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Financial Literacy and Investment Decisions among Young Adults

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Abstract

Financial literacy is the ability to understand and use financial knowledge, skills and attitudes for managing money and making sound investment choices. For young adults, who are at the beginning of their earning life and have a long investment horizon, this ability is particularly valuable. India has the largest young population in the world, and the number of first-time investors has increased sharply in recent years because of easy digital account opening, mobile trading applications and systematic investment plans. However, surveys show that the level of financial literacy of Indians remains low in comparison with many other countries. This paper studies the relationship between financial literacy and the investment decisions of young adults on the basis of secondary data drawn from national and international surveys, regulatory and industry statistics, and published research. Three comparison tables are used: financial literacy rates of selected countries, growth of demat accounts in India, and a comparison of the growth of demat accounts with the growth of monthly SIP contributions. The analysis shows that India lags behind the global average in financial literacy, that participation in the securities market has expanded rapidly, and that access to investment accounts has often grown faster than regular and planned investing. Earlier studies confirm that higher financial literacy is associated with greater market participation, better planning and more diversified portfolios, whereas low literacy and behavioural biases lead to mistakes. The paper concludes that financial education should be strengthened in colleges and online platforms so that the rise in participation is converted into informed and disciplined investment.

Keywords: Financial Literacy, Investment Decisions, Young Adults, Demat Accounts, Systematic Investment Plan, Behavioural Biases, Financial Education

Introduction

Financial literacy is generally understood as a combination of financial awareness, knowledge, skills, attitudes and behaviours that are necessary for taking sound financial decisions and achieving individual financial well-being (Atkinson and Messy 14). Remund explained that the concept includes knowledge of financial concepts, the ability to communicate about them, the skill to manage personal finances, and the confidence to plan for the future (Remund 279). In practice, researchers test the concept with a small set of questions on interest compounding, inflation and risk diversification, which are known as the "big three" questions (Lusardi and Mitchell 12).

Financial literacy is not the same as financial inclusion. Inclusion means access to bank accounts, credit, insurance and investment products, while literacy means the capacity to use these products wisely. A person may own a bank account and a demat account and still not understand the risk attached to a stock or a mutual fund. Huston therefore described financial literacy as having two

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dimensions, understanding and use, and argued that both should be measured (Huston 297). Without literacy, greater access can even increase the chance of costly errors.

Investment Decisions of Young Adults

An investment decision involves the choice of how much to save, where to invest, in which asset class, for how long and with what level of risk. Markowitz laid the foundation of modern portfolio thinking by showing that investors should evaluate risk and return together and gain from diversification (Markowitz 79). Young adults, usually considered to be persons between 18 and 35 years of age, have certain advantages, namely a long time horizon, the power of compounding and a higher capacity to take risk. They also face disadvantages, such as limited income, little experience, student or personal loans, and a tendency to follow peers and social media.

Shim and co-authors proposed that the financial well-being of young adults depends on financial knowledge, financial attitudes, financial behaviour and the influence of family and education, which they described as financial socialisation (Shim et al. 710). Chen and Volpe studied college students and found that their financial knowledge was limited, that women and students with less work experience scored lower, and that low knowledge affected their opinions and decisions (Chen and Volpe 113). The early years of earning therefore form the critical period in which good habits can be built or poor habits become fixed.

Financial Literacy and Investment Scenario in India

India presents a unique case. The country has a very large young population, rising incomes and a rapid expansion of digital financial services. Participation in the stock market and mutual funds has increased visibly in the last few years, helped by paperless account opening, low brokerage, mobile applications and the popularity of SIPs. At the same time, national surveys indicate that only a minority of adults can answer basic financial questions correctly. The National Centre for Financial Education reported a financial literacy level of about 27 per cent among adults in its 2019 survey (NCFE 12), and the SEBI-NCAER Investor Survey showed that a small share of households invested in securities market products and that awareness of these products was low (SEBI 18). Agarwalla, Barua, Jacob and Varma found, in a study of the working young in urban India, that financial knowledge was low even among educated young people and that their behaviour and attitudes were correlated with their knowledge (Agarwalla et al. 105).

