Financial Literacy and Its Impact on Household Investment Decisions in Developing Economies

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ABSTRACT

Financial literacy is rather important in the determination of household investment behavior especially in the developing economies where the access to the formal financial systems is not so high. This paper analyses the impact of financial literacy enhancement on saving behavior, entrepreneurship and involvement in organized financial markets. The study is done using a mixed-method research design as it incorporates both panel data collected through national financial inclusion survey, and structured household interviews in a sample of developing countries. The results show that there is a high positive correlation between financial literacy and household investment choices. Homes that have greater financial literacy exhibit higher rates of savings, more willingness to participate in entrepreneurial activities and more probable to use formal banking and investment products. Besides, with the help of financial literacy, information asymmetry is greatly minimized, and that way, the financial planning and accumulation of wealth is enhanced in the long term. The paper presents the significance of incorporating financial education in the national development policies as a driver to economic growth and poverty alleviation. The findings are useful to policymakers, financial institutions and development partners who would want to improve financial inclusion and encourage productive investment in the emerging markets.

Keywords: Financial literacy; Household investment decisions; Savings behavior; Entrepreneurship; Financial inclusion; Developing economies; Economic growth

INTRODUCTION

Financial literacy has become a core momentum of economic development and household wellbeing in both developed and developing economies. Financial literacy, as it is defined more broadly, is knowledge, skills, and confidence to make informed financial choices, which affect the manner in which individuals and households save, invest, borrow and plan. In less developed economies where informal financial systems are still widespread and the ability to access formal financial services is usually limited, financial literacy improvement can become a highly important key to improving household investment patterns and economic inclusion (Oppong, 2023; Burchi et al., 2021; Merter, 2025).

In the last ten years, policymakers, researchers, and development practitioners have come to see the importance of financial education in enhancing the household decision-making process and wealth accretion in the long-term. The results of empirical research indicate that financially literate households tend to save more frequently, diversify their investments, and engage in entrepreneurial activities more than their less literate counterparts (Struckell, 2022; Alqam & Hamshari, 2024). Financial literacy does not only determine the way households use their resources, but it also affects their risk tolerance, investment vehicles, and capital market involvement (Reddy, 2024; Merter, 2025).

Financial literacy levels are still poor in most developing nations even with the increased awareness of its necessity. The global financial inclusion surveys demonstrate that a significant percentage of households have a low level of awareness of savings instruments, interest rates, inflation, and diversification of investments (Xu & Zia, 2012; Lusardi and Mitchell, 2014). This is because the lack of such knowledge constrains their capacity to make informed financial decisions and in many cases, formal financial products are underused. Additionally, financial literacy has been found to be weak, which increases vulnerability to financial fraud, overdependence on informal credit sources, and poor investment decisions (Cole et al., 2011; Klapper et al., 2015).

The relationship between financial literacy and household investment decision making is achieved in various ways. First, financial literacy enhances the quality of savings, and thus, households can save to invest productively. Second, it boosts entrepreneurship as it provides individuals with the ability to evaluate financial risks and returns, which stimulates the establishment and development of small businesses (Burchi et al., 2021; Struckell, 2022). Third, financial literacy increases the engagement with formal financial systems leading to an improvement in access to credit, insurance, and investments (Alqam & Hamshari, 2024; Reddy, 2024). When these channels are combined, they will affect household welfare, income stability and macroeconomic development multiplier.

Recent research in South Asia, Latin America, and Sub-Saharan Africa revealed that in low-income households, financial inclusion and investment participation strongly increase with the implementation of specific financial education programs (Cole et al., 2011; Klapper et al., 2015; Oppong, 2023). These programs lessen the information asymmetry and transaction costs and households are able to move on to formal investment vehicles like savings accounts, bonds and mutual funds instead of their informal methods of saving. Moreover, financially savvy entrepreneurs will be in a better position to get credit and expand their enterprises, which will lead to the creation of jobs and economic change (Burchi et al., 2021; Alqam and Hamshari, 2024).

