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The Financial Capability and Financial Well-Being of Low-Income Entrepreneurs

By Jin Huang and Baorong Guo

Lack of credit presents a formidable financial barrier to entrepreneurship, particularly for low-income and financially vulnerable populations.[1] Beyond credit, low-income entrepreneurs may lack access to a range of financial services (e.g., banking, tax, and accounting services, insurance, and financial counseling) needed to support their entrepreneurial activities.[2] They may not have the financial knowledge or skills necessary to explore financial services and resources, plan new businesses, and make right financial decisions in their entrepreneurial pursuits. Therefore, it is important to look at financial barriers broadly and integrate access to financial services and individual financial knowledge/skills. This holistic approach is referred to as *financial capability*,[3] which is critical in all stages of entrepreneurship development. However, few studies have applied this concept to the entrepreneurship research among low-income individuals. In part, this is because financial capability is a newly developed concept.

To fill the gap in knowledge about barriers to low-income entrepreneurship, we analyze nationally representative cross-sectional data in the 2016 National Financial Well-Being Survey by the Consumer Financial Protection Bureau (CFPB). The results enable a description of the financial capability and financial well-being of low-income entrepreneurs.[4] We also compare them with low-income nonentrepreneurs and higher income entrepreneurs. For these analyses, entrepreneurs are survey participants who reported that they were self-employed. The low-income cutoff line is set at 200% of the federal poverty line for 2016.

Table 2 reports the means of five financial measures by group. Compared with low-income entrepreneurs and nonentrepreneurs, higher income entrepreneurs have statistically higher mean scores on financial well-being,[5] knowledge,[6] and skill.[7] Low-income entrepreneurs and nonentrepreneurs do not differ statistically on these three financial measures.

Figure 1. A Conceptual Framework of Financial Capability

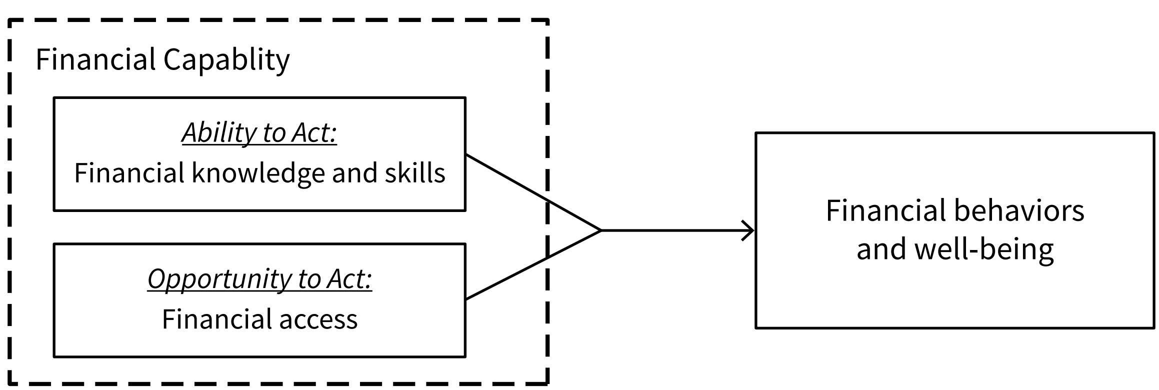

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Table 1. Three Groups in the Analytic Sample (*N* = 1,918)

Group	Sample
Low-income entrepreneurs (household income < 200% of federal poverty line)	134
Low-income nonentrepreneurs (household income < 200% of federal poverty line)	1,382
Higher income entrepreneurs (household income ≥ 200% of federal poverty line)	402

Table 2. Financial Well-Being and Financial Capability (*N* = 1,918)

Financial Well-Being and Financial Capability	Low-Income Entrepreneurs	Low-Income Nonentrepreneurs	Higher Income Entrepreneurs
Financial well-being score (14–95)	47.76	47.17	56.65[a]
Financial knowledge score (-2.05–1.27)	-0.68	-0.66	0.10[a]
Financial skill score (5–85)	47.97	46.55	52.99[a]
Mainstream financial products (0–8)	1.48[b]	1.90[c]	3.38
Alternative financial products (0–5)	0.64[b]	0.48[c]	0.24

[a] The mean differences of higher income entrepreneurs from low-income entrepreneurs and nonentrepreneurs are statistically significant at the .05 level.

[b] The mean differences of low-income entrepreneurs from higher income entrepreneurs and low-income nonentrepreneurs are statistically significant at the .05 level.

