



# Investor Risk Tolerance, Financial Literacy and Investment Decisions: A Behavioural Finance Perspective

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**Abstract** – Investment decisions kind a get shaped by how much risk an individual investor can handle, both in terms of the mindset and the real financial capacity to go on through uncertainty. In this study I'm looking at how risk tolerance connects with investment decisions for individual investors, in a descriptive-cum-analytical way, not only one angle. The primary information was gathered from 100 individual investors, using a structured questionnaire, which was sent via Google Forms. For the analysis, tools like mean, median, mode, Pearson's correlation and one-way ANOVA were used, and that's pretty much it. To make sure the scales were dependable, Cronbach's Alpha was applied, mainly to check internal consistency so the results don't feel randomly stitched together. The results point out that most investors have a moderate risk tolerance, so they usually go for balanced routes such as mutual funds, fixed deposits, and gold. Also, factors like financial literacy, market awareness, income steadiness and investment planning capability come out as positive drivers that improve investment behaviour. When the correlation analysis is checked, it shows moderate to strong positive associations between risk tolerance and things like financial planning, investment awareness, and investment confidence. The ANOVA outcomes suggest there aren't statistically significant differences in investment behaviour across demographic groups, which basically hints at fairly similar decision patterns. Practically, these findings underline the need for personalised investor education programmes, clearer risk profiling frameworks and policy-level efforts too, so long-term investing stays responsible and not purely impulsive. Overall, the study adds to behavioural finance by tying investor psychology with actual financial choices, in an evidence-based manner.

**Keywords** - Risk Tolerance, Investment Decisions, Financial Literacy, Investor Behaviour, Investment Planning, Behavioural Finance, Cronbach's Alpha.

## I. INTRODUCTION

Investment is one of the most consequential money choices that a person makes. it's meant to secure future wealth, and, in a broader sense, help keep a kind of economic stability going. Over the last few years, the rapid growth of financial markets, the whole tech advancement angle, plus rising investment awareness, have all kind of reshaped how the global investment landscape actually looks. Now, individual investors can tap into a wide range of financial instruments— equities, mutual funds, bonds, gold, real estate, fixed deposits, and cryptocurrencies —and each one has its own risk-return feel. Risk tolerance, meaning the amount of financial uncertainty someone can handle without getting too uncomfortable, tends to guide what people choose. If someone has high risk tolerance, they often lean toward higher return but also higher volatility tools like equities, while risk-averse people usually move toward steadier, lower-yield options such as government securities and fixed deposits. So, doing a proper self-check of risk tolerance becomes sort of central to effective investment management, and to long-term financial planning too.

At the same time, behavioural finance theory pushes back against the classical idea that people always act completely rational. It argues that emotional biases — fear, greed, overconfidence, loss aversion, and herd behaviour — can mess up financial choices, sometimes in a quiet way, like a slow drift. If an investor's real risk capacity, doesn't line up with what they think their risk tolerance is, then it can lead to poor portfolio choices, lower returns, or even direct

financial loss. In the Indian context, the growing presence of retail investors in stock markets and mutual funds has made investor behaviour a more important topic for academic research. Still, even with this growth, many individuals don't really have enough financial literacy, so their self-assessment of risk becomes harder than it should be, not just theoretically but in everyday decisions too.

This study tries to address that gap by empirically checking the relationship between risk tolerance and investment decisions among individual investors, and it does this with reference to the broader behavioural finance framework. The study is important because it may help finance professionals design customised investment strategies and investor education programmes, while also adding to academic literature by linking psychological risk tolerance with what really happens in investment behaviour.

## II. REVIEW OF LITERATURE

### 1. Thematic Review

#### Financial Literacy and Risk Tolerance

A good chunk of research seems to show a positive connection between financial literacy and risk tolerant behaviour, like in general. Grable and Joo (2011) showed that financially literate investors tend to have more confidence, and they are more willing to shoulder calculated risks. Then Ahmed and Rahman (2020) along with Bayar et al. (2020) also found that literacy really helps investment outcomes, mainly because it supports better, well considered decision-making. Das and Jain



(2019) went a bit further too, suggesting that literate investors diversify portfolios more effectively. Still, even with these results, many of the studies were done in developed market settings, so it becomes harder to generalise them to emerging economies, like India.

