

Financial literacy and investment decisions: A micro-level evidence-based study

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Abstract---Financial literacy plays a pivotal role in shaping individual investment decisions, particularly in emerging economies where financial inclusion is rapidly evolving. This study investigates the micro-level relationship between financial literacy and investment behavior among individual investors, with evidence derived from survey-based data collected across selected urban and semi-urban districts. The research employs a mixed-method design integrating descriptive statistics, correlation analysis, and multiple regression models to examine how knowledge, attitude, and financial planning competence influence portfolio diversification and risk-taking behavior. Results indicate that higher financial literacy significantly enhances investment decision quality, leading to more diversified portfolios and long-term asset allocation. However, the study also uncovers disparities in literacy levels across age, gender, and income groups, emphasizing that socio-demographic factors critically mediate financial choices. The evidence highlights the urgent need for structured financial education programs and regulatory frameworks promoting investor awareness and financial capability. The findings contribute to policy discourse by providing empirical insights into the behavioral mechanisms underlying financial decision-making and underscore the role of micro-level financial literacy as a cornerstone for sustainable economic participation and inclusive financial growth.

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I. INTRODUCTION

Financial literacy has emerged as one of the most critical competencies in the 21st century, shaping how individuals manage, allocate, and grow their financial resources. In an increasingly complex financial environment characterized by the proliferation of investment products, digital financial platforms, and volatile market dynamics, the ability to make informed financial decisions is no longer optional it is essential. Financial literacy encompasses a combination of awareness, knowledge, skills, attitudes, and behaviors necessary to make sound financial judgments and achieve personal financial well-being. Globally, studies have consistently shown that individuals with higher financial literacy are more likely to plan for retirement, manage debt efficiently, and diversify their investment portfolios. However, in developing economies such as India, financial literacy remains unevenly distributed, often limited by socioeconomic disparities, educational backgrounds, and access to financial information. Despite national efforts led by institutions like the Reserve Bank of India (RBI), Securities and Exchange Board of India (SEBI), and the National Centre for Financial Education (NCFE), the gap between financial knowledge and practical application remains substantial. This gap manifests in suboptimal financial behavior, such as reliance on informal lending, low insurance coverage, limited savings, and preference for traditional low-yield investments over capital market instruments. The global financial crises and recent market disruptions have further demonstrated that the lack of financial literacy not only affects individuals' financial stability but also influences broader economic resilience and national financial inclusion goals.

Investment decisions form the practical expression of financial literacy, as they translate an individual's knowledge and attitudes into real-world economic actions. The micro-level perspective of this relationship examining households and individual investors offers valuable insights into how cognitive, psychological, and socioeconomic factors shape financial behavior. In this context, behavioral finance theory provides a compelling framework, suggesting that decisions are often influenced not purely by rational economic reasoning but by biases, perceptions, and risk preferences. This study, titled "*Financial Literacy and Investment Decisions: A Micro-Level Evidence-Based Study*", seeks to explore the depth of this interrelationship through empirical investigation. The research focuses on identifying how varying levels of financial literacy impact individuals' investment decisions, risk-taking behavior, and portfolio diversification patterns. It also considers demographic moderators such as age, gender, education, occupation, and income, which often create differential access to financial knowledge and investment opportunities. By employing a mixed-method approach combining primary data from structured questionnaires and quantitative statistical modeling, the study aims to uncover patterns and correlations that can inform both academic understanding and policy formulation. Ultimately, the goal is to provide micro-level evidence that can help design targeted financial literacy interventions, bridge the literacy-behavior divide, and strengthen the foundations of informed investment culture. The study thus positions financial literacy not merely as an individual attribute but as a social and economic imperative central to sustainable financial inclusion, household welfare, and macroeconomic stability.

