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FINANCIAL LITERACY AND DEVELOPMENT OF STOCK MARKET

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ABSTRACT:-

The role of Financial literacy has gained importance in the wake of recent structural transformation such as demonetization, Pradhan mantra Jan Dhan Yojna (PMJY) for Financial inclusion and GST (Gross and Domestic Tax) in the financial sector of the country. If investors are financial literate, will be in a better position to make informed decision on financial matter. So, greater awareness about the capital market is required on the part of retail investors to evaluate the choices available to them. Capital market literacy should be seen as only a way to end financial illiteracy which would be resulting in high growth of financial sector and may come out in a significant increase in retail participation. Investor education should be provided to imbibe the cultivation of a saving culture aiming at promoting greater retail investor participation in the stock market. Financial Literacy is widely recognized as one of the most important engine of development of the financial system. Its contribution to GDP, individual and social welfare and business creation and expansion – have been amply documented. Indeed, access to formal financial institutions allows poor households to expand consumption, absorb disruptive shocks, manage risk and invest in profitable avenues. An effective strategy should be made to increase maximum participation of retail investors so that leverage the current demographic dividend in the country which includes large of youthful population. Thus, financial literacy may be considered as the ultimate pillar of any financial system, as it complements the important aspects like greater transparency, policies on consumer protection and regulation of financial institutions leading to the development of stock market.

The present paper emphasis on highlighting the need of financial literacy among Individuals for maximum participation of all the sections of the country in the development of the stock market of the country, several initiatives taken by RBI to improve financial literacy in India and give suggestions to improve the current level of financial literacy in the country.

KEYWORDS: Financial Literacy, Capital market, Stock market participation, Individual investors.



LITERATURE REVIEW

Most of the researches have been done in financial literacy in foreign countries. But few literature review related to financial literacy have been given in brief below.

Organization for Economic Co-operation and Development (OECD) defines Financial Literacy as “the process by which financial consumers investors improve their understanding of financial products, concepts and risks, and through information, instruction and or objective advice, develop the skills and confidence to become more aware of financial risks and opportunities, to make informed choices, to know where to go for help, and to take other effective actions to

improve their financial well-being.”

R. Manju and Dr. Gabriel Simon (2016). “Financial literacy and participation in capital market operations – A study among teachers.” This paper aims to assess the level of financial Literacy and participation in capital market operations among teachers and linkage between the two learning and teaching economics, management, finance, accounting subjects provide a strong base of financial literacy, but it would not affect in the building up of confidence to participate in capital market operations. Like any other Indian entail individual investors, they depend too much on bank deposits for their savings because of their presumed safety and lack of interest.

Barua, Kathuria and Malik (2016), “ADBI Working paper 568”; The authors are of the view that India ‘s financial inclusion agenda witness a paradigm shift over the last decade, away from an emphasis on credit to a more comprehensive approach towards financial services. This paper describes the structure of banking and micro finance institution in India relevant to the developing model of financial inclusion as well as relevant regulatory structure and modes of delivery. It assesses the suitability objective envisaged as critical for inclusion associated challenge of revamping consumer protection laws and imperative financial literacy.

Luca Spataro and Lorenzo Corsini (feb 2013), “ Endogenous Financial Literacy, saving and stock market participation. This paper analyzes that there is consolidated empirical literature providing evidence of the fact that financial literacy, human capital, savings and stock market participation are interconnected decisions. The effort is made to a theoretical explanation of such connections by building a framework that includes all these decisions in an encompassing model.

Mwangi Patrick Muchiri (2014),” The relationships between financial literacy and stock market participation by retail investors in Kenya.” The main focus of this study was to establish the nature of the relationships between financial literacy and stock market participation by retail investors in Kenya . The study employed a descriptive survey design. The target population was 836,250 retail investor participating in the NSE as at march 2013. A sample of 46 respondents was selected from five major stock brokerage firms based in Nairobi. Data was collected using descriptive statistics. The study revealed that retail investors have a high level of financial literacy. The results indicated that decision to invest in stock was influenced by various economic factors such as expected dividend, capital appreciation, affordability of shares and fluctuations in market indices among other factors. The findings conclude that these factors strongly influenced the level of stock market participation.

Ashok Thomas and Luca Spataro (2015), “Financial literacy, Human capital and Stock market participation in Europe: An Empirical exercise under Endogenous framework. The study says that Household’s stock market participation has significant effects on savings and on an economy’s financial development and performance. Yet participation into capital market is limited and quite heterogeneous both among and within several counties. The phenomenon represents an empirical puzzle whose understanding is rather incomplete. In this work we exploit a combination of data sets for 9 European countries and use different econometric specification that allow to control for endogeneity of financial literacy and human capital to assess the role of several variables in affecting the probability to participate in the stock market in year 2010. The study finds that besides socio-demographic variables, financial literacy has a positive and significant effect on stock market participation together with the level of human capital.

