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THESIS SUMMARY

SELECTED FINANCIAL IMPLICATIONS OF ETHNIC DIVERSITY: A GLOBAL PERSPECTIVE

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SUMMARY

This thesis explores the financial implications of ethnic diversity by using dataset of 187 countries of the world. Diversity is one of the buzzwords of the early twenty-first century and became a concept that bears multiple meanings to different groups of people. Diversity is most often referred to as the variety of human groups, societies, or cultures in a specific region, or in the whole world. In this globalized world, diversity on one side plays a vital and essential role in economic development but on the other side ethnic, cultural and religious polarization resulting conflicts, discrimination, segregation and bigotry are increasing gradually in the world's population that does not differ from social and financial exclusion. As escalating the heterogeneity society, decisions of the individuals cause catastrophically changes in fluctuation of sustainable stock market behaviour or financial markets. Diversity and its implication are a big challenge for researchers and policy makers of all the disciplines. By focusing on the multidimensionality of diversity, it is necessity of time to explore macro level relationship between diversity and financial indicators which are responsible for financial development of any country.

At the start of the twenty-first century, the world is returning to some of its fundamental, unresolved questions: wide-ranging social transformations, individual freedom, rise of the new knowledge-based economy, and the emergence of an information technology revolution. The World Culture Report 2000 appears at a time of growing awareness that the dimensions of globalization are economic and technological¹. The search for ways to influence – or invent – the social and ethical dimensions of globalization lead inevitably to questions of culture. These questions of cultural identity and expression, diversity and pluralism, cultural development and heritage go to the heart of UNESCO's mandate in the field of culture. Ethnic, religious identity and expressions are challenged in several ways by the processes of globalization.

Diversity plays an increasingly important role in opening the spaces for interactivity and negotiation in all these areas. Ethnic and religious identities have multiple and complex links with market knowledge. The processing of information into knowledge is a creative and culturally informed act, as is the use to which that knowledge is put. A truly knowledge-rich

¹For more detail see, world culture report 2000, UNESCO "Cultural diversity, conflict and pluralism", *Economia della Cultura, Società editrice il Mulino*, issue 3, pages 433-434.

world must be a culturally diverse world. Altering the course of global transformations is of course a far from easy task. The speed of social and economic change often goes counter to the rhythms of culture, which more often measure time in phases of experience, stages of life and even in generations than in the nanoseconds of the digital networks. Those who can take an active part in global cultural exchange often experience culture as a process rather than as a product and their personal sense of ethnic and religious identities become a gateway of receptivity towards other cultures. But for those who lack the means of exchange or of self-expression, or who experience globalization as an inexorable and alien process, there can be a retreat into a narrow sense of cultural identity that rejects diversity. As with so many other global issues today, this problem is closely linked to the steadily growing gap between the haves and the have-nots in the world.

The globalization issue is brought into the domain of behavioural finance by way of international trade and the notion of ‘ethnic and religious identity’ in the current debate. Recent years have witnessed an increase in the number of trade disputes, more acrimonious in that they challenge the right of nations to retain their consumption patterns, protect the private life of citizens, maintain the moral rights of authors, and stop the dissemination of new food technologies. The right approach is not to confront ethnic and religious fragmentation with globalizing economic forces but rather to synthesize identity claims and globalization.

Ethnic and cultural differences exist in all segments of society and at marketplaces. A country with different ethnic groups may float new ideas, competition, intercommunity trade, tourism attraction and generally a blend of culture from people of different backgrounds. This may be a blessing, if it brings about unity in diversity and provides fruitful outcomes of diverse society. But sometimes diverse society is itself the cause of conflict that may expect to affect socioeconomic circumstances. In all, various attributes of ethnic and religious diversity involve communities of different cultures and backgrounds. In short, all ethnic and religious conflicts and clashes have moderate to severe consequences, when society fights instead of participating in economic activities, then the growth and sustainable development of that economy fails to take place. In that situation, a terrible atmosphere comes-up, property is damaged, loss of human lives, infrastructure destruction and investors are scared and discouraged.