II. RELATED WORKS

Financial literacy has been the focus of extensive global research, reflecting its central role in improving household welfare, promoting savings, and enabling effective participation in financial markets. Lusardi and Mitchell [1] were among the earliest scholars to establish the link between financial literacy and economic behavior, demonstrating that individuals with greater financial knowledge are better equipped to plan for retirement, manage credit, and accumulate wealth. Subsequent studies extended this premise, emphasizing that financial literacy not only improves financial well-being but also reduces susceptibility

to economic shocks [2]. Huston [3] highlighted that financial literacy is both an understanding of financial concepts and the ability to apply them effectively, making it a multidimensional construct. Cross-national surveys such as those by OECD [4] further revealed that financial literacy levels are disproportionately low in developing countries, where cultural norms, education systems, and access to financial services constrain learning. In India, Atkinson and Messy [5] observed that despite rising financial inclusion, functional literacy meaning the ability to apply financial knowledge to decision-making remains alarmingly low, particularly among women, rural populations, and the self-employed. Similarly, Agarwal and Mazumder [6] noted that financial illiteracy contributes directly to suboptimal credit use, limited participation in equity markets, and an overreliance on informal finance. The interplay between literacy and economic empowerment has therefore become a major area of policy concern. Research by Cole, Sampson, and Zia [7] demonstrated that targeted financial education programs significantly improved savings behavior among low-income households in India and Indonesia, affirming the transformative potential of micro-level interventions. At a theoretical level, Lusardi and Tufano [8] introduced the concept of “debt literacy,” identifying that limited understanding of interest compounding and inflation often leads to chronic indebtedness, especially among lower-income segments. Hence, the early literature forms a solid foundation for understanding financial literacy as an essential determinant of individual and collective financial resilience.

Investment decision-making, as a behavioral outcome of financial literacy, has attracted increasing scholarly attention in recent decades. Rational choice theory assumes that investors act logically to maximize expected utility; however, empirical evidence reveals a consistent departure from rationality in real-world financial behavior. Kahneman and Tversky’s Prospect Theory [9] provided a seminal framework explaining how individuals evaluate gains and losses differently, leading to risk aversion or overconfidence biases. Researchers such as Barber and Odean [10] established that individual investors often trade excessively, motivated more by psychological impulses than by informed strategy, resulting in lower returns. Empirical investigations in emerging economies have found similar behavioral inconsistencies linked to literacy gaps. Al-Tamimi and Kalli [11] reported that investors with higher financial knowledge exhibit stronger diversification practices and are less prone to herd behavior, while Gaurav and Singh [12] demonstrated that rural Indian investors with basic financial training significantly improve their risk assessment and investment confidence. Furthermore, empirical evidence by Mandell and Klein [13] shows that even minimal financial education at the high school level has long-term effects on investment maturity and retirement planning. In a micro-level context, Bhushan and Medury [14] found that personal factors such as age, gender, and occupation influence financial decision-making more strongly than macroeconomic variables, illustrating the complexity of individual financial behavior. Similarly, Chen and Volpe [15] observed that students with greater financial literacy not only possess better investment knowledge but also demonstrate more disciplined financial attitudes, underscoring the cognitive-behavioral dimension of literacy. Collectively, these studies reveal that financial literacy acts as a cognitive enabler that transforms abstract economic knowledge into practical, goal-oriented investment behavior. They also affirm that behavioral biases such as overconfidence, mental accounting, and risk aversion moderate the link between knowledge and decision quality, especially in underdeveloped financial ecosystems.

Building upon these insights, recent empirical research has transitioned toward understanding financial literacy from an evidence-based, micro-level perspective that integrates demographic, psychological, and technological variables. Grohmann, Klühs, and Menkhoff [1] highlighted that financial literacy is not uniformly distributed across societies and that socio-demographic characteristics significantly determine both access to financial knowledge and the capacity to apply it. The proliferation of fintech platforms, digital wallets, and online trading systems has made financial markets more accessible, but also more complex. Studies such as those by Klapper, Lusardi, and van Oudheusden [2] indicate that while digital finance expands inclusion, it simultaneously increases the need for higher literacy levels to avoid misinformed investment decisions. Behavioral finance research, exemplified by Pompian [3], further demonstrates that emotional intelligence and self-control significantly mediate financial choices,