The Government and regulators have responded with the National Strategy for Financial Education, investor awareness programmes by SEBI and the stock exchanges, and the work of the National Centre for Financial Education (RBI 20). The success of these efforts will depend on how well they reach young adults and how well financial education is linked with real investment decisions.

Objectives, Scope and Significance of the Study

1. To explain the concept and importance of financial literacy for young adults.
2. To compare the level of financial literacy in India with that of selected countries.
3. To analyse the growth of investment participation in India using demat account and SIP data.

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4. To suggest measures for improving financial literacy and the quality of investment decisions among young adults.

Review of Literature

The review is organised under four heads: measurement and level of financial literacy, financial literacy and investment behaviour, behavioural factors, and Indian evidence. Lusardi and Mitchell reviewed the evidence from many countries and concluded that financial illiteracy is widespread, that it is more serious among women, the young and less educated persons, and that it is associated with poor planning and low wealth (Lusardi and Mitchell 12). In another overview they noted that understanding of basic concepts such as inflation and risk diversification was far from universal (Lusardi and Mitchell 499). The OECD/INFE survey reported that the average adult financial literacy score across participating countries was well below the maximum possible score, with weaknesses in financial knowledge and attitudes (OECD 20). Klapper, Lusardi and van Oudheusden, using the S&P Global FinLit Survey, found that only about one in three adults in the world was financially literate and that the rate varied widely across countries (Klapper et al. 4).

Van Rooij, Lusardi and Alessie showed that individuals with low financial literacy were much less likely to invest in stocks, and that lack of knowledge was one of the reasons for non-participation (van Rooij et al. 460). The same authors, in a later study, observed that low literacy was related to poor retirement planning and lower household wealth (van Rooij et al. 460, 470). Lusardi and Mitchell found that those who did not plan for retirement had much lower literacy (Lusardi and Mitchell 210). Klapper, Lusardi and Panos found that, in Russia during the financial crisis, higher literacy was linked with greater use of financial markets and better coping with shocks (Klapper et al. 3910). Lusardi and Tufano reported that individuals with low debt literacy tended to use costly borrowing and were more likely to face over-indebtedness (Lusardi and Tufano 340). On the question whether education can solve the problem, Fernandes, Lynch and Netemeyer found that financial education interventions explained only a very small part of the variance in financial behaviour, particularly when delivered long before the decision, which suggests that timing and design matter (Fernandes et al. 1870). Hastings, Madrian and Skimmyhorn also concluded that the link between literacy and outcomes is strong, but that causal proof of the effect of education programmes is still limited (Hastings et al. 360).

Kahneman and Tversky argued in prospect theory that people feel losses more than equivalent gains, which can lead to risk-averse choices in gains and risk-seeking choices in losses (Kahneman and Tversky 279). Odean documented that investors tend to sell winners too early and hold on to losers, a pattern called the disposition effect (Odean 1775). Barber and Odean found that overconfident investors trade too much and that high trading reduces net returns, with men trading more than women (Barber and Odean 262). These findings imply that knowledge alone is not sufficient; young investors also need awareness of their own biases.

Bhushan and Medury studied the financial literacy of working individuals in India and reported that literacy differed with gender, education, income and the nature of employment (Bhushan and Medury 157). Agarwalla et al. reported that a large proportion of young Indians were not able to answer basic questions, and that financial knowledge influenced behaviours such as saving and

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investing (Agarwalla et al. 107). The surveys of NCFE and SEBI confirm that the awareness of market-based products is limited, even though digital access has improved (NCFE 14; SEBI 22).

