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Influence of Financial Literacy on Investment Decision and Portfolio Diversification among Individual Investors

*Uneez B
Research Scholar. Department Commerce, Terf's Academy College of Arts and Science, Tirupur

Dr.P. Pavithra
Head And Associate Professor, Department of Commerce, Terf's Academy College of Arts and Science, Tirupur

*Corresponding Author

Abstract
Financial literacy plays an important role in determining individual financial decision or portfolio diversification practices. In a complex financial environment it is essential of understanding about financial products, evaluate risk and return, and make informed decisions to achieve their financial goals. This conceptual study examine the influence of financial literacy on investment decision making and portfolio diversification among individual investors. It explores the major dimensions of financial literacy, including financial knowledge, financial awareness , financial skill and financial behaviour and their relationship with investment choice, risk perception, asset allocation and diversification. Increase in financial literacy helps the individual in productive allocation of savings. The study is developed through a conceptual review of relevant literature and established financial theory , particularly modern portfolio theory and the theory of planned behaviour. The paper highlight the importance of financial education in encouraging informed, discipline and balanced investment practices. It also identifies implication for financial institutions, policymakers and individual investors.

Keywords*; Financial Literacy Investment Decision, Portfolio Diversification, Individual Investors, Risk Perception, Financial Behaviour.*

I. INTRODUCTION

Investment is a very significant factor of individual financial planning, as it helps to facilitate accumulation of wealth, protect their financial resources and achieve long term financial objectives. Individual investors can choose from various financial alternatives including shares, mutual funds, bonds, fixed deposits, gold and real estate. However selecting appropriate investment instruments requires an understanding of financial markets, investment risk, expected return and personal financial circumstances. Financial literacy is an individual very much helps in selecting the best portfolio and allocate savings in to a productive investment technically increase in the financial literacy benefit to the growth of economic development. Financial literacy has become increasingly important because investors face a wide range of financial products and information sources. Financial literate individuals are better equipped to understand interest interest rates, inflation, compound returns, market fluctuations and the relationship between risk and returns. Such knowledge may help them evaluate investment opportunities and avoid decision based solely on rumours, emotional reaction or misleading financial information.

Investment decision-making involves selecting financial instruments according to an investors objectives, income, financial commitments, investment horizon and risk tolerance. Portfolio diversification, meanwhile refers to allocation of investments in to a productive manner. Financial literacy may influence both the selection of investment and the construction of diversified portfolio. Nevertheless financial knowledge alone does not guarantee successful investment outcomes. Behavioural biases, overconfidence, limited financial resources and market uncertainty may also affect investor's decisions. Therefore, this conceptual paper examine how financial literacy can contribute to informed investment decision and portfolio diversification among individual investors.

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II. STATEMENT OF THE PROBLEM

Individual investors often make investment decision without adequately understanding the financial products available to them. Limited financial knowledge may lead to inappropriate investment choices, excessive exposure to risk, poor asset allocation and insufficient diversification. Some investors may concentrate their investments in a single asset class, while others may select financial instruments based on past returns or recommendations from friends and social media. Although financial literacy is widely considered important factor determining financial decision-making. Understanding financial concepts may improve investors ability to compare investment alternatives, but practical investment behaviour can also be affected by psychological, social and economic factors. The central problem addressed in this study is how financial literacy influence individual investors investment decision and their ability to develop diversification portfolios.

Objectives of the Study

1. To explain the concept and major dimensions of financial literacy
2. To examine the influence of financial literacy on individual investment decisions.
3. To explore the relationship between financial literacy and portfolio diversification.
4. To identify the role of risk perception, investor confidence and financial goals in investment behaviour.
5. To develop a conceptual framework linking financial literacy, investment decisions and portfolio diversification.

III. REVIEW OF LITERATURE

1. Financial literacy and investment decision

Financial literacy refer to the knowledge and skill required to understand financial concepts and make informed financial decisions. It includes understanding interest rates, inflation, investment risks, returns, savings and financial planning.

Prasad, Kiran and Sharma (2021) explored the influence of financial literacy on retail investors decisions concerning returns, risk and market analysis. Their findings reported a positive relationship between financial literacy and investment decision making, with risk and return analysis having a stronger influence than market analysis.

2. Financial literacy and portfolio choice

Portfolio choice involves deciding or selecting which financial asset to hold and how much of an investors wealth to allocate to each asset. Financial literacy can help investors understand the characteristics of financial instruments compare their cost and return and evaluate their suitability.

Chu, Waang, Xiao and Zhang (2017) investigated financial literacy, portfolio choice and financial well-being. Their study found that financial literacy was associated with household investment choices, including participants in stocks and mutal funds.

3. Financial literacy and risky financial asset

Research on household portfolio choice suggest that financial knowledge can help investors understand the characteristics of risky financial asset and compare investment products. A study published in Journal of Economic Psychology examined financial literacy and household portfolio choices using Chinese household data.

Research Gap

The reviewed literature addresses financial literacy in relation to investment decision, household portfolio choice and financial outcomes. However these relationship can brought together in a conceptual framework that consider both the selection of investments and the distribution of investment across a portfolio.