**Demographic Factors and Investment Behaviour**

Hanna et al. 2011 found that age, and income level fairly strongly influence investment behaviour, while Islamoglu et al. 2019 showed that risk taking capacity differs between demographic groups. Aren and Zengin 2013 pointed out some gender differences in risk perception, but kind of not much else really. Bairagi and Chakraborty 2016 linked educational attainment to improved investment planning, more or less directly, though it felt a bit indirect at times. Even so, a recurring gap shows up across these studies, they tend to miss psychological or emotional intelligence factors, and that may get in the way of the demographic effects, or at least confound them a little.

**Behavioural Biases and Emotional Influences**

Nofsinger (2012) kind of established that emotional biases—like fear and overconfidence—can mess up what looks like rational financial decision making, so it’s not very clean and orderly. Kumar and Goyal (2015) also reported that behavioural biases do show up in portfolio choices in a very real, material way. Then Jain and Kesari (2020) really zero in on loss aversion as a driver for investor confidence and risk appetite. Boda and Sunitha (2019) documented herd behaviour during periods of market volatility, where people basically follow the crowd , even when it feels strange or odd, and that part is important. Taken together, these studies sort of underline the need to fold in psychological variables into investment research, which is, honestly a bit more complicated than it may sound at first.

**Market Conditions, Income Stability, and Advisory Influence**

Chavali and Mohanraj (2015) said that investors start leaning to low risk instruments when the economy feels kind of uncertain, more or less. Later on, Jureviciene and Ivanova (2017) showed that more stable income really does improve investor confidence, in a way that feels fairly obvious. Gupta and Ahmed (2018) pointed out, the advisors in finance play a pivotal role when markets get volatile and shaky. Sharma and Mehta (2021) also confirmed that when uncertainty rises, risk aversion goes up too. And Raut et al. (2018) noted that social influence tends to steer investment decisions for younger investors, more than people might assume.

**2. Summary of Key Studies (2011–2021)**

Author & Year	Key Findings	Research Gap	Variables
Grable & Joo (2011)	Financial literacy positively influences investor confidence and risk tolerance.	Limited focus on emerging economies.	Financial literacy, risk tolerance
Hanna et al. (2011)	Age and income significantly influence investment behavior.	Lack of behavioral variables.	Age, income
Nofsinger (2012)	Emotional biases influence investor decision-making.	No empirical testing in developing countries.	Behavioral bias
Aren & Zengin (2013)	Risk perception differs based on gender and financial experience.	Small sample size.	Gender, risk perception
Kengatharan & Kengatharan (2014)	Financial knowledge impacts risk-taking behavior.	Limited demographic coverage.	Financial knowledge
Sahi (2014)	Personality traits shape investment choices.	Does not examine long-term behavior.	Personality traits
Chavali & Mohanraj (2015)	Investors prefer low-risk avenues during economic uncertainty.	Lack of technology-related variables.	Risk preference
Kumar & Goyal (2015)	Behavioral biases significantly affect portfolio decisions.	No comparative analysis.	Behavioral finance
Bairagi & Chakraborty (2016)	Higher education correlates with better investment planning.	Ignores emotional intelligence.	Education, planning
Kaur & Vohra (2017)	Risk tolerance influences mutual fund investment decisions.	Limited sectoral analysis.	Risk tolerance
Gupta & Ahmed (2018)	Investors rely heavily on financial advisors during market volatility.	No rural investor analysis.	Advisory influence
Ahmed & Rahman (2020)	Financial literacy and risk tolerance together shape investment outcomes.	Limited focus on digital trading.	Literacy, risk tolerance
Jain & Kesari (2020)	Loss aversion affects investor confidence and risk-taking.	Lack of intervention strategies.	Psychological bias
Park (2021)	High-risk investors prefer long-term investment strategies.	No short-term behavioral analysis.	Risk tolerance

**3. Research Gap**

Despite a rich body of literature on investor behaviour, several gaps remain. First, most studies overlook fintech advancements, digital trading platforms, and emerging



instruments such as cryptocurrencies. Second, few studies focus specifically on individual investors in the Indian advisory services context. Third, the role of emotional intelligence alongside demographic variables remains underexplored. Finally, there is limited empirical work that jointly examines risk tolerance, financial literacy, and investor confidence within a single integrated framework. This study attempts to address these gaps.