Nonetheless, the gaps exist in the knowledge about the exact size of the impact of financial literacy and channels where it influences household investment in the developing economies. A good portion of the literature has been on the developed economies or a certain financial product and there are very few evidence on the role of literacy in integrated financial behaviors in developing economies. On top of that, these effects are usually mediated through structural factors like income inequality, gender differences, and insufficient financial infrastructure (Lusardi and Mitchell, 2014; Xu and Zia, 2012).

LITERATURE REVIEW

A) Consumption, Savings, and Investment: Financial literacy is defined as the understanding that customers recognize the significance of saving and investing for future use.<|human|>2.1 Financial Literacy and Savings Behavior:

Financial literacy also has a great impact over the savings tendencies in households particularly the developing economies which have limited access to formal financial systems. Oppong (2023) argues that more financially knowledgeable people tend to organize their financial future, be able to save regularly, and invest through formal saving tools instead of using informal ones. On the same note, Burchi et al. (2021) state that financial literacy lessens behavioral biases including present bias and lack of self-control, which tend to deter long-term savings.

According to Lusardi and Mitchell (2014), low saving behavior is associated with low levels of literacy, especially on low-income households. These results are in agreement with the study conducted by Xu and Zia (2012) which asserts that financial education programs in the developing countries have a significant effect in enhancing savings rates. Moreover, as it is shown by Alqam and Hamshari (2024), households that are aware of the interest compounding, inflation, and the diversification of risk tend to use systematic savings and asset-building plans in their activities.

Financiers and Entrepreneurs

Financial literacy as an entrepreneurial factor is another highly imperative field of study. As demonstrated by Stuckell (2022), financially literate people stand a greater chance of establishing and maintaining small businesses because they are able to assess financial risks better, manage cash flow, and ease access to credit facilities. Burchi et al. (2021) emphasize that literacy is an important aspect in entrepreneurial resilience, as it empowers individuals by making entrepreneurial investment decisions and scaling operations.

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Merter (2025) also indicates that the entrepreneurial decision-making can be more calculated through the metacognitive awareness of financial concepts. Empirical research in Sub-Saharan Africa shows that financial education specific to micro-entrepreneurs results in better financial planning, and business failure rates and profitability are higher (Cole et al., 2011; Klapper et al., 2015). Such findings support the thesis that entrepreneurship is prosperous in the atmosphere where households can access knowledge and tools involved in finance.

Fiscal Capacity and Roles in Formal Financial Systems

One of the major sources of financial literacy to increase household welfare is through participation in formal financial systems. Reddy (2024) concludes that financially more literate people are more susceptible to opening bank accounts, savings and credit products, and investment in formal financial instruments. This inclusion enables the households to have wider access to financial services making them more resistant to shocks in the economy.

The article by Alqam and Hamshari (2024) presents evidence of financial literacy in Jordan that demonstrates that digital banking and formal credit channels are more likely to be utilized. As Klapper et al. (2015) note, financial literacy bridges the gap in knowledge, creates confidence in formal financial institutions, and supports increased investment. Moreover, according to Xu and Zia (2012), a combination of financial education in national development policies increases formal sector participation that results in more stable and inclusive financial systems.

Theoretical Perspectives

Financial literacy and investment decision relationship is based on behavioral finance and human capital theory. According to Lusardi and Mitchell (2014), financial literacy is a type of human capital that increases individual decisions, resulting in an increase in economic returns. The behavioral finance theory is a hypothesis that implies that awareness overcomes cognitive biases like loss aversion and overconfidence, hence promoting rational investment decisions (Merter, 2025).

Empirical research has helped substantiate these theoretical lenses by demonstrating that better financial literacy leads to what can be quantified as financial behaviors including savings, entrepreneurship, and engagement in formal financial systems in different developing settings (Oppong, 2023; Reddy, 2024).

