

“A Study on Investment Intention with Moderating effect of Financial Literacy”

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Abstract:

This study investigates the determinants of individual investment intention, focusing specifically on how financial literacy moderates these relationships. While traditional financial models assume rational decision-making, behavioural finance highlights that psychological, social, and cognitive factors heavily influence an individual's willingness to invest. Utilizing a quantitative research design, data was gathered via a structured questionnaire from a diverse sample of individual retail investors. The conceptual framework integrates elements of the Theory of Planned Behavior (TPB), examining variables such as perceived risk, expected return, financial socialization, and subjective norms as primary predictors of investment intention. Regression analysis and moderated moderation techniques were applied to evaluate the direct hypotheses and the interaction effects. The empirical findings reveal that while positive return expectations and favourable subjective norms significantly boost investment intention, high perceived risk acts as a substantial deterrent. Crucially, the analysis confirms that financial literacy plays a vital moderating role. For individuals with high financial literacy, the negative impact of perceived risk on investment intention is significantly mitigated, and the positive effect of financial knowledge translation is amplified. Conversely, low financial literacy exacerbates risk aversion, stalling investment action even when market conditions are favourable. These insights underscore the necessity of targeted financial education programs. The study concludes that fostering financial literacy is not merely about transmitting knowledge, but is a strategic imperative to convert latent investment intention into active market participation, thereby driving broader economic growth and personal wealth creation.

Keywords:

Investment Intention, Financial Literacy, Behavioural Finance, Perceived Risk

1. Introduction

In today's dynamic economic landscape, individual wealth creation is increasingly dependent on active engagement with financial markets rather than traditional savings methods. Navigating this environment, however, requires a deliberate transition from passive saving to active investing. Investment intention—the psychological readiness or formulation of a plan to commit capital to financial assets—serves as the critical precursor to actual investment behavior. Understanding what drives or deters this intention is vital for financial institutions, policymakers, and researchers alike, as retail investor participation plays a foundational role in deepening capital markets and fostering overall macroeconomic stability.

While traditional financial theories operate on the assumption that individuals are perfectly rational actors who flawlessly calculate risk and return, the realities of human psychology suggest otherwise. Behavioral finance demonstrates that investment intentions are shaped by a complex interplay of cognitive perceptions, social pressures, and behavioral biases. Factors such as a person's risk tolerance, their expectations of market returns, and the influence of social peers (subjective norms) heavily dictate their willingness to enter the market. Consequently, a potential investor may hold back not because an asset lacks financial viability, but because their subjective perception of the market creates a psychological barrier.

However, these behavioral drivers do not impact everyone in the exact same way; their influence is heavily dependent on an individual's personal toolkit of financial knowledge. This is where financial literacy emerges as a pivotal factor.

Financial literacy represents the ability to understand and effectively use various financial skills, including personal financial management, budgeting, and investing. Instead of acting merely as a direct driver, financial literacy operates as a lens through which an individual interprets the financial world, altering how factors like risk and return expectations ultimately shape their final intention to invest.

Despite the growing body of literature on behavioral finance, a critical gap remains in understanding exactly how financial literacy modifies the decision-making process. This study addresses that gap by exploring the moderating effect of financial literacy on individual investment intentions. By examining how varying levels of financial knowledge can either cushion the negative impacts of perceived risk or amplify the motivating power of expected returns, this research seeks to provide a nuanced framework. Ultimately, the findings aim to offer actionable insights for designing targeted financial education and investment products that can effectively convert hesitant observers into confident market participants.

Literature Review

Risk Tolerance

Risk tolerance is a vital component to the risk-assessment process. In making recommendations, a financial advisor needs to consider how much risk a client is willing to take (Roszkowski & Snelbecker, 1989). When offered a choice between a relatively small but certain payoff and one that is probable but not certain, most individuals will choose the likely payoff over the unlikely, but potentially larger, payoff. This is because individuals are less willing to pass up certainty with respect to financial risk. The textbook definition of risk tolerance (Dalton & Dalton, 2004, p. 898) is the following: "An estimate of the level of risk an investor is willing to accept in his or her investment portfolio." It is not unusual for individuals to have unrealistic expectations about the likelihood, or amount, of return, given the amount of risk they are willing to assume.

