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"An Empirical Study on the Factors Affecting Financial Literacy and its Effect on Investment Behavior among Individual in India"

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Abstract:

Financial literacy is required in order to make important financial decisions such as saving, borrowing, and investing. Despite the fact that several studies have been undertaken in order to identify elements of financial literacy, the majority of them have focused on developing countries. The aim of this study is to determine the factors that influence financial literacy levels in India, as well as the effect of financial literacy on investment behavior. For the purpose of the analysis, primary data from 309 respondents across India was collected and analyzed using analytical methods such as ordinary least square (OLS) regression and the t-test. Financial literacy was found to be poor among respondents, with substantial differences based on socio-demographic and economic factors.Surprisingly, financial literacy had little influence on investment activity. This research, to the best of the authors' knowledge, is one of the first, if not the first, of its kind in India. The findings have far-reaching implications for financial literacy and public policy initiatives.

Keywords: Financial Literacy, Investment Behavior, Financial Management, Personal Finance, Scio-economic Characteristics

Introduction:

Financial literacy, surprisingly, had little effect on investment behavior. This study is one of the first, if not the first, of its kind in India, to the best of the authors' knowledge. The results have far-reaching consequences for public policy and financial literacy programs.As a result, the amount of research related to financial literacy and education has increased proportionally. Most studies, however, are focused on developed countries, and information about financial literacy and its determinants in developing and underdeveloped countries is still scarce.

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This paper aims to investigate how demographic and socioeconomic factors affect financial literacy levels and investment behavior among people in India using surveys, regression analysis, and other empirical methods.

But first, let's answer the question, "What is financial literacy?" As Xu and Zia have pointed out (2012),"The word [financial literacy] can refer to a wide range of concepts, including financial understanding and information, such as financial goods, organisations, and concepts; financial abilities, such as the ability to measure compound interest payments; and financial capacity more broadly, such as money management and financial planning."

Low levels of financial literacy have been shown in the past to have negative consequences for individuals and their investment behaviour.People with poor financial literacy are more likely to have difficulties repaying debt, are less likely to participate in formal financial markets such as the stock market, and are less likely to plan for retirement, are more likely to borrow at high interest rates, and have less diversified portfolios.

A Harris Poll survey conducted on behalf of the NFFC in 2018 highlighted the widespread lack of competent financial management (National Foundation for Credit Counselling). 59 percent of the 2,017 US adults polled do not have a budget or keep track of their expenses, 25% do not pay their bills on time, and 28% do not set aside any of their earnings for retirement.49 percent are unsure whether they have enough money set aside for retirement, and 73 percent are concerned about their finances. Furthermore, despite the fact that 82 percent of people offer themselves a B or lower on their personal finance knowledge, 79 percent believe they will benefit from financial advice from a professional (Harris Poll, 2018).

The level of financial literacy varies greatly between countries. Various studies have repeatedly shown that the population of high-income countries is financially illiterate. While there is less data available for middle and low-income countries, literacy levels appear to be even lower (Xu& Zia, 2012).As previously mentioned, low levels of financial literacy may have negative consequences for individuals. As a result, policymakers who want to design effective financial education initiatives must accurately measure financial literacy and recognise its determinants.

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Review of Literature:

The collection of variables used in the empirical research was done with great care. First, demographic characteristics such as gender and age were included because previous studies have shown that women have lower financial literacy than men (Atkinson & Messy, 2012; OECD, 2013); Agarwal, Driscoll, Gabaix, &Laibson, 2009; Chen & Volpe, 1998; Scheresberg, 2013) and that financial literacy is poor among the young and elderly (Agarwal, Driscoll, Gabaix, &Laibson, 2009; Atkinson & Messy, 2012; OECD, 2013; Scheresberg, 2013);Lusardi& Mitchell, 2011; Scheresberg, 2013). Financial literacy follows an inverted-U shape in relation to age, according to studies (Xu& Zia, 2012).

