An Investigation of The Connection Between Individual Investors' Risk Preferences and Financial Literacy in Maharashtra

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Abstract

The goal of this study is to identify the association between between individual investors' risk preferences and knowledge about various sources of investments. A questionnaire technique and descriptive research methodology were used to gather information from 300 investors who were spread across rural, semi-rural, and urban regions. Preference of risk and knowledge of investment were also impacted by other variables including age, education, and even gender. The study also shows how financial education improves investors' investment practices and decision-making, resulting in more informed and self-assured choices that can support the growth of financial markets and increased economic participation.

Keywords: Financial Literacy, Risk Preference, Individual Investors, Investment Behavior, Maharashtra, Financial Education, etc.

Introduction

In the complex and ever-evolving world of finance, people's ability to make educated investment decisions has become essential. Literacy of Finance, or understanding and awareness of concepts of finance and risks, has a big impact on individual investment behaviour (Lusardi & Mitchell, 2014). Particularly in a varied state like Maharashtra, financial literacy influences not just the choice of investment vehicles but also the proportion of risk that potential clients are eager to undertake. Given the extensive variety of investment solutions and services available, a comprehensive understanding of the relationship between tolerance for risk and financial comprehension is essential for effective asset management and financial planning.

India's economic growth has spurred more financial inclusion, along with being one of the nation's most modernised and developed states, Maharashtra has witnessed a dramatic rise in the amount of individual investors. However, there are still discernible inequalities in financial knowledge between the urban and rural sections of the state. With the rise of new investment channels including mutual funds, stock trading, and digital assets, investors are exposed to varying degrees of risk. Risk preference, or a person's tolerance for uncertainty and potential financial loss, is one of the most significant elements affecting investment decisions (Grable, 2000). A deeper knowledge of how financial literacy influences risk-taking behaviour might help legislators, financial instructors, and investment advisers create efforts that encourage healthier investing practices.

Numerous studies conducted both domestically in India and abroad have shown that financial literacy improves a person's capacity to evaluate risk-return trade-offs, leading to more rational investment decisions (Van Rooij, Lusardi, & Alessie, 2011). However, further research is needed to fully examine the connection between Indian investors' risk appetite and knowledge of finances, particularly in Maharashtra. This study attempts to bridge that gap by investigating the relationship between an individual's knowledge of finances and their propensity to assume financial risks. By focussing on Maharashtra, the study collects a wide sample that includes both highly urbanised places like Mumbai and Pune as well as semi-urban and rural areas, providing a thorough understanding of the problem.

Literature Review

The ability to utilize information and expertise enables people to sustainably handle financial assets for long-term financial stability (Hung, Parker, & Yoong, 2009). The fundamental understanding of interest rates along with inflation and growth and risk management forms part of financial literacy according to Lusardi and Mitchell (2007). Studies show that proper financial decision-making follows directly from a sufficient understanding of financial matters.

Lusardi and Tufano (2015) showed that better knowledgeable individuals make strategic monetary investments while setting retirement savings goals and stay away from expensive debt options.

A person's judgment regarding risk acceptance or avoidance when selecting investments falls under risk preference description. According to Grable (2000) investors take one of three positions regarding risk acceptance: risk-averse and risk-neutral and risk-seeking. Research shows that risk preferences evolve based on several defining factors such as age together with income and gender and education along with cultural heritage (Roszkowski & Grable, 2005). Financial literacy functions as a vital psychological tool to help people understand risks accurately so they will likely take on riskier yet potentially wealthier investment opportunities. Many studies have researched how financial knowledge relates to tolerance for risk. Research conducted by Van Rooij Lusardi and Alessie (2011) demonstrated Dutch consumers with better understanding of finance attitudes to invest in riskier stocks. Yoong (2011) discovered that superior financial education initiatives boosted overall acceptance rates of risky investment assets which included mutual funds and stocks. A research conducted by Agarwalla, Barua, Jacob, and Varma (2015) emerged as the largest financial literacy study in India. The study revealed that numerous Indian households lacked essential financial understanding because of which they faced difficulties taking risks and making investments.

A theoretical basis for comprehending how people perceive risk is also provided by behavioural finance theories, such as Kahneman and Tversky's prospect theory (1979). Prospect theory states that people display loss aversion, preferring to avoid losses over obtaining comparable benefits, and assess possible gains and losses in relation to a reference point. Instead of being disproportionately swayed by emotional or cognitive biases, those who are financially knowledgeable should demonstrate more logical risk assessments (Pompian, 2006).

Financially aware investors appear to have a rising but cautious appetite for risk, according to recent Indian surveys. According to a research by Kapoor and Singh (2019), risk aversion is still high among young Indian investors despite improvements in financial understanding because of uncertainty about market behaviour and individual financial stability. Similar trends are expected given Maharashtra's socioeconomic variety, with differences depending on access to financial services, urbanisation, and regional literacy levels.

Despite these realisations, there is still little empirical data that shows a clear correlation between individual investors' risk tolerance and financial literacy in particular Indian states. By presenting solid data from Maharashtra, this study seeks to close this gap and provide insightful recommendations for financial education regulations and investment advice procedures aimed at improving investor outcomes.

Objectives:

The principal purpose of this research examines how risk tolerance of Maharashtra individual investors relates to financial literacy levels. The goal is to analyze risk-taking decisions of investor groups through financial literacy levels before identifying demographic factors which reduce this correlation.

