

## Financial Literacy Overconfidence and Risk Attitude of Individual Investors in Hyderabad

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### Abstract

There are three main categories that can be used to describe individuals attitude towards risk: risk-aversion, risk-neutral, and risk-seeking. This paper highlights the impact of a unique form of overconfidence, namely, financial literacy overconfidence on risk-seeking attitude of individual investors. Financial literacy overconfidence is the variation between investors subjective financial literacy score and objective financial literacy score. After analysing the responses from 520 individuals from the region of Hyderabad, we demonstrate a positive correlation between overconfidence and a risk-seeking attitude, while a negative correlation exists between under-confidence and a risk-seeking attitude. Findings recommend that along with increasing the financial literacy, financial experts and individuals should also increase their confidence to develop appropriate risk attitude and produce positive outcomes.

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**Keywords :** Financial Literacy; Individual; Investors; Overconfidence; Risk Attitude; Under-confidence; India

### I. Introduction

INDIVIDUALS EXPRESS DIFFERENT attitudes in decision-making that involve risk and uncertainty. Avoiding risk, being neutral to risk, tolerating the risk, and facing the risk are the different sorts of individuals responses when encountered with an uncertainty that is perceptual-driven i.e. risk (Hillson and Murray-Webster, 2005). Early research in psychology suggested that individuals risk attitude is a component of their personality i.e., the position of individuals on the spectrum ranging between risk-seeking and risk-aversion (Plax and Rosenfeld, 1976). Abdellaoui, Driouchi, and

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outcomes because of their higher levels of objective financial literacy. However, being under-confident hinders the opportunity for positive returns for these investors.

#### 6.1 Contributions and Recommendations

The contributions of the present study can be summed up into two main areas, first, by examining the influence of a discrete type of overconfidence on risk-seeking attitude. This institutes an interrelation between the financial literacy overconfidence, and the risk-seeking attitude. Second, it extends the current study upon the impact of financial literacy on the risk attitude. Employing this study, we have established that in addition to having high financial literacy in developing an appropriate risk attitude, investors also need to have confidence in their financial literacy and knowledge. Increased confidence in their financial skill and literacy will encourage the investors to develop appropriate risk attitudes and make more efficient decisions about their investments. We recommend that along with increasing the financial literacy, financial experts and individuals should also increase their confidence to develop appropriate risk attitude and produce positive outcomes.

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### Annexure

#### Risk Attitude - Imagine the below situation.

You possess an initial wealth of ₹ 10,000, which you can invest in a lottery (risky investment). You have a 50% chance that your wealth could double to ₹ 20,000 and another 50% chance that you could lose half the amount i.e., ₹ 5,000.

Instead of the lottery (risky investment), you can also invest your wealth of ₹ 10,000 in a risk-free alternative which gives a sure 4.4% interest rate per year i.e., it gives a sure amount of ₹ 10,440.

Select one of the below options according to your proportion of investment choice between risk-free alternatives and risky investments.

Risk-Free	Alternative (in thousands)	Risky Investment (in thousands)
1.	Nil	Ten
2.	One	Nine
3.	Two	Eight
4.	Three	Seven
5.	Four	Six
6.	Five	Five
7.	Six	Four
8.	Seven	Three
9.	Eight	Two
10.	Nine	One
11.	Ten	Nil

Source: Self computed