Based on these linkages, it is surprising, why economists gave less importance to social influences on financial markets. So, this dissertation is going to fill this gap, how social indicators such as ethnic and religious diversity link with the financial sector. This dissertation relates four distinct empirical chapters on ethnic and religious diversity and its financial

implications. Each chapter focuses on a unique set of research questions, methods, and data. The questions are raised such as does ethnic and religious polarization stimulate or relegate international trade? Why ethnic and religious polarizations affect the stock market development? If yes, then what are its channels? Does financial inclusion have been affected by ethnic and religious diversity? And what are channels through which diversity show the relationship with financial inclusion? Ethnic diversity whether in any shape linguistic or religious may perform for enhancement of size and development of informal economy? One can find a few studies covering these issues, in the past from a global perspective. This dissertation aims to cover aspects to analyse financial implications of ethnic and religious diversity for better policy implementation.

This dissertation considers ethnic diversification impact on financial development in the modern world. These days different cultures need to exist close to each other. The development of IT technology causes easier connections between countries and societies living in different parts of the world. It makes us think about the power of the diversity of our world. At the same time, the homogeneity/heterogeneity causes rapidly socioeconomic changes which indicate how much this topic is important, current and challenging in financial disciplines. This thesis also explores the impact of religious diversity on financial development (including stock market development, international trade volume, financial inclusion and informal economy) because both play a significant role in sustainable financial sector development. This thesis has identified the financial implications of ethnic and religious diversity at a global perspective and solved the puzzle whether ethnic and religious diversity has a direct impact/effect on financial development or not.

Ethnic and religious diversity is measured through the ethnic fractionalization index. In order to create the index of ethnic and religious diversity this thesis followed the ethnic fractionalization index of Alesina, Devleeschauwer, Easterly, Kurlat, and Wacziarg (2003). Diversity is basically time invariant data; very nominal change occurs in a long time. This thesis avoids using annual data (because of less variation in diversity data) and creates an index by following data per five years of interval from 1990-2015 (1990, 1995, 2000, 2005, 2010 and 2015). This time span is chosen as it maximizes the availability of data, mainly as the data retrieved from the cline center of democracy.

Based on the annual percentage of ethnic groups in each country, index of ethnic fractionalization (FRACT) calculates the degree of ethnic fractionalization (EF) using the most universally applied formula in the empirical literature measured by:

$$\text{FRACT}_j = 1 - \sum_{i=1}^N Z_{ij}^2$$

Whereas Z_{ij} is the share of group i in total population, ($i=1, \dots, N$) in the country j . Theoretically, the ethnic fractionalization index reflects the likelihood that two people chosen at random within a given country will be from different ethnic groups. The ethnic fractionalization index ranges from 0, when there is no ethnic fractionalization and all individuals are members of the same ethnic group to 1, where everyone belongs to his/her own ethnic group.

This thesis has used pooled ordinary least squares (pooled OLS) and fixed effect technique into empirical findings². Fixed effect models organize for or partial out the belongings of time-invariant variables with time-invariant effects. To use fixed effect models, we are only interested in analyzing the impact of variables that differ over time. When a using fixed effect model the individual may impact or bias the outcome variables and it should be needed to control for this. Stability of models has been tested through post-estimations tests in the thesis³.

In the chapter IV of the thesis author has tested the first empirical analysis, whether ethnic and religious diversity affect the stock market development or not? (H1). In the context of herd behaviors of the stock market, many researchers gave more focus to the development of the financial market based on their own diversified behaviors of any country. However, the effect of diversity (ethnic and religious) on stock market prosperity was ignored. In which one reason for this neglecting aspect is to find difficulty and complexity in measuring diversity in quantification. However, this problem has been resolved by the construction of fractionalization index by Alesina et al. (2003). In one aspect diverse society promotes technological innovation which ultimately promotes economic growth, and onwards leads to

² Suitability of fixed effect model is depending on Hausman test.

³ In all models, this thesis has performed post-estimation model tests to check if any violation of assumptions, autocorrelations and heteroscedasticity. In this regards, White's robust standard errors correction has applied in all the models. White's robust standard errors allow for possible cross-section heteroscedasticity and contemporaneous correlation among cross-sections for reliable significance interpretations and only affect the standard errors and not the estimators.

the prosperity of the stock market. On the other hand, financial innovations caused by diversity promote the prosperity and development of the stock market.

