

## FINANCIAL LITERACY AND HOUSEHOLD INVESTMENT DECISIONS: A QUANTITATIVE ANALYSIS

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### ABSTRACT

This research paper investigates the influence of financial literacy on household investment decisions, with a particular focus on asset allocation and portfolio diversification. By examining empirical evidence from studies conducted in Mumbai area, the study evaluates how enhanced financial knowledge contributes to diversified investment portfolios and increased market participation. The analysis utilizes quantitative regression techniques and observation evaluations to assess these relationships. The findings are intended to inform policymakers, educators, and financial practitioners on the importance of financial literacy initiatives for improved financial outcomes.

**Keywords:** Investment Behavior, Financial Education, Household Finance,, Financial Literacy.

### Introduction: -

Household investment decisions constitute a critical component of financial system efficiency and long-term economic development. In contemporary financial markets, individuals are increasingly expected to assume responsibility for managing complex portfolios involving multiple asset classes, varying risk profiles, and long-term return trade-offs. The ability of households to allocate assets optimally and diversify portfolios effectively is therefore not merely a private financial concern but a macroeconomic issue with implications for capital market participation, financial stability, and inclusive growth.

Financial literacy—broadly defined as the knowledge and capability to understand financial concepts, evaluate financial products, and make informed economic decisions—has been widely recognized as a foundational determinant of household financial behavior. Prior theoretical and empirical research suggests that financially literate individuals are more likely to participate in capital markets, hold diversified portfolios, and engage in forward-looking financial planning. Conversely, limited financial knowledge often leads to under-participation in financial markets, excessive concentration in low-risk or familiar assets, and suboptimal risk-return outcomes. Despite this growing body of literature, significant gaps remain in understanding how financial literacy concretely shapes household investment decisions in emerging market contexts.

In the Indian setting, these issues are particularly salient. Rapid financial sector expansion, increased access to market-linked instruments, and policy-driven financial inclusion initiatives have expanded the choice set available to households. Yet, empirical evidence indicates that investment behavior remains uneven, with substantial heterogeneity in asset allocation and portfolio diversification. Metropolitan regions such as Mumbai—India's financial capital—offer a unique empirical context due to their high financial market exposure, demographic diversity, and availability of investment opportunities. Nonetheless,

even within such an advanced financial ecosystem, disparities in financial literacy may lead to markedly different investment outcomes across households.

This study seeks to examine the influence of financial literacy on household investment decisions in the Mumbai area, with a specific focus on asset allocation strategies and portfolio diversification. By employing quantitative regression techniques alongside structured observational evaluations, the research empirically assesses the relationship between financial knowledge and key investment outcomes, including market participation and diversification intensity. The methodological framework allows for a systematic evaluation of how variations in financial literacy translate into observable differences in household portfolio construction.

The contribution of this research is threefold. First, it extends the empirical literature on household finance by providing micro-level evidence from an emerging urban financial center. Second, it offers a quantitative assessment of the role of financial literacy in shaping investment behavior, thereby addressing endogeneity and measurement concerns often highlighted in prior studies. Third, the findings hold significant policy relevance, informing the design of targeted financial education initiatives and investor awareness programs. By establishing a clear linkage between financial literacy and improved investment outcomes, the study underscores the importance of integrating financial education into broader strategies for sustainable economic and financial development.

## LITERATURE OF REVIEW

- Iyer and Nair (2024) examined digital financial literacy and investment behavior in urban India. Their study found that digitally literate investors are more likely to participate in online trading platforms and diversified investment products. The authors argue that digital financial literacy complements traditional financial knowledge in improving portfolio efficiency.
- Patel and Shah (2023) focused on household investment behavior in western India. Their findings reveal that financial literacy significantly improves investment decision-making and reduces excessive exposure to low-yield assets. The study underscores the relevance of behavioral finance in explaining deviations from optimal portfolio theory among less literate households.
- Mehta et al. (2023) analyzed the impact of financial literacy on portfolio diversification among urban Indian investors. Their empirical results indicate that financially literate households maintain more balanced portfolios and exhibit higher market participation. The study provides recent evidence supporting the integration of financial literacy into policy-driven financial inclusion strategies.
- Recent SEBI investor surveys highlight that awareness of financial products has improved in India; however, advanced financial literacy remains limited. SEBI (2023) reports that financially literate investors are significantly more likely to hold diversified portfolios and participate in equity and mutual fund markets. The findings reinforce the importance of structured financial education programs, especially in urban financial centers.
- Das and Agarwal (2022) examined mutual fund adoption in India using a behavioral finance approach. The study found that financial literacy positively influences mutual fund participation, while behavioral biases such as ambiguity aversion and herd behavior discourage diversification. The authors suggest that literacy-enhancing interventions can mitigate these behavioral distortions.

- RBI's recent household finance reports document a gradual shift in Indian household portfolios toward financial assets, particularly mutual funds. However, the reports emphasize that portfolio diversification remains inadequate. RBI (2022) identifies financial literacy as a key determinant of improved asset allocation and market participation, while also acknowledging behavioral biases as persistent barriers.

