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Financial Literacy and Investment Decisions

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Abstract

The paper attempts to better understand financial literacy and its relation to financial decision making and investments in financial market instruments (stocks, bonds and mutual funds). Questionnaires were used to measure numeracy and basic knowledge related to working of inflation and interest rates, as well as questions to measure more advanced knowledge related to financial market instruments (stocks, bonds and mutual funds). These questions are linked to data on socio-demographic characteristics like gender, age, education, occupation, family income, marital status. Does financial literacy affects decision to invest in stocks, mutual funds? Do more financially knowledgeable people more likely to hold stocks? Our results indicate that financial literacy affects decision making. Those with low financial literacy are more likely to rely on family and friends as their main source of financial advice and are less likely to invest in stocks.

I. Introduction

FINANCIAL LITERACY HAS in recent years gained the interest of various groups including governments, bankers, employers, community interest groups and financial markets. With the development of large number of financial products, complexity of financial markets and changes in demographic and economic factors, the need for improving the financial literacy has increased substantially. As some of these products are complex and difficult to understand, especially for financially unsophisticated investors and large number of new products and reforms in social security sector has increased individual's responsibility. Are individuals well equipped to make financial decisions? Does Financial literacy affects financial decisions. The research on this topic is not enough and the existing studies indicate that financial illiteracy is widespread and individuals lack knowledge on basic economic principles.

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Individuals in high and average financial literacy are more likely to invest in PPF, Mutual Fund and infrabonds as there awareness level about these products is high and these instruments are good tax reduction options. Better qualfied people and higher family income prefer to invest in ULIPs. Higher financial literate are more likely to have investment in stocks, insurance, Mutual funds, PPF, LIC and infrastructure bonds. Younger people and people with commerce background are more likely to invest more in shares. Investment in shares is found statistically significant with age,education and marital status. That woman is generally less financially knowledgeable than men. However, even the large majority of people with university degree do not participate in the stock market. People shy away from participating in stock markets as there is volatality and less awareness about investor protection measures .

In terms of policy implications, our findings suggest that financial literacy differs substantially depending on education, age, occupation and gender. Basic financial literacy is widespread according to our sample of study, but advance financial literacy relating to knowledge of stocks, bonds and diversification needs to be improved. One way to decrease the gender gap in stock market participation may be to increase numeracy skills, i.e. raise basic financial literacy, among women as there is link between financial literacy and economic decision making. Financial education programs can be designed to target the needs of specific group of people. Personal finance plays an important role in enhancing the quality of life, so the policy makers must take effective measures to improve people knowledge, which in turn will increase participation in the stock market.

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