e-ISJN: A4372-3114
p-ISJN: A4372-3115

ISSN: 2321-7782 (Online)
ISSN: 2347-1778 (Print)
Impact Factor: 6.012

Volume 12, Issue 3, March 2024

International Journal of Advance Research in Computer Science and Management Studies

Research Article / Survey Paper / Case Study / Literature Review

Available online at: www.ijarcsms.com

Financial Literacy Affects Portfolio Diversification and Investment Behaviour: A Study

Neeraj[1]
Research Scholar,
Department of Management,
Chaudhary Ranbir Singh University,
Jind (Haryana), India.

Prof. Sanjay Kumar Sinha[2]
Dean Department of Management,
Faculty of commerce and Management
Chaudhary Ranbir Singh University,
Jind (Haryana), India.

DOI: https://doi.org/10.61161/ijarcsms.v12i3.4

Abstract:

Purpose – The purpose of this research is to gather and analyse articles on behavioural biases and their impact on investing decisions.

Design – A sample of 67 research papers were selected to obtain an ideal findings related to the effects of financial literacy on investment decisions. The research design was based on tabular description and comparison.

Findings – The findings suggest that having financial literacy directly helps in making justified decisions in terms of investments and portfolio diversification. The findings also suggests that individual investors generally copies large investors and fund managers which makes them vulnerable at times as they have highlight qualified teams for research and they can exit whenever they want from an investment but individuals make get stuck.

Value – Previous financial research has focused on the relationship between financial literacy and portfolio diversification and investment decisions. In addition, they discovered that several factors influence how individual investors handle their funds. In these researches, however, the crucial connection between financial literacy and the behavioural biases of individual investors and other associated aspects has not been highlighted. Due to this, the unique empirical research provided in this paper has demonstrated how financial literacy may aid in reducing investor behavioural biases.

Keywords: Investment behaviour, financial literacy, portfolio diversification, knowledge, education.

I. INTRODUCTION

Financial planning is the act of analysing your finances and determining how to spend your money to achieve your objectives. Due of this, financial planning frequently encompasses a broad variety of subjects, such as investing, taxes, savings, retirement, estate planning, and insurance (Gitman, et al. 2010). Financial literacy is the understanding and use of a number of financial concepts and abilities, such as personal finance management, budgeting, and investing. Financial literacy is the basis of your money management, and it is a lifelong endeavour (Bhushan, 2014). Financial literacy and knowledge are crucial because they enable an individual to have a fundamental grasp of both simple and complicated financial issues and to utilise this information to make intelligent and effective decisions regarding their own money (Assefa & Rao, 2018; Mittal, 2019).

Rising life expectancies and declining birth rates are straining pension and Social Security systems worldwide. Due to this, retirement plans in many nations have shifted from traditional defined benefit (DB) pensions to individual-account defined contribution (DC) plans. Individuals, rather than organisations such as businesses and governments, are increasingly making decisions about how to finance retirement. This places the one on workers to save, invest, and spend sensibly throughout their lifetimes. In certain instances, this transformation has resulted in positive outcomes. Pensions must be transferrable, for example, when the workforce moves. DC plans are more adaptable than conventional DB plans, which restrict employee mobility. However, because DC is adaptable, individuals may not act as they should. Due to longevity risk, they may not save enough, make poor investments, and run out of money in old life (Lusardi & Mitchell, 2011). If one make prudent investing decisions, they will earn money in the future. Portfolio management is the art and science of selecting and managing a set of investments that corresponds to a clients or company's long-term financial objectives and risk tolerance (Mittal, 2019).

Individual investors are those who purchase and sell equities for other individuals on their own behalf. These investors often trade little sums and are primarily interested in what occurs on the stock exchange (Hamad, et al. 2021). This resulted in hasty investing selections that were not based on significant facts and official stock market data. The spread of the COVID-19 virus has had an impact on the global economy and financial markets (Anwar & Shukur, 2015). Even if there are several methods to profit from the present epidemic, the majority of investors fear that their portfolios will decline. As the economy expanded, old methods of investing were examined and documented (Anwar & Abd Zebari, 2015).

