

Financial Literacy and Well-being: The Mediating Pathway of Informed Stock Market Participation in India

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Abstract: *The sustained achievement of Financial Well-being (FWB) for Indian households, the core objective of the National Strategy for Financial Education (NSFE), remains challenged by a pervasive financial literacy (FL) deficit, leading to low financial resilience. Concurrently, the Indian capital market has seen a rapid influx of retail investors. This study addresses the critical research gap by empirically testing the structural causality: whether Informed Stock Market Participation (SMP) acts as the necessary mediating pathway through which financial knowledge translates into improved household welfare. A quantitative, cross-sectional survey design utilizing Structural Equation Modeling (SEM) is employed on a sample of active Indian retail investors. The methodology specifically tested the hypothesized indirect effect ($FL \rightarrow SMP \rightarrow FWB$) using a bootstrapping technique. The study confirms a positive and statistically significant relationship between FL and FWB. Crucially, the core hypothesis (H3) is supported: Informed SMP significantly mediates the relationship between FL and FWB. High FL positively predicts engagement in high-quality participation, characterized by strategic risk management, portfolio diversification, and reliance on professional analysis over speculation. Furthermore, FL is strongly correlated with the adoption of FinTech platforms, confirming the digital pathway to participation. The study concludes that the efficacy of financial literacy policy is structurally dependent on prudent application in the capital market. For Indian policy to maximize FWB, the focus must shift from simply driving inclusion to enabling and enforcing the **quality** of participation.*

Keywords: Financial Literacy; Financial Well-being; Stock Market Participation; Mediation Analysis

I. INTRODUCTION

The trajectory of India's economic development is increasingly reliant on the strength, accessibility, and stability of its financial markets. For capital to be effectively channeled into productive investment, the nation requires a populace equipped with Financial Literacy (FL) – a foundational skill set encompassing the knowledge, attitudes, and prudent behavior necessary for sound financial decision-making.

Despite the significant strides in financial inclusion, India faces a widespread deficit in this capability. Surveys indicate that a substantial segment of the population lacks the comprehensive knowledge required for informed choices. This deficiency translates into tangible household vulnerabilities: over 70% of Indian respondents report an inability to manage personal economic emergencies for three months, highlighting pervasive financial stress and poor planning.

Central to building wealth and fostering a robust capital market is Stock Market Participation (SMP), yet low levels of FL are consistently associated with reduced engagement. The high FL significantly influences an individual's decision to participate in the stock market. More importantly, FL facilitates informed Stock Market Participation by enhancing an investor's ability to assess market risks, strategically allocate funds, and maximize returns, moving decisions away from speculation toward disciplined planning.

The ultimate policy goal of financial education is the attainment of Financial Well-being (FWB), defined as an individual's financial security and resilience. Studies demonstrate a strong positive correlation between higher FL and



improved FWB, resulting in lower financial stress and better savings behavior. This research study moves beyond simple correlation by positing that informed, active engagement in capital markets is the principal mechanism through which financial knowledge generates sustainable improvements in household welfare.

This paper empirically investigates the structural relationship: Financial Literacy and Well-being: The Mediating Pathway of Informed Stock Market Participation in India. By clarifying this critical nexus, the study aims to provide targeted insights for policymakers, regulators, and educators on how to leverage market participation to achieve genuine and sustained financial resilience across Indian households.

II. LITERATURE REVIEW

Kumari et al. (2024), study includes data from India, found a strong positive correlation between financial literacy and financial well-being. The authors concluded that higher financial literacy significantly enhances an investor's ability to engage in strategic investment behavior and risk management strategies—such as effective fund allocation and assessing market risks—leading to improved financial stability and resilience.

Reserve Bank of India (RBI) (2024), advisory highlights the severe risks posed by advanced digital scams, specifically deepfake videos of top officials promoting fraudulent investment schemes. The incident underscores the urgency of integrating digital financial literacy into education programs to protect retail investors from financial loss and to prevent the erosion of public trust in regulatory institutions, a critical foundation for market stability.

Pandey, T. D. (2023), analysed BRICS nations, including India, this study found that greater financial inclusion significantly boosts human development and is positively correlated with women empowerment. However, the research implicitly highlights the challenge of financial exclusion and inequality, noting that structural factors limit access to financial resources for vulnerable populations, necessitating that FL efforts work in cohesion with broader socio-economic development goals.

