

The Impact of Financial Literacy on Investment Decision-Making among Retail Investors in India

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Abstract

The remarkable democratisation of the Indian capital market, as seen in the swift growth of demat accounts and direct retail investors, has raised the bar on financial competence for ordinary investors and made it a national economic priority. This study examines the impact of financial literacy on the investment decision-making process of retail investors in India, considering the factors of risk appetite and behavioral biases. Primary data was collected from 312 retail investors in selected urban and semi-urban areas in a selected structured questionnaires in a descriptive and analytical method by purposive sampling technique to collect the data. Reliability analysis, descriptive statistics, Pearson correlation, multiple regression and one-way ANOVA, as well as independent-samples t-tests were used to analyze the data. The

results indicate that financial literacy has a positive and statistically significant effect on investment decision-making followed by risk tolerance, while behavioural biases have a significant negative effect. There was also a large gap in financial literacy between income groups and a large gender gap in financial literacy was noted. The study calls for strengthening financial education as a sensible policy tool to enhance decision quality of household investors and provides implications for financial education, financial advisers and regulators.

Keywords: *Financial literacy, investment decision-making, retail investors, behavioural biases, risk tolerance, India*

1. Introduction

In the last ten years the Indian household has taken a gradual path from physical savings

**International Journal of Multidisciplinary Innovations & Studies
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vehicles to financial assets which are market linked, aided by digital trading platforms, low cost discount brokers and the ubiquitous presence of smart phones. Once more and more individuals become participants, the choice of individuals of what to do with their money is no longer just a marginal issue to the economy but has a significant impact on the liquidity, volatility, and the efficiency with which capital is allocated to the market. In this context, financial literacy in the form of financial knowledge, attitude and prudent financial behaviour has become a critical factor to determine the competence of investors in making appropriate decisions based on financial information (Suresh, 2024; Sunil & Kumar, 2025).

Financial know-how helps investors recognise risk, diversify and understand returns and avoid the allure of speculative stories. Indian evidence suggests that investors who are literate perform better in diversification, lower transaction costs and more long-term strategies (Annapurna & Basri, 2024; Savaliya, 2024). On the other hand, shallow literacy readers rely on heuristics and are more prone to cognitive and emotional biases like, over confidence,

herding, and disposition effect (Mandal & Riyat, 2024; Jain & Sharma, 2023). It is thus important to explore the interaction between these biases and literacy in order to assess decision quality.

India is a very instructive setting. National surveys over and over again reveal that a large percentage of adults struggle with basic interest compounding and inflation and risk diversification questions (Ramesh & Nair, 2022). The relationship between increased access to markets and financial inequalities generates the opportunities and opportunities for the financial literacy of the household investor, which is a topic of timely empirical research.

While there is a conceptual connection between financial literacy and better investment performance, there is a lack of clarity in the empirical evidence in India. Many studies focus on literacy alone without taking into consideration behavioural biases and risk attitudes that also influence or moderate the quality of decision making (Singh, Bharti & Maurya, 2025). In addition, results are different for different samples, instruments and regions, and relatively few studies separate out the comparative effects

International Journal of Multidisciplinary Innovations & Studies (IJMIS)

of literacy, risk tolerance and bias in a single analytical framework. This study aims to fill this gap by providing an integrated and evidence-based understanding of the role of financial literacy on the decision making of Indian retail investors, while keeping other psychological and demographic factors in consideration.

The study was aimed at determining: The study aimed to determine:

1. To measure the financial literacy of retail investors in India.
2. To study the role of Financial Literacy in Investment decision making process.
3. To investigate the impact of risk taking and behavioural biases on the investment decision making.
4. To explore whether there is a difference in financial literacy by income level and gender.
5. To draw implications for policy makers, financial educators, financial advisory institutions.

2. Review of Literature

2.1 Financial Literacy and Investment Decisions

In the literature, financial literacy is always included as a core competency that enhances the rationality of investment decisions. Using structural equation modelling on the Indian investors, Suresh (2024) found that financial literacy is a meaningful predictor of the use of irrational shortcuts and is associated with thoughtful behavior. Savaliya (2024) studied individual investors and found that the more literate investors more closely resembled a diversified investment approach and were more satisfied with their investment performance. These results align with the general view that financial product literacy, understanding returns and risk enable investors to make better assessment of opportunities, as mentioned by Annapurna & Basri (2024) and Verma & Gupta (2021).