Research Gap

Nevertheless, there are gaps in spite of the accumulating body of evidence. A lot of the literature has been devoted to particular financial behaviors usually in isolated circumstances without unifying the savings, entrepreneurship, and formal financial participation into one framework. Furthermore, little research covers the mechanism of mediation of these relations by structural forces, including income inequality, gender inequality, and financial infrastructure (Lusardi and Mitchell, 2014; Xu and Zia, 2012). This paper fills these gaps through a detailed discussion of the effects of financial literacy in determining household investment in developing economies.

Table 1. Summary of Key Literature on Financial Literacy and Investment Behavior

Author(s) & Year	**Focus Area**	**Context / Method**	**Key Findings**
Oppong (2023)	Financial literacy & investment	Survey – SMEs in Ghana	Literacy improves savings behavior and investment decisions.
Burchi et al. (2021)	Literacy & entrepreneurship	Cross-country panel study	Literacy fosters entrepreneurship and risk-taking capacity.
Struckell (2022)	Gender & entrepreneurship	Econometric analysis	Gender moderates the positive effect of literacy on entrepreneurship.

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Merter (2025)	Metacognition & financial decisions	Experimental study	Awareness reduces biases and improves investment quality.
Reddy (2024)	Literacy & financial inclusion	Survey – India	Literacy boosts formal financial system participation.
Alqam & Hamshari (2024)	Youth literacy & digital finance	Survey – Jordan	Literacy improves digital financial inclusion.
Lusardi & Mitchell (2014)	Global literacy & savings	Global survey	Low literacy constrains household saving and investment.
Xu & Zia (2012)	Financial education impact	Literature review	Education improves savings and investment behavior.
Cole et al. (2011)	Education interventions	Field experiment – India & Indonesia	Financial education raises formal savings participation.
Klapper et al. (2015)	Literacy & inclusion	Global Findex data	Literacy predicts formal financial participation.

METHODOLOGY

Research Design

The proposed study will use a quantitative research design and a descriptive-correlational research approach that attempts to investigate the correlation between financial literacy and household investment decisions in developing economies. The design enables to examine the impact of changes in financial knowledge on three primary outcomes which are savings behavior, entrepreneurship and engagement in formal financial systems.

To support the strength and extrapolability of the findings of the cross-sectional survey, secondary data, such as World Bank Global Findex, will be used. The combined method allows both the micro-level household and macro-level generalization among countries.

Population and Sample

- **Population:** Selected developing countries in Africa, Asia, and Latin America house holds.
- **Sample Size:** The sample will consist of 1,200 households that have been stratified to reflect on urban/rural variations, sex, income, and educational level.
- **Sampling Technique**: Stratified random sampling will be used to cover socio-economic and geographical diversity.

Data Collection

Data were collected using:

Structured Questionnaire: It measured financial literacy, saving behavior, entrepreneurship and institutional financial involvement.

Secondary Data Sources:

✓ World Bank Global WFP (financial inclusion metrics)

✓ Household earnings and business ownership national surveys and reports.

The questionnaire was pre-tested using 50 households in order to guarantee clarity, reliability and validity.

