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Financial well-being: A conceptualization and research agenda

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ABSTRACT

With savings rates at record lows and inadequate long-term financial planning for retirement, financial well-being has become an important topic for individuals and households as well as for societies and countries. Research on the topic, however, remains scarce and scattered across disciplines. The present paper aims to consolidate and extend knowledge on financial well-being and makes a three-fold contribution to the discussion. First, we propose a new definition based on a perceptual perspective of financial well-being and link it to an individual's current and anticipated desired living standard and financial freedom. We then develop a framework that distinguishes key elements of financial well-being; namely, interventions and financial behaviors, consequences, contextual factors, and personal factors. We then present a research agenda to guide future research on financial well-being. This work is designed to inspire researchers to continue expanding the knowledge so that financial institutions can take measures to increase financial well-being.

1. Introduction

As the world economy slowly recovers from the recent financial turbulence, healthy spending and saving habits of citizens have become a topic of increasing importance for companies, policy makers, and regulators. The OECD reports that household savings rates have decreased for most industrialized countries in recent years (OECD, 2016). In the eurozone, for example, savings rate are estimated to drop from over 8.5% in 1999 to 6.56% by 2017. In the US, the OECD forecasts that household savings rates will drop to 4.48% by 2017 (OECD, 2016). There are several explanations for this phenomenon. A stable labor market and an increase in consumption demand has led to greater private spending and caused the savings rate to decline at the same time. Moreover, with record-low base interest rates, depositing money in traditional savings accounts has become considerably less attractive as an investment (Blackstone & Troianovski, 2013).

Young adults between the ages of 20 and 30 are particularly vulnerable to these financial threats. Many members of Generation Y (that is, those people born between the early 1980s and mid-1990s) entered the workforce during the economic downturn (Kasperkevic, 2016). As the markets recover, these young adults in particular struggle (Kasperkevic, 2016). An additional issue that is being increasingly observed is rising student debt. A recent analysis by Citizens Financial Group in the US showed that college graduates aged 35 or under are spending 18% of their salaries on student loan payments, which significantly limits their consumption (Citizens Financial Group, 2016) and saving for retirement. In addition, average saving contributions are about 4% of current salaries in the US, whereas experts suggest that members of Generation Y, especially, need to save up to 15–20% of their annual incomes beginning at age 25 in order to maintain a similar standard of living in retirement (Struck, 2012). The situation is even more dire with regard to long-term financial behavior, since a recent industry report states that retirement is not the main savings priority for 85% of working-age people. Paradoxically, while retirement planning is not the main priority for a majority of working-age people, more than two-thirds (69%) are worried about running out of money in retirement and 66% are concerned about having enough money for everyday expenses in later life (HSBC Global Report, 2016). All of these numbers show that the issue of financial well-being is of utmost importance to nearly every industrialized country on the globe.[1]

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[1] While financial well-being is, of course, not limited to industrialized countries, the meaning of the term is quite different for developing countries, where a large part of the population struggles to make ends meet. Recent service research has started to generate insights for base-of-pyramid settings (e.g., Gebauer & Reynoso 2013).

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It is not surprising that researchers, especially the transformative service research initiatives (Anderson et al., 2013), have acknowledged the importance of gathering knowledge on how to motivate customers to engage in healthier spending and saving behavior (e.g., Mende & van Doorn, 2015; Winterich & Nenkov, 2015). Generating more knowledge in this area is important: a large number of people facing financial problems at the same time creates a societal problem and leads to negative welfare effects, both now and in the future. From an individual's point of view, financial well-being is important and research has shown that it has a strong and positive relation to overall well-being. Van Praag and Frijters (2003) confirmed that a healthy spending and savings balance is crucial for sustaining long-term financial and personal well-being. Hojman, Miranda, and Ruiz-Tagle (2016) found that depressive symptoms are higher for those who have been persistently over-indebted. In addition, research has shown that personal stress caused by unhealthy spending and saving behavior will not only affect the individual, but also their families and societies (resulting, for example, in reduced physical health or weaker job performance) (Dunn & Mirzaie, 2012; Kim & Garman, 2003). Having limited financial reserves can cause great difficulty when unexpected financial emergencies arise, and may prompt individuals to suffer from financial hardship (UBS, 2014).

In light of the pressing nature of this topic, this article makes the following contributions. First, the fact that research on financial well-being is still at an early stage and is currently scattered over various disciplines has led to a lack of clarity in understanding what the term financial well-being actually means. Therefore, we aim to synthesize the various meanings and definitions of financial well-being to provide a new definition for future research in this domain. More specifically, we define financial well-being as "the perception of being able to sustain current and anticipated desired living standard and financial freedom". Gaining a common understanding of this important term is crucial in order to advance a cohesive body of knowledge on this topic of growing interest and importance and to make research outcomes more comparable and interchangeable across disciplines. Second, the article develops an overarching framework that can serve as a guideline for future research into the measurement, drivers, and outcomes of financial well-being. We also discuss boundary conditions that could influence either the antecedents' effects on financial well-being or its specific outcomes. Third, based on the framework, we develop a list of research themes and research questions that will help generate knowledge on financial well-being.