Research Methodology

The study uses a descriptive and analytical design and relies completely on secondary data. International comparison data on financial literacy were taken from the S&P Global FinLit Survey. Data on demat accounts and on monthly SIP contributions were taken from the figures published by the depositories (NSDL and CDSL) and the Association of Mutual Funds in India (AMFI) for the end of each financial year. The conceptual and empirical background was prepared from journals, books and reports listed in the references. Year-on-year percentage growth, increase over the base year and the difference between growth rates (in percentage points) were calculated to make the data comparable. Figures are rounded and are used only for comparison and trend analysis, and the latest official figures should be checked before the data are reused.

The study has the following limitations. Literacy survey results refer to specific years and use different methods, so cross-country comparison is approximate. The number of demat accounts is not the number of unique investors, because one person may hold more than one account. SIP inflows represent mutual fund investors only. Since the study does not use primary data, it cannot measure the knowledge of individual young adults or directly prove that literacy caused their investment decisions.

Data Analysis and Discussion

Table 1 compares the percentage of financially literate adults in India with that in selected countries, as reported by the S&P Global FinLit Survey. An adult was counted as financially literate if he or she answered at least three of the four basic questions on numeracy, interest, inflation and risk diversification correctly (Klapper et al. 4).

Table 1: Comparison of Adult Financial Literacy Rate of Selected Countries

Country	Financial Literacy Rate (%)	Difference from Global Average of 33% (percentage points)	Gap Compared with India (percentage points)
Norway, Denmark, Sweden	71	38	47
United Kingdom	67	34	43
Singapore	59	26	35
United States	57	24	33
Japan	43	10	19
Brazil	35	2	11
China	28	-5	4
India	24	-9	0

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World (average)	33	0	9
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Source: Klapper, Lusardi and van Oudheusden, S&P Global FinLit Survey (2015); differences calculated by the author.

India stands 9 percentage points below the global average and 47 points below the best-performing Nordic countries. Even China, a large developing economy, shows a higher rate. The gap is important for young adults because the investment products now available to them, such as equity, mutual funds, derivatives and crypto assets, are more complex than the simple savings products of earlier generations. The later NCFE survey placed adult literacy in India at about 27 per cent, which is a small improvement but still far below the levels in developed economies (NCFE 12). Lusardi and Mitchell observed that such low levels of literacy are linked to weak planning and low participation in risky assets (Lusardi and Mitchell 12), so the figures in Table 1 are a warning sign for the quality of investment decisions.

Growth of Demat Accounts in India

The number of demat accounts is a useful, though imperfect, indicator of how many persons have access to the securities market. Table 2 shows the growth in demat accounts at the end of each financial year from 2019-20 to 2023-24.

Table 2: Growth of Demat Accounts in India (2019-20 to 2023-24)

Financial Year (March end)	Demat Accounts (crore)	Increase over Previous Year (crore)	Growth over Previous Year (%)	Level Compared with 2019-20 (times)
2019-20	4.09	-	-	1
2020-21	5.51	1.42	34.7	1.35
2021-22	8.97	3.46	62.8	2.19
2022-23	11.45	2.48	27.6	2.8
2023-24	15.14	3.69	32.2	3.7

Source: Compiled from data published by NSDL and CDSL; growth calculated by the author. Figures are rounded.

The number of demat accounts has increased 3.7 times in four years. The highest growth, about 63 per cent, was recorded in 2021-22, a period characterised by lockdown-induced savings, free time at home, falling brokerage, simple mobile onboarding and rising stock indices. Many of the new account holders were young adults who opened accounts through mobile applications, sometimes after seeing investment content on social media. This expansion is a positive development for financial inclusion. However, given the literacy gap shown in Table 1, it also raises the possibility that many new investors entered the market without adequate understanding of risk. Barber and Odean's evidence on overconfidence and excessive trading shows why this can be costly (Barber and

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Odean 262), and Odean's finding on the disposition effect indicates the kind of errors that inexperienced investors may repeat (Odean 1775). Since one person may have more than one account, the table indicates access to the market and not the number of unique investors.