[c] The mean difference between low-income nonentrepreneurs and higher income entrepreneurs is statistically significant at the .05 level.

Low-income entrepreneurs own fewer mainstream financial products and use more alternative financial products than low-income nonentrepreneurs and higher income entrepreneurs do.[8] Together, these results suggest that barriers to accessing financial services are greater for low-income entrepreneurs.

Table 3 details distributions on the use of five mainstream and alternative financial products by group. Compared with higher income entrepreneurs, both low-income entrepreneurs and nonentrepreneurs are less likely to have checking/savings accounts but more likely to use alternative products. Also, the probabilities of having health insurance and retirement accounts are respectively lower among low-income entrepreneurs than among members of the two other groups.

Regression analyses in Table 4 suggest that financial skills and mainstream financial services are positively associated with financial well-being scores for all three groups. Financial knowledge also has a positive correlation with the financial well-being scores for higher income entrepreneurs. However, the use of alternative financial services is negatively correlated with the financial well-being scores of low-income entrepreneurs and nonentrepreneurs.

Low-income entrepreneurs encounter barriers to accessing mainstream financial products and use more alternative financial services. These factors may affect their financial well-being. The findings suggest the importance of financial capability for low-income entrepreneurs. They also suggest the need for a comprehensive financial guidance system to promote financial capability as a path to successful entrepreneurship.

Table 3. Use of Mainstream and Alternative Financial Products (*N* = 1,918)

Financial Products	Low-Income Entrepreneurs	Low-Income Non Entrepreneurs	Higher Income Entrepreneurs
Checking/savings accounts (%)	61.39	66.57	81.74[a]
Health insurance (%)	32.50[b]	44.52	71.56
Retirement accounts (%)	8.30[b]	20.52	55.01
Payday loan (%)	7.92	6.07	1.73[a]
Pawn loan (%)	5.99	4.11	1.44[a]

[a] The mean differences of higher income entrepreneurs from low-income entrepreneurs and nonentrepreneurs are statistically significant at the .05 level.

[b] The mean differences of low-income entrepreneurs from higher income entrepreneurs and low-income nonentrepreneurs are statistically significant at the .05 level.

Table 4. Regression Analyses to Predict Financial Well-Being (*N* = 1,918)

	Low-Income Entrepreneurs		Low-Income Nonentrepreneurs		Higher Income Entrepreneurs	
Variables	*M1*	*M2*	*M1*	*M2*	*M1*	*M2*
Financial knowledge	-2.38	-2.32	0.19	0.79	2.75***	4.04***
Financial skills	0.33***	0.36***	0.26***	0.28***	0.32***	0.36***
Mainstream financial products (0–8)	1.42*		1.80***		1.73***	
Alternative financial products (0–5)		-3.21**		-3.01***		-1.53

Note. M1 = Model 1; M2 = Model 2.

*$p < .10$; **$p < .05$; ***$p < .01$.

Notes

1. Klapper, Laeven, and Rajan (2004); Lofstrom, Bates, and Parker (2014).
2. Galindo and Méndez (2014).
3. Sherraden (2013); see Figure 1 in this brief.
4. Consumer Financial Protection Bureau (2017).
5. *Financial well-being* is measured by the CFPB's validated, 10-item, 5-point, Likert financial well-being scale reported by survey respondents, with such items as "I could handle a major unexpected expense," and "I have money left over at the end of the month." The responses to these 10 items can be converted to a score ranging from 0 to 100. The sample range of the financial well-being scale in the survey is from 14 to 95.
6. *Financial knowledge* is indicated by a 10-item scale developed by Houts and Knoll (sample range is -2.05 to 1.27; Knoll & Houts, 2012; Lusardi & Mitchell, 2008). The scale includes items on such matters as understanding of long-term returns on investment, credit card minimum payments, and bonds and interest rates.
7. *Financial skill* is measured by a 10-item scale validated by the CFPB, with a theoretical range from 0 to 100 and a sample range from 5 to 85. For

example, the survey asked respondents whether they know how to make good financial decisions and how to save.

8. We count the number of financial products (from 0 to 8) owned by survey respondents as a proxy for financial access. Specified by the CFPB, *mainstream financial products* include a checking or savings account, retirement savings account, nonretirement investment, health insurance, and life insurance, pension, education savings account, and student loan. We count the *alternative financial products* (from 0 to 5) used by survey respondents as a proxy for negative financial access. Those products include payday loans, pawn loans, reloadable cash cards, nonbank services for international money transfers, and nonbank services for check cashing.

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