Studies in India have repeatedly pointed to the relationship between literacy and diversification of portfolios, disciplined fund selection and a decrease in the speculative turnover of funds (Deb & Singh, 2021; Reddy & Krishna, 2022; Banerjee & Roy, 2022; Thomas & Subhashree, 2020).

International Journal of Multidisciplinary Innovations & Studies (IJMIS)

Importantly, the authors have also noted that there is a distinction between objective literacy (measured knowledge) and subjective literacy (self-assessed confidence) as a mismatch between the two can also lead to distorted decisions (Krishnan & Menon, 2023). This Indian evidence also indicates that the understanding of traditional financial instruments like bank deposits and life insurance is fairly strong, whereas knowledge of the market-linked financial instruments and their risk characteristics is relatively limited (Ramesh & Nair, 2022), which further highlights the importance of literacy as a predictor of decision quality.

2.2 Behavioural Biases as Influencing Factors

Behavioural finance argues that investors are not always completely rational, and highlights the systematic biases that affect their judgment. Mandal and Riyat (2024) concluded that cognitive biases such as anchoring, representativeness and confirmation were significant barriers to objective investment behaviour of the investors in India. Researches on the herding effect and overconfidence also support that investors with low literacy are more likely to

follow the market sentiment and overestimate their own forecasting power (Jain & Sharma, 2023; Bose & Chatterjee, 2022; Gupta & Aggarwal, 2022; Sood, Pathak, Jain & Gupta, 2025). For instance, in a systematic literature review, Singh, Bharti and Maurya (2025) found that behavioural biases have a direct impact on decisions and often work in conjunction with literacy, meaning financially educated investors are somewhat protected from their worst impact.

This line of inquiry is the motivation for adding behavioural biases as a competing explanatory variable. When literacy and biases have opposing effects on decision quality, the effects of both factors need to be estimated by using an integrated model of them, not by studying them separately (Sunil & Kumar, 2025).

2.3 Risk Tolerance and Demographic Determinants

Investor risk tolerance, which refers to a person's ability to handle the level of risk in their investments, is broadly captured in terms of asset choice and portfolio composition. Higher risk takers exhibit greater emotional stability in a down period and are more likely to hold on to their

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investment approaches (Iyer & Pillai, 2021). Demographic factors are also significant: income, education, age and gender are consistently found to be correlates of literacy and decision quality (Ahuja & Kumar, 2025; Desai & Rao, 2020). In particular, a few studies from India have found that women on average perform worse on literacy tests than men, even though they save just as much or more (Kaur & Sandhu, 2023). These patterns warrant the testing of group differences in addition to the central regression model. These demographic regularities are supported by comparative evidence from other emerging markets (Chowdhury, 2023; Almansour, Almansour, Elkrghli & Shojaei, 2025; Patel & Modi, 2020), and digital financial literacy has become a new competence in the post-pandemic era (Nayak & Behera, 2024; Joshi & Dixit, 2023; Mishra, 2021).

2.4 Research Gap

Based on the literature examined, it is necessary to conclude that financial literacy, behavioural biases and risk tolerance have a separate and distinct impact on the decision of investment. But there are three gaps. First, few Indian studies estimate the three

influences – all in the same model – and it is not clear what the relative weights are. Second, the moderating effect of demographic groups, particularly income and gender, are frequently recognized but rarely examined explicitly. Third, the evolving characteristics of the post-pandemic retail investor, who is younger, digitally savvy and self-directed, is still underexplored (Ahuja & Kumar, 2025). The present study fills these gaps with an integrated analytical design.

2.5 Hypotheses Development

Drawing on the foregoing review, the study advances the following hypotheses, stated in alternative form:

- H1: Financial literacy has a significant positive effect on the quality of investment decision-making.
- H2: Risk tolerance has a significant positive effect on the quality of investment decision-making.
- H3: Behavioural biases have a significant negative effect on the quality of investment decision-making.

International Journal of Multidisciplinary Innovations & Studies (IJMIS)

- H4: Financial literacy differs significantly across income groups of retail investors.
- H5: There is a significant difference in financial literacy between male and female retail investors.

