Exploring The Mediating Role of Financial Capability in The Relationship Between Financial Knowledge and Financial Well-Being: A Conceptual Framework.

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Abstract

This conceptual study aims to investigate the mediating effect of financial capability on the relationship between financial knowledge and financial well-being. Employing a cross-sectional design, data will be collected from a sample of low-income entrepreneurs and non-entrepreneurs, ranging from 100 to 200 participants. The research focuses on three key constructs: financial knowledge, financial capability, and financial well-being. Financial knowledge will be assessed through measures of financial literacy, education, and awareness; financial capability through access to financial services, financial behaviors, and attitudes; and financial well-being through financial security, freedom, and the ability to meet financial goals. The expected findings suggest that financial knowledge will significantly enhance financial capability, which, in turn, will positively influence financial well-being. The study anticipates that financial capability will mediate the relationship between financial knowledge and financial well-being, indicating that improved financial knowledge leads to better financial behaviors and access to services, ultimately enhancing overall financial health. These findings aim to provide a comprehensive understanding of the interplay between financial knowledge and capability in influencing financial well-being, highlighting the necessity for financial education programs that foster both knowledge and capability, particularly among low-income groups.

Keywords: Financial Knowledge, Financial Capability, Financial well-being, Low-income Entrepreneurs.

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Introduction

Financial well-being significantly impacts personal financial success, work productivity, overall well-being, and the development of a healthy economy (Utkarsh et al., 2020). Factors such as financial socialization, financial literacy, attitude towards money, financial satisfaction, perceived financial capability, and financial stress are interconnected with financial well-being (Fan & Henager, 2021; Choung, 2023). Individuals with higher financial knowledge are more likely to make informed financial decisions, access financial services, and achieve greater financial well-being (Choung, 2023; Zhang & Chatterjee, 2023). These aspects comprehensively can lead to improved financial well-being for individuals.

Financial capability and financial knowledge are crucial factors in determining an individual's financial well-being. The literature emphasizes key themes such as the levels of financial literacy across different groups, the impact of financial literacy on financial planning and behavior, and the significance of financial education in enhancing financial well-being (Goyal & Kumar, 2020). Financial capability is defined as the ability of an individual to effectively apply financial knowledge, engage in positive financial behaviors, and leverage available financial opportunities to achieve financial well-being (Xiao et al., 2022). A prior study has shown that the propensity to plan is a vital component of financial capability that significantly contributes to consumer financial well-being (Xiao & O'Neill, 2018). Additionally, research indicates that subjective financial literacy, desirable financial behavior, and a financial capability index are strong mediators between financial education and financial satisfaction, highlighting the importance of a comprehensive approach to financial education (Xiao & Porto, 2017). Overall, these studies underscore the need for tailored financial knowledge programs to enhance individuals' financial capabilities and ultimately improve their financial satisfaction and well-being (Xiao & O'Neill, 2016). Previous studies have explored the relationship between financial capability, financial knowledge, and financial well-being. Some studies have investigated factors related to financial planning and its impact on financial satisfaction (Xiao & O'Neill, 2018). Others have examined how subjective and objective financial knowledge, financial behavior, and socio-economic status influence financial well-being (Riitsalu & Murakas, 2019). Research has also looked into the mediating roles of financial literacy, financial behavior, and financial capability between financial education and financial satisfaction (Xiao & Porto, 2017). However, a gap exists in the literature regarding a systematic conceptual review and synthesis of financial capability, which involves applying appropriate financial knowledge, engaging in desirable financial behaviors, and utilizing available financial opportunities for achieving financial well-being (Xiao et al., 2022). Additionally, the mediating effect of different aspects of financial capability, such as objective and subjective financial knowledge, financial behavior, and financial attitude, in the relationship between financial socialization and financial well-being requires further exploration (Pak, 2023). These gaps are due to the complexity of the interactions between financial knowledge, financial behavior, and financial well-being, as well as the necessity for more comprehensive frameworks that consider various mediating factors in these relationships. The purpose of this study is to explore the mediating effect of financial capability on the relationship between financial knowledge and financial well-being.

Literature review

Financial well-being

Financial well-being is a multifaceted concept that encompasses various aspects of an individual's financial health and satisfaction. It goes beyond just the monetary aspect and extends to overall happiness, freedom from financial worries, and the ability to maintain desired living standards (Sabri et al., 2012; Lone & Bhat, 2022). This state of financial well-being is crucial not only for personal financial success but also for enhancing work productivity, overall well-being, and contributing to the development of a healthy economy (Utkarsh et al., 2020). It involves a subjective appraisal of one's financial situation, encompassing feelings of financial security in both the present and the future (Sang, 2021). Moreover, financial well-being is influenced by factors such as financial socialization, financial literacy, attitude towards money, and financial self-efficacy (Utkarsh et al., 2020; Lone & Bhat, 2022). It is a comprehensive construct that takes into account both objective financial conditions and individuals' perceptions of their financial status (Choung, 2023).