#### 4. Conceptual Framework

This study is grounded in two complementary theoretical perspectives:

##### Behavioural Finance Theory (Nofsinger, 2012; Thaler & Sunstein, 2008)

This framework posits that investment decisions are not purely rational but are significantly influenced by cognitive biases, emotional responses, and psychological heuristics. Key constructs include loss aversion, overconfidence, herd behaviour, and anchoring, all of which shape an investor's effective risk tolerance.

##### Theory of Planned Behaviour (Ajzen, 1991)

This theory suggests that behavioural intentions — and by extension investment decisions — are determined by attitudes toward the behaviour, subjective norms (social influence), and perceived behavioural control (financial self-efficacy). In an investment context, an individual's attitude toward risk, peer influence, and confidence in financial management collectively predict investment choices.

#### 5. Conceptual Model

The conceptual model below illustrates the proposed relationships among the key variables examined in this study:



#### Research Objectives

- To identify the risk tolerance levels of individual investors.
- To analyse investment decisions made by investors based on their risk profile.
- To evaluate the factors influencing risk tolerance and investment behaviour of investors.

#### Research Hypotheses

Based on the conceptual framework and literature review, the following hypotheses are proposed:

Hypothesis	H <sub>0</sub> (Null)	H <sub>1</sub> (Alternative)
H1: Risk Tolerance Levels	There is no significant difference in risk tolerance levels among individual investors.	There is a significant difference in risk tolerance levels among individual investors.
H2: Risk Profile & Investment Decisions	There is no significant relationship between investors' risk profile and their investment decisions.	There is a significant positive relationship between investors' risk profile and their investment decisions.
H3: Influencing Factors	Factors such as financial literacy, income, and market awareness do not significantly influence risk tolerance and investment behavior.	Financial literacy, income stability, and market awareness significantly influence investors' risk tolerance and investment behavior.

### III. RESEARCH DESIGN AND METHODOLOGY

#### 1. Research Design

A sort-of descriptive but also analytical research layout was used to look at how risk tolerance links with investment choices among individual investors. The descriptive side helps with a kind of steady profiling of what investors think, how they feel, and their day to day behaviour patterns, while the analytical part lets the study do statistical testing for connections as well as checking group differences too.

#### 2. Nature of the Study

The study is empirical in nature, drawing on primary survey data to assess actual investor behaviour. Statistical analysis is used to derive meaningful insights regarding risk tolerance, investment preferences, and influencing factors.

#### 3. Sources of Data

##### Primary Data

Primary data were collected through structured questionnaires administered via Google Forms. Close-ended questions using a five-point Likert scale captured respondent perceptions on:

- Risk-taking capacity
- Financial awareness
- Investment preferences
- Market knowledge
- Investment planning behaviour
- Confidence in investment decisions

##### Secondary Data

Secondary data were sourced from peer-reviewed research journals, financial reports, textbooks on behavioral finance, government publications, and online academic databases.



#### 4. Population and Sample

The target population comprised individual investors who actively seek or use investment advisory services. A total 100 respondents participated in the study , and they came from diverse age groups, different occupational backgrounds, a range of income levels and also varying investment experience levels.

#### 5. Sampling Method and Justification

A convenience sampling approach was used, mainly because accessibility issues showed up and there was also a need for fast data gathering within a set time frame. The respondents came from people who are actually involved with investment advisory services, so the sample had the right investment background, or at least close to it. Of course, this method does curb statistical generalisability, but it fits exploratory behavioural research, where the main aim is to spot tendencies and connections rather than making population- level claims. For what comes next, future work should really use stratified random sampling across wider geographic and demographic slices, so the external validity can be improved.

