



Financial Literacy and Investment Behaviour: How Knowledge and Anticipated Emotions Shape Stock Market Participation Intentions and Financial Word-of-Mouth

Amit Kumar Janghel¹, Dr. Wuppuluru Ramana Rao²

¹ Research Scholar, Faculty of Commerce, The ICFAI University, Raipur, India

² Assistant Professor, Faculty of Commerce, The ICFAI University, Raipur, India.

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Corresponding Author:

Amit Kumar Janghel

Abstract:

This paper investigates how financial literacy and anticipated emotions jointly shape individuals' intentions to participate in the stock market and their propensity to engage in financial word-of-mouth (WOM). We propose a model where financial literacy increases participation intentions and financial WOM both directly and indirectly through increased perceived behavioural control. Anticipated emotions — specifically anticipated pride and anticipated regret — exert direct effects on participation intentions and WOM and moderate the influence of financial literacy on intentions. We outline a rigorous cross-sectional empirical design for surveying adult retail investors/potential investors ($N \approx 600$), validated measures for objective and subjective literacy and anticipated emotions, and a structural equation modelling (SEM) approach complemented by moderation and mediation tests. The paper offers theoretical integration of cognitive and affective determinants of investment behaviour and provides actionable implications for policy makers, financial educators, and platforms seeking to broaden informed equity participation. Key practical recommendations include pairing numeracy-based literacy training with emotionally-aware experiential interventions (simulations, phased entry) and using literate investors' WOM strategically while curbing misinformation.

Keywords: financial literacy, anticipated emotions, stock market participation, investment intention, word-of-mouth, behavioural finance, SEM

1. Introduction

Retail participation in equity markets substantially affects households' financial outcomes, retirement readiness, and wealth accumulation. Despite increasingly easy access to equity markets through low-cost brokerage services and mutual funds, participation rates vary widely across demographic groups and countries. Empirical literature consistently shows that financial literacy — measured by objective questions about interest, inflation, and diversification — is a strong predictor of whether households hold equities, even after controlling for income, wealth, education, and risk tolerance. This evidence suggests an important role for knowledge in enabling participation.

However, cognitive capacity is only half the story. Behavioural finance shows that affective mechanisms — how people anticipate they will feel about outcomes — influence choices under risk. Anticipated emotions such as regret (the fearful anticipation of future remorse) and pride (the anticipated pleasure from making a “good” choice) influence both the willingness to take risk and subsequent decisions to realize gains or hold losses. When combined, cognitive and affective factors can explain heterogeneity in participation decisions among people with similar knowledge.

Classic work on anticipated regret demonstrates how expectation affect leads to precautionary behaviour in risky choice contexts; more recent applications examine regret/pride in investment decisions and the disposition effect.

Complementing individual-level determinants, social diffusion via word-of-mouth (WOM) is a key mechanism through which knowledge and behaviours propagate across communities. Investor WOM — conversations with friends, family, or colleagues about investment opportunities and experiences — affects awareness and perceived normative acceptability of participation. Seminal empirical studies show local social interactions influence portfolio holdings and trading decisions, suggesting that individuals' propensity to discuss investments shapes market-level diffusion patterns.

This study integrates these streams by examining how financial literacy and anticipated emotions jointly determine: (a) intention to participate in the stock market and (b) the intention to engage in financial WOM. We propose and test a theoretical model where literacy affects intentions and WOM directly and indirectly via perceived behavioural control, while anticipated pride and regret exert both direct influences and moderation effects on the literacy intention link. By linking cognitive, affective, and social channels, the paper advances our understanding of how to foster informed equity participation and how investor education can be optimized.

2. Literature review and theoretical framework

2.1 Financial literacy and market participation

Financial literacy is commonly operationalized as objective knowledge of basic financial concepts (numeracy, interest compounding, inflation, and diversification), with well-established measures such as Lusardi & Mitchell's "Big Three" (or "Big Five") questions and other validated batteries. Multiple studies show that higher literacy increases the probability of stock ownership and more sophisticated portfolio choices. Van Rooij, Lusardi, and Alessie (2007, 2011) provide seminal evidence: even modest improvements in objective literacy predict substantially higher stock market participation rates across countries and cohorts. Recent work highlights the dual role of knowledge and confidence (financial self-efficacy) — both are important for translating knowledge into market entry.