## **RESEARCH METHODOLOGY: -**

### **Research Design**

#### **Nature of Study**

The secondary data primarily consist of published reports, policy documents, and empirical research studies related to financial literacy, household finance, investment behavior, and capital market participation in India. Key sources include publications and databases of the Reserve Bank of India (RBI), Securities and Exchange Board of India (SEBI), Ministry of Finance, and other government and regulatory bodies.

The secondary data was gathered from publicly available resources such as articles, research papers and government websites.

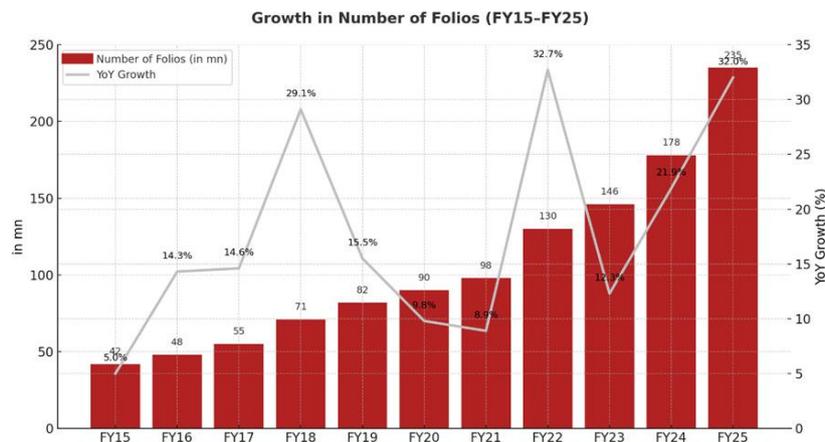
#### **Research Objectives**

- To assess the relationship between financial literacy levels and household portfolio diversification in Mumbai City.
- To examine the impact of financial literacy on stock market participation.
- To determine how financial literacy influences household asset allocation, specifically the inclination towards risky investments.
- To inform policymakers and educators about the potential benefits of financial literacy initiatives on investment behaviors and overall financial outcomes

#### **Limitation of study**

1. The study is geographically limited to the Mumbai region; therefore, findings may not be generalizable to rural or semi-urban India.
2. The cross-sectional design restricts the ability to capture changes in financial literacy and investment behavior over time.
3. Financial literacy is measured using self-reported responses, which may be subject to response bias.
4. Behavioral biases are difficult to measure precisely and may not be fully captured through structured questionnaires.
5. The study focuses primarily on quantitative analysis and does not include in-depth qualitative insights.
6. Market conditions and macroeconomic factors at the time of data collection may influence investment behavior.

## Growth in Financial Years



The above provided bar and line chart illustrates the Growth in the Number of Folios in India from the financial year 2015 (FY15) to the financial year 2025 (FY25). The primary y-axis, represented by the red bars, tracks the total number of folios in millions (mn), while the secondary y-axis, represented by the light grey line, tracks the Year-over-Year (YoY) Growth in percentage. The number of folios has seen substantial growth over the decade, starting at 42 mn in FY15 and steadily rising to an estimated 235 mn by FY25. The YoY growth rate has been volatile, peaking dramatically at 29.1% in FY18 and reaching its highest point of 32.7% in FY22, before experiencing another high of 32.0% in FY25. Conversely, the growth rate slowed down significantly to 8.9% in FY21, making the period from FY21 to FY25 a time of accelerating growth in the number of investment accounts.

## FINDINGS

The findings from this research have several important policy and practical implications. First, there is a clear need for enhanced financial education programs that aim to boost household financial literacy. Increased investment in such educational initiatives may lead to a more informed public, better equipped to manage personal finances and invest wisely. Additionally, financial advisors and market regulators can benefit from integrating financial literacy assessments into their advisory and risk management frameworks. By understanding the link between financial literacy and investment decisions, tailored financial products and services can be developed to better meet the needs of diverse households.

## CONCLUSION

The importance of financial literacy in influencing family investment choices in the Mumbai area is demonstrated empirically by this study. The study demonstrates a strong and statistically significant correlation between financial literacy and investing behaviour by analysing asset allocation trends and portfolio diversification using quantitative regression analysis and survey-based evaluations. In line with the tenets of Modern Portfolio Theory, households with higher levels of financial literacy are observed to build more diversified and balanced investment portfolios, exhibiting greater involvement with risk-bearing financial instruments.

Financial literacy has a significant impact on how people allocate their investments, as confirmed by the survey data and quantitative regression analysis. A deeper comprehension of financial concepts reduces reliance on conventional and low-return investing alternatives by enabling people to assess risks and rewards more skillfully. The results emphasise the necessity of more robust financial literacy initiatives and helpful laws that promote

households' ability to make wise financial decisions. Enhancing financial literacy can help people make wiser investment decisions and enhance their long-term financial security.

The paper also makes recommendations for future lines of inquiry. To gain a better understanding of how household investment decisions change over time, future research may look at investing behaviour over a longer time frame and incorporate more socioeconomic aspects. Overall, the study highlights how crucial it is to raise financial literacy in order to encourage wise investing practices and stable finances.

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