Literature shows the impact of diversity on time preference and found that is the time preference indicator: and time preferences are closely related, and different diversity will lead to different time preferences. The intertemporal investment consumption theory indicated that the different time preference of investors shaped by cultural diversity will deduce different trading strategy choices, thus affecting the financial market. Behavioral finance studies have indicated that the heterogeneity of the expectations and beliefs caused by cognitive differences has an important impact on the financial market.

Researchers want to know whether the increase in the level of diversity will promote the prosperity of the financial market. Diversity plays a different role in different countries. Compared to the common ethnic and cultural conflicts in African countries, different ethnic groups in the European and American multinational countries get along well, and there is frequent diversity communication between them. In a high-quality legal environment, diversity shows constructive force while in low-quality legal system environments, diversity shows destructive force. The relationship between diversity and stock market development are merging from the assumption of different theoretical models.

The empirical findings show that diversity (i.e., ethnic and religious) has a significantly positive impact on stock market development (including market capitalization, market liquidity, turnover ratio, listed domestic companies, S&P/global equity index). It means that, if the diversity is well-established, shareholder engagements focus on persuading companies to take advantage of the benefits associated with cultural diversity, including improved decision-making, oversight and financial performance. However, in some extent literature also found the relationship between diversity and stock market development through their socio-economic cost. They argued that ethnic diversification can sometimes be an engine for productivity and innovation, because different ethnic groups have different productive skills which complement each other. Ethnic mix also embodies abilities, experiences and cultures when turns productive then may lead to innovation and creativity. Diversity may be helpful to ensure sustainable development because diversity itself demands for the intergroup cohesion process. Groups coming with different interests, but equal influence will compete, thus forcing conciliation on the growth-oriented policies from which all could lead to earn profit.

Furthermore, rise in both types of diversity do not create conflict inside and outside the society because of cohesive measures and collective actions. Fractionalization has the aptitude to make societies safe and emphasized that ethnic diversity has a positive role on stock market because it creates a non-coercive, stable, development-oriented state through intensive public engagements, it minimizes the possibility of civil war due to conflict. It improves varied productivity and innovation and lays a foundation for better performance of the private sector. Ultimately, the evidence suggests ethnic fractionalization enhances stock market development. The results, therefore, strengthen the emerging positive consequences of ethnic diversity on the stock market.

Chapter V begins an in-depth exploration of ethnic and religious diversity and international trade (H2). Every year, the flow of diversified groups with totally different cultures and norms is growing in volume. Developing trust and economic development among various nations may assist to boost the trade via ethnic diversity, therefore, it seemed more difficult or challenging for assorted nations to be engaged in international trade while designing agreement across legal and political boundaries. However, increase in transaction costs associated with ethnic diversity may also reduce the likelihood of international trade. Consequently, this generates a multicultural society which may lead to clashes and conflicts within society as well as organizations. Thus, diversity among the firms parade foreign markets which successfully may increase the global welfare of the society. On the other hand, most empirical studies examine the relationship between diverse society and trade through gravity models. In addition, it implies that ethnic groups are demanding local commodities within and across countries which may result in reduction in transaction costs.

Furthermore, it might be possible that a significant part of ethnic groups will not affect international trade as much. Particularly, most communities regard only the negative consequences of ethnic group's arrival. However, there is a need to highlight the positive consequences too. Most studies have revealed that diversity enhances economic development through investment and trades, and within firms generate new ideas that lead to inspiring innovation and trade. Hence, the relationship between diversity and international trade is more interesting to be studied.

Moreover, diverse societies due to their unique history and different cultural background may add new knowledge to a society. Parallel use of complementary knowledge and their networks, new horizons of foreign markets can be unlocked for trade, which enhances exports. Besides,

different immigrant ethnic groups generate a demand for foreign products which is generally unknown in the community of immigrant countries. Thus, imports increase and the scope of diversified products in those countries broadens, which later increases welfare because of the consumption of a large number and variety of goods available to diverse ethnic groups as confirmed from the love of variety model.

Different ethnic groups and immigrants due to their unique and diversified skills produce a variety of goods and later export them to other countries by means of their networks. Intuitive factors boost up imports because international trade requires the knowledge about market, culture and the language of trading countries to minimize transaction cost and diversity acts as a bridge for providing information to firms to perform business with the migrant's originate country or a country producing their demanded products. In other words, the more diverse society means more the export market can be expanded which stimulates international trade. Therefore, this is the first study of this type which shows a very interesting relationship between ethnic and religious diversity, international trade volume by using data of 187 countries of the world.