Second, we wanted to see how socioeconomic characteristics like education level and indicators of success like income and wealth influenced financial literacy. Individuals with higher levels of education have more access to financial information and are are more financially literate, according to previous research (Chen & Volpe, 1998; Lusardi& Mitchell, 2011).Lower levels of income are associated with lower levels of financial literacy (Atkinson & Messy, 2012). One potential explanation for this is that people from low-income households are more likely to drop out of school, which leads to their long-term lack of financial literacy (Calamato, 2010).

In light of research by Monticone (2010) and Hastings and Mitchell (2011) demonstrating that wealth has a positive impact on financial literacy, information on whether the respondent owned a home, had retirement savings, and kept investments was also gathered to verify this assertion. Ownership of a home, retirement savings, and/or assets were used as proxies for wealth in this case.

Third, we applied variables to the regression analysis to assess exposure to financial information through experiences with others. Respondents were questioned about their marital status because many studies have shown that singles are significantly more likely than married people to have low financial literacy (Calamato, 2010; Brown & Graf, 2013).This occurs because consumer debt is a significant threat to the well-being of married relationships, so married people have a stronger motivation to improve their financial literacy (Dew, 2008).

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The study looked at the effects of peers on financial literacy in order to better understand the impact of social interaction on financial literacy. Peers are one of the most important sources of financial knowledge and advice, according to numerous studies (Brown, Ivkovich, Smith, &Weisbenner, 2008; Hong, Kubik, & Stein, 2004; van Rooji, Lusardi, &Alessie, 2007).Peers play an important role in deciding whether or not to participate in and contribute to a pension plan (Duflo&Saez, 2003). Furthermore, unemployed workers were found to have a lower degree of financial literacy due to their lack of experience with economic and financial topics (Chen & Volpe, 1998; Calamato, 2010; Kim & Garman, 2004).As a result, the respondents' occupational status was included in the regressions.

In light of Amadeu (2009)'s findings that more interaction with economics and finance courses in undergraduate studies has a positive effect on one's financial activities and that students of Economics, Business Administration, and Accounting have a higher degree of financial literacy, the study looked into whether the respondent's occupation and/or education are related to finance.In addition, since Hong, Kubik, and Stein (2004) found that churchgoers were more likely to invest in stocks, the study looked at whether the respondent was a member of any social clubs and whether he or she was a frequent attendee.

Research Methodology:

Due to the lack of prior data on financial literacy in India, we conducted a survey to assess financial literacy and investment behaviour among Indians of working age. The survey was available online for 30 days and was open to responses. Only people over the age of 18 were allowed to take part in the poll. Within the time frame used to create the survey, 309 people replied. Before being asked a few questions to judge their level of financial literacy and sophistication, respondents were asked multiple questions about their socio-demographic and economic circumstances.

The assessment of financial literacy is a difficult task in and of itself. “While it is important to determine how financially literate people are, in practise it is difficult to explore how people interpret economic information and make informed decisions about household finances,” Lusardi and Mitchell (2011a) write.Financial literacy, according to Xu and Zia (2012), consists of a number of components, including financial understanding and expertise,

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as well as financial skills and capacity, all of which are difficult to quantify in a survey of reasonable duration.However, for the purposes of this research, a collection of three questions developed by Lusardi and Mitchell are used, which are widely used in the literature to assess financial literacy.

Three main financial principles, interest rates, inflation, and risk diversification, are all tested in these questions. Each correctly answered question is worth one point, and the aggregate score is determined by averaging the three questions' answers. One of the most important benefits of using these questions is that they provide a solid foundation for cross-national comparisons.

Results & Findings:

After adjusting for all variables, a multivariate study was used to determine which factors were related to financial literacy among respondents. The mean of a respondent's responses was used to measure an aggregate Lusardi and Mitchell score of 1; each of the three correct answers was given 1 point, and the arithmetic mean was determined.This served a dual purpose: the aggregate formed a measure of overall financial literacy among respondents, and it also helped minimise statistical errors associated with a limited sample size.

