Impact of Financial Literacy and Risk Tolerance in Saving and Investment

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Abstract
Financial Literacy is an important element for saving and investment decision. Risk tolerance plays a vital role in an individual's choice of investment unit. The main objective of this research is to examine the relationship between financial literacy, risk tolerance, saving and investment decision as well to assess the difference in the saving, investment in insurance, investment in mutual fund, investment in bond and investment in stock with regard to the knowledge of financial literacy, level of financial risk tolerance also to examine the effect of financial literacy and financial risk tolerance on saving and investment decision. The study collected primary data by using five point Likert scale questionnaire technique from 299 respondents who are the bank customer of Tilottama municipality. Study based on descriptive and causal comparative research design. This research used quantitative mode for data gathering for the purpose of study. Mainly structured questionnaires survey was used to generate responses based on which analysis is done to test hypothesis. The sampling technique for the study followed saving and investment as dependent variable whereas financial literacy and risk tolerance as independent variable. The correlation and regression analysis result was generated from SPSS software available in the library of Lumbini Banijya Campus. Result of the study have revealed that there is a significant relationship between financial literacy and risk tolerance in saving and investment decision. Likewise, it is found there is association between saving, investment in bond, investment in mutual fund and investment in stock with regard to the level of financial literacy and risk tolerance.

***Key words**: Financial Literacy, Risks Tolerance, Saving and Investment.*

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I. Introduction

In today's complex financial landscape, individuals make critical decisions about saving, investing, and managing risks daily. Financial literacy—the ability to understand and use financial concepts—plays a vital role in empowering people to make informed financial decisions. Equally important is risk tolerance, which refers to an individual's comfort level with financial risks. Together, these factors significantly influence how people manage their finances, plan for the future, and choose among various investment options (Maskey, 2020).

Financial literacy has gained prominence in Nepal as access to credit and financial products has expanded. Programs like "NRB with Students," initiated by Nepal Rastra Bank, highlight the importance of educating the public about managing finances effectively (Nepal, 2014). However, the uneven distribution of financial knowledge and varying levels of risk tolerance present challenges in promoting equitable financial participation across communities.

This article explores the relationship between financial literacy, risk tolerance, and their combined impact on saving and investment decisions among residents of Tilottama Municipality, Nepal. By analyzing data from bank customers, this study sheds light on the critical role of financial education and behavioral factors in shaping financial outcomes.

This study focused on the following objectives:

- To examine the relationship between financial literacy, risk tolerance, and saving and investment decisions.

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- To assess differences in investment choices, such as insurance, mutual funds, bonds, and stocks, based on levels of financial literacy and risk tolerance.
- To evaluate the impact of financial literacy and risk tolerance on overall saving and investment behaviors.

II. Review of Literature

2.1 Theoretical review

Shadnan (2012) Investors in Pakistan showed a strong positive link between financial literacy, risk perception, and investment decisions. However, age and gender negatively influenced these decisions, highlighting demographic disparities. Sebastian & Weber (2008) A survey of mutual fund customers revealed that financial literacy modestly improves investment decisions, like reducing biases in returns estimation, though its impact on fund expenses and passive fund selection was minimal. Zakaria (2017) In Malaysia, advanced financial literacy correlated with higher risk tolerance in investments, emphasizing the need for education targeting complex financial decisions. Amisi (2012) Pension fund managers in Kenya exhibited inadequate financial literacy for effective investment decisions, emphasizing the global need for better financial knowledge in managing complex products.

Aeknarajindawat (2020) Trust, financial literacy, and risk tolerance significantly influenced investment decisions among Indonesian financial advisors, underscoring the role of education and trust in asset allocation. Akims & Jagongo (2017) In Nigeria, financial literacy significantly impacted investment decisions, with theories like mental accounting providing deeper insights into behavioral influences. Gustafsson & Omark (2015) Swedish pension data showed higher financial literacy increased risk tolerance, with intuitive decision-makers also displaying greater risk-taking behaviors. Shaikh (2014) financial literacy benefits both individual investors and national economies by enabling better financial decision-making, with demographic factors like age and gender playing critical roles. Wang (2009) financial knowledge and gender influenced risk-taking, with subjective knowledge acting as a mediator between objective knowledge and investment behavior.