The mechanisms are (i) reduced perceived complexity and uncertainty, (ii) increased perceived control over outcomes, and (iii) improved capacity to evaluate risk-return trade-offs — all of which lower psychological barriers to participation. The Theory of Planned Behaviour (TPB) situates perceived behavioural control as a proximal antecedent of behavioural intention and thus provides a useful conceptual bridge linking literacy to intention.

2.2 Anticipated emotions: regret and pride in finance

Anticipated emotions refer to affective forecasts about how one will feel after the outcomes of a contemplated action. Zeelenberg and colleagues formalized anticipated regret's role in decision making, demonstrating that expectation of regret alters choices under risk by biasing toward decisions that minimize potential future remorse. Anticipated pride

has received less attention but theorized to motivate approach behaviours — the expectation of positive feelings following successful decisions can increase risk-taking propensity. Applied to investments, anticipated regret can discourage entry into risky markets while anticipated pride can increase willingness to participate — and both can shape subsequent communication behaviours (e.g., bragging about gains or staying silent about losses). Empirical work specific to investing links these emotions to choices to buy, hold, or sell, and to the disposition effect.

2.3 Word-of-mouth and social diffusion of investments

WOM plays a critical role in spreading financial information and shaping participation. Studies of mutual fund managers and households show that peer behaviour and local interactions predict holdings and trades — an effect that persists after controlling for observable fundamentals. Hong, Kubik, and Stein (2005) demonstrated spatial clustering of trades among fund managers, while household-level analyses point to the importance of neighbourhood and social network effects in investment uptake. WOM can therefore magnify the effects of individual literacy and affect by making investment seem normative and accessible, or by amplifying caution if networks express fear.

2.4 Integrative framework and hypotheses

We adopt TPB as the organizing framework and extend it with anticipated-emotion constructs. In TPB terms, financial literacy increases perceived behavioural control, thereby increasing intention. Meanwhile anticipated pride/regret shape attitudes toward participation and may alter the strength of the literacy intention association. Finally, intention leads to WOM propensity because the more committed an individual is to participate, the more likely they are to discuss and recommend investment decisions; literacy may also increase WOM directly by increasing confidence to speak authoritatively. Figure 1 (conceptual model) summarizes these paths.

From this framework we derive testable hypotheses:

H1: Financial literacy positively predicts stock market participation intentions.

H2a: Anticipated pride positively predicts participation intentions.

H2b: Anticipated regret negatively predicts participation intention

H3: Financial literacy positively predicts financial WOM propensity.

H4a: Anticipated pride positively predicts financial WOM propensity

H4b: Anticipated regret negatively predicts financial WOM propensity.

H5: Anticipated emotions moderate the association between financial literacy and participation intentions (pride strengthens it; regret weakens it).

H6: Stock market participation intention mediates the relationship between financial literacy and financial WOM propensity.

3. Methodology

3.1 Research design and sampling

We propose a cross-sectional survey study targeting adults aged 21–60 with bank accounts and internet access. Sample size: target $N = 600$ to allow reliable estimation in SEM (rule-of-thumb: 10–20 observations per estimated parameter and adequate power for interaction tests). Recruitment strategy: a mixed-mode approach using (a) a national online panel provider to reach a demographically diverse sample, supplemented by (b) targeted recruitment at investor-education workshops and social media investor communities to ensure sufficient numbers of both experienced and novice potential investors. Stratify the sample across urban/rural, age, and education to improve representativeness.

Informed consent, data privacy protections, and an ethics protocol will be followed (IRB approval sought if required by the host institution).

3.2 Measures

All multi-item attitude/behavioural scales use Likert-type responses (1 = Strongly disagree to 7 = Strongly agree) except where specified.

Financial literacy (objective): Use the “Big Three” questions developed by Lusardi & Mitchell (numeracy/interest, inflation, diversification) plus two additional questions on risk diversification and bond-stock difference to form a 5-item objective battery. Score as proportion correct (0–1). This objective metric is widely used and shown to predict participation.

Financial literacy (subjective/confidence): Self-assessed financial knowledge/confidence (3 items): “I feel confident making financial decisions about investments,” “I understand how stock returns and risk work,” “I know how to choose between investment options.” (Cronbach’s α expected $> .80$). Including subjective confidence permits comparison of knowledge vs. self-efficacy roles.

Anticipated emotions: Two constructs measured via multiple items adapted from prior anticipated-emotion scales:

- *Anticipated pride* (3 items): e.g., “If I invest and earn a good return, I will feel proud,” “I expect I would feel satisfaction if my investments perform well.”
- *Anticipated regret* (3 items): e.g., “If I invest and lose money I would feel very regretful,” “I worry I might regret investing and losing savings.”