particularly under uncertainty. Empirical investigations in India by Sharma and Pandey [4] suggest that urban investors display more analytical investment behavior, whereas rural participants rely heavily on peer advice and informal networks. The Reserve Bank of India's Financial Literacy and Inclusion Survey [5] supports these findings, reporting that nearly 76% of respondents lack basic understanding of inflation, interest rate, and diversification. Moreover, the integration of technology in financial decision-making has shifted the literacy paradigm from traditional knowledge toward digital literacy. Studies by Bongomin et al. [6] and Xiao and Porto [7] show that digital competency enhances not only accessibility to financial instruments but also the ability to interpret online financial data and make informed decisions. Yet, disparities persist particularly among older adults, women, and low-income groups where psychological barriers, mistrust, and lack of exposure continue to inhibit participation. In this regard, the present study contributes by adopting a micro-level, evidence-based approach, combining statistical modeling with behavioral analysis to evaluate how financial literacy influences investment choices among diverse demographic groups. It seeks to bridge the gap between theoretical postulations and empirical realities, providing actionable insights for educators, policymakers, and financial institutions aiming to foster inclusive financial ecosystems through targeted literacy interventions.

III. METHODOLOGY

3.1 Research Design

The present study adopts a **mixed-method empirical research design** that integrates quantitative and qualitative techniques to investigate the impact of financial literacy on investment decisions at the micro level. The design incorporates both **descriptive and inferential statistical approaches**, ensuring a comprehensive understanding of behavioral, cognitive, and demographic variables influencing financial decisions. A **cross-sectional survey** was conducted across selected districts representing urban, semi-urban, and rural segments to capture diverse financial behaviors. Quantitative data were gathered through structured questionnaires assessing financial knowledge, attitude, and behavior, while qualitative insights were obtained via focused group discussions and expert interviews. The study framework is inspired by behavioral finance theory, which posits that individual investment choices are not entirely rational but shaped by psychological and informational asymmetries [16]. Statistical techniques, including **correlation analysis, regression modeling, and ANOVA**, were employed to test relationships between literacy scores and investment patterns. This hybrid design ensures validity, triangulates findings, and provides micro-level evidence linking literacy levels with real investment behaviors [17].

3.2 Sampling Framework and Respondent Profile

A **stratified random sampling method** was employed to ensure representation across income, occupation, and education categories. A total of **450 respondents** were surveyed, distributed across three regions: **urban (150), semi-urban (150), and rural (150)**. The sample included both male and female investors between the ages of 21 and 60 years, covering salaried professionals, entrepreneurs, and small investors. The survey instrument comprised three major sections financial knowledge (10 questions), financial attitude (5 questions), and financial behavior (10 questions) modeled after the **OECD/INFE Financial Literacy Assessment Toolkit** [18].

Table 1 presents the demographic characteristics of respondents that form the foundation of this study's micro-level analysis.

Table 1: Socio-Demographic Profile of Respondents

Variable	Category	Frequency (n=450)	Percentage (%)
Gender	Male	270	60.0
	Female	180	40.0

Variable	Category	Frequency (n=450)	Percentage (%)
Age Group	21–30 years	110	24.4
	31–40 years	150	33.3
	41–50 years	115	25.5
	Above 50 years	75	16.6
Education	Secondary	90	20.0
	Graduate	230	51.1
	Postgraduate & Above	130	28.9
Occupation	Salaried	200	44.4
	Self-employed	130	28.9
	Students/Other	120	26.7
Monthly Income	Below ₹25,000	100	22.2
	₹25,000–₹50,000	180	40.0
	₹50,000–₹1,00,000	120	26.7
	Above ₹1,00,000	50	11.1

The demographic diversity ensures that the results capture varying literacy levels and investment preferences influenced by social and economic factors [19].

3.3 Data Collection and Instrumentation

Primary data were collected using a **structured questionnaire** distributed both online and offline. The tool was pretested through a pilot survey of 50 respondents to ensure clarity and reliability. Internal consistency was verified using **Cronbach's alpha ($\alpha = 0.87$)**, indicating a high level of reliability. The questionnaire items were derived from validated frameworks such as **Lusardi & Mitchell's Financial Literacy Scale** and **OECD's Core Competencies Framework**. The variables were operationalized into measurable constructs under three major domains:

- **Financial Knowledge** – understanding of inflation, interest rates, risk diversification, and investment products.
- **Financial Attitude** – perception of saving, willingness to take calculated risk, and long-term goal orientation.
- **Financial Behavior** – budgeting, saving, investment diversification, and debt management practices.

Each variable was scored on a **five-point Likert scale (1=Strongly Disagree to 5=Strongly Agree)**. Composite literacy scores were computed by summing weighted averages across all three domains [20].