Methodology:

The research approach for studying risk tolerance relationships to financial literacy among individual investors in Maharashtra operated descriptively. The data collection method incorporates a systematic questionnaire containing closed-ended questions. A convenience-based sampling method selects 300 individual investors who come from various urban, semi-urban, and rural regions of Maharashtra for maintaining sample variety. The examined data requires statistical assessment to uncover relationships between significant variables.

Data Analysis:

Descriptive statistics as well as correlation analysis were used to examine the information gathered from the questionnaire completed by 300 individual investors in Maharashtra. The goal was to evaluate respondents' risk tolerance and financial knowledge levels and ascertain how the two factors related to one another.

Table 1 Demographic information

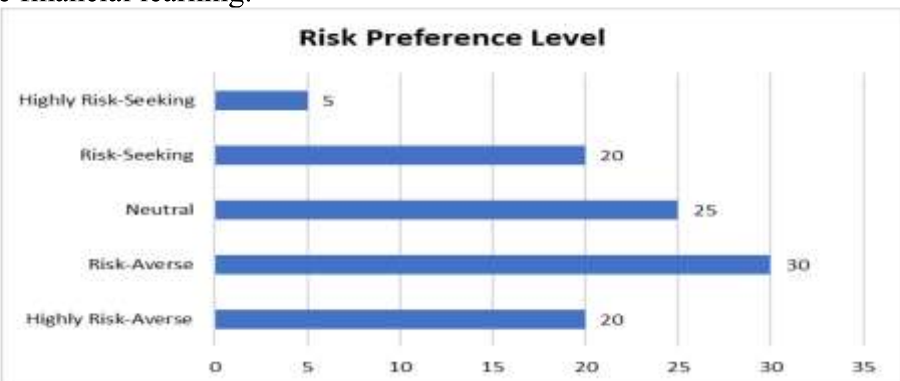
Demographic Variable	Categories	Frequency	Percentage (%)
Gender	Male	180	60.0
	Female	120	40.0
Age Group	18–30 years	90	30.0
	31–45 years	120	40.0
	46–60 years	70	23.3
	Above 60 years	20	6.7
Education Level	Undergraduate	100	33.3
	Postgraduate	150	50.0
	Professional Qualification	50	16.7

All major factors received proportional representation according to the demographic analysis of respondents. The 300 individual investors surveyed show moderate gender balance since sixty percent are men while forty percent are women. The investor population featured a significant number of people in their late 20s through 30s up to early 40s because data showed 40% respondents were between 31 and 45 years old together with 30% who belonged to the 18 to 30 age group. The investigated population held advanced educational credentials since postgraduate students comprised 50% of the total while 33.3% were undergraduates and 16.7% belonged to professional groups. The research measured money and risk management patterns appropriately by collecting data from individuals at different age groups with diverse levels of expertise and educational attainment.

Ten knowledge-based questions from a financial literacy questionnaire were used to evaluate the respondents. Low (0–4 right answers), Moderate (5–7 right answers), and High (8–10 right answers) were the three score categories.

Fig. 1

According to the findings, just 25% of respondents had high financial learning, and 50% had intermediate financial learning.



According to the respondents' risk preference levels, a sizable percentage of Maharashtra's individual investors behave cautiously while making investments. The participants' inclination for safer and more secure investing alternatives was evident from the fact that almost 50% of them were either extremely risk-averse (20%) or risk-averse 30%. About 25% had a neutral approach to risk, indicating adaptability to changing market conditions. On the other hand, a comparatively smaller percentage of respondents (20%) and 5% were classified as risk-seeking or very risk-seeking, respectively, indicating a lower willingness to explore high-risk, high-return investment possibilities. These results imply that although a sizable portion of investors remain cautious, there is a rising market sector that is more willing to take on financial risk, maybe as a result of exposure to a wider range of investment alternatives or more financial knowledge.

Pearson's correlation coefficient was computed to examine the connection between risk tolerance and financial literacy. The following outcome was obtained from the analysis:

Coefficient of correlation (r) = 0.42

P-value (significance) = 0.000 ($p < 0.01$)

This positive connection implies that a stronger willingness to accept financial risks is substantially correlated with better financial knowledge.

Variables	Pearson Correlation (r)	Significance (p-value)
Financial Literacy & Risk Preference	0.42	0.000

The data shows that among Maharashtra's individual investors, risk appetite is favourably influenced by financial literacy. Higher financial literacy increases the likelihood of risk-seeking behaviour from investors, whereas lower financial literacy increases risk aversion. These results emphasise how crucial it is to raise financial literacy in order to facilitate wiser investing choices.

Conclusions:

Personal investors across Maharashtra demonstrate a meaningful positive association between their risk tolerance capabilities and financial educational background. Individuals who understand finances well tend to take carefully planned risks but those less knowledgeable about finances avoid risk. People between 31 to 41 years of age who have completed at least 12th grade tend to demonstrate an understanding of financial matters according to demographic statistics. Financial education proves essential in developing investor behavior because knowledgeable individuals successfully determine and control investment risks.

Recommendations:

According to the results, it is advised that focused financial literacy initiatives be put in place to improve individual investors' investing skills, particularly for those who are risk adverse because of ignorance. To provide seminars, online courses, and advisory services centred on risk assessment, portfolio diversification, and investment planning, financial institutions, academic institutions, and governmental organisations should cooperate together. Additionally, as financial literacy levels may be lower in rural and semi-urban areas, extra effort should be made to reach these individuals. In addition to enabling investors to make wise choices, raising general financial literacy will support the expansion and stability of the larger financial system.

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