THE IMPACT OF FINANCIAL LITERACY ON PORTFOLIO MANAGEMENT BEHAVIOR OF AN INDIVIDUAL INVESTORS

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ABSTRACT

One of the important component of portfolio management is the financial literacy of the individual investors. This paper aims at identifying the problems in portfolio management by the individual investors. The focus of this paper is on poor financial literacy as one of the important factor leading to the lack of proper portfolio management behavior. After studying the past researches and theories certain conclusions are drawn whether which are the factors that impacts the decision making process, it is identified that imparting financial literacy will lead to sound financial behavior in decision making. Further, financial education of individual investors is very important for the nation's economic growth and development.

KEYWORDS: Portfolio management, financial literacy, economic growth, financial behavior, imparting

1. Introduction

Portfolio management is an art and science of making decisions about investment mix and policy, matching investments to objectives, asset allocation for individuals and institutions, and balancing risk against performance. But the individual investors are not financially literate to understand the technical jargons of the financial market. Which highly influence the portfolio management behavior of an individual investors.In last three decades financial market have also become very complex. Investment opportunities have expanded beyond national borders. Today an individual investor have variety of investment avenues. These dramatic changes in the financial system have occurred in conjunction with structural changes in national economic policy. The launch of new economic policy in 1991 has open the doors for new opportunities. So to invest the leftovers in a challenge now a days. The investment decision making process is a critical process which depends upon various factors that may vary among individuals. Different people behave differently.

At the time of making investment decision investors come across very complex factors viz., risk, ambiguity and choice overload. These factors are challenging for financial professional, experienced investors and especially the ordinary private household.

Doing the good investment is challenging for people with minimal or without any know how and experience about investing. So the financial literacy plays a very important role in the decision making process of leftover.

Financial literacy has recent years gained the interest of various groups. The importance of improving financial literacy has increased due to factors including the development of new financial products, the complexity of financial market and the changes in political, demographic and economic factors. previous studies depict that seminars, written communications and website informations are good methods in conveying financial education.

This study assesses the financial literacy of the individual investors who invest in the local financial market.

2. Problem Statement

I'm trying to discover the factors having impact on portfolio management behavior of an individual investors.There are many factors that affect an investor decision making process like demographics, income level, qualification, financial knowledge and pervious experience with investment.Many studies are supposed to be done on finding the various factors but I've considered the influence of financial literacy on portfolio management behavior of an individual investors.

3. Research Gap

The pervious studies lack in the focus in some of the factors responsible in portfolio management behavior of an individual investors. They've only covered many psychological factors and some materialistic factors. In this research I've introduced very important factor of financial literacy and then its impact on the portfolio management behavior of an individual investor. This study proves to be a milestone for future researches. On the other hand it will help investors as well on how much knowledge they should have to cope up with risky situation and how to handle the risky investments.

Financial literacy proves to be an important determinant, while further research is required to explore more dimensions which can influence investment decisions.

4. Literature Review

Financial Literacy, portfolio management behavior

Volpe et al. (2002) Argued that online investors should have more knowledge than normal investors to succeed in the securities markets, because they are more likely to be surrounded by financial misinformation and manipulation. Therefore, the authors examined investment literacy of 530 online investors and the difference in the literacy level among various groups of participants using age, income, gender, education, and previous online trading experience as variables. The study demonstrated that the level of financial literacy varied with people's education, experience, age, income, and gender. Particularly, women had much lower financial literacy than men and older participants performed better than younger participants. As well, online traders had higher knowledge than others. Moreover, investors with higher income had more knowledge in investment than those with lower income, and investors with college or higher degree performed better than those with low education.

Hilgert et al.,(2003)Financial literacy has significant effect on individual Financial behaviors as it will give favorable results.

Volpe and Chen (2006) surveyed 212 benefit administrators in charge of personal finance programs in the US-based companies in order to specify important personal finance issues for working adults and assess their level of knowledge. The results revealed that the least important areas were estate planning and investment. Specifically, the least important topics were having knowledge of mutual fund prospectuses, mutual fund fees, and expense ratios. The participants also indicated that working adults were actually least knowledgeable about the same topics that they viewed as least important. In general, the benefit administrators indicated that the level of knowledge of working adults was relatively low.

Al-Tamimi (2006) investigated the most and least influencing factors on the UAE investor's behavior by surveying 343 individual investor. The most influencing factors were, in order of importance: corporate earnings, get rich quickly, stock marketability, past performance of the firm's stock, government holdings, and the creation of the organized financial markets. In addition, two factors had unexpectedly the least influence, namely religious reasons and family member opinions. However, the author did not consider the relationship between financial literacy and investment decision, which will be dealt with in the current study.

Hussein A. Hassan Al-Tamimi and Al Anood Bin Kalli , (2009) The financial literacy level is found to be affected by income level, education level, and workplace activity. High-income respondents hold high educational degrees, and those who work in the field of finance/banking or investment had as expected a higher financial literacy level than others. Whereas, financial illiteracy exists regardless of the age of the respondents. A significant difference in the level of financial literacy was found as well between the respondents according to their gender. Specifically, women have a lower level of financial literacy than men. Finally, the results indicate that there is a significant relationship between financial literacy and investment decisions. The most influencing factor that affects the investment decision is religious reasons and the least affecting factor is rumors.