Table 2: Measurement Framework for Financial Literacy Constructs

Dimension	Indicators	Measurement Scale	Reference
Financial Knowledge	Inflation understanding, Interest rate, Compound returns, Portfolio diversification	5-point Likert	[18], [19]
Financial Attitude	Future orientation, Risk perception, Saving preference	5-point Likert	[16], [20]
Financial Behavior	Budget discipline, Debt control, Investment frequency	5-point Likert	[17], [21]

Secondary data were sourced from RBI reports, SEBI investor surveys, and National Centre for Financial Education (NCFE) publications for validation.

3.4 Analytical Framework

The data analysis was conducted using **SPSS v28** and **AMOS** for confirmatory factor analysis (CFA) and regression modeling. Descriptive statistics summarized the mean literacy scores, while inferential techniques established causality between literacy and investment outcomes. The study adopted the following analytical steps:

1. **Descriptive Analysis:** Mean, standard deviation, and frequency distribution of key variables.
2. **Correlation Analysis:** To assess the linear relationships between literacy components and investment outcomes.
3. **Multiple Regression Analysis:** To determine the influence of literacy dimensions on investment decision quality.
4. **ANOVA Testing:** To identify group-level differences across gender, income, and education segments.
5. **Validation:** Cronbach's alpha for reliability and CFA for construct validity (factor loadings > 0.60).

The dependent variable **Investment Decision Quality (IDQ)** was derived from responses on risk diversification, asset allocation, and return consistency, while independent variables included **Financial Knowledge (FK)**, **Financial Attitude (FA)**, and **Financial Behavior (FB)**. The regression model is expressed as:

$$IDQ = \beta_0 + \beta_1 FK + \beta_2 FA + \beta_3 FB + \varepsilon$$

3.5 Ethical Considerations and Data Reliability

The study adheres to ethical research standards as recommended by institutional review boards and the **Indian Council of Social Science Research (ICSSR)**. All participants provided informed consent, and their data were kept confidential. No financial incentives were provided to ensure unbiased responses. The study followed the ethical principles outlined by Creswell and Poeth [22], emphasizing voluntariness and data protection. Reliability testing yielded Cronbach's α values above 0.80 for all subscales, confirming internal consistency.

3.6 Limitations and Assumptions

While the methodology is rigorous, several limitations exist. First, the reliance on self-reported survey data may introduce response bias. Second, the cross-sectional design restricts causal inference over time. Third, financial literacy was measured through standardized indicators that may not capture contextual variations such as cultural or regional financial behaviors. Nevertheless, these limitations are mitigated through triangulation of quantitative and qualitative data, ensuring analytical robustness and interpretive validity [23].

Table 3: Summary of Analytical Techniques and Purpose

Analytical Method	Purpose	Statistical Tool	Expected Outcome
Descriptive Statistics	To summarize respondent demographics and literacy scores	SPSS	Mean, SD, Frequency
Correlation Analysis	To measure linear association between variables	SPSS	Pearson's r values
Regression Modeling	To estimate impact of literacy dimensions on investment decisions	AMOS	β coefficients, R^2 values
ANOVA	To test group differences across socio-demographics	SPSS	F-values, p-values
Reliability and Validity Tests	To confirm consistency and construct strength	SPSS/AMOS	$\alpha \geq 0.80$, factor loadings ≥ 0.60

Through this methodological framework, the study aims to empirically establish how financial literacy dimensions influence micro-level investment decisions. By integrating behavioral finance insights, validated survey instruments, and statistical modeling, the research contributes not only to academic understanding but also to policy interventions that enhance financial inclusion and literacy-driven investment culture in emerging economies.

IV. RESULT AND ANALYSIS

4.1 Overview of Financial Literacy Levels

The analysis of responses revealed substantial variation in financial literacy across demographic segments. Overall, the mean composite literacy score across all respondents stood at **62.7%**, which indicates a moderate level of financial awareness and capability. Respondents from urban areas exhibited significantly higher literacy levels (71.4%) compared to those from semi-urban (61.2%) and rural regions (55.6%). Gender-wise analysis demonstrated that male respondents (65.9%) consistently outperformed female respondents (57.3%) in knowledge-based questions, especially those related to investment diversification, compound interest, and inflation. Education emerged as the most decisive factor influencing financial literacy graduates and postgraduates scored higher on conceptual understanding and risk management than those with only secondary education. Income also showed a positive correlation, with individuals earning above ₹1,00,000 per month displaying the highest literacy levels and active participation in capital markets. The results confirm that financial literacy is not uniformly distributed but strongly shaped by socio-economic status, education, and exposure to financial instruments.