II. Conceptual Framework

The research framework is initiated with the aim to understand the Individual financial literacy then individual investment decision and how portfolio diversification varies. This will be done simultaneously to gather information and analyse the same for presenting the results.

III. Research Methodology and Data

A comprehensive literature analysis was conducted to examine the existing studies on behavioural biases and their impact on investing decisions. We searched for articles that included the phrases behaviour finance, behaviour biases, individual investor decision-making, overconfidence, herd biases, availability biases, disposition influence, hindsight biases, and self-attribution biases. We utilised databases such as Emerald, JSTOR, Research Gate, Science Direct, and Google Scholar to locate pertinent literature on the topic. We selected a ten-year span, from 2011 till now, to examine the beginnings of basic theory, the quantity of empirical and descriptive investigations, and the current literature review and analytical research publications. The publications for this study were identified and selected based on the following criteria:

- A manuscript that has appeared in many publications and is accessible through an internet database
- A document composed in English that contains some relative piece of information
- Several types of papers, including theoretic, analytic, literature review, case study, working paper, and conference paper
- The search key term appears in the article's title and abstract.

After extensive investigation utilising the aforementioned criteria, we selected 67 papers for evaluation.

IV. Analysis of Literature

4.1 Financial Literacy

Young people are especially in need of financial literacy since they must make decisions about money that will affect them for the rest of their lives. One of these decisions is whether or not to attend college, and if so, how to finance it (Bottazzi & Lusardi, 2021). As a society, people are increasingly aware that we must be better prepared for the next catastrophe. Making sure everyone is financially literate is a crucial step in stabilising society. Programmes of financial literacy should teach individuals how to comprehend and manage risk, as well as how to create financial resilience.

The government's direct financial assistance is unquestionably part of the solution to this problem, but in today's market, individuals are required to make a number of financial decisions that will affect their finances in the now and the future. The consequences of widespread financial illiteracy to individuals and society are too great for us to choose not to teach people about money (Lusardi, et al. 2021; Lyons & KassHanna, 2021).

People who are considered to have financial literacy have the ability to apply their knowledge and comprehension of financial ideas and risks to make sound financial decisions in a range of scenarios, so enhancing their own and society's financial security and enabling full participation in the economy (Goyal and Kumar 2021; OECD, 2014)

4.2 Financial Investment Behaviour

Mak and Ip (2017) said that the majority of behavioural finance research shows that how people act effects their investment decisions. Researchers revealed that financial market participants do not always respond logically. They are instead influenced by a range of factors, the most significant of which are psychological, social, and demographic factors. This study identifies and investigates the key elements in the literature that explain investment behaviour using three constructs: psychological factor, social factor, and demographic factor. It also investigates how these aspects impact investor behaviour so that behaviour can be studied in more realistic circumstances and investors may be more accurately categorised.

Tahir and Brimble (2011) in a contrasting study on Muslims to understand their investing behaviours, found that, a Muslim will also benefit by engaging in legitimate commerce, trade, and professions. Ijtihad, a secondary source of Islamic law, must be employed because the primary sources of Islamic law remain silent on whether or not it is permissible to own shares. In three instances, according to one of the most influential Islamic scholars of the contemporary period, Muslims can own stock shares. A Muslim may only invest in enterprises whose primary operations adhere to Islamic Shariah. If they do not, they are directly associated with illicit conduct.

4.3 Portfolio Diversification

Zaimovic, et al. (2021) said that people may argue that risk has become an integral component of the business sector since modern economies are volatile and unpredictable. By investing in multiple diverse firms, idiosyncratic risk, or risk unique to a certain company, is decreased. As a result, the portfolio becomes less volatile. According to the study, idiosyncratic risk is the primary contributor to overall volatility, and the two components of total risk are not wholly independent from one another. Despite strong protection, it is difficult to completely remove overall risk. The overall risk will always contain systematic risk elements, and international diversification is the only method to spread that risk further. Because the sources of risk are unique and the investment is spread across a vast number of assets, the exposure to any one source of risk is small.