Research Methodology

Research Design: The present study adopted a conceptual research design to examine the influence of financial literacy on investment decisions and portfolio diversification among individual investors. The study aims to develop a theoretical understanding of the relationship between financial knowledge, investment behaviour, risk assessment and portfolio allocation.

Source of Data: The study is based exclusively on secondary data collected from published research articles, academic journals, books, conference proceeding and relevant institutional publications.

Method of Analysis: The study employs a thematic review and conceptual synthesis of existing literature. The reviewed concepts and findings are analyzed to identify potential relationships between financial literacy, investment decisions and portfolio diversification. Modern portfolio theory and the theory of planned behaviour provides the theoretical foundation for developing the conceptual framework.

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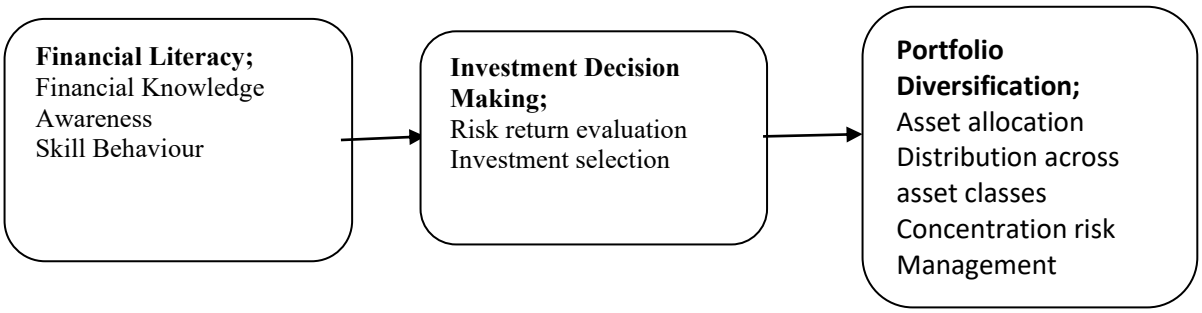
Conceptual Framework

The proposed conceptual framework presents financial literacy as the primary explanatory variables, investment decision making as an outcome and portfolio diversification as a further outcome that may be influenced by financial literacy and investment choice.



The proposed conceptual framework linking literacy with investment decisions and portfolio diversification. The framework proposes that financial literacy may influence portfolio diversification directly, by improving investors understanding of asset allocation and indirectly by supporting better informed investors decision.

IV. DISCUSSION

1. Influence of financial literacy on investment decision.

Financial literacy can contribute better financial or investment decision directly enhance growing of funds as well as wealth.It helps the investors to improve ability to evaluate financial information. Individual who understand investment risk and return may be more capable of comparing alternative and identifying investment that match their financial objectives.

2. Influence of financial literacy on portfolio diversification

Financial literacy may promote diversification by helping investors understand the importance of spreading investment across assets with different risks characteristics. Financial literacy can also improve understanding of diversification limits. Investors may learn that diversification reduces certain risks but cannot eliminate market wide risk

3. Role of risk perception

Risk perception concern how investors understand and evaluate the possibility of financial loss. Financial literate investors may be more capable of distinguishing between different types of risk, including market risk, credit risk, liquidity risk and inflation risk.

4. Investors confidence and behavioural biases

Financial literacy may improve confidence in investment decision making. Yet excessive confidence can lead investors to trade frequently, underestimate risks or concentrate their investments

Implications of the Study

1. Implication for individual investors

Individual investors should develop financial knowledge before making investment decision. Understanding investment risk , return, diversification and financial planning can help them select suitable financial products and avoid excessive concentration.

2. Implication for financial institutions

Banks investment companies and financial advisers can support investors by providing accessible financial education, transparent product information and tools for understanding portfolio risk.

3. Implication for policymakers

Policymakers and educational institution cam promote financialliteracy through financial educational programmes, investor awareness, initiatives and accessible learning resource.

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Limitation and Scope for Future Research

As a conceptual study this paper does not collect primary data or statistically verify the proposed relationships. The conceptual framework is developed from existing literature and financial theory;therefore, its propositions require further empirical investigation.

Future researchers may;

1. Conduct a survey among individual investors to measure financial literacy and investment behaviour.
2. Examine whether financial literacy significantly predict portfolio diversification.
3. Compare investment behaviour across age groups, income level and educational backgrounds
4. Investigate the mediating role of investment decision-making and the moderating role of investment decision making and the moderating role of risk tolerance.

V. CONCLUSION

Financial literacy is an important component of individual investment decision making and portfolio management. It provide investors with the knowledge and skill needed to understand financial products, evaluate risk and return and make choice consistent with their financial objectives. This conceptual study proposes that financial literacy may influence investment decisions by improving financial understanding, product evaluation and investment planning. It may also contribute to portfolio diversification by helping investors recognize concentration risk and understand the benefits and limitations of allocating investments across different assets. However, financial literacy alone cannot guarantee successful investment outcomes. Risk tolerance financial goals, investor confidence, behavioural biases and market conditions may also shape investment behaviour. The study highlights the importance of combining financial education with disciplined decision making and appropriate portfolio planning.

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