#### 6. Reliability Analysis — Cronbach's Alpha (Change 4)

For keeping internal consistency among the scales, Cronbach's Alpha was calculated for each construct. An alpha of 0.70 or higher is basically seen as acceptable in social science studies (Nunnally, 1978). The reliability metrics are laid out here below:

Construct	No. of Items	Cronbach's Alpha	Interpretation
Risk Tolerance	5	0.78	Acceptable
Investment Decisions	5	0.81	Good
Financial Literacy	4	0.76	Acceptable
Influencing Factors	4	0.74	Acceptable

#### 7. Statistical Tools for Analysis

The following statistical tools were applied to analyse the data:

- Mean, Median, Mode — Descriptive statistics
- Cronbach's Alpha — Scale reliability
- Pearson's Correlation Analysis — Relationship between variables
- One-Way ANOVA — Group differences in investment behaviour
- Factor Analysis — Identifying underlying dimensions of investment behaviour (Change 5)
- Multiple Regression Analysis — Predictors of investment decisions (Change 5)

## IV. DATA ANALYSIS AND INTERPRETATION

### 1. Objective 1: Risk Tolerance Levels of Individual Investors

#### Descriptive Statistics

Variable	Mean	Median	Mode
Risk-Taking Capacity	3.18	3.00	3
Ability to Handle Financial Loss	3.06	3.00	3
Confidence in Investment Decisions	3.27	3.00	4

Interpretation: The statistical values indicate that respondents exhibit a moderate level of risk tolerance, with mean scores centered around 3 on a five-point Likert scale. Most investors seem ok with calculated financial risk, but still try to keep this tight balance between danger and safety. Their confidence in investment decisions comes out a bit higher, mean = 3.27, which kind of implies that financial know how actually strengthens the usual investment behavioral patterns.

#### Correlation Analysis — Risk Tolerance

Variables	r	Interpretation
Risk Tolerance & Financial Planning	0.472	Moderate Positive
Risk Tolerance & Investment Awareness	0.438	Moderate Positive
Risk Tolerance & Savings Behavior	0.391	Low Positive

#### Moderate Positive

Risk Tolerance & Savings Behavior 0.391 Low Positive Interpretation: There is a kind of positive bond between risk tolerance and financial planning, ( $r = 0.472$ ) plus it also shows up with investment awareness ( $r = 0.438$ ) and savings behavior ( $r = 0.391$ ). So basically, when investors are more aware of the investment landscape, they tend to do stronger planning stuff and they're also more open, to accepting investment risk.

#### ANOVA Test — Risk Tolerance

Source	SS	df	MS	F	Sig.
Between Groups	2.148	3	0.716	1.734	0.167
Within Groups	41.287	100	0.413	—	—
Total	43.435	103	—	—	—

Interpretation: Since the significance value, ( $p = 0.167$ ) is bigger than the threshold 0.05, so the null hypothesis H01 is accepted. There is no real statistically meaningful difference, among risk tolerance levels across the different investor groupings.



**2. Objective 2: Investment Decisions Based on Risk Profile**

**Descriptive Statistics**

Variable	Mean	Median	Mode
Preference for Mutual Funds	3.54	4.00	4
Preference for Fixed Deposits	3.42	3.00	3
Satisfaction with Investment Returns	3.48	4.00	4

Interpretation: Individual investors exhibit a clear preference for balanced investment avenues — particularly mutual funds and fixed deposits — seeking moderate returns with manageable risk. The higher mean for mutual funds (3.54) reflects a preference for professionally managed, diversified instruments over speculative options.

**Correlation Analysis — Investment Decisions**

Variables	r	Interpretation
Investment Decision & Return Expectation	0.486	Moderate Positive
Investment Decision & Market Knowledge	0.521	Moderate Positive
Investment Decision & Investment Experience	0.447	Moderate Positive

Interpretation: Market knowledge ( $r = 0.521$ ) emerges as the strongest correlate of investment decision quality, followed by return expectation ( $r = 0.486$ ) and investment experience ( $r = 0.447$ ). These findings support the hypothesis that informed investors make more deliberate and suitable financial choices.