Use validated anticipated-regret items as anchors and adapt for investment context. The Anticipated Regret Scale (ARS) and domain-specific instruments provide items for adaptation.

Participation intention: 3-item TPB-style intention measure: “I intend to buy (or increase) stocks in the next 12 months,” “I will make an active effort to participate in the stock market in the next year,” “It is likely I will invest in stocks within the next 12 months.

Financial WOM propensity: 4-item scale adapted from marketing/WOM literature, tailored to finance: “I am likely to discuss stock investments with friends or family,” “I would recommend stock investments to someone interested,” “I often share investment information I find useful,” “I would post about investment experiences on social media.

Control variables: Age, gender, education, household income, employment status, prior investing experience (binary and continuous measures of portfolio value), risk tolerance (single 1–7 item), trust in financial institutions (single item), social-network exposure to investing (how many close contacts invest: 0,1–2,3–5,6+).

3.3 Questionnaire flow and attention checks

Start with informed consent and short eligibility checks, then objective literacy items (to avoid priming), followed by subjective confidence, anticipated emotion items, intention/WOM scales, control/demographic questions, and debrief. Include two attention-check items (e.g., “please select ‘agree’ for this item”) and remove respondents failing checks.

3.4 Data analysis plan

1. **Data cleaning:** Remove speeders, failed attention checks, and incomplete responses. Examine distributions and missingness; use multiple imputation if missingness is <10% and ignorable.
2. **Scale validation:** Conduct Exploratory Factor Analysis (EFA) for new/modified scales in a split-sample ($n \approx 200$) and Confirmatory Factor Analysis (CFA) on holdout data ($n \approx 400$). Evaluate reliability (Cronbach’s α , composite reliability), convergent validity (factor loadings, AVE), and discriminant validity (Fornell-Larcker).
3. **Common-method bias:** Test via Harman’s single-factor test and a CFA marker variable approach.
4. **Structural model:** Estimate full structural equation model (SEM) using maximum likelihood with robust standard errors. Test direct effects (H1–H4), mediation (H6) with bootstrap confidence intervals (5,000 resamples), and moderation (H5) via latent interaction terms or product indicators; probe significant interactions with simple slopes at ± 1 SD. Report effect sizes (standardized coefficients), model fit indices (CFI, TLI, RMSEA, SRMR), and R^2 for key endogenous constructs.
5. **Robustness checks:** Re-estimate using PLS-SEM (SmartPLS) to check stability; run OLS/logistic regressions for alternative specifications; run multi-group analyses separating novice investors (no prior holdings) from experienced investors to test heterogeneity.

Power calculation: For SEM with 20–30 parameters and medium expected effects ($\beta \approx .20-.30$), $N = 600$ provides $> .90$ power; interaction detection requires larger samples — hence the target N .

4. Measurement items and table (for the survey instrument)

Table 1: Core constructs and example items (Likert 1–7 unless objective).
(Here I list items you can place verbatim in a questionnaire.)

1. Objective Financial Literacy (5 items — score 0/1):

Q1 (Interest/numeracy): If you have \$100 in a savings account earning 2% interest per year, how much would you have after 5 years? (multiple choice)

Q2 (Inflation): If inflation is 3% and interest is 2%, will your money buy more, the same, or less in one year?

Q3 (Diversification): True/False: A stock mutual fund that holds 100 stocks is less risky than a fund that holds 3 stocks.

Q4 (Bond/stock): Which typically offers higher long-run returns, stocks or bonds?

Q5 (Compound interest): Simple multi-year compounding item.

1. Subjective financial confidence (3 items):

“I feel confident making decisions about investments.”

“I know where to find reliable investment information.”

“I can evaluate the riskiness of investment options.”

2. Anticipated pride (3 items):

“If I invest and it performs well I will feel proud.”

“I would be likely to tell friends if my investment gave a good return.”

“I expect to feel satisfied if my investments perform above expectations.”

3. Anticipated regret (3 items):

“I would feel very regretful if I lost money after investing.”

“Fear of future regret makes me cautious about investing.”

“I often think I might regret investing my savings if things go wrong.”

4. Participation intention (3 items):

“I intend to invest in stocks in the next 12 months.”

“I will actively seek opportunities to invest in equities over the coming year.”

“It is likely that I will make a stock purchase within 12 months.”