INTRODUCTION

Stock market is the part of a financial system concerned with raising capital by dealing in shares, bonds and other long –term investment. The capital market plays a vital role in facilitating the process of economic growth as well as secure financial lives of many individuals. Many investors see stock as a form of investment to generate their assets based income. The capital market plays a fundamental role in stimulating economic growth and development through mobilization of resources in an economy. The market provides a platform for exchange of financial assets (stock and bonds) following established regulations to provide continuous liquidity in the market. The Indian capital market is formalized by existence of two main securities exchange, the National Stock Exchange (NSE) and Bombay Stock Exchange (BSE) consisting of the primary and secondary segments

where investor participate. The Bombay Stock Exchange has some of the highest number of listed firms in the entire world with an estimate about 5600 companies. The National Stock Exchange, NSE in India has more than 1750 companies which are listed. The direct participation of the retail investor in India 's equity market is only 1.4% of the population as against 50-55% in developed economies. The distribution of shareholder across the country is skewed. It is mainly concentrated in western states of India such as Gujarat and Maharashtra. More shareholder resides in big towns and city. Recent reforms of financial sector in several countries entail a high degree of responsibility on individual financial decisions to focus the role of financial literacy. Financial Literacy may act as an obstacle to the demand for more sophisticated financial products and thus to the channels through which financial development of stock market takes place.

The regulator of the stock market has been making sustained efforts to spread financial literacy among retail investor participation in the market so that the larger number of Indian participates in India 's growth story. Along with the structural reforms in financial market of India, there is a dire need for the more financial penetration of the investor in the financial market. It is imperative that structured regulations are put in place which not only make products available to the investors, therefore achieving the financial inclusion in the country. The financial sector requires the active participation of the investors so that the equity in the financial market increases and this is possible only where investors are provided proper advice to enable them to make informed decisions about the investment avenues.

In India, majority of population of financially is excluded and co-exist with various financially included sections which invest in capital market and other advanced financial products. It, therefore needs a tiered approach for a national strategy to include spreading awareness about basic financial products and link the excluded section to the formal financial sector, educating the existing user of financial products and services to enable them to make informed choices and ensuring consumer protection for all the users of financial products and services.

Current economic conditions have raised serious concern about India's financial security especially for those who lack the skills and resources to withstand financial market downswings and take advantage of upswings. Looking beyond the financial crisis, these lessons leave individuals and policy makers with new concern as they look to the future. Poor saving and investment decisions may be less visible but carry serious implications for long-term financial security for major parts of the Indian's population. Recent evidence suggests an underlying more fundamental problem that has highlighted such concerns: a major part of total population of India have low level of financial literacy. The less financially literate may be more likely to unknowingly, make financial mistakes, less likely to engage in recommended financial practices and less likely to be able to cope with sudden economic crisis and brace themselves for economic crisis.

OBJECTIVE

1. To understand the concept of financial literacy and the status of financial literacy in India.
2. To emphasize the role of financial literacy in the development of stock market of India
3. To understand the various initiative taken by RBI to improve financial literacy across the country.
4. To give suggestions to enhance the level of financial literacy in the country.

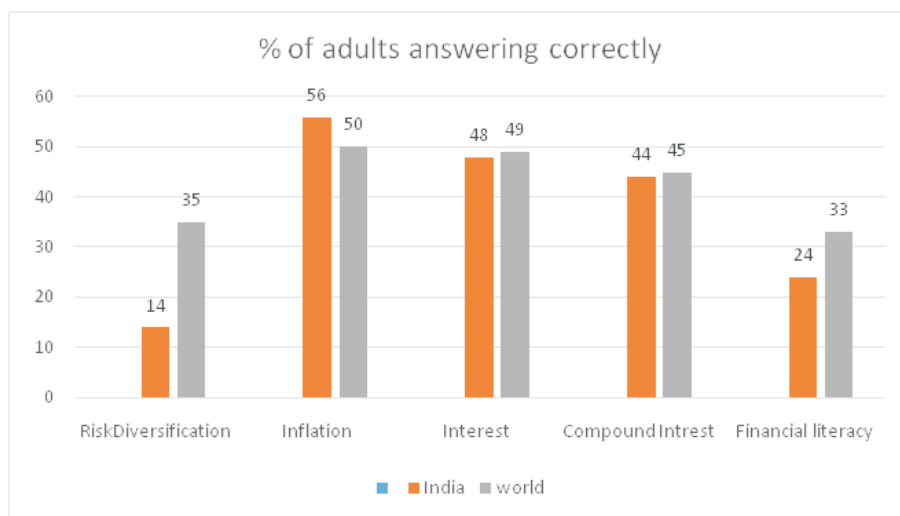
The level of Financial literacy in India

If individuals are not financial literate, they will be able to choose the right saving or investment for themselves and may be at risk of fraud. If individuals do become financial literate, they will be more likely to save and to challenge financial services providers to develop products that truly meet their needs and will have positive impact on both investment levels and stock market participation translating into rise in economic growth of the country. In recent times, increasing awareness, building public confidence and participation in capital market have become essential to the development of the capital market. Capital market begins to lack products and liquidity without active and continuous participation. The level of knowledge about capital market activities significantly and directly related to capital market participation.