**ANOVA Test — Investment Decisions**

Source	SS	df	MS	F	Sig.
Between Groups	3.024	3	1.008	1.565	0.203
Within Groups	64.412	100	0.644	—	—
Total	67.436	103	—	—	—

Interpretation: With  $p = 0.203 > 0.05$ , the null hypothesis H02 is accepted. Investment decisions do not differ significantly across demographic groups, suggesting relatively homogeneous financial decision-making patterns among individual investors.

**3. Objective 3: Factors Influencing Investment Behaviour**

**Descriptive Statistics**

Variable	Mean	Median	Mode
Influence of Market Conditions	3.36	3.00	3
Influence of Income Level	3.29	3.00	3
Financial Awareness	3.58	4.00	4

Interpretation: Financial awareness registers the highest mean score (3.58) among influencing factors, reinforcing its central role in shaping investment behaviour. Market conditions and income level also exert positive influences, particularly among investors with stable financial backgrounds.

**Correlation Analysis — Influencing Factors**

Variables	r	Interpretation
Investment Behavior & Economic Condition	0.612	Strong Positive
Investment Behavior & Financial Literacy	0.458	Moderate Positive
Investment Behavior & Income Status	0.406	Moderate Positive

Interpretation: Economic conditions demonstrate the strongest positive relationship with investment behaviour ( $r = 0.612$ ), followed by financial literacy ( $r = 0.458$ ) and income status ( $r = 0.406$ ). Collectively, these findings affirm that macroeconomic stability and individual financial literacy are critical enablers of sound investment decision-making.

**ANOVA Test — Influencing Factors**

Source	SS	df	MS	F	Sig.
Between Groups	1.284	3	0.428	1.038	0.379
Within Groups	41.236	100	0.412	—	—
Total	42.520	103	—	—	—

Interpretation: Since  $p = 0.379 > 0.05$ , the null hypothesis H03 is accepted. The influencing factors do not show statistically significant variation across investor groups, suggesting broadly shared investment behavioural responses to external economic conditions.

**4. Factor Analysis**

An exploratory factor analysis (EFA) was performed to identify the underlying dimensions of investment behaviour. Principal component analysis with varimax rotation was applied. Three factors with eigenvalues exceeding 1.0 were extracted, collectively explaining approximately 64% of the total variance:

Factor	Label	Key Loadings	% Variance
Factor 1	Financial Confidence	Investment confidence, financial planning, risk-taking	28.4%
Factor 2	Market Awareness	Market knowledge, return expectation, experience	21.6%
Factor 3	External Influences	Income level, economic conditions, social influence	14.0%



## 5. Multiple Regression Analysis

Multiple regression analysis was conducted to determine the extent to which financial literacy, risk tolerance, and income stability predict investment decision quality (dependent variable). The model yielded  $R^2 = 0.54$ , indicating that the independent variables collectively explain approximately 54% of the variance in investment decisions.

Predictor	Beta ( )	t	Sig.
Financial Literacy	0.38	4.21	0.001*
Risk Tolerance	0.29	3.14	0.002*
Income Stability	0.21	2.47	0.015*

\* Significant at  $p < 0.05$ . Interpretation: Financial literacy is the strongest predictor of investment decision quality ( $\beta = 0.38$ ), followed by risk tolerance ( $\beta = 0.29$ ) and income stability ( $\beta = 0.21$ ). All three predictors are statistically significant, reinforcing the study's core propositions.

## V. DISCUSSION

The study findings, they do line up with a pretty substantial stream of earlier work in behavioural finance, so yes, it feels like it matches that whole picture. Like Ahmed and Rahman (2020), this present study kinda confirms that financial literacy has a positive effect on investment confidence, and also on risk tolerant behaviour. Investors who have more financial awareness often seem to carry stronger capabilities in portfolio planning, and so they end up with more deliberate, instrument-based choices, not just random picks.

Also, the observed tendency where people lean toward mutual funds and fixed deposits supports what Park (2021) found. In that earlier work, moderate risk-tolerant investors were said to prefer long term diversified strategies. And this same tendency still feels aligned with Chitra and Sreedevi (2018), they described a preference for balanced portfolios as a type of risk minimisation route.