Empirical findings show that ethnic and religious diversity both have a significant positive impact on international trade (i.e., total trade volume, exports and imports) in case of high income and middle income countries and vice versa in the case of low income countries. In high and middle income countries, ethnic and religious diversity have a significant positive impact on international trade via creating new ideas, invention and innovation. Because high-income countries are more civilized and possess high moral value so that diversity consistently proves a nexus with trade and institutional quality in high-income and middle-income countries than the low-income countries. Low income-countries will have to implement economic reforms to foster productive inclusion of poorer households, civil activism, social cohesion and create new competitive advantages. In this regard, social policies may play a vital role in low-income countries but without supporting education, healthcare policy, secure life, labor productivity and economic growth is redundant. To ensure social inclusion in low-income countries needs to create a secure and peaceful society through strong institutional quality to shape up the socio-economic life of individuals in multiple ways to make a cohesive society.

Ethnic and religious diversity is affecting international trade due to immigrants demanding foreign products rather than immigrants possessing superior foreign knowledge or foreign networks which decrease trade cost and stimulate trade. It supports that, the more diverse

cultures live in a country the more fractionalized the country is, which increases international trade. A shared religious belief may enhance trust and therefore reduce transaction costs between trading partners. This effect should be particularly important for goods that are sensitive to trust. However, it should be noted that the channel through which imports are affected is always present as migrants demand foreign products.

Our results suggest that beyond economic and institutional factors, ethnic and religious diversity may be a factor of interest when evaluating trade as an economic development tool. Social and environmental dimensions for sustainable development cannot be treated separately and to prevail equity among ethnic groups needs to be focused. The notion of social cohesion and harmony is so important to bring about the positive consequences of ethnic fractionalization. The above discussion concludes that in multi-ethnic societies should design their policies and strengthen their institutions for sustainable economic development which requires profound involvement in the political process of all social groups.

Aside from conflicts can be caused by more and diverse nationalities within a country although it can also, amongst others, enhance international trade through two channels. First, boosting imports, immigrants demand some of their home-country products. Second, immigrants decrease the transaction costs with respect to uncertainty and incomplete information, which in turn increases exports. Moreover, firms are becoming multinationals, their employees work from over the world, having different nationalities and cultures. With the use of this supplementary knowledge and their networks, new foreign markets can be opened for trade, which enhances exports. Besides, the inflow of migrants generates a demand for foreign products before unknown in the destination country. Thus, imports increase and the product scope of countries broadens too, which increases welfare since consumers, overall, followed the love of variety approach (because consumer has a demand for multiple varieties of a product over time).

Chapter VI shows the role of ethnic and religious diversity in financial inclusion (H3). Diversity and inclusion are extremely important in business, perhaps now more than ever. Not only does diversity improve the innovation and scope of your business, but it also increases employee satisfaction, making business more attractive to potential candidates. Besides, having a diverse workforce is simply the right way to do things. The finance sector has had a problem with lack of representation in the past, but that is changing rapidly. It is essential that business keeps up, making sure that the industry remains appealing to the next generation of

professionals. Typically, the larger, regulated firms have led the charge on diversity in financial services. It has done this for many years, working toward inclusion goals. It has changed their approach to hiring and has revisited their values, which is having a positive impact on their work culture.

Financial inclusion is the provision of access to financial services to all members of the population particularly the poor and the other excluded members of the population. Financial inclusion is also defined as the use of, and access to, formal financial services. These definitions have one thing in common which is that they emphasize that each member of the population should have access to available financial services. Financial inclusion has been a major policy objective for the government of many developing and emerging countries, and there is great promise that financial inclusion will bring the excluded population into the formal financial sector so that they can have access to formal financial products and services. Many governments are making tremendous efforts to achieve high levels of financial inclusion for the benefit of their citizens.