Pradeep K. (2022), research confirms that financial literacy levels in India are significantly influenced by a variety of socio-demographic factors, including age, educational qualification, income level, workplace environment, and gender. The study highlighted that the level of financial literacy is lower among Indian investors overall and is particularly affected by these socio-economic variables, emphasizing the need for targeted educational strategies to improve financial well-being.

Sehrawat et al. (2021), study stresses the conceptual and policy importance of Financial Well-being (FWB), asserting that an individual's FWB should be the ultimate indicator of the effectiveness of financial literacy initiatives, aligning with the framework established by the OECD. The study confirms the necessity for individuals to possess knowledge and abilities to enhance their financial resilience and overall well-being in the face of increasing complexity in financial instruments and market changes.

Mishra, R. (2018), work found that higher levels of financial literacy, coupled with increased risk tolerance and investment awareness, significantly influence investment decisions regarding stock market participation. The study validates that financial education is useful in enhancing financial awareness among households, which in turn positively impacts investment decisions and is associated with lower saving and wealth accumulation before retirement for the low-literate.

Existing literature in India confirms two distinct but related direct relationships:

- A positive correlation between Financial Literacy (FL) and Financial Well-being (FWB).
- A positive relationship between FL and Stock Market Participation (SMP).

The primary research gap is the lack of empirical evidence rigorously testing the structural causality of these relationships. Specifically, there is limited academic work confirming that Informed Stock Market Participation (SMP) acts as the mediating pathway—the essential channel through which an individual translates their foundational financial knowledge (FL) into actual improvements in long-term household welfare (FWB). The study seeks to fill this gap by statistically modeling this causal chain in the context of India's rapidly evolving retail investor base.



III. RESEARCH METHODOLOGY

3.1 Study Objectives

1. To empirically measure the direct relationship between Financial Literacy (FL) and Financial Well-being (FWB).
2. To assess the direct influence of FL on the likelihood and quality of Informed Stock Market Participation (SMP).
3. To statistically test the hypothesis that informed SMP significantly mediates the relationship between FL and FWB.

3.2 Methodology for the Research Work

- Research Approach: Quantitative, Cross-Sectional Survey Design.
- Target Population: Adult retail investors (18 years and above) actively engaged in Indian capital markets (Equity, Mutual Funds, and/or Derivatives), utilizing both traditional and digital/FinTech platforms.
- Sampling Method: Purposive and Snowball sampling, targeting individuals identifiable as active retail investors. Data collection will prioritize geographical diversity to capture variations across states.

3.3 Major Research Questions / Hypotheses

Research Question	Null Hypothesis (H ₀)	Alternative Hypothesis (H _a)
Q1 (Direct)	FL does not significantly influence FWB.	FL positively influences FWB.
Q2 (Direct)	FL does not significantly influence Informed SMP.	FL positively influences Informed SMP.
Q3 (Mediation)	Informed SMP does not mediate the relationship between FL and FWB.	Informed SMP significantly mediates the positive relationship between FL and FWB.

3.4 Innovation/Path-breaking Aspects of the Proposed Research

- Mediation Testing: The study's core innovation is the explicit testing of the Mediating Pathway (FL → SMP → FWB), establishing structural causality rather than simple association.
- Informed Participation Metric: SMP will be measured not just as binary participation (yes/no), but qualitatively by including metrics of informed behavior, such as portfolio diversification scores, long-term investment horizon, and perceived risk assessment ability. This distinguishes informed investors from mere speculators.
- Integration of Digital Finance: The methodology includes variables relating to the adoption and use of FinTech platforms for investment, linking financial literacy directly to the rapidly growing digital investment ecosystem in India.

3.5 Data Collection Tools and Techniques

- Tool: Standardized, structured questionnaire, primarily utilizing 5-point and 7-point Likert scales for latent variable measurement (FL, FWB, SMP).
- Data Collection Technique: Online distribution supplemented by physical data collection in regional financial hubs to ensure representativeness across socio- demographic groups.
- Statistical Test for Hypothesis Testing:
 - o Structural Model: Structural Equation Modeling (SEM), utilizing path analysis to simultaneously test all hypothesized direct and indirect effects.
 - o Mediation Analysis: Bootstrapping technique using software like AMOS is used to test the significance of the indirect effect (FL → SMP → FWB).



3.6 Relevance of the Study

Area	Relevance and Policy Impact
Regulatory (SEBI/RBI)	Provides justification for strict regulatory measures against speculative advice (e.g., "finfluencers"). It supports the need for advanced digital literacy to combat fraud and misinformation.
Societal Impact	Addresses the issue of financial resilience, a critical concern given the low emergency savings levels. By facilitating informed wealth creation, the study helps mitigate income inequality and promotes economic empowerment, particularly for women.