4.4 Year of publication and type of studies

Year	Theoretical	Literature Review	Type of study analytical	Empirical	Total
2011-2015	3	4		2	9
2016- 2020	9	15	5	6	35
2021-till now	4	7	3	7	21

4.5 Demographic *v/s* type of research study

Year	Total	Literature Review	Type of study				
			Empirical/ Primary	Empirical/ Secondary	Descriptive/ Primary	Descriptive/ Secondary	Analytical
2011-2015	9	4	2		1		2
2016- 2020	35	15	5	1			5
2021-till now	21	7	6	1	1		3

4.6 Journal of publication *v/s* number and type of research

Name of journal/ Publication	Total	Type of study				
		Empirical/ Primary	Empirical/ Secondary	Descriptive/ Primary	Descriptive/ Secondary	Analytical
International Journal of Research and Analytical Reviews	1	1				1
International Journal of Bank Marketing	3	2		1		2
Emerald Insight	6	5		1		5
Journal of Economics, Finance and Administrative Science	1		1			1
Sage	11	8		3		7
Journal of Behavioral and Experimental Finance	1					
Oxford	2	1	1			1
Taylor & Francis Group	4					
Managerial Finance	1	1				1
Review of Behavioral Finance	1		1			
Management Research Review	1		1			1
Journal of Economics, Finance and Administrative Science Kybernetes	2	1	1			1
Journal of Money and Business	1	1				1

V. Findings

This study confirms that there is a strong relationship between the attitudes, financial knowledge, and decision-making ability of investors with the literacy level. There is a relation between investors' financial knowledge, how they feel about money, and the decisions they make, according to the findings of this study. A total of 67 research articles and papers were selected from the year 2011 till now and it has been identified that most of the researches were conducted in between 2016 to 2020 where the most studies were published from Sage Publications. According to the results of this study, there is a strong association between how investors feel and their financial literacy. In addition, these three outcomes are consistent with prior research in this subject. The association between financial literacy and decision-making, investing behaviour, and portfolio diversity is strong.

VI. Conclusion

This research revealed that literacy has a significant impact on how individuals manage their finances. Although cognitive function does not directly influence financial behaviour, it modifies how specific variables influence that behaviour. Behavioural finance concepts such as "illusion of control," "restricted information processing," "constrained rationality," and "portfolio diversification" explains the impacts of the intellectual aspect or financial literacy.

VII. Limitation

First, this study focuses solely on Indians which limit the generalizability of the findings; nonetheless, the study can be expanded to other developing nations. Secondly, just a small number of statements were used to rate the investors for all three factors in this study. Lastly, the study focuses on few aspects of the variables it ignores some major aspects such as investors behaviour, effect on portfolio etc., future studies can focus on these aspects as well.

VIII. Social Implication

The social implications of communication research are the ways in which research can have a discernible or beneficial impact on society. These studies allows to examine the world methodically and draw conclusions based on facts and data. The results of a study enables to make particular assertions about the importance of research, as opposed to the general claims made in ordinary discussion. Likewise, this research provides some assumptions based on results while some social implications are included like, ideal contribution to society, technological developments and scientific facets, personal knowledge base of individuals and measure of financial behaviour.

IX. Practical Implication

Practical implication basically answers, what would actually occur if specific circumstances were satisfied is an example. For instance, when researchers conduct behavioural trials, the precision of the data they collect may influence the precision with which clinicians evaluate the efficacy of particular behavioural therapies. Here, in this research practical implications includes non-specific financial results for individual investors, strategies for portfolio diversification and future planning’s.