Subjective Norms

Subjective norms can be defined as social pressure to act or not to act (Ajzen, 2011). SN refers to an individual's perceptions of how they would be viewed by other groups in society if they performed a certain behaviour. Subjective norms in decision-making are influenced by normative beliefs about close family members, friends, and associates. Many researchers posit the influence of subjective norms in the area of investment in financial securities (Ibrahim & Arshad, 2018; Lai, 2019; Ryu & Ko, 2019).

Overconfidence Bias

The literature on overconfidence has broadly investigated its impact on financial decisionmaking, mainly focused on financial markets and trader behavior. In this area, three major consequences of overconfidence have been documented: overconfidence causes too much trade (Barber & Odean, 2000; Glaser & Weber, 2007; Kim & Nofsinger, 2002; Odean, 1999; Statman, Thorley, & Vorkink, 2004), excessive volatility (Daniel, Hirshleifer, & Subrahmanyam, 1998; Gervais & Odean, 2001) and a combined phenomenon of under- and overreaction to information (Daniel & Titman, 1999; Daniel et al., 1998; Glaser & Weber, 2007; Lee & Swaminathan, 2000). In corporate finance, important impacts have been observed such as over-investment or preference for debt financing (Malmendier & Tate, 2005).

Social Interaction

Hindsight bias may be another key root of overconfidence, where people deem information on previous success to be a predictor of their future success. In the much-cited book *Black Swan*, Taleb (2007) cautions that the past is not a good predictor of the future, despite our tendencies to build the rationale of the future on events of the past. Interestingly, perceived and actual expertise is likely to increase hindsight bias (Knoll and Arkes [2017]).

Financial Literacy

Financial literacy is a factor that influences an individual's investment interest. It refers to knowledge of financial securities and their technical and fundamental evaluation for investment purposes (Aren & Hamamci, 2020). The understanding of financial securities helps investors make investment decisions with confidence

(Purwidiandi&Tubastuvi, 2019). Financial literacy is a factor that allows investors to manage their investments in such a manner so as to acquire maximum returns (Lusardi & Mitchell, 2008).

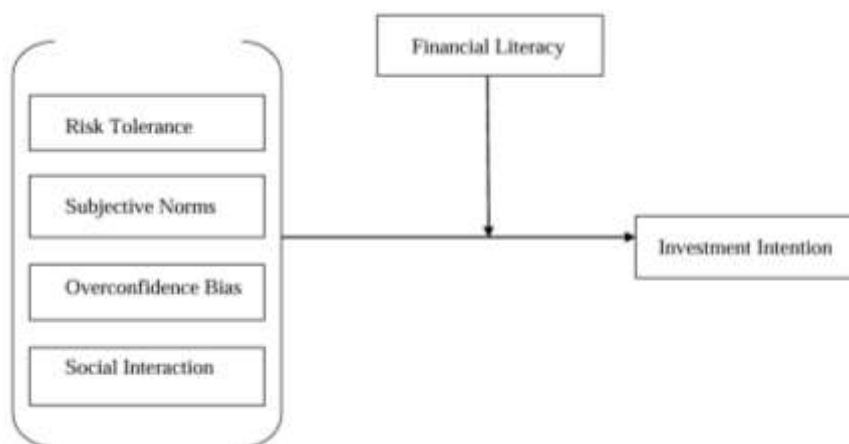
Investment Intention

According to risk homeostasis theory, “people have a certain target level of risk, and to reach this level they engage in activities that have the highest net balance of benefits over losses” (Burns & Wilde, 1995). Risk is considered as an important factor regarding investment behaviour (Kiev, 2003). Keller and Siegrist (2006) revealed that “financial risk tolerance, income level and investment account have significant impact of investment intention”.