Table 4: Mean Financial Literacy Scores by Demographic Segment

Demographic Variable	Category	Mean Literacy Score (%)	Interpretation
Gender	Male	65.9	Moderate-High
	Female	57.3	Moderate
Age Group	21–30 years	59.8	Moderate
	31–40 years	64.2	Moderate-High
	41–50 years	66.7	High
	Above 50 years	58.1	Moderate
	Education	Secondary	54.3
	Graduate	64.8	Moderate-High
	Postgraduate & Above	70.2	High
Monthly Income	Below ₹25,000	55.7	Low-Moderate
	₹25,000–₹50,000	61.1	Moderate
	₹50,000–₹1,00,000	67.5	High
	Above ₹1,00,000	73.6	Very High
Region	Urban	71.4	High
	Semi-Urban	61.2	Moderate
	Rural	55.6	Low

The findings from Table 4 underline that individuals with higher educational qualifications and incomes possess a stronger foundation of financial knowledge. However, the disparity across gender and region highlights the ongoing need for targeted literacy programs and inclusion-focused educational policies.



Figure 1: Financial Literacy [24]

4.2 Correlation Between Financial Literacy and Investment Behaviour

A correlation analysis was conducted to examine the relationship between the three dimensions of financial literacy knowledge, attitude, and behavior and key investment decision variables such as **risk tolerance, diversification, and investment frequency**. The analysis revealed that all three dimensions are positively and significantly correlated with investment outcomes, with financial knowledge showing the strongest relationship ($r = 0.78$), followed by financial behavior ($r = 0.71$) and financial attitude ($r = 0.64$). These results imply that individuals with higher literacy are more likely to diversify their portfolios, invest in multiple financial instruments, and adopt a long-term investment perspective. The weakest correlations were found between literacy and short-term speculative trading, suggesting that informed investors prioritize stability and sustainability over immediate returns.

Further regression analysis confirmed that **financial knowledge** contributes approximately **42% of the variance** in investment decision quality, indicating its dominant influence among the literacy dimensions. **Financial behavior** contributed 31% and **financial attitude** accounted for 27%, suggesting that while awareness is crucial, disciplined actions and positive perceptions of financial planning are equally significant in shaping prudent investment behavior.

Table 5: Correlation and Regression Summary of Financial Literacy Dimensions

Variables	Correlation with Investment Decision Quality (r)	Standardized Beta (β)	Significance Level (p)
Financial Knowledge (FK)	0.78	0.42	< 0.001
Financial Attitude (FA)	0.64	0.27	< 0.01
Financial Behavior (FB)	0.71	0.31	< 0.01
R ² (Model Summary)	–	0.69	–
Adjusted R ²	–	0.67	–

The model achieved an **R² value of 0.69**, indicating that approximately 69% of the variation in investment decision quality can be explained by the three literacy dimensions. The remaining 31% is attributed to unobserved behavioral and contextual factors such as risk perception, peer influence, and

access to investment information. This robust model underscores that improved financial literacy directly enhances the rationality, consistency, and diversification of individual investment decisions.

4.3 Investment Preferences and Risk Tolerance Patterns

An analysis of investment preferences indicated that **bank deposits (72%)**, **mutual funds (51%)**, and **life insurance (48%)** were the most popular investment options among respondents. However, participation in **equity markets (29%)** and **government bonds (18%)** remained relatively low, primarily due to perceived risk and lack of market understanding. Respondents with higher literacy scores displayed a stronger inclination toward diversified portfolios, combining both market-linked and fixed-return instruments. Risk tolerance analysis revealed that 62% of participants preferred low-risk investments, 27% adopted moderate-risk strategies, and only 11% were classified as high-risk takers. Interestingly, younger respondents and those with postgraduate education demonstrated a higher appetite for risk, likely due to longer investment horizons and better comprehension of market dynamics. The analysis also revealed behavioral distinctions between genders female investors were found to be more conservative, preferring safe, long-term instruments, whereas males exhibited a greater propensity toward equities and speculative investments. Rural respondents tended to favor traditional savings mechanisms such as recurring deposits, while urban participants showed a greater adoption of digital investment platforms. These findings indicate that **literacy is a powerful enabler of financial confidence**, bridging the gap between awareness and action.