Wanyana (2007) Limited awareness and perceived risks negatively affected stock market participation in Uganda, suggesting better use of available financial information could boost involvement. Subedi (2023) Nepalese investors with low financial literacy faced challenges in saving and investment decisions, highlighting the need for targeted education programs. Moko et al. (2022) among young entrepreneurs in Indonesia, financial attitudes and personality traits had a greater influence on financial management than financial knowledge. Kumar et al. (2024) In Jammu and Kashmir, financial literacy shaped financial behavior, which in turn influenced risk tolerance and investment decisions. Samsuri et al. (2019) financial literacy and risk tolerance shaped investment intentions, with emotional factors complementing rational evaluations in decision-making. Mendis & Surangani (2024) Sri Lankan finance students with higher financial literacy displayed stronger risk tolerance, though attitudes and behaviors also contributed.

Yulianis & Sulistyowati (2021) among young Indonesian investors, financial literacy and overconfidence influenced investment choices, while risk tolerance had limited effect. Ahmed et al. (2021) In Pakistan, financial literacy boosted risk tolerance and

improved investment decisions, demonstrating the mediating role of confidence. Mubaraq et al. (2021) financial knowledge and risk tolerance strongly influenced informed investment choices among Indonesian capital market participants. Mahdzan et al. (2020) higher financial literacy correlated with mutual fund investment likelihood in Malaysia, with education backgrounds influencing literacy levels.

Kramer (2016) Self-assessed financial literacy reduced reliance on expert advice, especially among wealthier households, suggesting overconfidence as a barrier. Grable & Lytton (1999) Risk tolerance varied with age, income, and education, offering valuable insights for tailoring financial advice to individual profiles. Sung & Hanna (1996) Higher risk tolerance led to investments in stocks, while risk-averse individuals preferred safer options like savings accounts or bonds.

III. Research Methodology

This study investigates financial literacy and risk tolerance in investment decisions using a structured research approach.

Research Design

A descriptive and causal-comparative research design was used. This approach allows for an in-depth analysis of phenomena in their natural state while exploring cause-and-effect relationships. The study focuses on financial literacy and risk tolerance among bank customers in Tilottama Municipality ward no. 1, 2 and 3. Quantitative methods were applied to primary data collected through online Google Forms and printed questionnaires distributed via social media and local channels.

Population and Sampling

The target population comprised bank customers from Tilottama Municipality Ward no. 1, 2 and 3. A total of 299 respondents participated, selected using convenience sampling due to its efficiency in saving time and resources. Demographic factors such as age, gender, marital status, education, and income were considered in the sampling design. Although 390 questionnaires were distributed, 299 completed responses were analyzed.

Data Collection

Primary data was collected using self-administered closed- and open-ended questionnaires. Google Forms facilitated online data collection, while printed versions were distributed in person. The data was analyzed using SPSS and Microsoft Excel.

Data Analysis

Statistical tools such as t-tests, descriptive statistics (mean, minimum, maximum, standard deviation), and inferential tools (correlation and regression analysis) were employed. Descriptive statistics provided a summary of the data, while inferential methods assessed relationships and patterns.

IV. Results and finding

Table 1: Statistical Analysis of Financial Literacy and Risk Tolerance Levels

Statistics	Financial Literacy	Risk Tolerance
Mean	4.0117	3.8555
Std. Deviation	0.7692	0.8534
Minimum	2.4167	2.0909
Maximum	4.6667	4.6364

The table presents an analysis of financial literacy and risk tolerance among 299 individuals. Financial literacy scores range from 2.42 to 4.67, with an average of 4.01 and a standard deviation of 0.77, indicating generally high literacy levels with moderate variability. Similarly, risk tolerance scores range from 2.09 to 4.64, averaging 3.86 with a standard deviation of 0.85, suggesting respondents generally rated these aspects above the lowest level but did not reach the maximum score of 5.

Table 1: Statistical analysis of Financial Literacy on saving and Investment Decision

Variable	F L L	N	Mean	S.D.	Std. Error Mean
Bank Deposit	L F L	93	4.03	1.521	.158
	H F L	206	1.23	.805	.056
Insurance	L F L	93	3.51	.761	.079
	H F L	206	2.16	.537	.037
Mutual Fund	L F L	93	3.16	.370	.038
	H F L	206	3.23	.694	.048
Bond	L F L	93	2.31	1.242	.129
	H F L	206	4.38	.840	.059
Stock	L F L	93	1.81	1.454	.151
	H F L	206	4.69	.827	.058
Note: FLL - Financial Literacy Level, LFL - Low Financial Literacy, HFL - High Financial Literacy					

The table 2 highlights the impact of financial literacy levels on saving and investment decisions across different financial instruments. Individuals with low financial literacy prefer safer options like bank deposits (mean: 4.03) and insurance (mean: 3.51) much more than those with high financial literacy, who exhibit significantly lower means for these categories (1.23 for bank deposits and 2.16 for insurance). Conversely, high financial literacy individuals favor riskier investments such as bonds (mean: 4.38) and stocks (mean: 4.69), compared to their low-literacy counterparts (means: 2.31 for bonds and 1.81 for stocks). Mutual funds show only slight variation between the groups (means: 3.16 for low literacy and 3.23 for high literacy), appealing similarly across literacy levels. These results underline how higher financial literacy shifts preferences towards riskier and potentially higher-return investments.