Research Gap:

The research gap lies in the need to explore how financial literacy and social norms interact across demographic factors like area of residence, gender, age, education, occupation, and income to influence investment intentions and behavioural biases such as risk tolerance and overconfidence. While the data highlights distinctions in financial literacy and investment behaviour across these groups, it does not examine how social norms and subjective standards mediate or moderate these effects. Specifically, the impact of social influences in rural versus urban settings, gender-based differences in reliance on social norms, and how varying levels of income and education affect risk tolerance remain underexplored. Investigating these interactions could provide a more comprehensive understanding of how demographic factors shape investment intentions and behaviour.

Research Model



Hypothesis of the study:

H1: Higher risk tolerance positively influences investment intention.

H2: Positive subjective norms positively influence investment intention.

H3: Higher levels of overconfidence bias positively influence investment intention.

H4: Increased social interaction positively influences investment intention.

H5: Financial literacy moderates the relationship between risk tolerance and investment intention, such that higher financial literacy strengthens the positive relationship.

H6: Financial literacy moderates the relationship between subjective norms and investment intention, such that higher financial literacy strengthens the positive relationship.

H7: Financial literacy moderates the relationship between overconfidence bias and investment intention, such that higher financial literacy weakens the positive relationship.

H8: Financial literacy moderates the relationship between social interaction and investment intention, such that higher financial literacy strengthens the positive relationship.

Research Objectives:

- To examine the relationship between risk tolerance and investment intention.
- To analyse the impact of subjective norms on investment intention.
- To investigate the effect of overconfidence bias on investment intention.
- To explore the role of social interaction in shaping investment intention.
- To assess the moderating role of financial literacy in the relationship between risk tolerance and investment intention.
- To evaluate the moderating effect of financial literacy on the relationship between subjective norms and investment intention.

Scope of the study:

This study examines the investing intentions of clients. It looks at how important variables like social interaction, subjective norms, overconfidence bias, and risk tolerance affect the choices made by both seasoned and inexperienced investors. I have taken samples from Rural & Urban city for the purpose of data collection. In order to comprehend financial literacy's influence on these relationships, its moderating effect will also be investigated. Through the research, organization will be able to better understand investor behaviour and use that knowledge to strengthen investor engagement strategies, advisory services, and financial literacy programs. The results of this study may potentially serve as a model for other stock market firms and advance more general scholarly investigations into the actions of investors in financial markets.

Sample size: 309

Sample extent: Gujarat, India

Research Design: Descriptive Research Design

Sampling Method: Non probability convenience sampling

Reliability scale

Cronbach's alpha values demonstrate that all variables have good internal consistency. Acceptable reliability is shown by Risk Tolerance (.909), Subjective Norms (.899), Overconfidence Bias (.900), Social Interaction (.922), indicating that the measures employed to gauge these behavioural characteristics are reliable. Investment Intention (.879) and Financial Literacy (.869) both exhibit excellent dependability, indicating that these variables are measured with a high degree of internal consistency. For additional examination, the scales are generally dependable.

