"Financial Literacy and Investors Behaviour: A Theoretical perspective"

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"The number one problem with today's generation and economy is lack of financial literacy" -Alan Greenspan, Chairman, Federal Reserve Bank

Abstract:

This study attempts to synthesise various studies on Financial Literacy which have been carried out all over the globe. The paper includes analysis of various researches conducted in India as well as in the rest of the world and its effects on the financial behaviour of the investors in various countries. The study attempts to identify the significance of financial literacy for people who make financial decisions and those who do not. The present global economic crises have focused on the requirement of high awareness of financial knowledge awareness and financial education, so that investors can take less risk prone financial decisions. This study has been concluded with the outcomes of various studies and surveys conducted at national and international level on financial literacy and investor's behaviour.

Keywords: *Financial literacy, financial knowledge, Investment decisions, Investors behaviour.*

INTRODUCTION:

Financial Literacy is the ability to have awareness and understanding of financial products, in context of risk and returns associated with them to make right financial choices. This article covers the concept of financial literacy its focus on different global practices on financial literacy, the global prospective on financial literacy, investor's behaviour in various countries. In the end it covers possible outcomes of various studies conducted in different countries especially for investment decisions. The article is concluded with key observations and research gap.

Based on the review of various research papers for understanding the concept of financial literacy and investment this paper is classified in four categories:

1. Understanding financial concept.
2. Factors affecting investment decisions.
3. Finding related to financial literacy and investment decisions in selected countries.
4. Scope for future research

I. Understanding financial concepts:

Financial literacy is the ability to understand how money works in the world: how someone manages to earn or make it, how that person manages it, how he/she invests it and how that person donates it to help others. More specifically, it refers to the set of skills and knowledge that allows an individual to make informed and effective decisions with all of their financial resources. The need for financial literacy and its importance for financial inclusion have been acknowledged by all possible stakeholders - policymakers, bankers, practitioners, researchers and academics – across the globe. Various financial literacy programmes have thus been implemented by concerned institutions, with a lot of them being unique in their approach and delivery mechanisms. Financial literacy was first time conceived by **Jumpstart coalition** in their inaugural study in jumpstart survey of financial literacy (1977). It was conducted among the students of high school jumpstart defines financial literacy as "the *ability to use knowledge* and skills to manage one's financial resources effectively for lifetime financial security." **Jacob,Hudson and bush(2000)** stated that financial literacy not only provide convenience but also it is an *necessary survival tool*.in this context **Hogarth J.M(2006)** also explained in his study that financial education should include knowledge and understanding the issues related to money management, asset, banking, insurance and taxes. **OECD (2005)** defines financial literacy as ― "the process by which financial consumers/investors improve their understanding of financial products and concepts and, through information, instruction and/or objective advice, develop the skills and confidence to *become more aware of financial risks and opportunities*, to make informed choices, to know where to go for help, and to take other effective actions to improve their financial well-being‖" (p. 26). In this context **PACFL(2008)** also advocate that *financial education is the process* in which individual can improve their understanding of financial concepts, services and products.**Lusardi and Mitchell(2007)** explains financial literacy as it is *the familiarity with the concepts of economics* so that people can take wise investment decisions. While **Schagen and lines (1996)** defines financial literacy is not only just familiarity but it is an ability to *make informed judgements* that means that means financially literate person can take effective decisions related to management of money. In contrary to this **Beal Delpuchitra(2003)** argued that it only ability to understand the all concepts related to financial literacy is not enough but a financial literate person should also possess *a facilitating attitude* for effective financial management.

II. factors affecting investment decisions:

Decision making can be defined as choosing the best alternative from various available alternatives. Financial literacy plays a vital role in making investment decisions. A right investment can give a right return. Due to lack of financial literacy people make wrong investment decisions related to how much to save for future heavily depends upon the immediate money requirement. **Karlson et.al.,(2004)** analysed that individual make financial decisions on day to day basis and their decisions are necessary for survival, it is a kind of forbidding task. Many other researchers in the area of consumer financial behaviour found that there are various factors which affect the decision making ability of an individual. Baker and **Haslem(1974)** examined that firms financial stability, firms expected return and dividend policy are major considerations for investment decisions. **Epstien(1994)** stated that investors demand for social information which indicates information related to product safety quality and companies environment.in addition to this **Blumberg et.al.,(1977)** added that stakeholders always wants to see company grow so that they are interested in companies investment in social and related issues. **Merikas financial et.al, (2003)** suggest that one cannot rely on single interned approach, there are various other factors such as personal/subjective information, accounting information, condition of financial statement expected dividends, firms stability and status in industry and past performance of firm is also a influencing factor for investment decisions while **Hodge (2003)** analysed that firms audited financial statements have more reliance with lower estimation of earning quality. When making an investment decisions. In addition to this **Benston et,al.,(2006)** has added that investors require more information than just financial statements, an investor consider expected changes in the market conditions, firms competitors and performance, its potential value of firms new product, domestic inflation rates , current and future government policies, quality of management and relation of customers with employee. **Chandra et.al. (2011)** found that in their study that investors not only take interest in professional and contextual source of information, they also follow technical analysis of accounting and financial information and market share of company.