Financial capability

Financial capability refers to an individual's ability to effectively utilize financial knowledge, engage in favorable financial practices, and leverage available financial opportunities to enhance their financial well-being (Xiao et al., 2022). This concept involves not only possessing a certain level of financial literacy but also actively demonstrating positive financial behaviors that contribute to achieving financial stability and success (Xiao & O'Neill, 2016). The definition of financial capability can vary among scholars, with some emphasizing knowledge, habits (behavior), status, and access as integral aspects of financial capability (Kim & Xiao, 2020). Researchers have identified key components to measure financial capability, including objective and subjective financial literacy, desirable financial behaviors, perceived financial capacity, and an overall financial capability index (Xiao et al., 2015). This capacity is essential for achieving financial inclusion, which requires a variety of tailored financial products and services to address existing disparities, particularly noticeable among women in the MENA region (Saviano et al., 2017). Factors influencing the development of financial capability include attitudes towards finance, reliance on professional advice, financial knowledge, and confidence, as demonstrated in studies such as the Canadian Financial Capability Survey (Georgieva et al., 2021). Research suggests that financial capability serves as a mediator between internal and external factors and financial well-being, highlighting its critical role in shaping individuals' financial outcomes over time (Potocki & Białowąs, 2022). Furthermore, in the context of small and medium enterprises (SMEs), managerial accounting skills significantly contribute to driving firm growth and success, underscoring the importance of owner/manager financial management capabilities in promoting business prosperity (Mbogo, 2011).

Financial knowledge

Financial knowledge is a crucial factor in individuals' financial well-being and decision-making processes. It is widely acknowledged that having a good understanding of financial concepts and practices is essential for making informed financial decisions and achieving financial stability. Studies have shown that financial literacy, which includes knowledge, attitudes, and behaviors related to finance, plays a key role in enabling individuals to manage their finances effectively (Potrich et al., 2016). This knowledge not only empowers individuals to make responsible financial decisions but also has broader implications for societal welfare and economic policies aimed at improving overall financial literacy levels (Lusardi & Mitchell, 2013). Furthermore, financial knowledge is often seen as a prerequisite for financial education initiatives and is crucial in explaining variations in financial outcomes among individuals (Huston, 2010). Research indicates that individuals with higher levels of financial literacy are better equipped to compare financial products and services, leading to more informed financial choices (Świecka et al., 2021). Additionally, studies have demonstrated that financial knowledge influences behaviors such as credit management, with individuals who have internalized financial knowledge displaying more prudent financial behaviors (Xiao et al., 2011). In essence, the importance of financial knowledge extends beyond individual financial management to encompass broader economic implications and policy considerations.

Hypotheses development and Conceptual Framework

Financial knowledge is a critical factor in shaping an individual's financial capability. Financial literacy, often used interchangeably with financial knowledge, is a key element influencing financial education and outcomes (Huston, 2010). Financial capability as the ability to apply appropriate financial knowledge to make sound financial decisions that result in satisfactory financial outcomes (Chen et al., 2022). The components of financial capability, which encompass objective and subjective financial literacy, desirable financial behavior, perceived financial capability, and a financial capability index (Xiao et al., 2015). Çera et al. (2020) stress the importance of studying financial knowledge independently to understand its specific impact on financial capability, particularly as consumer attention shifts towards enhancing financial capability. In summary, a solid grounding in financial knowledge is essential for individuals to cultivate the necessary skills and behaviors that form the basis of financial capability, ultimately leading to enhanced financial well-being and future financial security. Therefore, this study proposes the following hypothesis:

H1: Financial knowledge has an effect on individuals' financial capability

Financial knowledge is a crucial role in influencing financial well-being through various mechanisms. Studies have shown that individuals with higher levels of financial literacy tend to make better decisions regarding their portfolios and investments, ultimately leading to improved financial well-being (Chu et al., 2016). Additionally, subjective and objective financial knowledge, along with prudent financial behavior, have been linked to enhanced financial well-being, highlighting the importance of understanding financial concepts and applying them effectively in managing personal finances (Riitsalu & Murakas, 2019). Moreover, subjective financial knowledge has been found to positively impact financial behavior and, subsequently, financial well-being among working adults, emphasizing the significance of informed decision-making in financial matters (She et al., 2021). Furthermore, research indicates that financial literacy not only empowers individuals to make sound financial choices but also contributes to their overall financial well-being by fostering responsible financial behavior and decision-making (Aydın & Akben-Selçuk, 2019). Therefore, the following hypothesis is proposed:

H2: Financial knowledge has an effect on individuals' financial well-being

Financial capability is a critical factor in determining an individual's financial well-being. It is defined as the ability to apply appropriate financial knowledge, engage in desirable financial behaviors, and leverage available financial opportunities (Xiao & O'Neill, 2018; Xiao et al., 2022). Research has shown a strong link between financial capability, which includes financial knowledge, skills, and access to financial products and services, and financial well-being (Guo & Huang, 2023). Additionally, studies have indicated that financial capability acts as a mediator between financial education and financial satisfaction, underscoring its importance in improving individuals' financial outcomes (Xiao & Porto, 2017). Furthermore, the positive association between financial planning and well-being persists even when controlling for financial capability, reinforcing the relationship between financial capability and financial well-being (Fan & Henager, 2021). Therefore, promoting financial capability through education, skill-building, and access to resources is crucial for enhancing financial well-being and overall financial satisfaction. Thus, we present the following hypothesis:

H3: Financial capability has an effect on individuals' financial well-being

Financial capability is a critical factor in mediating the relationship between financial knowledge and financial well-being. It involves the effective application of financial knowledge and the engagement in positive financial behaviors to improve one's financial situation (Xiao & O'Neill, 2016). This combination of knowledge and behavior is essential for attaining financial well-being (Xiao & O'Neill, 2018). Research has shown that financial capability acts as a mediator between financial education and financial satisfaction, highlighting its importance in the process of achieving financial well-being (Xiao & Porto, 2017). By utilizing appropriate financial knowledge, engaging in favorable financial behaviors, and seizing available financial opportunities, individuals can progress towards enhancing their financial well-being (Xiao et al., 2022). Additionally, studies have demonstrated that financial capability, which includes objective and subjective financial knowledge, financial behavior, and financial attitude, can mediate the relationship between financial socialization and financial well-being, emphasizing its crucial role in shaping individuals' financial outcomes (Pak, 2023). Thus, we hypothesize the following:

H4: Financial capability mediates the relationship between financial knowledge and financial well-being.

Research Methodology

The study will employ a cross-sectional design, collecting data at one point in time to examine relationships among variables. The population will consist of low-income entrepreneurs and non-entrepreneurs, with a sample size ranging from 100 to 200 participants, determined based on the required power and effect size. The research will focus on three key constructs: financial knowledge, financial capability, and financial well-being. Financial knowledge will be measured using questions assessing financial literacy, education, and awareness. Financial capability will be evaluated through items assessing access to financial services, financial behaviors, and attitudes. Financial well-being will be measured using items related to financial security, freedom, and the ability to meet financial goals.

Data collection will be conducted using a structured questionnaire administered through online surveys or in-person interviews, ensuring clarity and comprehensibility to facilitate accurate and reliable responses. The data analysis will be conducted using Partial Least Squares - Structural Equation Modeling (PLS-SEM), involving several steps. Data screening will check for missing values, outliers, and normality. The measurement model will assess the reliability and validity of the measurement items using Cronbach's alpha and composite reliability, as well as factor analysis. The structural model will estimate the relationships among the constructs using path analysis, while mediation analysis will test the mediating effect of financial capability on the relationship between financial knowledge and financial well-being using the bootstrapping method.

The steps in the PLS-SEM analysis will include data preparation, ensuring readiness for analysis by checking for missing values, outliers, and normality. The measurement model will involve assessing reliability with Cronbach's alpha and composite reliability and conducting factor analysis to assess validity. The structural model will estimate relationships among constructs through path analysis, and mediation analysis will use bootstrapping to test the mediating effect of financial capability. The analysis will be conducted using software such as SmartPLS, specialized for PLS-SEM.

Conclusion

This conceptual study aims to elucidate the potential relationships between financial knowledge, financial capability, and financial well-being. The expected findings are that financial knowledge will have a significant positive effect on financial capability, indicating that individuals with higher financial literacy, education, and awareness are likely to exhibit better financial behaviors, attitudes, and access to financial services. This suggests that enhancing financial knowledge can empower individuals to manage their financial resources more effectively. Additionally, it is anticipated that financial knowledge will positively influence financial well-being, with individuals possessing greater financial knowledge experiencing higher levels of financial security, freedom, and the ability to meet financial goals, underscoring the importance of financial education in promoting overall financial health.

Furthermore, the study expects to find that financial capability has a significant positive impact on financial well-being. Individuals who possess strong financial capabilities, including positive financial behaviors and attitudes, as well as access to financial services, are expected to report higher levels of financial well-being, highlighting the critical role of financial capability in enhancing individuals' financial status. The study also anticipates discovering that financial capability mediates the relationship between financial knowledge and financial well-being. This means that financial knowledge not only directly affects financial well-being but also indirectly influences it through the enhancement of financial capability. In other words, increased financial knowledge leads to improved financial capability, which in turn leads to better financial well-being.

These expected findings will contribute to the literature by providing a comprehensive understanding of how financial knowledge and capability interact to influence financial well-being. The results are expected to emphasize the need for financial education programs that not only enhance knowledge but also develop financial capabilities. This holistic approach is anticipated to be more effective in improving individuals' financial well-being, especially among low-income groups.

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