

A Study on Financial Literacy and Emotional Investment Decisions

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ABSTRACT

Financial literacy and emotional investment decisions are two critical aspects of modern personal finance and investor behaviour. Financial literacy refers to the knowledge, skills, and awareness that enable individuals to make informed and effective financial decisions, encompassing concepts such as risk and return, inflation, diversification, time value of money, and investment products. At the same time, investment decisions are often governed not by pure rationality but by emotional and psychological factors including fear, greed, overconfidence, anxiety, and herd behaviour. This study examines the relationship between financial literacy and emotional investment decisions among individual retail investors. Primary data was collected through a structured questionnaire distributed to 120 respondents comprising students, salaried employees, business professionals, and retirees. The findings indicate that a majority of respondents possess a basic to moderate level of financial literacy, which contributes to more informed and rational investment behaviour. However, emotional factors continue to significantly influence investment decisions, particularly during periods of market volatility. The study concludes that enhancing financial literacy can meaningfully reduce emotional bias and promote disciplined, long-term investment behaviour.

Keywords: *Financial Literacy, Emotional Investment Decisions, Behavioural Finance, Investor Behaviour, Emotional Bias.*

1. INTRODUCTION

According to the Organisation for Economic Co-operation and Development (OECD), Financial Literacy is defined as “a combination of awareness, knowledge, skill, attitude and behaviour necessary to make sound financial decisions and ultimately achieve individual financial wellbeing.”

Financial literacy and emotional investment decisions are two important aspects of modern financial management and personal finance. In today's dynamic and complex financial environment, individuals are required to make various financial decisions such as saving, investing, borrowing, retirement planning, and wealth management. The ability to understand financial concepts and apply them effectively is known as financial literacy.

Financial literacy refers to the knowledge, skills, and awareness that enable individuals to make informed and effective financial decisions. It includes understanding concepts such as interest rates, inflation, risk and return, diversification, time value of money, financial planning, and investment products like stocks, mutual funds, bonds, insurance, and fixed deposits.

At the same time, investment decisions are not purely rational. They are often influenced by emotions such as fear, greed, overconfidence, anxiety, and herd behavior. Emotional investment decisions refer to financial decisions that are influenced by psychological factors rather than logical analysis. Behavioral finance explains how emotions and cognitive biases affect investor behavior and financial markets.

In India, with the rapid growth of stock markets, mutual funds, digital trading platforms, and fintech applications, more individuals are participating in financial markets. However, low levels of financial literacy and high emotional involvement often lead to poor investment decisions, financial losses, and wealth erosion. Therefore, this study aims to examine the relationship between financial literacy and emotional investment decisions. It

seeks to understand whether higher financial literacy reduces emotional bias and improves rational investment behavior.

This study is descriptive in nature. It focuses on describing the level of financial literacy among investors and identifying the emotional factors influencing their investment decisions. The data for the study was collected through a structured questionnaire using Google Forms. The responses were analyzed using simple statistical tools such as percentages and charts to present a clear understanding of investors' awareness and behavior.

2. REVIEW OF LITERATURE

Kahneman and Tversky (1979) introduced the Prospect Theory, which challenged traditional finance assumptions of rational behavior. Their theory explains that investors evaluate gains and losses differently and are generally loss-averse. Investors tend to fear losses more than they value equivalent gains, leading to irrational decision-making. The theory provides foundational understanding of how emotional responses distort investment choices.

Shefrin (2002) highlighted that psychological biases such as overconfidence, anchoring, and representativeness significantly influence investor behavior. Statman further argued that investors are “normal” rather than fully rational and seek both utilitarian and emotional benefits from investments. Together, their work explains how emotional biases contribute to market anomalies and mispricing of securities.

Lusardi and Mitchell (2014) conducted extensive research on financial literacy and retirement planning. Their studies revealed that individuals with higher financial literacy are more likely to plan for retirement, diversify their portfolios, and accumulate wealth effectively. They emphasized that financial education plays a crucial role in improving financial well-being and economic stability. The study demonstrates a strong positive link between financial knowledge and long-term investment discipline.