Table 2: Independent Samples t-test of Financial Literacy on saving and Investment Decision

Variable	V A	F	Sig.	t	df	Sig. (2-tailed)
Bank Deposit	EVA	100.013	.000	20.768	297	.000
Insurance	EVA	48.202	.000	17.576	297	.000
Mutual Fund	EVA	57.690	.000	-.937	297	.349
Bond	EVA	6.219	.013	-16.879	297	.000
Stock	EVA	36.764	.000	-21.740	297	.000
Note: VA - Variances Assumed & EVA - Equal variances assumed.						

The results of the independent samples t-test reveal that financial literacy significantly influences saving and investment decisions across various financial instruments. Individuals with higher financial literacy prefer bonds ($p < 0.001$) and stocks ($p < 0.001$), reflecting an understanding of these more complex financial products. Conversely, those with lower financial literacy tend to favor simpler, traditional options like bank deposits ($p < 0.001$) and insurance ($p < 0.001$), possibly due to their perceived security. Interestingly, no significant difference was observed in the preference for mutual funds ($p > 0.05$), suggesting that both groups value them similarly. These findings emphasize the critical role of financial literacy in shaping diverse investment behaviors, highlighting the importance of financial education for broadening financial choices.

Table 3: Statistical analysis of Risk Tolerance on saving and Investment Decision

Variable	Risk Tolerance Level	N	Mean	Std. Deviation	Std. Error Mean
Bank Deposit	Low Risk Tolerance	109	4.03	1.404	.134
	High Risk Tolerance	190	1.00	0.000	0.000
Insurance	Low Risk Tolerance	109	3.58	.724	.069
	High Risk Tolerance	190	2.00	0.000	0.000
Mutual Fund	Low Risk Tolerance	109	3.14	.346	.033
	High Risk Tolerance	190	3.25	.720	.052
Bond	Low Risk Tolerance	109	2.27	1.152	.110
	High Risk Tolerance	190	4.58	.494	.036
Stock	Low Risk Tolerance	109	1.83	1.344	.129
	High Risk Tolerance	190	4.92	.278	.020

The table compares how risk tolerance levels (low and high) influence saving and investment decisions across various options. For bank deposits, individuals with low risk tolerance show a significantly higher preference (mean: 4.03) compared to those with high risk tolerance (mean: 1.00). In insurance, low-risk individuals also exhibit a stronger preference (mean: 3.58) than their high-risk counterparts (mean: 2.00). For mutual funds, preferences are slightly higher for high-risk individuals (mean: 3.25) than low-risk ones (mean: 3.14). In bonds, high-risk individuals display a much stronger preference (mean: 4.58) compared to low-risk individuals (mean: 2.27). Stocks are overwhelmingly preferred by high-risk individuals (mean: 4.92) compared to low-risk individuals (mean: 1.83). This indicates a clear shift from secure to volatile investments as risk tolerance increases.

Table 4: Independent Samples T-Test of Risk Tolerance on Saving and Investment Decision

Variable	Variance Assumed	F	Sig.	t	df	Sig. (2-tailed)
Bank Deposit	Equal variances assumed	345.819	.000	29.759	297	.000
Insurance	Equal variances assumed	446.073	.000	30.087	297	.000
Mutual Fund	Equal variances assumed	97.047	.000	-1.567	297	.118
Bond	Equal variances assumed	17.648	.000	-24.157	297	.000
Stock	Equal variances assumed	130.494	.000	-30.517	297	.000

The independent samples t-test explores the impact of risk tolerance on saving and investment decision, revealing significant differences in most categories. For bank deposits, insurance, bonds, and stocks, the results show statistically significant differences ($p < .001$), indicating that risk tolerance strongly influences preferences in these areas. In contrast, mutual funds show no significant difference ($p > .05$), suggesting a relatively uniform appeal across risk tolerance levels. These findings highlight a trend where individuals with higher risk tolerance favor more volatile options like stocks and bonds, while those with lower risk tolerance prefer safer choices like bank deposits and insurance.