There is no doubt that the financial inclusion programs and policies adopted in some countries have been successful. Yet, the two major concerns that often arise is the concern that financial inclusion may spread the risks of the financial system to the poor and vulnerable customers in society and increase the number of high-end (or high-income) consumers benefiting from financial institutions. The second concern is whether financial inclusion should be targeted to those who have never been included in the formal financial sector or to those who have been relatively distant to using financial products more and more frequently. The policy literature contains many idealistic interpretations on how to achieve financial inclusion, while the academic literature is mostly focused on the relationship among financial inclusion and poverty levels and income inequality as well as the effect of financial inclusion on the economy. Theories can explain why different ideas exist on what financial inclusion objectives should be and how to achieve financial inclusion. Theories can explain the current observations in financial inclusion practice and can also explain abnormal deviations that exist in practice so that a coherent and comprehensive system of principles for financial inclusion can be developed. Therefore, a good financial inclusion theory or set of theories is one that provide a system of ideas to explain financial inclusion objectives, processes or outcomes.

This topic has become quite fashionable in a variety of policy areas, but about this review, several questions arise. Are some communities being indirectly discriminated against because

their income or residence is considered high-risk, and so they fail to get loans, mortgages or insurance, or are offered higher rates for those financial services and products? Is credit-scoring fair? Should or can it be? Do some communities evaluate risk differently from others? Do ethnic societies use higher-risk informal services and products such as loan sharks either out of necessity or because they evaluate the risk of such transactions differently from other communities?

This study shows very interesting findings between diversity and financial inclusion (by creating index of usages dimension; account, saving, loans, access dimension: number of ATMs, bank branches and barriers dimensions; trust, affordability, distance, documents respectively). The results pointed out that diversity (ethnic and religious) has a significant positive impact on financial inclusion. It indicates that diversity either ethnic or religious both have enormous support for financial inclusion. It shows the robustness of results such as diversity (ethnic and religious) has a significantly positive impact on financial inclusion of all the countries (including high, middle and low income countries).

In this regard, there are best practice examples such as China, South Asia, India, Singapore and Malaysia where there are numerous religions, races, cultures but take advantage of holding and successfully mixing majority/minority groups in new globalization. They celebrate all the various ethnic and religious festivals days and show a respect for each other that is rather unique. Not that there is no tension or discrimination, but it is a peaceful nation that has embraced its diversity. Although achieving diversity and respect for people is a challenge all over the world, there is also good progress going on around the world.

According to the United Nations (UN) report 2017, if the diversity is well-established, shareholder engagements focus on persuading companies to take advantage of the benefits associated with gender diversity, including improved decision-making, oversight and financial performance. Culture evolves in the form of greater trust, control and other traits, individual's attitudes towards financial market change, and they engage in greater financial transactions. Considering multiple dimensions of culture, trust is a key cultural trait, should positively influence financial market; uncertainty avoidance. Diversity also brings about variety in abilities, experiences, cultures which may be productive and may lead to innovation and creativity. Diversity is helpful in ensuring the emergence of stable development since the diversity by itself calls for the intergroup negotiating process. Thus, diversity is an asset in promoting public discussion which is a pillar to form a stable, non-coercive, development-oriented state.

In the Chapter VII author has examined the role of ethnic and religious diversity in the size and development of informal economy (H4). Informal economy is a complex, controversial and a multidimensional phenomenon when explained in the presence of other tangible and intangible factors, to observe their influence on economy. A very old notion of informal economy emerges from excluded people of capitalist nature of a society. Generally, it is perceived that different ethnic groups either are voluntary excluded or involuntary isolated from the formal economy through legal binding. A less explored tale is the focus of present study in case of developed and developing countries that how different channels of ethnic diversity affect informal economy in the separate realm of both types of countries. Pressure of immigrants in developed countries, perhaps is one of the reasons, to escape from legal binding for being engaged in informal economy to earn their livelihood, thus leads to the development of informal sector to absorb them, while developing countries are facing severe ethnic diversity naturally and thus by means of social exclusion, they are engaged in informal economy.

Informal economy is well prevalent with different names such as informal sector, grey economy, black economy, shadow economy and underground economy. Informal economy is known as that type of the economy where people do not embrace their legal responsibility to obey rules of business, such as to pay tax and record their transactions. In simple words those activities which do not appear in the gross domestic product of a country. Many reasons behind avoidance of civil responsibilities such as cost of registration, unable to pay taxes/distrust of tax system, lack of education, complexity in government rules and regulations, cultural conflict and misperception. In a broad sense, informal economy includes the self-employed people in informal business and people employed in informal jobs in urban and rural areas. But the nature and size of the informal economy diverge greatly across countries and regions which mainly depend on enhancement of heterogeneity society.