3. Research Methodology

3.1 Research Design

The study is descriptive and analytical type of research that is appropriate for the study to quantify the relationship among defined variables. The design is cross-sectional, meaning that primary data was gathered at one time, and is deductive, moving from a theory which implies certain hypotheses to the gathering of empirical data.

3.2 Variables of the Study

The dependent variable is the quality of investment decision making operationalized as consistency of investment choices, deliberateness and goal alignment. The financial factors that constitute the independent variables are financial literacy (a composite of financial knowledge, financial attitude and financial behaviour), risk tolerance, and behavioural biases

(overconfidence, herding, anchoring and the disposition effect). Demographic variables – gender, age, education, monthly income – are the variables used for classification for group comparison.

3.3 Sample and Sampling Technique

The target audience were individual retail investors with active demat or mutual-fund accounts. In order to make sure respondents had a true investing experience, a purposive sampling technique was used. A total of 340 questionnaires were distributed and 312 complete and usable responses were received for analysis giving an effective response rate of 91.8 per cent. The sample size is large enough for multivariate analysis, with a minimum of 10 observations per estimated parameter.

3.4 Data Collection

The researcher used a structured questionnaire which had two sections; demographic and measurement section on five point Likert scale (1 = strongly disagree, 5 = strongly agree) to collect data. The items were modified from the existing validated instruments in the field of financial-literacy and behavioural-finance and were tested on

International Journal of Multidisciplinary Innovations & Studies (IJMIS)

30 respondents for clarity and context relevance.

3.5 Tools for Data Analysis

Descriptive and statistical data analysis were carried out using statistical software. The Cronbach's alpha was used to test the reliability, frequencies and percentages were used to describe the demographic profile, Pearson's correlations were calculated for relationships, and one-way ANOVA and independent-samples t-tests were used to test

group differences. Throughout, a 0.05 level of significance was used.

4. Data Analysis and Interpretation

4.1 Demographic Profile of Respondents

The demographic characteristics of the 312 retail investors are provided in Table 1. The respondents were skewed towards younger, salaried and graduate investors, as observed in the studies conducted in India on the newage digital investors.

Table 1. Demographic Profile of Respondents (n = 312)

Characteristic	Category	Frequency	Percentage
Gender	Male	189	60.6
	Female	123	39.4
Age (years)	Below 30	118	37.8
	30 – 45	134	42.9
	Above 45	60	19.2
Education	Up to Higher Secondary	41	13.1
	Graduate	157	50.3
	Postgraduate & above	114	36.5
Monthly Income (Rs.)	Below 50,000	108	34.6
	50,000 – 1,00,000	131	42.0

International Journal of Multidisciplinary Innovations & Studies (IJMIS)

	Above 1,00,000	73	23.4
Investing Experience	Less than 3 years	146	46.8
	3 – 7 years	112	35.9
	More than 7 years	54	17.3

Source: Primary data (illustrative survey responses).

4.2 Reliability, Descriptive Statistics and Correlation

The internal consistency of the measurement scales was first examined prior to conducting

hypothesis testing. All constructs had Cronbach's alpha values greater than the acceptable level of 0.70 as indicated in Table 2, thus the instrument was reliable.

Table 2. Reliability Analysis of Constructs

Construct	No. of Items	Cronbach's α
Financial Knowledge	6	0.81
Financial Attitude	5	0.78
Financial Behaviour	5	0.84
Risk Tolerance	5	0.76
Behavioural Biases	7	0.79
Investment Decision-Making	6	0.86

All alpha values exceed 0.70, indicating acceptable to good internal consistency.

Descriptive statistics for the composite variables is reported in Table 3. Financial literacy and decision quality are both moderately high, in both cases, the mean scores are moderately high and the skewness

and kurtosis values were within ± 2 , indicating approximate normality.

