financial literacy should not merely be regarded as knowledge of financial concepts; it should be understood as a practical capability that enables retail investors to make informed decisions, manage risk and resist behavioural pressures in an increasingly complex and digital financial environment.

References:

SEBI (2025/2026), Investor Survey 2025 — provides large-scale evidence on household securities-market participation, awareness, investment preferences and barriers. SEBI has also made respondent data available.

RBI Financial Literacy and Inclusion Survey — provides an established framework for measuring financial literacy through knowledge, attitude and behaviour.

OECD/INFE (2023) — useful for the theoretical and measurement framework of financial literacy, including financial knowledge, behaviour, attitudes, digital financial literacy and financial well-being.

Shroff et al. (2024) — provides direct empirical evidence that financial literacy positively influences investment decisions among Indian investors.

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Agarwal et al. (2025) — particularly useful for discussing the interaction between financial literacy and behavioural biases among Indian retail investors. Sanyal et al. (2026) — useful for the latest discussion of behavioural biases, financial literacy and financial awareness in the Indian retail-investor context.