Comparison of Demat Account Growth and SIP Contribution Growth

Participation, in the sense of opening an account, is different from the disciplined and regular investing that financial literacy is expected to promote. A systematic investment plan (SIP) requires the investor to commit a fixed amount at regular intervals, and it reflects planning, patience and an understanding of long-term investing. Table 3 compares the growth in demat accounts with the growth in monthly SIP contributions.

Table 3: Comparison of Growth in Demat Accounts and Monthly SIP Contributions

Financial Year	Monthly SIP Contribution, March (₹ crore)	SIP Growth (%)	Demat Account Growth (%)	Difference: Demat Growth minus SIP Growth (percentage points)
2019-20	8,641	-	-	-
2020-21	9,182	6.3	34.7	28.4
2021-22	12,286	33.8	62.8	29
2022-23	14,276	16.2	27.6	11.4
2023-24	19,271	35	32.2	-2.8

Source: SIP data from AMFI; demat growth from Table 2; growth and differences calculated by the author. Figures are rounded.

Table 3 shows that during 2020-21 and 2021-22 the number of demat accounts grew about 29 percentage points faster than the monthly SIP contribution. In other words, access to the market expanded much faster than regular, planned investing. This is what the literature predicts when entry becomes easy but financial knowledge has not improved at the same pace: participation increases, while planning and discipline take longer to develop (Fernandes et al. 1870; Lusardi and Mitchell 12). In 2023-24, however, SIP growth of 35.0 per cent was higher than demat growth of 32.2 per cent, and the difference turned negative. This suggests that a part of the new investor base is moving toward regular and long-term investing, which is consistent with the effect of awareness campaigns and market experience (RBI 20; Hastings et al. 360). The trend should be read with care, since the data are aggregate and cannot show the specific role of financial literacy. Even so, the comparison supports the view that financial education should be targeted at turning access into informed and continued investment.

Major Findings

The study offers the following findings. First, the financial literacy of Indian adults is lower than the global average and far lower than that of advanced economies, as seen in Table 1. Second,

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participation in the securities market has expanded at a remarkable speed, since demat accounts increased 3.7 times between 2019-20 and 2023-24. Third, in the early years of this expansion, account opening grew much faster than regular SIP investment, which indicates that easy access moved ahead of knowledge and planning. Fourth, by 2023-24 the growth of SIP contributions exceeded the growth of demat accounts, suggesting an improvement in disciplined investing. Fifth, earlier research agrees that higher financial literacy is related to greater market participation, better planning and stronger household wealth, while behavioural biases such as overconfidence, loss aversion and the disposition effect can reduce the quality of decisions even when some knowledge exists.

Suggestions

Colleges and universities should add short, practical courses on personal finance, covering budgeting, compounding, inflation, risk, diversification and the working of mutual funds and the stock market. Education should be delivered close to the time when young adults start earning and investing, because the timing of training affects its usefulness (Fernandes et al. 1870). Regulators and brokers should provide simple risk disclosures, investor awareness content in regional languages and warnings against unverified tips on social media. Mobile investment platforms can include basic quizzes, risk profiling and cooling-off prompts before high-risk trades. Parents and families should involve young persons in household financial discussions, because financial socialisation influences later behaviour (Shim et al. 710). Finally, researchers should use primary surveys and field experiments among Indian college students and young professionals to measure the direct effect of literacy and education on their portfolios.

Conclusion

Financial literacy is a basic life skill that determines how well young adults convert income into long-term wealth. The secondary data used in this paper show that India has a low level of financial literacy in comparison with the world average, while participation in the securities market has increased at a very fast rate. The comparison of demat accounts and SIP contributions suggests that, in the initial years, access grew faster than disciplined investment, and that the pattern started to improve in 2023-24. Earlier studies show that knowledge improves participation, planning and wealth, and that psychological biases can undermine even informed investors. The challenge for India is therefore not only to open more accounts but also to build the knowledge, attitude and behaviour that make investment safe and rewarding. If financial education is made practical, timely and widely available, the large young population of the country can become a strong base of informed investors who support both their own financial security and the growth of the economy.

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