Literatures also suggest that there is a relationship of individual social and demographic variable and behavioural fiancé for making investments decisions. **Clark-Murphy can Gerrens,(2001)** proved that women are less confident in making financial decisions **Chen and Volpe(1988)** suggested women are less knowledgeable than man on the issues related to personal finance. Age is another factor that affects investment decisions. **Hrrison (2003)** added that past investment experiences affect investment decisions related to future financial planning. Similarly, **Lwellen et al.(1977)** suggested that investors with lower age, high level of income, higher education, and with less family members are more risk tolerant as they invest more in risky assets than conservative one.

Risk tolerance is another important factor which influences the investment decisions of an individual. **Wllech & kogen(1996);Palsson (1996)** found that risk taking ability decreases with age in reality we can say that younger investors have more number of years to cover the losses if occurred in any risky investment however, relationship between gender and risk tolerance is complex equation. **Gerrans and clarl-murphy(2004)** stated that effect of gender in relation with risk tolerance is not uniform it also depends on the marital status, weather an individual consider him/her informed and aged for taking risk related to investment.**Bajtelsmit et al.(1999)** suggest that single women are more risk averse than single men or married couple. In contrary to this **Grable and Joo (1999)** proved that gender is not a significant prognosticator of individual ability to take risk in investment decisions. Adding to this the **survey of consumer finances (scf.1977)** measured risk tolerance but it was also analysed that gender did not influence investment t choices but the differences appeared because of the result of net worth and the expectations of an inheritance. Contrary to this Sung and **Hunna(1996)**proved that other than gender, education also plays a vital role in risk bearing ability of individual. Adding to these **Arlen et al. (2007)** focuses that lack of confidence in investors is another factor that make them rely on financial advices. Sung and **Sandager(1997)** stated that mostly consumer need certified financial planners for making any investment decision n as they are less confident in their knowledge and choices. **Nick et al.(2010)** proved in their study that consumer rely on various sources of information such as websites, telephone representatives of company, friends, family members, magazines, newspapers, consumer advice organizations.

By discussing all these factors it can be concluded that investors are differentiated by the range of their demographic social profiles, activities, age, risk tolerance capacity, their need for financial information, and other variables which influence the decision of investors. Investor's level of sophistication also plays an important role; this level of sophistication can also be termed as level of financial literacy.

III. OTHER FINDING FROM VARIOUS STUDIES: -

country	Conducted by	Conducted on	Result and observations
U.S	Schagen and Lines(1996)	General population divided into four groups: young people in work, students in higher education, single parents, families lives in subsidized housing	-single parents are less committed to savings. -students have least confidence in dealing financial matters.
U.S	Chen and volpe (1998)	924 college students were examined from 13 colleges. This survey analysed the relationship between financial literacy and students.	-personal finance knowledge and skill are low among students. - Overall median percentage of correct score was 55.56%. -poor responses were on investment and best responses were on general knowledge.
U.S	Volpe et al. (2002)	Survey on 530 online investors for checking their	- Investors were able to answer