Huston (2010, p.306), Financial literacy such as health or general literacy might be conceptualized with two main dimension: understanding personal nance knowledge and using it. Hence, it could be described as "*measuring how well an individual can understand and use personal nance-related information*". It is also added that this description is coherent not only with other literacy concepts but also with definitions in the extant Financial literature.

As for Kindle (2010, p.472), this study manifests the relation of becoming financially unlucky to social well-being by suggesting a connection between being psychologically uneasy and unfavorable financial events such as financial stress, overdebtedness . Hence, the study aims to measure social work students' awareness of whether financial literacy is relevant to their future implementations since they are potential social workers of the future. These students reported that financial knowledge is found to be highly relevant for some problems such as poverty.

Makarov and Schornick (2010) Literacy can also be enhanced by the people who have enough resources and utilize these resources to obtain financial information for implying better outcomes from investment decisions. Wealthier households can spend more money to get access to financial information. By using this information they are usually less uncertain about the risky assets as they are aware of all the information about the financial market. As the wealth of investor increases, his absolute risk tolerance will also increase because he can have every type of information by using his money, but on the other hand less wealthy individuals are uncertain because they can't purchase that much information).

Altintas, (2011)Poor financial choices could have a number of negative consequences for young people. Financially illiterate graduates might be subject to various financial or judicial enforcements, such as bankruptcy, mortgage crises or financial frauds. In order to protect young adults from the costly consequences of financial illiteracy, the evaluation of financial literacy must be analyzed for transforming them into financially knowledgeable individuals by the help of financial education .

Van Rooij et al. (2011b) analyzed the relationship between households' financial literacy and its stock market participation in the context of the Netherlands, finding that those with low financial literacy are much less likely to invest in the stock market. In line with this conclusion, Calvet *et al.* (2007) reported that loweducation and low-wealth investors are likely to hold poorly diversified portfolios, which is consistent with the results of Christelis *et al.* (2010) and Van Rooij *et al.* (2011b), who find that more financially literate individuals tend to include stocks in their portfolios because they better understand the principle of risk diversification.

Klapper et al. (2012) study the consequences of greater financial literacy on the use of financial products and financial planning in Russia. Financial literacy is positively related to participation in financial markets and negatively related to the use of informal sources of borrowing.

Carpentier and Suret (2012) administered a survey to 1,814 Canadian investors who manage their own stock portfolios, in order to estimate the level of investors' knowledge and rationality, concluding that their knowledge scores are generally mediocre. The authors find that investors are generally unaware of gaps in their financial knowledge. However, they indirectly recognize these gaps by expecting to achieve returns below than or equal to those of the market index.

Calcagno and Monticone (2015) Argued that financial literacy is a necessary element of financial Decision making, and many low age people having desire of getting financial qualification. Major proportion of college students said they required more education on managing finances, many would like to get information about financial management topics in high school, and less proportion would desire to get such information as college.

Rabeea Rizvi* & Afsheen Abrar (2015) Finally, the results indicate that age, income, language and orientation of education have significant role in determining the investment style of an investor. Whereas financial literacy and accounting information are most influencing factors on the decision making behavior of individual investors.

By integrating the factors we can hypothesize that: H1: Financial literacy is positively related with portfolio management behavior of an individual investors.

5. Methodology

5.1 *Empirical Model*

On the basis of above hypothesis a general model can be formulated showing the important relationship between financial literacy and portfolio management behavior of an individual investor.

Financial Literacy* =I> *Behavior* =I> *Portfolio Management

5.2 Variables

1. Financial literacy
2.Increase in risk taking capacity
3.portfolio management.

The model gives the demonstration of variables and the relationship among them. Hypothesis are devised on the basis of model which after testing concludes that financial literacy leads to sound portfolio management behavior.

6. Conclusion

This paper tries to construct a theoretical model that proves to be useful for the investors. Financial decision making becomes easy with the sound financial knowledge, and hence losses can be avoided or can be minimize in future.While making an investment, investors faces many problems which leads to wrong financial decision making.These are risk, ambiguity and choice overload faced by every investors weather a financial professionals, experienced investors or a households.

Higher financial literacy will lead to a great risk tolerance. Even past experience will make you financial literate because you have a portfolio of good and bad experience.The investor with financial literacy will be familiar with the technical jargons and knowhow and make him to take a sound decision making regarding making of an efficient portfolio. This study proves to be a milestone for future researchers. Financial literacy proves to be an important determinant while making portfolio management decision.

As in previous studies only questionnaires were used as instrument, there must be the usages of other research tools to make the data more authentic. Qualitative studies like interviewing the investors to get insight about how these factors are impacting and many other factors that influencing the portfolio management behavior can be explored.

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