The regression analysis yielded a number of important results. Even after controlling for a variety of sociodemographic, economic, family, and personal factors, women still had lower financial literacy than men.Women had a 12 percent lower chance of getting the interest rate question right, a 12 percent lower chance of getting the inflation question right, and an 11 percent lower chance of getting the risk diversification question right. This shows that, even after controlling for other variables, an individual's gender is a strong predictor of financial literacy.

The age of the respondents was also a statistically important indicator of financial literacy. When compared to those between the ages of 18 and 34, people aged 45 to 54 were 5% more likely to correctly answer the inflation question and 11% more likely to correctly answer the risk diversification question.They also had an 8 percent higher overall score than

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the control group. For people aged 55 to 64, the related figures were 9%, 23%, and 13%, respectively. As a result, age was a significant predictor of financial literacy.

Financial literacy was also strongly linked to educational attainment, especially among college graduates. Higher levels of educational achievement, such as a bachelor's or master's degree, were found to be associated with higher financial literacy ratings.The effects of an undergraduate degree were not found to be statistically significant after accounting for the large number of variables in the model. Having a post-graduate degree, on the other hand, raised the chances of correctly answering the questions by 9%, 20%, and 10%, respectively.

There was a strong connection between marital status and financial literacy as well. Married people were more likely to offer accurate answers to the three financial literacy questions, with interest rate and risk diversification questions being 11 percent and 12 percent more likely to be answered correctly, respectively. Married people also had a 9% higher overall score than their single counterparts.This discrepancy could occur because sound financial decisions are critical to the marriage's success (Calamato, 2010).

Another important factor in financial literacy was income. Previous research has found that higher income levels are linked to higher levels of financial literacy (Monticone, 2010; Hastings & Mitchell, 2011; Atkinson & Messy, 2012).People earning between $1,000 and $2,000 per year had a 5% higher aggregate score than the control group, while those earning more than $2,000 per year had a 12 percent higher aggregate score. Financial literacy was clearly influenced by one's income.

Finally, non-family social contact in the form of membership in a social club had a limited but substantial effect on financial literacy. Although the differences between not becoming a member of any club and being a non-active member were minor and not statistically relevant, attending a social club on a regular basis had a significant impact on respondents' financial literacy.Daily attendees of clubs scored 7% higher on average than those who did not attend any clubs. This backs up previous research that shows daily social contact improves financial literacy (Hong ,Kubik, & Stein, 2004).

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Conclusion:

Despite the fact that multiple financial education initiatives have been launched around the world and numerous studies to assess the determinants of financial literacy have been performed, the majority of them concentrate on developed economies, and data on emerging economies remains scarce.

This paper presents new facts regarding financial literacy in India and its determinants. Financial literacy was found to be poor, and key financial concepts such as interest calculation, inflation impact, and risk diversification due to multiple investments were not fully understood by the respondents.Just 14% of all respondents correctly answered all three financial literacy questions. Significant differences were also discovered in different sub-groups within the study, including differences based on gender, age, income, educational attainment, and wealth, among other factors.

The expected positive relationship between financial literacy and stock market participation, which is often seen in studies in developed countries, was not found in this study's sample.However, sociodemographic, fiscal, and family characteristics were found to be significant predictors of whether or not a respondent would invest in stocks, mutual funds, or fixed income securities.

The consequences of these results for policymakers and financial education initiatives are important. As the government and employers transfer the burden of saving and investing decisions onto employees, it is becoming increasingly necessary to equip workers with basic financial information to make these critical decisions.To accomplish this goal effectively, it is critical to recognise that the adult population has a wide range of financial literacy; adults should not be viewed as a homogeneous community. Sex, age, educational attainment, income, and wealth, among other factors, should be taken into account when developing public initiatives aimed at improving financial literacy, as seen in this report.Disadvantaged groups, such as women, the elderly, and those with low incomes and educational attainment, should be targeted for financial literacy programmes.

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