In contemporary world, informal sector highlights its attribute of expanding its size and development. In case of developing countries where economic and political stability is missing, do not play their role efficiently, and in such situations informal sectors become a large and more important ingredient for economic prosperity. In this context, ethnic diversity plays a vital role in expansion of informal economy in both developed and developing economies. The appearance of informal economy is due to the ethnic diversity at large and this phenomenon is a riddle for developing and developed nations with multiple reasons.

At one side, informal sector may create a worse condition due to conflict between diverse societies, exclusion and so on but on the other side, it plays a prominent role in income

generation, production, urbanization and employment creation for any economy. Due to ever increasing growth of population and urbanization the informal sector is only source to absorb one part of the labor force not in rural but also in urban areas. Informal sectors somehow are necessary for low income countries because of missing social safety nets, less employment insurance, low wage rate and lack of resources. Different ethnic groups and excluded people due to inability of fulfilling their legal responsibility for failing to fulfill immigration laws of developed countries, and later lead to the development of informal economy. These are mostly own brothers and sisters, former union members and those who have no jobs or employment anywhere. They do not have another alternative for their survival and to engage in daily course of life.

The informal economy is highly segmented by sector, workplace, employment status, and by social group and gender they belong to. But those who work informally have one thing in common that they lack legal and social protection. However, informal economy is basically more complex than we deem it based on summative factors. With the increase in heterogeneity in any society, the formation of informal economy becomes simple such as easy entrance, and for those who needs to join the sector, may find desire work for cash earnings, to skill labor from informal education and to establish small business. The spectrum of informal economy ranges from self-employment or unpaid family labor to street vendors, shoe shiners, and junk collectors.

The result shows that diversity (ethnic and religious) has a significant positive impact on informal economy. It also confirms the hypothesis that ethnic and religious diversity both are important indicators which enhance the size and development of informal economy. Ethnic mix is also helpful in bringing variety in abilities, share their experiences, and cultures which may lead to innovation and creativity which ultimately results in enhancement in informal economy. Groups coming with different interests, but equal influence will compete, thus forcing conciliation on the growth oriented policies from which all could lead to earn profit. This diversity is an asset in promoting public discussion which is a pillar to form a stable, non-coercive, development-oriented state. The results obtained in all types of countries present similar picture of positive significant role of ethnic diversity and religious diversity to affect size of and development of informal economy.

In all the debates, ethnic and religious diversity work as a double edge of sword; it has positive as well as negative financial implications. In this context, increasing diversity is itself not good or bad; its implication made good or bad. If a country wants to see the beauty of diversity and

get the fruitful benefits, try to make society more cohesiveness. Every study has some limitations which allow the researchers to interpret the results within proper parameters. This study has also some limitations regarding limiting scope to cover the ground of diversity relationship with stock market development, international trade, financial inclusion and informal economy.

In addition to this, diversity is a multidimensional concept, i.e., demographic, socioeconomic, political, geographical, cultural and dynamic in nature etc. So, it is impossible to show that variables included in this study are the only predictors of diversity as well as international trade and financial inclusion. However, there are several other financial variables which may affect the stock market development such as political stability, institutional quality, government policies, which are did not covered by this thesis. This thesis does not check the impact of Gini index regarding to the distribution of income in response to the financial inclusion, within the country and across the countries. This thesis only explores the macro level / aggregated level analysis relationship with stock market development, international trade and financial inclusion. Therefore, it is more appropriate to generalize small units such as city, provinces, towns and places to places.

The study uses diversity based on ethnic and religious only, whereas other determinants of diversity such as race, gender, may be guidelines for further research. The current study did not include any political or ideological variables, whereas the variation of political change has an impact on the domestic conflict or civil war, and it is a new direction for future research. Therefore, future research may analyze the data and development of informal economy and if any discrepancy occurs then improve the credibility and reliability of informal economy figures for better policy implication.

This dissertation suggests that ethnic and religious diversity is an inherent part of most societies that have both negative as well as positive consequences in financial sector development. However, unintended negative impacts of such increased diversity can be minimized by establishing cohesiveness in society. So, there is an emergent need to providing equal opportunity to all groups and encourages promoting cohesive culture because diversity is a natural phenomenon. A cohesive and peaceful society can get the fruitful results through diverse population and can enhance financial sector development.