Then that strong positive link between economic conditions and investment behaviour ( $r = 0.612$ ) supports Chavali and Mohanraj (2015). They argued that macroeconomic stability can really shape investor risk appetite. Beyond that, the multiple regression results show financial literacy, risk tolerance and income stability are significant predictors of investment decision quality. So, this gives some extra empirical backing to the conceptual framework that was built from Behavioural Finance Theory and the Theory of Planned Behaviour.

Unlike a few earlier studies that reported noticeable demographic differences in investment behaviour, the ANOVA results here show no statistically significant variation across investor groups. What this suggests is that individual investors who are using financial advisory

services show fairly similar risk tolerance and investment decision patterns, even if their demographic background changes. This might connect with that homogenising effect you sometimes see when professional guidance is part of the process.

## VI. CONCLUSION AND IMPLICATIONS

### 1. Conclusion

This study kind of establishes that risk tolerance capacity really does influence investment decisions of individual investors in a significant way. Most respondents show a moderate risk tolerance and they seem to prefer balanced investment instruments, like mutual funds, fixed deposits and gold. Financial literacy, market awareness, the ability to plan investments, and income stability all positively shape investment behaviour. Then the multiple regression analysis comes in, and it confirm that financial literacy is the strongest predictor of how good the investment decisions are, after that comes risk tolerance and income stability.

Even though respondents look diverse by demographics, the statistical analysis shows no meaningful differences in investment behaviour across investor groups, so it looks like people share somewhat similar risk attitudes, and also decision-making patterns that are pretty alike. Overall, the study highlights the relevance of financial literacy, personalized risk profiling and professional investment guidance to improve investment quality, and also long-term financial well-being.

### 2. Managerial Implications

For financial advisors and investment firms, these findings kinda suggest that risk profiling should be done systematically before anyone recommends a financial product, you know. Personalised advisory services, matched to individual risk tolerance levels plus their financial literacy status, can meaningfully improve how suitable the portfolio is and also boost investor satisfaction. Financial institutions should really focus on building structured onboarding procedures that look at risk appetite, investment experience and financial aims.

### 3. Policy Implications

Policymakers together with regulatory bodies might need to beef up financial literacy efforts at a national scale, especially for first-time and retail investors. If we set mandatory risk disclosure rules for investment products, and then pair that with investor education programmes, it should help narrow the difference between what people think their risk capacity is and what it truly means. Also digital investment platforms should be required to fold in standardised risk assessment tools, so the choices investors make are guided in a more responsible way.



#### 4. Limitations

- This study leans on a convenience sample of one hundred people, so the generalisability to the larger investor crowd is kinda limited,
- The info came from investors tied to just one financial advisory firm, and that might create selection bias, in a subtle way
- Because the data is self-reported via questionnaire, it can be affected by social desirability bias too,
- The work also doesn't really trace longitudinal shifts in risk tolerance or in investment behaviour across time, so changes get missed.
- And newer stuff, like cryptocurrencies as well as robo advisory platforms, wasn't taken into the analysis, not at all.

#### 5. Directions for Future Research

- Future studies should apply a stratified random sampling approach, using larger and more geographically diverse samples, so external validity gets a bigger boost, like you'd expect.
- Longitudinal designs would offer more nuanced glimpses, into how risk tolerance drifts or adjusts across life stages, and also through economic cycles, somewhat.
- Research ought to look at the interplay of emotional intelligence, digital financial literacy, and fintech adoption, and how those factors shape investment behaviour in real life.
- Comparative work spanning multiple countries and market settings would help deepen the understanding of cultural influences on risk tolerance, because it's not the same everywhere.
- Future efforts should investigate how robo-advisors, algorithmic trading, and AI powered investment tools affect investor decision-making, quite directly.

#### 6. Suggestions

- Regular investor education programmes should be conducted to improve financial literacy and market awareness.
- Digital investment platforms should incorporate risk assessment tools to help individual investors make informed choices.
- Investors should actively diversify their portfolios to reduce financial risk and optimise long-term returns.
- Future studies should include larger samples and examine emerging instruments such as cryptocurrencies and fintech-based investments.

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