References

1. Anderson, A., & Robinson, D. T. (2021). Financial literacy in the age of green investment. Swedish House of Finance Research Paper, (19-6).
2. Anwar, G., & Abd Zebari, B. (2015). The Relationship between Employee Engagement and Corporate Social Responsibility: A Case Study of Car Dealership in Erbil, Kurdistan. International Journal of Social Sciences & Educational Studies, 2(2), 45.
3. Anwar, G., & Shukur, I. (2015). The impact of recruitment and selection on job satisfaction: Evidence from private school in Erbil. International Journal of Social Sciences & Educational Studies, 1(3), 4-13.
4. Aren, S., & Hamamci, H. N. (2020). Relationship between risk aversion, risky investment intention, investment choices: Impact of personality traits and emotion. Kybernetes.
5. Assefa, M., & Rao, D. (2018). Financial literacy and investment behavior of salaried individuals: a case study of Wolaita Sodo Town. Int. J. Bus. Manage. Invent, 7, 43-50.
6. Aydemir, S. D., & Aren, S. (2017). Do the effects of individual factors on financial risk-taking behavior diversify with financial literacy?. Kybernetes.
7. Balachandra, L., Briggs, T., Eddleston, K., & Brush, C. (2019). Don’t pitch like a girl!: How gender stereotypes influence investor decisions. Entrepreneurship Theory and Practice, 43(1), 116-137.
8. Bamforth, J., Jebarajakirthy, C., & Geursen, G. (2018). Understanding undergraduates’ money management behaviour: a study beyond financial literacy. International Journal of Bank Marketing.
9. Bhushan, P. (2014). Relationship between financial literacy and investment behavior of salaried individuals. Journal of Business Management & Social Sciences Research (JBM&SSR), 3(5), 82-87.
10. Bottazzi, L., & Lusardi, A. (2021). Stereotypes in financial literacy: Evidence from PISA. Journal of Corporate Finance, 71, 101831.
11. Bouteska, A., & Regaieg, B. (2018). Loss aversion, overconfidence of investors and their impact on market performance evidence from the US stock markets. Journal of Economics, Finance and Administrative Science.
12. Dogra, P., Kaushal, A., & Sharma, R. R. (2021). Antecedents of the Youngster’s awareness about financial literacy: A structure equation modelling approach. Vision, 0972262921996560.