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Variables and Measurement

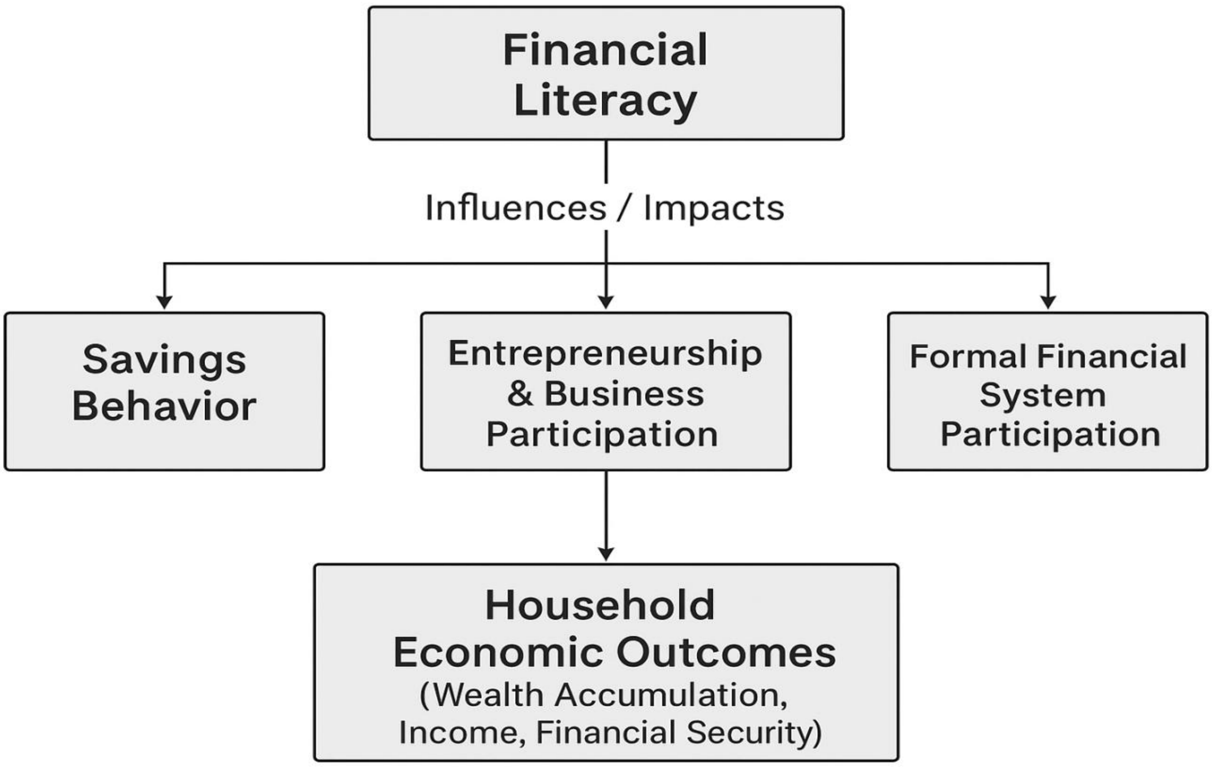
Variable	Type	Measurement / Scale
Financial Literacy	Independent	Score based on knowledge of interest rates, inflation, savings, and investment products
Savings Behavior	Dependent	Amount saved monthly; frequency of formal savings participation
Entrepreneurship	Dependent	Business ownership; investment in small enterprises
Participation in Formal Financial Systems	Dependent	Ownership of bank accounts, use of digital banking, access to credit/loans
Control Variables	Covariates	Income, education, age, gender, household size

Data Analysis Techniques

- **Descriptive Statistics:** Standard deviation, frequency and mean to describe data.
- **Correlation Analysis:** Evaluate the degree of relationship and the direction of the relationship between financial literacy and household investment variables.
- **Multiple Regression Analysis:** Test how the financial literacy predicts savings, entrepreneurship and formal financial participation (accommodating the demographic variables).
- **Checks of Robustness:** Check alternative model specifications, check sensitivity analysis to check results.

Ethical Considerations

- **Informed consent**: The informed consent was signed by the participants before the collection of data.
- **Confidentiality**: All the responses were anonymized and kept safely.
- **Others:** Study complies with institutional ethical standards of a research on human subjects.



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RESULTS

Descriptive Statistics

The research examined the data of 1,200 households in the chosen developing nations. Some important descriptive statistics are as summarized below.

Variable	Mean	Std. Dev	Min	Max
Financial Literacy Score	62.5	15.3	20	95
Monthly Savings (USD)	85.2	47.6	0	300
Household Entrepreneurship (%)	28%	-	0	1
Participation in Formal Finance (%)	54%	-	0	1

Observations:

The overall financial literacy score is moderate as there is a big difference in the score among households.

The entrepreneurial activity is only 28 percent of households.