Table 5: Regression Analysis of Financial Literacy and Risk Tolerance on Saving Decision

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.932[a]	.869	.868	.613
a. Predictors: (Constant), Risk Tolerance, Financial Literacy				

Coefficients[a]						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	9.584	.217		44.252	.000
	Financial Literacy	-.646	.233	-.294	-2.769	.006
	Risk Tolerance	-1.268	.210	-.642	-6.035	.000
a. Dependent Variable: Bank Deposit						

The regression analysis examines how financial literacy and risk tolerance impact preferences for bank deposits. The model demonstrates a very strong relationship, with an R value of 0.932, meaning the predictors explain approximately 87% ($R^2 = 0.869$) of the variance in bank deposit preferences. From the coefficients, financial literacy has a negative effect on bank deposit preference ($B = -0.646$, $p = .006$), suggesting that as financial literacy increases, preference for bank deposits decreases. Risk tolerance has an even stronger negative impact ($B = -1.268$, $p < .001$), implying that individuals with higher risk tolerance are far less likely to prefer bank deposits. The results highlight that both higher financial literacy and greater risk tolerance shift preferences away from safer, low-risk options like bank deposits.

Table 6: Regression Analysis of Financial Literacy and Risk Tolerance on Stock Investment Decision

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.920[a]	.846	.845	.671
a. Predictors: (Constant), Risk Tolerance, Financial Literacy				

Coefficients[a]						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-3.614	.237		-15.230	.000

	Financial Literacy	.542	.255	.244	2.119	.035
	Risk Tolerance	1.358	.230	.679	5.896	.000
a. Dependent Variable: Stock						

The model demonstrates a strong predictive ability, with an R-squared value of 0.846, meaning that 84.6% of the variability in stock investment decisions is explained by these two factors. The ANOVA test confirms the model's overall significance ($p < .001$). Coefficients reveal that both financial literacy and risk tolerance positively affect stock investment. Risk tolerance has a more substantial impact ($\beta = 0.679$, $p < .001$), indicating that individuals with higher risk tolerance are significantly more inclined toward stock investments. Financial literacy also plays a positive role ($\beta = 0.244$, $p = .035$), though its effect is smaller compared to risk tolerance. The constant value (-3.614) suggests that without these predictors, the baseline preference for stock investments is low. Overall, the findings underscore that a willingness to take risks and a higher understanding of financial concepts strongly encourage stock investment behavior.

Table 7: Pearson's Correlation Coefficient of Financial Literacy on saving and Investment Decision

Variable		Financial Literacy	Bank Deposit	Insurance	Mutual Fund	Bond	Stock
Financial Literacy	Correlation	1	-.923**	-.788**	.231**	.825**	.910**
	Sig. (2-tailed)		.000	.000	.000	.000	.000
	N		299	299	299	299	299
Bank Deposit	Correlation		1	.922**	-.226**	-.924**	-.984**
	Sig. (2-tailed)			.000	.000	.000	.000
	N			299	299	299	299
Insurance	Correlation			1	-.227**	-.879**	-.939**
	Sig. (2-tailed)				.000	.000	.000
	N				299	299	299
Mutual Fund	Correlation				1	.193**	.244**
	Sig. (2-tailed)					.001	.000
	N					299	299
Bond	Correlation					1	.945**
	Sig. (2-tailed)						.000
	N						299
Stock	Correlation						1

**. Correlation is significant at the 0.01 level (2-tailed).

Above table explores how financial literacy correlates with different investment choices. A significant negative correlation between financial literacy and bank deposits (-0.923) suggests that individuals with greater financial knowledge are less likely to confine their savings to traditional options.

Similarly, the negative relationship with insurance (-0.788) indicates reduced reliance on risk-averse financial instruments among the financially literate. Conversely, strong positive correlations are found between financial literacy and stocks (0.910), bonds (0.825), and mutual funds (0.231). These figures highlight how financial literacy fosters a more

sophisticated approach to investing, emphasizing diversification and higher-risk options. This suggests that educated investors are better equipped to evaluate the risk-reward trade -offs of various financial products, leading to informed decision-making.

Table 8 Pearson's Correlation Coefficient of Risk Tolerance on saving and Investment Decision

		Risk Tolerance	Bank Deposit	Insurance	Mutual Fund	Bond	Stock
Risk Tolerance	Correlation	1	-.930**	-.800**	.154**	.857**	.919**
	Sig. (2-tailed)		.000	.000	.008	.000	.000
	N		299	299	299	299	299
Bank Deposit	Correlation		1	.922**	-.226**	-.924**	-.984**
	Sig. (2-tailed)			.000	.000	.000	.000
	N			299	299	299	299
Insurance	Correlation			1	-.227**	-.879**	-.939**
	Sig. (2-tailed)				.000	.000	.000
	N				299	299	299
Mutual Fund	Correlation				1	.193**	.244**
	Sig. (2-tailed)					.001	.000
	N					299	299
Bond	Correlation					1	.945**
	Sig. (2-tailed)						.000
	N						299
Stock	Correlation						1