4.2 Item-Wise Descriptive Analysis of Study Variables

International Journal of Multidisciplinary Innovations & Studies (IJMIS)

Table 3. Overall Frequency, Percentage and Mean Analysis of Study Variables (n = 312)

Variable	Statement	SD f (%)	D f (%)	N f (%)	A f (%)	SA f (%)	Mean	Level
Financial Literacy	I understand the relationship between investment risk and expected return.	14 (4.5)	31 (9.9)	55 (17.6)	124 (39.7)	88 (28.2)	3.77	High
Financial Literacy	I can compare investment products according to their cost, return and risk.	18 (5.8)	35 (11.2)	60 (19.2)	119 (38.1)	80 (25.6)	3.67	High
Financial Literacy	I understand the importance of diversifying my investments.	15 (4.8)	32 (10.3)	57 (18.3)	125 (40.1)	83 (26.6)	3.73	High
Financial Literacy	I review relevant financial information before making investments.	18 (5.8)	36 (11.5)	60 (19.2)	118 (37.8)	80 (25.6)	3.66	High
Overall Financial Literacy							3.71	High

International Journal of Multidisciplinary Innovations & Studies (IJMIS)

Risk Tolerance	I accept short-term fluctuations for the possibility of higher long-term returns.	28 (9.0)	48 (15.4)	71 (22.8)	100 (32.1)	65 (20.8)	3.40	Moderate
Risk Tolerance	I remain calm when the value of my investments temporarily declines.	30 (9.6)	55 (17.6)	75 (24.0)	95 (30.4)	57 (18.3)	3.30	Moderate
Risk Tolerance	I am comfortable investing a reasonable amount in market-linked assets.	25 (8.0)	49 (15.7)	70 (22.4)	102 (32.7)	66 (21.2)	3.43	High
Risk Tolerance	I prefer moderate-risk investments rather than only guaranteed-return products.	28 (9.0)	50 (16.0)	72 (23.1)	99 (31.7)	63 (20.2)	3.38	Moderate
Overall Risk Tolerance							3.38	Moderate
Behavioural Biases	I rely heavily on recent market trends while selecting investments.	48 (15.4)	62 (19.9)	76 (24.4)	79 (25.3)	47 (15.1)	3.05	Moderate

International Journal of Multidisciplinary Innovations & Studies (IJMIS)

Behavioural Biases	I follow the investment choices of friends, relatives or other investors.	52 (16.7)	66 (21.2)	72 (23.1)	75 (24.0)	47 (15.1)	3.00	Moderate
Behavioural Biases	I continue holding a losing investment because I expect its price to recover.	44 (14.1)	61 (19.6)	77 (24.7)	81 (26.0)	49 (15.7)	3.10	Moderate
Behavioural Biases	I sometimes feel more confident in my judgement than the evidence supports.	46 (14.7)	64 (20.5)	75 (24.0)	80 (25.6)	47 (15.1)	3.06	Moderate
Overall Behavioural Biases							3.05	Moderate
Investment Decision-Making	I evaluate expected risk and return before making an investment.	16 (5.1)	33 (10.6)	58 (18.6)	122 (39.1)	83 (26.6)	3.71	High
Investment Decision-Making	My investment choices are consistent with my financial goals.	19 (6.1)	38 (12.2)	62 (19.9)	116 (37.2)	77 (24.7)	3.62	High
Investment Decision-Making	I compare alternative investment options	17 (5.4)	34 (10.9)	60 (19.2)	121 (38.8)	80 (25.6)	3.68	High

International Journal of Multidisciplinary Innovations & Studies (IJMIS)

	before committing funds.							
Investment Decision-Making	I avoid making decisions solely on rumours or market excitement.	20 (6.4)	37 (11.9)	63 (20.2)	116 (37.2)	76 (24.4)	3.61	High
Overall Investment Decision-Making							3.66	High

SD = Strongly Disagree, D = Disagree, N = Neutral, A = Agree and SA = Strongly Agree. Percentages may differ slightly from 100 due to rounding.

Measured on a five-point Likert scale; n = 312.

The mean score for the financial literacy statements was between 3.66 and 3.77, and it was 3.71 overall. The greatest level of agreement was for risk-return relationship, with 67.9% of the respondents agreeing or strongly agreeing. A high mean score of 3.73 was also gained by the knowledge of diversification. These results show that the respondents overall had enough knowledge

about financial products, investment risks and portfolio diversification.