4.4 Discussion of Findings

The results from this study reaffirm that financial literacy is not merely a theoretical construct but a practical determinant of investment success. Higher literacy levels enhance individuals' capacity to evaluate financial risks, interpret information, and make informed decisions that optimize long-term returns. Respondents with strong literacy skills exhibited disciplined investment behavior, balanced risk exposure, and diversified portfolios indicators of mature financial decision-making. In contrast, low-literacy groups showed dependency on informal financial advice, limited diversification, and susceptibility to misinformation. The data also demonstrated a **positive feedback loop**, where prior investment experience reinforces literacy through experiential learning.



Figure 2: Components of Financial Literacy [25]

Overall, the findings emphasize that financial literacy operates as both a cause and consequence of effective investment behavior. The evidence suggests that empowering individuals with structured financial education, practical exposure to financial products, and access to credible information channels can substantially improve financial outcomes. This research therefore supports the argument for **institutionalized financial education programs** at schools, workplaces, and community levels to strengthen the micro-foundations of financial inclusion and investment participation. The integration of behavioral insights with traditional economic education can further refine such programs, leading to more rational, confident, and economically resilient investors.

V. CONCLUSION

The present study provides comprehensive micro-level evidence on the relationship between financial literacy and investment decisions, revealing that financial literacy acts as a critical determinant of rational and informed investment behavior. By integrating behavioral, cognitive, and socio-economic dimensions, the analysis demonstrates that individuals with higher levels of financial literacy are more likely to plan, diversify, and manage risk effectively in their investment portfolios. The findings confirm that financial knowledge significantly enhances investment decision quality, while positive financial attitudes and disciplined financial behavior further reinforce prudent financial actions. Demographic variations particularly those related to education, income, and gender play a crucial role in shaping financial outcomes, indicating that financial literacy is not uniformly distributed but influenced by structural inequalities and access to information. The study also reveals a strong interdependence between knowledge and practice, suggesting that understanding financial concepts alone is insufficient without the ability and motivation to apply them. The results highlight that literacy-driven investors are more confident, rational, and resilient in navigating financial uncertainty, while those with limited literacy remain vulnerable to misinformation, impulsive decision-making, and financial stress. Moreover, the evidence underscores that improving financial literacy not only benefits individual households but also strengthens the financial system by promoting inclusion, stability, and long-term capital formation. Policymakers, educators, and financial institutions therefore have an essential role in developing comprehensive financial education frameworks that target diverse demographic groups, particularly those with low exposure to financial instruments. Financial literacy should be institutionalized as a lifelong competency integrated into formal education, workplace training, and community outreach initiatives. The integration of digital tools, gamified learning platforms, and personalized advisory systems can further democratize access to financial knowledge, ensuring that literacy translates into behavioral transformation. Ultimately, this study reaffirms that financial literacy is not merely a personal skill but a collective economic imperative that underpins sustainable investment behavior, equitable growth, and the resilience of emerging economies.

VI. FUTURE WORK

Future research can expand upon the present study by adopting a **longitudinal design** to assess how financial literacy influences investment behavior over time, capturing behavioral evolution as literacy levels change. Incorporating **psychometric and neuroeconomic variables** such as cognitive bias, emotional regulation, and decision heuristics could provide deeper insights into behavioral dynamics. Comparative studies across countries or states may help identify contextual determinants that shape literacy outcomes under different economic conditions. Moreover, integrating **machine learning and predictive analytics** could enhance understanding of investment behavior patterns and forecast literacy-linked decision outcomes. Future work should also explore the role of **digital financial literacy**, especially in the context of fintech adoption and online investment platforms, which increasingly define modern investment practices. A multidimensional approach combining traditional literacy measures with technological competency and behavioral adaptability will allow a more holistic understanding of financial decision-making and help design policies that are both inclusive and future-ready.

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