Financial capital primarily consists money market instrument such as treasury bill, certificate of deposit,

bonds, stocks/equity, options, future, mutual funds etc. which are used to purchase economic capital (Webster 2002). A country may be flourished with all of the major economic resources, but without adequate financial resources risk laying idle and having no positive impact on national development. India, is rich with young human resources but lacks required capital, has to wait for foreign investors with the financial capital needed to optimum utilization of these resources. Financial Literacy helps in making households aware of the existence of financial products in the market and making the decision about financial product ownership. Financial Literacy of the middle class in a developing economy may pay double benefit. Firstly, financial literacy helps to increase individual welfare by inculcating better financial behaviour. Secondly, financial literacy may help to mobilizesavings, to diversify risks and to ease the proper use of debt which altogether supports financial development and thus indirectly growth.

As per the survey conducted by Standard and Poor’s Rating Services Global Financial Literacy Survey which is the world’s largest, reliable well known global agency for measurement of financial literacy. It figures out that the knowledge of four basic financial concepts: risk diversification, inflation, numeracy and interest compounding. According to the survey conducted in 2014, “ more than 70% Indian have performed badly in financial literacy”. India’s rating lags the worldwide average, but is almost at par with that of other BRICS nation and South Asian Nations.



Source: S&P Fin Lit survey

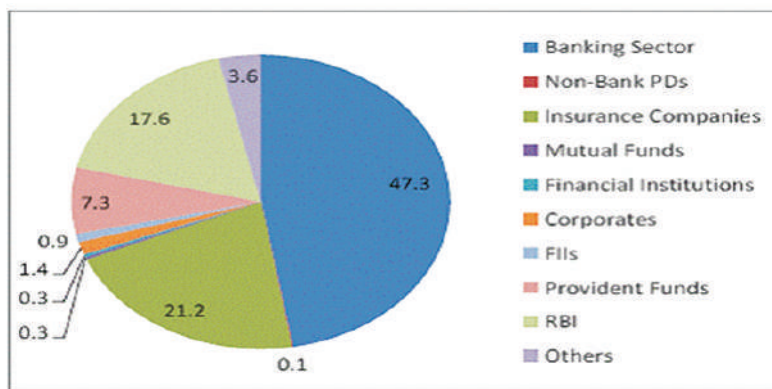
The above graph clearly depicts that the statistics are quite disappointing, more than 76% Indians adult do not have basic financial literacy, meaning thereby that three out of four Indian are Financial illiterate and they don’t understand the most basic and key financial concepts. In India, the gender gap is more with 73% of men and 80% women are not financially literate. Individual investor in India need to be well informed in order to take informed decisions about various investment products in the market and avoid getting involved into scams. Also, investor need to learn to take responsibility for their financial decisions on financial matter.

The stock market participation in India

Selecting the right product and services according to one’s own saving and investment objective is not an easy task for an ordinary investor. The growing number and complexity of financial product and services offered by financial institutions requires high degree of financial literacy nowadays. Stock market participation among individual investor is an important aspect as they are potential investor as well as work in financial services firms that actively participate in stock market. Stock market need to have increased participation from retail investor as they convert personal saving to investment. Indian stock market has been growing over years, expected to continue its growth of Indian economy. Stock market participation can lead to significant increase in

saving as the stock market generate higher rate of returns than the deposit rate if invested properly. India has got the highest percentage of savings in the world. With about 36% goes to gold and 64% goes to banks in fixed deposit and 6% to the capital market. People have a wrong myth that stock market is too risky and only rich people can invest in stock market and that is why people in our country restrain themselves from investing in security market. It is quite visible from the graph given below.