Rural residents (136 participants, or 44.0% of the sample) may be less financially literate, which may have an impact on their willingness to take risks and adherence to social norms. On the other hand, because they have greater access to financial resources, urban dwellers (173 participants, or 56.0%) probably have greater financial knowledge, which may increase their investment intentions and lessen overconfidence bias. Among the samples, Males (212 participants, 58.6% of the sample) may be more confident in their ability to manage assets, which may strengthen their intention to make investments. Additionally, there may be a chance of overconfidence bias and a larger risk tolerance as a result of this. However, women (97 participants, 31.4%) might have a more cautious approach to investing, with a greater influence from social contacts and subjective standards on their choices. With 23 participants, or 7.4% of the sample, the -intention investing. With their advanced financial knowledge, the postgraduates (135 participants, 43.7%) and PhD holders (3 participants, 1.0%) are probably less reliant on social cues and have a larger risk tolerance and lesser overconfidence. Because of their employment security, government sector personnel (34 participants, 11.0%) may have moderate investment aspirations but a reduced risk tolerance. The private sector, on the other hand, may exhibit a wider spectrum of investment behaviours, frequently exhibiting greater risk tolerance and financial literacy along with a propensity toward overconfidence (213 participants, 68.9%). Due to their entrepreneurial impulses, self-employed people (41 participants, 13.3%) may have a high-risk tolerance, whilst retirees (5 participants, 1.6%), on the other hand, are likely to choose cautious investments. When creating investment intentions, students (14 participants, 4.5%) may rely more on social connections and have lesser financial literacy. Ages between 18 to 25 (188 participants, 60.8%) are a younger demographic that is likely to be less financially literate and, thus, have a lower risk tolerance. Social contacts are a major

factor in these individuals' investment decisions. Ages 26 to 35 (100 participants, 32.4%) may show signs of rising financial literacy, which could result in increased investment intentions and a decrease in the overconfidence bias. The participants with the highest financial literacy are likely to be those between the ages of 36 and 45 (16 participants, 5.2%) and those over 45 (5 participants, 1.6%). This translates into more stable and informed investing intentions with less reliance on arbitrary standards. The study found that 88 participants, or 28.5%, had a family income of less than Rs. 10,000 per month. These individuals may have weaker financial literacy, which could lead to a lower risk tolerance and a greater reliance on social contacts and subjective norms when making investment decisions. The majority of participants, or 171 out of 55.3%, who earn between Rs. 10,001 and Rs. 25,000, may have a moderate level of financial literacy and balanced investing objectives. Individuals who earn between Rs. 25,001 and Rs. 50,000 (44.2%) and Rs. 50,000 and above (6.1%) are likely to be more financially literate, have greater investing objectives, a higher risk tolerance, and rely less on subjective norms.

Findings of the study

The study revealed a diverse range of investor preferences and behaviors. While most participants enjoyed social interaction, a small minority preferred solitary investment decisions. Financial literacy was found to significantly influence investment intentions, risk tolerance, and decision-making. The majority of participants exhibited a high-risk tolerance, indicating a willingness to invest in potentially high-reward, high-risk assets. Social norms, including the opinions of friends, family, and colleagues, played a crucial role in shaping investment intentions. Overconfidence bias was prevalent among participants, potentially leading to suboptimal investment decisions. The study found that risk tolerance, financial literacy, and subjective norms all significantly influence investment intention. Higher risk tolerance is associated with increased investment intention, while financial literacy plays a mediating role in this relationship. Subjective norms, particularly when combined with higher financial literacy, also positively impact investment intention.

Conclusion

The study provides significant insights into the diverse preferences and behaviors of investors, highlighting the critical roles of risk tolerance, financial literacy, and social norms in shaping investment intentions. The findings indicate that while many investors thrive on social interactions, a minority prefers solitary decision-making, emphasizing the importance of understanding individual preferences in financial advising. Higher risk tolerance is associated with a greater likelihood of investment, but financial literacy enhances this relationship, enabling investors to act more confidently on their risk preferences. Furthermore, the influence of subjective norms underscores the importance of social contexts in financial decision-making. Despite the valuable insights gained, the study acknowledges limitations such as sample size, cultural specificity, and reliance on self-reported data, which may affect the generalizability and accuracy of the findings. Future research should aim to expand on these limitations by including larger, more diverse samples and employing longitudinal and objective measures. In conclusion, this study underscores the complex interplay between risk tolerance, financial literacy, social influences, and investment behavior. By addressing the identified limitations and focusing on the recommendations provided, both researchers and financial practitioners can work towards enhancing investor outcomes and fostering a more informed investment community.

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