RESEARCH GAP

Despite substantial theoretical and empirical research on financial literacy and behavioral finance, limited studies focus on understanding both the level of financial literacy and the emotional factors influencing investment decisions among retail investors in India, particularly at the regional level. Existing studies in the Indian context are relatively limited and do not adequately capture the growing influence of digital trading platforms and fintech applications on investor behaviour and emotions. The present study addresses this gap by collecting primary data from individual retail investors to describe their level of financial literacy and to identify the emotional biases that influence their investment decisions.

3. OBJECTIVES OF THE STUDY

- To assess the level of financial literacy among students, employees, employers, and common individuals who participate in financial investments.
- To evaluate the awareness of respondents regarding basic financial concepts such as inflation, interest rates, risk and return, diversification, and investment planning.
- To identify the influence of emotional factors such as fear, greed, overconfidence, and herd behaviour on investment decisions.
- To analyze the investment preferences of respondents across different financial instruments such as equity shares, mutual funds, fixed deposits, and other avenues.
- To examine whether individuals with higher financial knowledge demonstrate more rational and disciplined investment behavior.
- To provide suitable suggestions for improving financial literacy and reducing emotionally driven investment decisions.

4. RESEARCH METHODOLOGY

Need for the Study

The need for the study arises due to the increasing complexity of financial markets and the growing participation of individual investors. In recent years, financial inclusion initiatives and digital platforms have encouraged more people to invest in financial markets. However, the level of financial literacy among the general public remains relatively low. Many investors make decisions based on tips from friends, social media influence, or market rumours rather than proper analysis. Therefore, this study aims to understand the level of financial literacy among investors and to identify the emotional factors that influence their investment decisions.

Scope of the Study

The present study focuses primarily on describing the level of financial literacy among selected respondents and identifying the emotional factors influencing their investment decisions. The study is confined to individual investors, particularly retail investors who actively participate in financial markets. It covers the awareness and understanding of financial concepts such as inflation, interest rates, risk-return trade-off, diversification, and financial planning. In addition, it identifies emotional and

psychological biases such as fear during market downturns, greed during bullish trends, overconfidence, herd behaviour, loss aversion, and regret avoidance among investors.

Sample of the Study

The sample of the study consists of 120 respondents representing different categories of individual investors. The respondents include students who have basic knowledge or interest in financial markets, salaried employees who invest part of their income, business and self-employed professionals, and retired individuals who participate in financial activities. The study adopts the Convenience Sampling Method, wherein respondents were selected based on accessibility, availability, and willingness to participate in an online survey conducted through Google Forms.

5. DATA ANALYSIS & INTERPRETATION SECTION A: DEMOGRAPHIC PROFILE OF RESPONDENTS

Table 1: Demographic Profile of Respondents

Variable	Category	No. of Respondents	Percentage (%)
Age	18 to 25 years	93	77.50%
	26 to 40 years	16	13.33%
	41 to 55 years	5	4.17%
	Above 56 years	6	5.00%
Gender	Male	62	51.67%
	Female	58	48.33%
Education	Higher Secondary	11	9.17%
	Graduate	38	31.67%
	Post-Graduate	67	55.83%
	Professional Degree	4	3.33%
Occupation	Student	64	53.33%
	Salaried Employee	40	33.33%
	Business/Self-employed	11	9.17%
	Retired	5	4.17%
Income	Below Rs.25,000	72	60.00%
	Rs.25,001 to Rs.50,000	38	31.67%
	Rs.50,001 to Rs.1,00,000	6	5.00%
	Above Rs.1,00,000	4	3.33%

Source: Primary Data

The table shows that the majority of respondents are young 18 to 25 years, students, and belong to lower income groups, indicating early-stage investors dominate the sample. Educational levels are relatively high, with most being graduates and postgraduates. Gender representation is balanced, suggesting equal participation. Overall, the sample mainly represents young, educated retail investors with limited income but growing financial involvement.