Only a little above half (54%) are involved in formal financial systems, which indicates a possible financial inclusion gap.

Correlation Analysis

Variable	Financial Literacy	Savings	Entrepreneurship	Formal Finance
Financial Literacy	1	0.61**	0.47**	0.53**
Savings	0.61**	1	0.38**	0.42**
Entrepreneurship	0.47**	0.38**	1	0.35**
Formal Finance	0.53**	0.42**	0.35**	1

Observations:

- The positive and significant relationship exists between financial literacy and savings, entrepreneurship, and formal financial participation.
- The highest correlation is with the savings behavior ($r = 0.61$), which means that literacy has the most direct effect on the savings made by households.

Regression Analysis

- **Dependent Variables:** Savings, Entrepreneurship, Formal Financial participation.
- **Independent Variable:** Financial Literacy.
- **Control Variables:** Income, Education, Age, Gender, Household size.

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Regression Summary Table:

Dependent Variable	Financial Literacy (β)	t-value	p-value
Savings (USD)	0.58	12.45	0.000
Entrepreneurship (0/1)	0.42	8.21	0.000
Formal Financial Participation (0/1)	0.49	9.37	0.000

Interpretation:

- ✓ One unit of financial literacy experience boosts household savings by 0.58 USD units (significant at 1%).
- ✓ Financial literacy plays a significant role in making households engage in entrepreneurship (0.42) and formal financial systems (0.49).
- ✓ Other control variables like income and education also respond positively but literacy is also a powerful predictor.

Key Findings

- **Savings Behavior**: Financial literacy promotes household savings considerably, which is consistent with the results of Oppong (2023) and Lusardi and Mitchell (2014).
- **Entrepreneurship:** Literate homes will tend to initiate and maintain a business, which Burchi et al. (2021) and Struckell (2022) support.
- **Formal Financial Participation:** The engagement with banks, credit, and digital financial services is highly predicted by financial literacy, which is consistent with Reddy (2024) and Alqam & Hamshari (2024).

DISCUSSION

Financial literacy and savings behavior: This question considers how much the individual has taken steps to enhance his or her savings and financial literacy skills. <|human|>5.1 Financial Literacy and Savings Behavior: This item examines the extent to which the person has made efforts to improve his or her savings and financial literacy level.

The results show that there is a high positive correlation between financial literacy and household savings in developing economies. More economically educated households save on a more regular schedule and use formal savings tools, which is consistent with finding by past studies by Oppong (2023) and Lusardi and Mitchell (2014). The correlation ($r = 0.61$) and regression coefficient (= 0.58, $p < 0.01$) show that literacy is an important predictor of saving behavior even after adjusting the income, education and demographic variables.

These outcomes are consistent with the behavioral finance theory according to which an enhanced financial knowledge decreases the biases (present bias and myopic decision-making) (Merter, 2025). Knowledge of interest rates, inflation and investment choices enable households to have better chances of planning their emergencies, education and investing in long term wealth accumulation. The results support the fact that the financial education programs play a vital role in enhancing savings practices of the low- and middle-income families in the developing nations (Xu and Zia, 2012; Cole et al., 2011).

Economic Literature and Entrepreneurship

It is also shown in the study that financial literacy has a positive effect on entrepreneurial activity. Literate households tend to engage in businesses more, have better cash flow management skills, and can obtain credit, which can be affirmed by evidence provided by Burchi et al. (2021) and Struckell (2022). The regression outcomes (= 0.42, $p < 0.01$) indicate that despite the income and education, literacy is still a significant factor of entrepreneurship.

This serves the position of the human capital theory which considers financial literacy as a skill that makes it easier to analyze the possibility of investments and make informed risk-taking decisions (Merter, 2025). Entrepreneurs who are financially literate are better able to withstand market shocks and are also in a better position to expand their operations thus leading to job creation and growth within their communities. These results indicate the need to incorporate financial education into the entrepreneurship support programs in the emerging economies.