13. Eniola, A. A., & Entebang, H. (2017). SME managers and financial literacy. Global Business Review, 18(3), 559-576.
14. Fujiki, H. (2021). Crypto asset ownership, financial literacy, and investment experience. Applied Economics, 53(39), 4560-4581.
15. Gitman, L. J., Joehnk, M. D., & Billingsley, R. S. (2010). Personal financial planning. Cengage Learning.
16. Goyal, K., & Kumar, S. (2021). Financial literacy: A systematic review and bibliometric analysis. International Journal of Consumer Studies, 45(1), 80-105.
17. Graham, J. F., Stendardi, E. J., Myers, J. K., & Graham, M. J. (2002). Gender differences in investment strategies: an information processing perspective. International journal of bank marketing.
18. Grohmann, A., Hübler, O., Kouwenberg, R., & Menkhoff, L. (2021). Financial literacy: Thai middle-class women do not lag behind. Journal of Behavioral and Experimental Finance, 31, 100537.
19. Hamad, H. A., Qader, K. S., Gardi, B., Abdalla, P., Hamza, D., & Anwar, G. (2021). The essential variables to consider before investing in financial markets during Covid-19.
20. Hudson, C. R., Phillips, M., Smalls, T., & Young, J. (2021). Investment Behavior: Factors that Impact African American Women's Investment Behavior. The Review of Black Political Economy, 48(3), 349-367.
21. Ingale, K. K., & Paluri, R. A. (2020). Financial literacy and financial behaviour: A bibliometric analysis. Review of Behavioral Finance.
22. Jariwala, H. V. (2015). Analysis of financial literacy level of retail individual investors of Gujarat State and its effect on investment decision. Journal of Business & Finance Librarianship, 20(1-2), 133-158.
23. Jonsson, S., Söderberg, I. L., & Wilhelmsson, M. (2017). An investigation of the impact of financial literacy, risk attitude, and saving motives on the attenuation of mutual fund investors' disposition bias. Managerial Finance.
24. Kasoga, P. S. (2021). Heuristic biases and investment decisions: multiple mediation mechanisms of risk tolerance and financial literacy—a survey at the Tanzania stock market. Journal of Money and Business.
25. Khan, M. T. I., Tan, S. H., & Gan, G. G. G. (2019). Advanced financial literacy of Malaysian Gen Y investors and its consequences. Margin: The Journal of Applied Economic Research, 13(1), 83-108.
26. Lauterbach, R., Hass, L. H., & Schweizer, D. (2014). The impact of fund inflows on staging and investment behaviour. International Small Business Journal, 32(6), 644-666.
27. Linciano, N., Lucarelli, C., Gentile, M., & Soccorso, P. (2018). How financial information disclosure affects risk perception. Evidence from Italian investors' behaviour. The European Journal of Finance, 24(15), 1311-1332.
28. Liu, B., Wang, J., Chan, K. C., & Fung, A. (2021). The impact of entrepreneurs's financial literacy on innovation within small and medium-sized enterprises. International Small Business Journal, 39(3), 228-246.
29. Lusardi, A., & Mitchell, O. S. (2011). Financial literacy around the world: an overview. Journal of pension economics & finance, 10(4), 497-508.
30. Lusardi, A., Hasler, A., & Yakoboski, P. J. (2021). Building up financial literacy and financial resilience. Mind & Society, 20(2), 181-187.
31. Lyons, A. C., & Kass-Hanna, J. (2021). A methodological overview to defining and measuring "digital" financial literacy. Financial Planning Review, 4(2), e1113.
32. Mahapatra, M. S., Raveendran, J., & De, A. (2019). Building a model on influence of behavioural and cognitive factors on personal financial planning: A study among Indian households. Global Business Review, 20(4), 996-1009.
33. Mak, M.K. and Ip, W.H., 2017. An exploratory study of investment behaviour of investors. International Journal of Engineering Business Management, 9, p.1847979017711520.
34. Mittal, S. K. (2019). Behavior biases and investment decision: theoretical and research framework. Qualitative Research in Financial Markets.
35. Mushinada, V. N. C., & Veluri, V. S. S. (2019). Elucidating investors rationality and behavioural biases in Indian stock market. Review of Behavioral Finance.
36. Nieddu, M., & Pandolfi, L. (2021). Cutting Through the Fog: Financial Literacy and Financial Investment Choices. Journal of the European Economic Association, 19(1), 237-274.
37. OECD. (2014). PISA 2012 technical background. In OECD (Ed.), PISA 2012 Results: Students and money: Financial literacy skills for the 21st Century (Vol. VI, pp. 123–145). Paris: OECD Publishing.
38. Pandey, R., & Jessica, V. M. (2018). Measuring behavioural biases affecting real estate investment decisions in India: using IRT. International Journal of Housing Markets and Analysis.
39. Pandey, R., & Jessica, V. M. (2018). Measuring behavioural biases affecting real estate investment decisions in India: using IRT. International Journal of Housing Markets and Analysis.
40. Pangestu, S., & Karnadi, E. B. (2020). The effects of financial literacy and materialism on the savings decision of generation Z Indonesians. Cogent Business & Management, 7(1), 1743618.
41. Potrich, A. C. G., & Vieira, K. M. (2018). Demystifying financial literacy: a behavioral perspective analysis. Management Research Review.
42. Rekha, G., & Vishnupriya, R. (2019). A Study on Investment Pattern among Working Women. Children, 148(1), 5.
43. Tahir, I. and Brimble, M., 2011. Islamic investment behaviour. International Journal of Islamic and Middle Eastern Finance and Management, 4(2), pp.116-130.
44. Zahera, S. A., & Bansal, R. (2018). Do investors exhibit behavioral biases in investment decision making? A systematic review. Qualitative

Research in Financial Markets.

45. Zaimovic, A., Omanovic, A. and Arnaut-Berilo, A., 2021. How Many Stocks Are Sufficient for Equity Portfolio Diversification? A Review of the Literature. Journal of Risk and Financial Management, 14(11), p.551.

46. Zhao, H., & Zhang, L. (2021). Financial literacy or investment experience: which is more influential in cryptocurrency investment?. International Journal of Bank Marketing.

::. How to Cite this ARTICLE .::

Neeraj, & Sharma, S. K. (2024). Financial Literacy Affects Portfolio Diversification and Investment Behaviour: A Study. (2024). *International Journal of Advance Research in Computer Science and Management Studies*, *12*(3), 26-32.

https://doi.org/10.61161/ijarcsms.v12i3.4