SECTION B: FINANCIAL LITERACY AND EMOTIONAL FACTORS IN INVESTMENT DECISIONS

Table 2: Financial literacy and emotional factors in investment Decisions

Variable	Category	No. of Respondents	Percentage (%)
Understanding of Risk & Return	Very well	30	25.00%
	Fairly well	34	28.33%
	Basic understanding	47	39.17%
	Hard but unclear	2	1.67%
	Not at all	7	5.83%
Awareness of Investment Avenues	Aware of many options	61	50.83%
	Limited awareness	36	30.00%
	Very little awareness	18	15.00%
	Not aware	5	4.17%

Inflation Awareness	Yes	95	79.17%
	No	15	12.50%
	Somewhat	10	8.33%
Investment Monitoring	Daily	38	31.67%
	Weekly	30	25.00%
	Occasionally	29	24.17%
	Monthly	23	19.17%
Basis of Investment Decisions	Always based on analysis	43	35.83%
	Mostly based on analysis	39	32.50%
	Sometimes based on analysis	19	15.83%
	Mostly based on tips	17	14.17%
	Completely based on tips	2	1.67%
Market Anxiety	Very anxious	38	31.67%
	Slightly anxious	32	26.67%
	Neutral	42	35.00%
	Calm	6	5.00%
	Completely calm	2	1.67%
Fear of Loss	Frequently	32	26.67%
	Sometimes	52	43.33%
	Rarely	20	16.67%
	Never	16	13.33%
Herd Behaviour	Very likely	35	29.17%
	Likely	20	16.67%
	Not sure	38	31.67%
	Unlikely	11	9.17%
Reaction to Falling Prices	Strongly agree	13	10.83%
	Agree	11	9.17%
	Neutral	40	33.33%
	Disagree	32	26.67%
	Strongly disagree	24	20.00%
Emotional Influence	Influence a lot	27	22.50%
	Influence somewhat	41	34.17%
	Neutral	36	30.00%
	Very little influence	7	5.83%
	No influence	9	7.50%

Source: Primary Data

The table presents a detailed view of financial literacy and emotional behaviour among respondents. It shows that while a majority of investors possess at least a basic understanding of financial concepts and are aware of investment avenues, emotional factors such as fear, anxiety, and herd behaviour continue to influence their decisions. Many respondents rely on analysis for decision-making, yet emotional responses to market fluctuations remain significant. Overall, the findings indicate a combination of rational knowledge and emotional influence in investment behaviour.

SECTION C: RELATIONSHIP BETWEEN FINANCIAL LITERACY AND EMOTIONAL DECISIONS

Table 3: Relationship between financial literacy and emotional decisions

Variable	Category	No. of Respondents	Percentage (%)
Financial Knowledge & Calmness During Volatility	Strongly agree	8	6.67%
	Agree	26	21.67%
	Neutral	33	27.50%
	Disagree	18	15.00%
Financial Literacy	Strongly disagree	35	29.17%
	Reduces	46	38.33%

Reduces Emotional Bias	significantly		
	Reduces moderately	28	23.33%
	No change	25	20.83%
	Slight increase in bias	16	13.33%
	Not sure	5	4.17%
Emotion-driven Decisions Lead to Poor Outcomes	Yes	76	63.33%
	No	26	21.67%
	Not sure	18	15.00%
Financial Education Improves Rational Behaviour	To a great extent	62	51.67%
	To some extent	29	24.17%
	Slightly	25	20.83%
	Not really	2	1.67%
	Not at all	2	1.67%
Nature of Investment Decisions	Highly rational	32	26.67%
	Mostly rational	42	35.00%
	Balanced	33	27.50%
	Mostly emotional	11	9.17%
Reaction to Market Losses	Highly emotional	2	1.67%
	Stay calm and hold investments	53	44.54%
	Analyse before acting	40	33.61%
	Panic but try to stay rational	16	13.45%
	Usually panic and sell	11	8.40%
Financial Education Controls Emotions	To a great extent	47	39.17%
	To some extent	64	53.33%
	Very little	2	1.67%
	Not at all	7	5.83%

Source: Primary Data

The table shows that respondents generally believe financial literacy helps reduce emotional biases and improves rational decision-making. A majority agree that emotional decisions lead to poor outcomes and that financial education enhances investment behaviour. However, some respondents still experience emotional instability during market volatility. Overall, financial literacy plays a significant but not complete role in controlling emotional investment decisions.