		financial literacy.	50% questions correctly. - Investors of 50 years of age are more knowledgeable than younger investors. -women have low level of financial knowledge. -overall knowledge of online investors is insufficient.
U.S	Moore (2003)	Telephonic survey was conducted on two focus groups: (i) Consumer: who borrowed from lenders. (ii) General population.	- consumers had less understanding of specific financial terms then general public. - consumers are less interested in investing in stocks, they have long term saving plans.
U.S	National council on economic education(2007)	In schools across the state.	- 34 state had standards for personal finance. - 20 out of these 34 require that these standards should be implemented. - only 6 states required that students should pursue a course on personal fiancé. - large number of young people in U.S were not being taught personal finance at school.
U.K	The Adult Financial Literacy Advisory Group(Ad FLAG) (2000)	Study on various organizations across the public, private and voluntary sectors.	The need for financial literacy is increasing because of changing working patterns, ageing of population, less involvement of government and more complex financial products.
U.K	Lusardi and Mitchell(2006)	Total of 1269 adults aged over 50 years.	-there is strong relationship between financial knowledge and planning -overall financial literacy is poor among older Americans
Australia	ANZ bank study(2003)	i. A telephonic survey of 3548 adults. ii. In depth interviews of 202 people	A strong co-relation was found between financial literacy level and social economic status.
Australia	Beal and Delpachitra(2003)	Survey on 789 students from university of southern Queensland was conducted.	Findings on various objectives were: -Basic concepts: 97% students answered correctly. -Market and instrument of financial market: 87.5% correct responses, Role of cash rate:44.1% correct response, Australian asset class: 36.7% correct. -Financial planning: 27.9% correct responses.

			- Analysis and decision making: 64.5% correct responses.
Singapore	MoneySENSE(2005)	2023 Singapore citizens and permanent residents were tested. Questionnaire was divide into three tiers: Tier I-money management Tier II- Financial planning Tier III-Investment knowledge	Financial literacy knowledge and action score in tier I was 74 and for Tier II was 62 out of total 2023 responses mean score of Financial literacy for Tier III was 67 out of 662
India	Indian protection survey(2007) by NCAER and Max NewYork Life Insurance company limited	63000 households from across the country were surveyed	- 87% Indians who save out of which 36%keep their money at home. Investments are done for emergencies(83%),wedding and social events(63%), child education(81%),old age(47%). -only 3% population under study invest in bonds and other instruments.

Key observations:

After doing the in-depth study of level of financial literacy and investor's behaviour in different countries through various studies the following findings and observations can be drawn:

1. The young population lacks financial literacy, which leads to poor financial management and less risk tolerance
2. Colleges and schools should impart basic financial literacy courses to educate students about personal financial management.
3. People are less aware about new or latest avenues of investment.
4. The investment decisions are influenced by investor's demographic and social economic profiles. Risk bearing capacity, saving habits and financial assistance.
5. By seeing demographic profile the females have low level of financial literacy than men. They should take more initiatives in making financial decisions.
6. According to global survey by standard & poor's India constitutes 17.5% of population by approximately.
7. It can also be concluded from various studies that investors follows the conventional methods of saving and investment.
8. Studies also reveal that financial literacy encourages savings which leads to investment.

Recommendations:

Based on the reviews of various research studies and considering the current scenario in financial education the researcher suggests investors, policy makers and regulatory authorities and financial education providers to promote financial literacy.

For investors

1. Investor should take interest in financial knowledge and awareness.
2. The syllabus in schools, colleges and universities should include courses which enhance the financial knowledge and awareness among youth of the nation. So that they become informed investors.
3. Females should take more initiatives in financial matters.
4. Employees should be provided with more financial education programmes by the employers at workplace.

For policy makers and regulatory authorities:

1. Financial education courses or material should be desined which focused on personal fiancé and it should be provided to the students among the age group og 18-25 and 26-35 years.so that youth of the nation should have high level of financial literacy.
2. The investors who are having the age of 56 years or above should be targeted so that they learn the importance of retirement planning.
3. Programmes should be designed to target female so that they know the importance of financial education. And their participation in investment decisions at household level as well as an individual level.
4. Primary and secondary school level education should include financial education and money management as syllabus.
5. Financial literacy should be taken either as a pragmatic perspective or as a policy perspective.

For financial education providers:

1. Financial education should be provided as instruction or information not as an advice.
2. Financial education should be provided in unbiased and fair manner.
3. Companies should provide financial education as a part of corporate social responsibility.

RESEARCH GAP:

This review of literature represents the level of financial literacy in various countries is low irrespective of stage of development. This study also revealed that there exist a relationship between demographic profile of country and its level of financial literacy. It also shows that financial behaviour is the outcome of financial education. In this context researchers can further proceed with some exploratory research to find out whether developed countries possess sufficient level of financial literacy which in turn leads to better investment decisions.

CONCLUSION:

This paper provides the theoretical framework for financial behaviour. It presented the review of various studies to establish a relationship between financial education, financial behaviour, and financial literacy.
After discussing about financial literacy and investment decisions. It can be concluded that financial education should be given par importance in respect to demographic profile, education, age and gender. People should know the money management so that they can spend right, save right, and invest right.

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