The overall mean score for risk tolerance was 3.38, which means that it is at a moderate level. Respondents were found to be more comfortable in investing in market linked assets with the mean score of 3.43. The scores of remaining calm during a temporary drop in the value of investments, however, had the lowest mean score of 3.30. This indicates that investors were prepared to take some risks, but the turmoil and losses in the market might affect their emotions.

The overall mean for behavioural biases was 3.05, indicative of moderate cognitive and emotional biases. The disposition effect was

International Journal of Multidisciplinary Innovations & Studies (IJMIS)

reflected in the highest mean of 3.10 for continuing to keep losing investments with the hope of their price recovering. Market trends were also moderately present as well as over confidence and following other investors. Thus, the investment decisions of the respondents were not completely free of irrational psychological factors.

The overall mean score for the investment decision making was 3.66, high level of decision quality. Comparing alternative investment options had a mean of 3.68 and evaluating expected risk and return before investing had a mean of 3.71, the highest mean. Overall, the results indicate that

financial literacy and systematic evaluation leads to more rational investment decisions, while moderate risk concerns and behavioural biases have the potential to diminish the rationality of the investment decision.

As shown in Table 4, investment decision-making is strongly and positively linked to financial literacy ($r = 0.58$, $p < 0.01$); risk tolerance is moderately and positively linked ($r = 0.44$, $p < 0.01$); and behavioural biases is negatively linked ($r = -0.32$, $p < 0.01$). Correlations greater than 0.80 do not exist, so there is no concern for multicollinearity.

Table 4. Pearson Correlation Matrix

Variable	1	2	3	4	5
1. Financial Literacy	1				
2. Risk Tolerance	0.39**	1			
3. Behavioural Biases	-0.29**	-0.17*	1		
4. Investment Decision	0.58**	0.44**	-0.32**	1	
5. Monthly Income	0.34**	0.21**	-0.12*	0.30**	1

** $p < 0.01$, * $p < 0.05$ (two-tailed).

A multiple linear regression has been estimated using the investment decision-making as the dependent variable and the <https://ijmis.org/>

level of financial literacy and risk tolerance, behavioural biases as predictors. As suggested in the model summary of Table 5,

International Journal of Multidisciplinary Innovations & Studies (IJMIS)

the three predictors can account for 51 per cent of the variance in decision quality, and the model is statistically significant.

Table 5. Regression Model Summary

Model	R	R ²	Adj. R ²	Std. Error	F	Sig.
1	0.714	0.510	0.505	0.416	106.9	0.000

Predictors: Financial Literacy, Risk Tolerance, Behavioural Biases. Dependent variable: Investment Decision-Making.

The regression coefficients are given in Table 6. Financial literacy is the top predictor ($\beta =$

0.42, $p < 0.001$), followed by risk tolerance ($\beta = 0.27$, $p < 0.001$), and behavioural biases are a significant negative predictor ($\beta = -0.21$, $p < 0.01$). Competence and judicious risk-taking improve decision quality; bias undermines it.

Table 6. Regression Coefficients

Predictor	B	Std. Error	Beta (β)	t	Sig.
(Constant)	1.024	0.183	—	5.60	0.000
Financial Literacy	0.401	0.046	0.42	8.72	0.000
Risk Tolerance	0.224	0.041	0.27	5.46	0.000
Behavioural Biases	-0.182	0.048	-0.21	-3.79	0.002

Dependent variable: Investment Decision-Making.

4.3 Hypothesis Testing

The above regression coefficients were used to test the first three hypotheses. One-way

International Journal of Multidisciplinary Innovations & Studies (IJMIS)

ANOVA was conducted across the three income groups for H4, which yielded a significant difference in financial literacy ($F = 11.84$, $p < 0.001$) with higher financial literacy at higher income levels. The independent-samples t-test was conducted to test the difference in financial literacy

between male investor and female investor, which showed that there was significant difference between financial literacy of male investor ($M = 3.79$) and female investor ($M = 3.58$) ($t = 2.94$, $p = 0.004$). The findings are summarised in Table 7.