KEY FINDINGS

1. Majority of respondents 78% belong to the 18–25 age group and 53% are students, indicating that young and early-stage investors dominate the study, while participation from older and experienced investors is comparatively low.
2. Gender distribution is nearly balanced 52% male and 48% female, and a large proportion of respondents are highly educated 56% postgraduates and 32% graduates, showing that education plays a significant role in investment awareness and participation.
3. Most respondents 60% fall under the below Rs.25,000 income category, indicating that the sample largely consists of low-income or financially dependent individuals, with limited representation from higher income groups.
4. A majority of respondents possess a satisfactory level of financial literacy, with basic to good understanding of risk and return, awareness of investment avenues, and strong knowledge of inflation, although some respondents still have limited awareness.

5. Investors show active involvement in managing their investments and largely rely on analysis rather than tips, indicating a preference for informed and rational decision-making.
 6. Emotional factors significantly influence investment behaviour, as many respondents experience anxiety during market fluctuations and are affected by fear, uncertainty, and herd behaviour.
 7. Despite emotional influences, most respondents do not engage in panic selling during market declines, indicating relatively stable behaviour, although emotions such as fear and greed still impact decisions to some extent.
 8. Respondents show mixed opinions regarding the role of financial literacy in maintaining emotional stability during market volatility, suggesting that financial knowledge alone may not fully control emotions.
 9. A majority believe that financial literacy helps reduce emotional bias and that emotionally driven decisions lead to poor outcomes, reflecting awareness of behavioural biases among investors.
 10. Financial education is perceived as highly beneficial, as it improves rational decision-making, helps control emotions, and enables investors to remain calm or analyze situations during market losses, leading to more stable investment behaviour.
6. Financial education initiatives should be expanded through digital platforms, social media, and workshops to reach a wider audience, especially young and first-time investors. Increased accessibility can improve overall financial awareness levels.
 7. Investors should be made aware of behavioural biases such as herd behaviour, which can lead to irrational decisions. Understanding these biases can help investors maintain independent and logical thinking while investing.
 8. Proper awareness about risk management techniques, such as diversification and asset allocation, is essential. This helps investors manage losses effectively and maintain a balanced investment portfolio.

6. CONCLUSION

The study on financial literacy and emotional investment decisions highlights the important role that financial knowledge plays in shaping the behaviour of retail investors in the stock market. The findings indicate that most respondents possess a basic to moderate level of financial literacy, which enables them to understand fundamental concepts such as risk and return, inflation, and various investment avenues. This level of awareness contributes to more informed decision-making and helps investors evaluate investment opportunities in a more structured manner.

The study also reveals that a significant number of investors actively monitor their investments and prefer to base their decisions on financial analysis and available information. This reflects a positive shift towards rational and informed investment behaviour among retail investors. It also suggests that increasing exposure to financial knowledge and market information is helping investors become more confident and systematic in their investment approach.

However, despite the presence of financial awareness, emotional factors continue to play a major role in investment decisions. Behavioural influences such as fear of loss, greed, anxiety during market fluctuations, and herd behaviour are observed among a considerable proportion of respondents. These emotional responses often impact decision-making, particularly during periods of market volatility, leading to either panic selling or overconfidence in certain situations.

Overall, the study concludes that financial literacy significantly improves rational investment behaviour, but does not completely eliminate emotional influences. Therefore, it is essential for investors to not only enhance their financial knowledge but also develop emotional discipline. A balanced combination of financial understanding and behavioural control is necessary for making stable, consistent, and long-term investment decisions in the stock market.

7. REFERENCES

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SUGGESTIONS

1. Since financial literacy plays a crucial role in improving investment decisions, investors should make continuous efforts to enhance their knowledge about basic financial concepts such as risk–return, inflation, and diversification. This will help them make more informed and rational investment choices.
2. Regular participation in investor education programs and financial awareness initiatives can improve understanding of market behaviour and investment strategies. Such programs help investors reduce confusion and build confidence in decision-making.
3. As emotional factors like fear and greed significantly influence investment decisions, investors should focus on developing emotional discipline. Avoiding impulsive reactions during market fluctuations can lead to more stable and consistent investment outcomes.
4. Investors should rely more on proper research and financial analysis rather than depending on tips, rumours, or peer influence. Analytical decision-making helps in minimizing risks and improving long-term returns.
5. Although many investors actively track their investments, they should avoid over-monitoring and reacting to short-term market fluctuations. Adopting a long-term investment perspective can reduce panic and improve overall performance.

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