Participation of Investor in Govt Securities market in India



Source:-www.rbi.org.in

India is among the world’s most efficient financial market in terms of technology, regulation and system. It also has the highest saving rate in the world. People have a habit of saving but where these savings to be invested is a cause of concern. Investment by households have been more in the form of Fixed deposit, risk free Govt securities and low-yielding instrument or in non-financial assets. A majority of our households do not want to invest in new modern financial markets. Unless the common person starts investing in stock market and having a positive perception toward the stock market, is protected from wrong doings, weather creation for the investors and the earning will remain a distant dream. We need to convert a country of savers into a nation of investor. Stock market are considered to be highly risk and a chance of investors loosing wealth is very high if they fail to understand the stock markets. Individual across the globe have become increasingly active in financial markets with advent of new technology and financial product. Also the shift from defined-benefit defined contribution pension plans and the development of pension funds by shifting the decision making responsibility from the Govt and employers to private individuals, have contributed to raise stock market participation. Although increased participation on rates are still relatively low in many countries and show a substantial variability across globe (Comp bell 2006, Guiso et al 2008). There can be significant welfare loss in non-participation of individuals, in the form of reduction of returns to households saving and lesser and accumulation from the perspective of the financial system, a higher participation rate could favour a greater breadth and depth of capital markets, which is an important determinant of the equity premium and of the stock market volatility.

The Indian capital market is currently undergoing transformation with the objective of restoring investor confidence, the capital market is faced at the macro-level on how to attract capital, improve corporate governance, safeguard investor’s right and empower the public through continuous information disclosure and education. In India, the public is largely uneducated about the essence of working and benefits of the capital market. The recent crisis in the banking industry and capital market which led to the erosion of public trust and confidence in the financial system, could be attributed to the lack of financial knowledge by the populace on the working fundamental of financial system especially the capital market. The investor was unaware of the high risk involved while accessing huge margin loan during the market’s bullish period. If the investors had known the magnitude of risks they undertook before the downward trend in stock. Stock prices could have been minimized if not averted. Perhaps if the investors were better informed on the enormity of risks that were associated with

their level of activities in the companies in the capital market, the level of their investment decision would have been different.

Several measures taken by RBI to enhance the level of financial literacy in India

A large section of India consists financial illiterate people who are poor and who are operate on the margin. These groups are really vulnerable who got into the vicious circle of poverty due to lack of necessary financial knowledge, skill and behaviour to make sound financial decisions and ultimately achieve individual financial well-being. The lack of basic knowledge about financial production and services and their risk-return framework is one common instance of financial illiteracy that is widely observed.

1. The Reserve bank of India has been actively participating in the field of mitigating financial illiteracy in the country. In this context, a project named "Project Financial Literacy" has already been implemented. The main objective of this project is to provide information regarding the central bank and general banking concepts to the various section groups of the society including school and college going children, women, rural folk, rural and urban poor, defense personnel and senior citizen. Information is distributed to the target audience through presentations, pamphlets, brochures, films website etc. It has started a financial education site from Nov 2007 commemorating children's day. The site was mainly made to teach the basics of banking, finance and central banking to children in different age groups.

2. RBI has been conducting essay competitions to promote financial awareness among school children on topics related to banking and finance. The bank launched the "RBI young scholars award" scheme for outstanding students in order to generate interest in creating awareness of banking sector of the country. (Academic Foundations continuing series 1998)

3. The Reserve Bank has asked the lead bank in each district to draw a road map for ensuring that all villages will have access to the financial services through a banking outlet need not to be a banking branch. Moreover, the Reserve bank's outreach program aimed for Indian villages aims at connecting senior staff of the Reserve Bank staff has been able to visit all the villages as part of imparting financial education.

4. In India, majority of population is financially excluded and co-existing with various other financially included section of population which invest in capital market and use other financially included section of population which invest in capital market and use other advanced products. The RBI is adopting a unified and coordinated national strategy for financial education. we need a tiered approach under National Strategy for spreading awareness about basic financial products to link them to the formal financial sector.

5. Credit counselling is a process in which the consumers are educated about how to avoid debts that cannot be repaid. In normally involves negotiating with creditors to establish a debt management plan for the consumer. A few banks working in the Public and private sector has taken initiative in this regard. The 'ABHAY' counselling center in various parts of the state of Maharashtra was started by the Bank of India. The "DISHA

6. TRUST" and other organization initiated by the ICICI banks and "Garmin Para marshKendra's started by the Bank of Baroda set up counselling centers assists people in face on face basis as well as on telephone, email or through letters.

7. The Reserve Bank of India will soon launch a financial literacy drive in 80 block in nine states on a pilot basis to educate people on – e transaction, financial sector borrowing and insurance purchases. The main objective of CFL is to inculcate the habit of making a saving, a household budget and recording financial transaction, encourage transactions in saving account and active saving by depositing in banks.

CONCLUSION

From the study, it was figured out that the level of financial literacy is very low in our country. The stock market participation is entirely dependent on the level of financial literacy. Thus, imparting financial literacy should be on priority list of policymakers, Govt agencies, educators etc. It is suggested that financial literacy is the first requisite step among individual for participation in the capital market from all section of the society with more concentrated effort in rural sector due to poor level of education and household income. This would make them to understand the value of money, its need and importance of being financially literate

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