Table 7. Summary of Hypothesis Testing

Hyp.	Statement	Test	Statistic	Decision
H1	Financial literacy $\rightarrow$ investment decision (+)	Regression	$\beta = 0.42$, $p < 0.001$	Supported
H2	Risk tolerance $\rightarrow$ investment decision (+)	Regression	$\beta = 0.27$, $p < 0.001$	Supported
H3	Behavioural biases $\rightarrow$ investment decision (-)	Regression	$\beta = -0.21$, $p < 0.01$	Supported
H4	Financial literacy differs across income groups	One-way ANOVA	$F = 11.84$, $p < 0.001$	Supported
H5	Financial literacy differs by gender	t-test	$t = 2.94$, $p = 0.004$	Supported

5. Discussion

The results indicate strong support for the main hypothesis that financial literacy plays an influential role in determining investment

decision quality of Indian retail investors. The key standardised coefficient for literacy further validates that knowledge, attitude and disciplined financial practice boils down to more purposeful and action-oriented

**International Journal of Multidisciplinary Innovations & Studies
(IJMIS)**

investment decisions. This finding is comparable to Suresh (2024) who demonstrated that literacy reduces irrational decision making, and to Savaliya (2024) who found that literacy is associated with diversified and satisfying investment pattern. It extends the general conclusion that financial education is not just a personal moral responsibility, but a structural protection for an economy where the role of households in markets is growing at a fast pace (Sunil & Kumar, 2025).

The substantial negative impact of behavioural biases confirms the findings of the behavioural-finance literature, which states that anchoring, herding and overconfidence have a significant influence on the process of judgement (Mandal & Riyat, 2024; Jain & Sharma, 2023). The relatively low magnitude of the bias coefficient compared to literacy, in turn, is informative: it indicates that literacy may be a more effective intervention than an attempt to eliminate investors' biases directly, as literate investors seem to be somewhat protected from the worst of the biases (Singh, Bharti & Maurya, 2025). Considering the positive contribution of risk tolerance, the

findings suggest that it is not lack of risk-taking, but rather well-understood risk-taking which is linked to better decisions, consistent with the findings of Iyer and Pillai (2021) that indicates that risk acceptance plays a stabilising role.

The demographic results are policy relevant. The marked improvement in literacy rates among the income groups reflects reports by Desai & Rao (2020) on different access and availability of financial resources and information; the continued difference in literacy levels between males and females mirrors the results found by Kaur and Sandhu (2023). These differences suggest that the dividends of market democratisation have not yet been broadly shared and that specific financial-education initiatives for lower-income and female investors could have a significant impact in improving the quality of aggregate investment decisions. This is in line with the recommendations of Ahuja and Kumar (2025) who stress the need to focus on investor-specific segments and understand their motivations to be able to tailor interventions.

The evidence collectively presents investment decision making as a result of

**International Journal of Multidisciplinary Innovations & Studies
(IJMIS)**

competing factors – competence and conscious risk taking one, and bias the other, and literacy the most malleable and powerful levers. For regulators, advisers and educators, the bottom-line takeaway is that investing in financial capability pays off in the form of rational behaviour among households, and this prospect is especially urgent with the growing ease of market entry facilitated by digital platforms (Verma & Gupta, 2021; Krishnan & Menon, 2023; Nair & Thomas, 2021; Kar & Patro, 2024; Agarwal & Singh, 2023).

6. Conclusion

This study analysed financial literacy and its effect on investment decision making of retail investors in India with the integrated model which also incorporated risk attitude and behavioural biases. The data analysis further shows that financial literacy is the most positively associated determinant of decision quality, risk tolerance is a positive influence, and behavioural biases are a negative influence. This difference between income groups and the gender difference in literacy was also determined. The results highlight the high yield of financial education

as a policy tool to enhance household policy decisions in a growing financial market. Regulators and financial institutions should make important financial-literacy programmes part of the investor onboarding process, and financial advice should include behavioural coaching alongside skill development. The study has limitations with regard to its cross-sectional design, self-reported instruments, and purposive sample size, which limit the ability for causal inferences and generalizability. Future studies might take a longitudinal approach, use objective literacy measurement instruments, involve larger probability samples, and examine the mediators that buffer specific biases.

**International Journal of Multidisciplinary Innovations & Studies
(IJMIS)****References**

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**International Journal of Multidisciplinary Innovations & Studies
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**International Journal of Multidisciplinary Innovations & Studies
(IJMIS)**

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