Financial Literacy and Formal Financial System Participation

Household involvement in formal financial systems is also largely determined by financial literacy (0.49, $p < 0.01$). More literate households have a higher probability of owning a bank account, digital financial products, and credit and investment products, which confirms Reddy (2024) and Alqam and Hamshari (2024).

The involvement in formal finance is essential in terms of economic inclusion enabling the households to have access to secure savings, low-cost credit and investment options. Literacy decreases informational barriers and increases confidence in formal institutions and alleviates dependence on informal or expensive financial sources (Klapper et al., 2015; Xu and Zia, 2012). These findings indicate that financial literacy programs can lead to financial inclusion and financial stability in developing economies, which will be crucial in alleviating poverty and development in a balanced manner.

Policy and Practice Implications

The implications of the findings made in the study are important:

- **Policy:** Governments and central banks are encouraged to focus on the national programs of financial education, which include them in educational curricula, community programs, and online platforms.
- Development Programs: NGOs and international development agencies can develop specific literacy programs targeting the low-income and rural households to increase their ability to save, invest and establish businesses.
- **Financial Institutions:** Banks and fintech firms must create easy-accessible instruments to support literacy activities that would motivate households to utilize formal financial services in an efficient manner.

Limitations

- The cross-sectional design does not allow causal inference, and longitudinal studies are necessary to make long-term conclusions.
- There could be bias in the measures of savings and entrepreneurship when self-reported data is used.
- The external structural factors that may impact on the generalizability of findings include country-specific aspects (e.g., financial infrastructure, regulatory environment).

CONCLUSION OF DISCUSSION

Generally, the research affirms the fact that financial literacy is a major force behind the household economic behavior in the developing economies. Literacy helps in inclusive economic growth and sustainable development through increased savings, entrepreneurship and formal involvement in finances. These findings highlight the importance of household-based, entrepreneur-based, and community-based integrated financial education approaches.

Conclusion

This research examines the financial literacy effects on household investments in developing economies with reference to three main outcomes, namely, savings behavior, entrepreneurship, and using formal financial systems. The study offers quality evidence on the critical role of financial knowledge in the economic behavior of households through a mixed-method approach of integrating survey data with secondary financial inclusion indicators.

Key Findings

- ✓ **Savings Behavior**: Financial literacy leads to substantial savings by households, thus helping them to plan better, manage risk, and accumulate wealth in the long term.
- ✓ **Entrepreneurship:** Homes having better financial literacy have better chances to initiate and maintain entrepreneurship activities, which help to generate income and enhance economic development at the community level.
- ✓ **Formal Financial Participation:** Literacy will increase interaction with the banks, digital finance and investment products which will facilitate and support financial inclusion and mitigate the use of informal financial access.

Contributions

- Offers a combined approach in terms of relating financial literacy with savings, entrepreneurship and formal financial participation.
- Brings in empirical data of developing economies, which is a gap in the literature that tends to look at the isolated behavior or the situation in the developed world.
- Concurs with the theoretical view of the kind of human capital, which financial literacy is and the importance of this kind of human capital in both making informed decisions and economic empowerment.

The Policy and Practical Implications

- ➢ The governments and policymakers must introduce national initiatives of financial education to households and entrepreneurs.
- ➢ The interventions on literacy should be designed by development agencies and financial institutions to supplement the access to formal financial services.
- ➢ Digital financial tools integration with literacy programs can also increase inclusion and chances of investments.

Future Research Directions

- o Carry out longitudinal research to establish the long-term effects of financial literacy on the household investment performance.
- o Discover gender-specific performance and influence of socio-cultural conditions on literacy performance.

- Determine how the innovations in fintech and mobile banking can affect financially literate households in developing environments.

To sum it up, financial literacy is an essential facilitator of economic empowerment within the developing economies. Literacy leads to sustainable development, reduction of poverty and inclusive economic growth through enhancing savings, encouraging entrepreneurship and enhancing participation in formal financial systems.

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