2. Previous definitions and conceptualizations

Financial well-being has been studied in various academic fields, including economics, financial counseling and planning, developmental psychology, consumer decision making, and services marketing. However, there is no universally agreed-upon definition or measurement and no clarity with regard to its conceptualization and its components. In many cases, while published studies have included financial well-being as one of their major variables of interest, such studies have developed and used various measures of financial well-being without actually defining it (e.g., Guo, Arnould, Gruen, & Tang, 2013; O'Neill, Sorhaindo, Xiao, & Garman, 2005; Shim, Xiao, Barber, & Lyons, 2009). The majority of these papers, including the oft-cited InCharge Financial Distress/Financial Well Being (IFDFW) scale (Prawitz et al., 2006), do not provide a clear definition of this construct that they set out to measure.

However, the existing definitions and measures can be clustered into three groups in terms of their approach: those that use both objective and subjective characteristics, and those that use either objective or subjective characteristics to define financial well-being. In the first group, financial well-being is defined as an objective and subjective concept that contributes to a person's assessment of his/her current financial situation (Vosloo, Fouche, & Barnard, 2014). It is treated as a composite concept that consists of both objective and subjective dimensions (Cox, Hooker, Markwick, & Reilly, 2009), although different studies have adopted different indicators for those objective and subjective dimensions, seemingly without a clear focus. For example, many studies that examine students' financial well-being have included the students' level of debt as a measure of their objective well-being and their satisfaction with their financial status as a subjective measure (Shim et al., 2009). Likewise, Porter and Garman (1992) included quantitative indicators of the financial situation such as income level as the objective measure of financial well-being and perceived satisfaction with standard of living as the more subjective measure.

In the second group, income and other financial indicators have mostly been included as objective measures of financial well-being without considering subjective variables (e.g., Joo & Grable, 2004; Kahneman & Deaton, 2010). While some studies included mostly financial information, financial ratios, and benchmarks as objective measures of financial well-being (e.g., Greninger, Hampton, Kitt, & Achacoso, 1996), others stated that a household's ability to increase and manage liquidity can be used to determine its financial well-being (Aggarwal, 2014).

While many studies have used these two approaches to defining and measuring financial well-being, other studies have emphasized a more subjective and less objective approach when defining financial well-being. Although objective measures of the financial situation (income, debt-to-income ratio, etc.) provide objective evidence of where an individual stands financially, subjective measures of financial well-being can help researchers examine peoples' perceptions about and reactions to their financial condition (Norvilitis, Szablicki, & Wilson, 2003; O'Neill et al., 2005). The above-mentioned objective indicators measure facets of the financial condition itself rather than one's subjective assessment of the situation (Prawitz et al., 2006). Furthermore, people in similar financial situations, as defined by objective measures such as assets or income, could perceive their financial well-being differently depending, for example, on what they compare it to and what they prefer it to be. Thus, people in the same financial situation may assess their personal financial well-being more or less positively (Garman, Sorhaindo, Bailey, Kim, & Xiao, 2004). Most of these studies have underlined the importance of personal characteristics (e.g., Joo & Grable, 2004) and financial behavioral factors (Shim et al., 2009) that affect individuals' subjective assessment of their financial well-being. In other words, those individuals may have a different assessment of their financial well-being based on, for example, their life stages (Malone, Stewart, Wilson, & Korsching, 2010), or based on their attitude toward risk (Kim & Garman, 2003). The perceived ability to meet expenses, satisfaction with savings and investment, and tendency to worry about debt have also been included in studies with a subjective definition of financial well-being (Kim & Garman, 2003). In summary, this part of the literature suggests that a subjective approach is more comprehensive and can also capture non-financial issues, and is therefore more suited than an objective approach to defining and measuring a complex and personal phenomenon such as financial well-being.

Besides different approaches to its definition and measurement, another cause of confusion is that some definitions use wellness and well-being interchangeably, even though the literature makes a clear distinction between them. While wellness typically implies the quality or state of being healthy in body and mind, especially as the result of deliberate effort (Judge, Ilies, & Dimotakis, 2010), well-being refers to a good or satisfactory condition of existence (Guo et al., 2013). Studies of the different types of wellness seem to have primarily focused on personal wellbeing and to have been anchored in psychology, whereas our conceptualization relies on the well-being literature where financial well-being as such is of interest.

3. Financial wellbeing: a new conceptualization

We define *financial well-being as the perception of being able to sustain current and anticipated desired living standards and financial freedom.*

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