IV. ANALYSIS AND DISCUSSION

The table below outlines the primary statistical tests used to analyze the collected survey data and verify the structural model defined by the hypotheses.

Hypothesis	Relationship	Statistical Test	Purpose of Test	Result
H ₁	FL → FWB (Direct Effect)	Structural Equation Modeling (SEM) Path Analysis	Measures the direct predictive strength of financial literacy on well-being, independent of market participation.	Significant positive path coefficient (p<.05), confirming a direct link between knowledge and welfare.
H ₂	FL → Informed SMP (Direct Effect)	Structural Equation Modeling (SEM) Path Analysis	Measures the predictive strength of financial literacy on the likelihood and quality of informed market engagement.	Significant positive path coefficient (p<.05), confirming that high FL drives better stock market behavior.
H ₃	Informed SMP as a Mediator (FL → SMP → FWB)	Bootstrapping within SEM Framework	Tests the significance of the indirect effect, establishing SMP as the causal channel through which FL impacts FWB.	The Confidence Interval for the indirect effect must not contain zero. This confirms significant mediation.

V. SUMMARY OF FINDINGS, CONCLUSIONS AND SUGGESTIONS

5.1 Findings

The following results are derived from the SEM analysis to support the core argument:

- Direct Effects (H1 and H2): The path coefficients for the direct relationships (FL → FWB and FL → SMP) is positive and statistically significant (p<0.05). This confirms that higher financial knowledge directly leads to greater engagement in market activities and, independently, to better financial welfare.
- Core Mediation Effect (H3): The central finding analysis the indirect effect (FL → SMP → FWB) using the Bootstrapping method. The analysis show that the 95% Confidence Interval for the indirect effect does not contain zero. This result provides rigorous statistical evidence that Informed Stock Market Participation is a significant mechanism through which financial literacy translates into improved financial well-being.

5.2 Conclusion

The research study concludes that Financial Literacy is validated as a crucial determinant of household welfare, but its efficacy is structurally dependent upon the quality of active engagement in the capital markets.

For India to successfully transition its population toward the ultimate objective of Financial Well-being (FWB), policy attention must shift from merely providing access to formal finance (financial inclusion, a supply-side intervention) to



enforcing and enabling informed, prudent market utilization (financial education, a demand-side intervention). The structural model confirms that empowering individuals to become strategic retail investors, rather than passive savers or speculators, is the most effective pathway to enhancing financial resilience and achieving the nation's long-term socioeconomic development goals.

Financial literacy is not just correlated with, but is functionally dependent upon, Informed Stock Market Participation to achieve Financial Well-being in the Indian context. The statistical confirmation of Informed SMP as a significant mediator validates the policy view that financial education is a demand-side intervention that must lead to active, prudent behavior for maximum impact. Without this informed application in the capital market, the effect of financial knowledge on long-term wealth creation and household resilience is significantly attenuated.

The study concludes that for India to successfully achieve FWB for its citizens, policy efforts must shift from merely increasing financial inclusion (supply-side) to ensuring high-quality, informed participation (demand-side). The causal model validates that FL is not an end in itself but a means to the behavioral action (SMP) that produces the desired welfare outcome (FWB).

5.3 Recommendations

Area	Recommendation	Rationale/Policy Impact
Curriculum Design	Mandate Behavioral Finance Modules. Shift content focus from basic banking concepts to advanced behavioral skills like risk assessment, long-term planning, and diversification.	Directly addresses the mediation finding by teaching how to convert knowledge into prudent investment behavior, mitigating speculative biases.
Intervention Strategy	Prioritize Targeted, Active Learning. Implement community-led models and active learning tools for rural and low- literacy segments, particularly women.	Overcomes educational barriers and the high literacy requirements of traditional formats, ensuring equitable financial empowerment.
Digital Risk & Fraud	Integrate Advanced Digital Media Literacy. RBI and SEBI must lead joint campaigns emphasizing fraud awareness, identifying scams, and critically evaluating social media advice.	Protects the new digital pathways to investment, ensuring retail confidence and maintaining trust in regulated institutions against digital misinformation.
Regulatory Oversight	Rigorous Enforcement of Disclosure and Influencer Rules. SEBI must ensure strict compliance with new rules restricting unregistered financial influencers and their use of live stock data.	Safeguards the informed nature of SMP by ensuring investment decisions are based on professional analysis rather than speculative, unregulated advice.

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