5. Financial WOM propensity (4 items):

“I would recommend stock investing to a friend who asked.”

“I discuss investing ideas with people close to me.”

“I share investment information I think is useful.”

“I would post about my investment success on social media.”

5. Expected/illustrative results and interpretation

Based on extant studies and theory, we expect the following pattern (to be confirmed by data):

- **H1 supported:** Objective financial literacy (proportion correct) shows a significant, positive standardized effect on participation intention ($\beta \approx .20-.35$, $p < .01$), consistent with van Rooij et al. and Lusardi & Mitchell findings. This effect remains after controlling for income, education, and risk tolerance.
- **H2a/H2b supported:** Anticipated pride positively predicts intention ($\beta \approx .10-.25$), while anticipated regret negatively predicts intention ($\beta \approx -.12$ to $-.30$). These effects remain robust when knowledge and confidence are included in the model.
- **H3 supported:** Financial literacy positively predicts WOM propensity directly ($\beta \approx .12-.25$), reflecting that knowledgeable individuals are more willing and able to discuss investment topics. Subjective confidence also predicts WOM and may partially mediate literacy’s effect.
- **H4 supported:** Anticipated pride increases WOM propensity (people expecting pride are more likely to share successes), whereas anticipated regret reduces WOM (people fearing shame/regret may avoid sharing).
- **H5 (moderation):** Interaction: the literacy→intention association is stronger among respondents who report high anticipated pride; conversely, among those high in anticipated regret the positive effect of literacy is attenuated. Simple slope tests show literacy has a larger marginal effect at +1 SD pride and smaller (or non-significant) effect at +1 SD regret.
- **H6 (mediation):** Participation intention mediates literacy→WOM (indirect effect significant by bootstrap), but a residual direct effect of literacy on WOM remains, indicating both pathways.

Robustness & heterogeneity: Effects are typically stronger among novice investors (where knowledge reduces threshold barriers) and somewhat weaker among highly experienced investors (whose behavior depends more on portfolio strategies).

6. Discussion

6.1 Theoretical contributions

This study integrates cognitive (financial literacy) and affective (anticipated pride/regret) explanations of investment intentions within a TPB-derived framework and links these to social diffusion behaviors (WOM). It advances the literature by: (a) modelling anticipated emotions as both direct predictors and moderators of knowledge effects, (b) including both objective and subjective literacy measures to disentangle knowledge from confidence, and (c) extending the investigation to financial WOM — an under-explored but impactful channel for diffusion.

These contributions respond to calls for more psychologically rich models of financial decision-making, which incorporate affective forecasts alongside traditional cognitive variables. The moderation findings (if observed) would show that literacy alone is insufficient: emotional expectations condition whether knowledge translates into action.

6.2 Practical and policy implications

- **Design of investor education:** Numerical instruction should be coupled with experiential modules (simulated trading, gamified small-stake pilot investments) to shape anticipated emotions — reduce anticipated regret through exposure and increase anticipated pride via small wins and feedback.
- **Nudges and phased entry:** Policymakers or platforms can use features such as staged investments (auto-savings into low-volatility products first), loss-limiting tools, and clear de-risking paths to reduce affective barriers.
- **Leveraging WOM:** Literate investors can act as credible peer-educators. Programs that seed community ambassadors with correct information can accelerate informed participation; however, platforms should monitor misinformation and encourage evidence-based sharing.

6.3 Limitations and directions for future research

- **Causality limits:** Cross-sectional survey design constrains causal inference; panel or experimental interventions (randomized literacy training with affective-targeted components) would strengthen causal claims.
- **Behavioral outcomes:** Intentions and WOM propensity may not fully translate to actual purchases or communications; linking survey data to brokerage records or social-media behavior would improve behavioral validity.
- **Cultural/contextual boundaries:** The interplay of literacy and anticipated emotions may vary across countries with different social norms and institutional protections (e.g., investor protection laws). Cross-country replication recommended.
- **Additional affective constructs:** Future studies could test anticipated anxiety, excitement, or social-emotional outcomes (shame/pride in social context) and analyze network structure effects on WOM diffusion dynamics.

7. Conclusion

Expanding equity market participation requires more than numeracy training. While financial literacy is a robust predictor of participation and of the willingness to discuss investments, affective expectations — anticipated pride and

regret — crucially shape whether knowledge becomes action. Education that both improves knowledge and addresses emotional expectations, combined with mechanisms that harness credible WOM, offers a promising route to increase informed retail participation and financial inclusion.

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