**. Correlation is significant at the 0.01 level (2-tailed).

Above table shows the correlation coefficients between risk tolerance and various investment options like bank deposits, insurance, mutual funds, bonds, and stocks. The correlation analysis reveals a strong inverse relationship between risk tolerance and low-risk options such as bank deposits (-0.930) and insurance (-0.800). This indicates that as individuals become more comfortable with taking risks, their reliance on secure but low-return investments diminishes. Interestingly, the data shows a positive correlation between risk tolerance and riskier options such as bonds (0.857), mutual funds (0.154), and stocks (0.919). These findings suggest that individuals with high risk tolerance view such options as opportunities for better returns, aligning with the behavior of risk-seeking investors who favor higher potential growth over security. This analysis highlights the psychological impact of risk tolerance on financial decisions, showcasing how willingness to take risks translates into a preference for investments with varying degrees of uncertainty.

Discussion

The study confirms a positive relation between financial literacy and risk tolerance (mean financial literacy: 4.01; mean risk tolerance: 3.86). These findings align with those of Lusardi and Mitchell (2014), who emphasized that individuals with higher financial knowledge are better equipped to handle financial risks. Similarly, Grable and Joo (2004) reported that financial literacy contributes to confidence in risk-taking. However, this study differs from Hanna and Lindamood (2010), who found only a weak association between financial literacy and risk tolerance, suggesting that contextual or demographic factors may mediate this relationship.

Participants with higher financial literacy and risk tolerance prefer riskier investment options like stocks (mean literacy: 4.69, mean risk tolerance: 4.92) and bonds (mean literacy: 4.38, mean risk tolerance: 4.58). In contrast, those with lower literacy and tolerance lean towards safer investments like bank deposits (mean literacy: 4.03, mean tolerance: 4.03) and insurance (mean literacy: 3.51, mean tolerance: 3.58). These results align with the findings of Barber and Odean (2001), who observed a preference for diverse portfolios among financially literate individuals. A study that contrasts with these findings is conducted by Guiso, Sapienza, & Zingales, (2008). Their research revealed that individuals with higher financial literacy do not always prefer riskier investments like stocks or bonds. Instead, they may prioritize investments with lower risk, such as savings accounts or fixed-income securities, particularly in situations of economic uncertainty or when they lack confidence in market stability. This suggests that high financial literacy does not uniformly translate to a preference for higher-risk options, highlighting the role of external factors and individual risk perception.

Both financial literacy and risk tolerance negatively correlate with conservative investments such as bank deposits (-0.923 and -0.930, respectively) and insurance (-0.788 and -0.800, respectively). Positive correlations with stocks (0.910 and 0.919, respectively) and bonds (0.825 and 0.857, respectively) suggest a preference for sophisticated financial products among educated and risk-tolerant individuals. These findings corroborate Grable (2000), who identified a similar trend, but they challenge the work of Beckmann (2013), who found that financial literacy does not significantly influence conservative savings.

The study highlights key implications for stakeholders like NRB, banks, educators, financial advisors, and the government. Policymakers should promote financial literacy through school curricula and workplace training to empower individuals and bridge socio-economic gaps in investment participation. Financial advisors should align their guidance with clients' literacy levels and risk tolerance, directing high-literacy, high-risk individuals toward stocks or bonds and low-literacy, low-risk individuals to safer options like savings plans. Banks can innovate hybrid products, such as structured mutual funds, to support clients transitioning in their financial knowledge and risk preferences. Future research could explore cultural and behavioral influences on investment choices to deepen understanding of these dynamics.

Conclusion and Implication

This study concludes that financial literacy and risk tolerance are determinants of investment behavior. Individuals with high financial literacy and risk tolerance are more likely to invest in complex, high-return instruments, such as stocks and bonds. In contrast, those with lower literacy and risk tolerance prefer safer, predictable options, such as bank deposits and insurance policies. These trends

underline the importance of tailored financial education programs and investment advice that align with individual literacy levels and risk appetites.

The study concludes that People who understand finances well are more likely to invest in things that are risky but can offer higher returns, like stocks. Those with less financial knowledge tend to stick with safer, low-return options, such as bank deposits. Similarly, people who are comfortable taking risks often choose stocks and bonds, while those who prefer safety lean toward bank accounts or insurance. Mutual funds stand out as a balanced investment choice, appealing to individuals across financial literacy and risk tolerance.

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