# Parental Financial Socialization and Financial Instability of Young Adults: The Mediating Role of Financial Capability Trajectory

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## Background

From a development perspective, "transition to adulthood" is defined as a distinctive transitional period (Arnett, 2000). As young adults are expected to establish financial independence from their parents, developing financial capability during the transition to adulthood can be viewed as a critical factor to lay the foundation for successful life outcomes (Lee & Mortimer, 2009). Despite challenging economic conditions, many young adults gain more independence over their financial status upon successfully negotiating developmental transitions (Schulenberg & Maggs, 2002). Some individuals, however, may not feel competent about their financial stability carrying substantial amounts of debt, which contributes to their future financial hardship (Roberts & Jones, 2001). Therefore, it is crucial for young adults to accomplish capabilities to manage their financial resources responsively during this transitional period (Lee & Mortimer, 2009).

Financial capability, including financial knowledge, skills, self-efficacy, and financial behaviors, is a key factor for the economic success of young adults (Taylor, 2011). The current study focuses on two components of financial capability: (1) financial self-efficacy and (2) financial behavior (i.e., borrowing behavior). Financial self-efficacy refers to how confident one is that she/he can perform a particular behavior and financial behavior is the action component of financial capability (Serido et al., 2014). Previous studies indicated that financial self-efficacy as a factor to influence unhealthy credit-card behavior (Xiao et al., 2011). In addition, previous research on psychology have indicated that self-efficacy is an antecedent of later behavioral change (Gutter & Çopur, 2011) and change in self-efficacy could be also induced by behavioral feedback (Gist, 1987). Although the two components of financial capability (i.e., self-efficacy and behavior) are closely related and can develop over time interacting each other, most previous research has focused on an impact of self-efficacy on financial behavior at single points in time, and little research has been done to examine the dynamic developmental process of financial capability and the interplay of two aspects of financial capability over time. Thus, research examining the developmental trajectories of financial capability and the interplay of two components of financial capability development is warranted.

Building upon consumer socialization theory (Ward, 1974), previous research has documented that young adults' financial capability is affected by financial socialization from parents, such as communication with parents (Lee & Mortimer, 2009). Young adults' financial capability, in turn, were shown to be associated with their economic well-being (Shim et al., 2009). However, most previous studies have examined with cross-sectional data or regression models, focusing on discrete financial status at single points in time. Less is known about the continuous developmental process involving young adults' financial capability

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stemming from earlier financial socialization environments and its contribution to young adults' later financial stability.

Therefore, the current study aims to examine the potential mediating role of the financial capability development to link early parental financial socialization to later financial stability among young adults in a single analytic framework. More specifically, the present study investigates how two components of financial capability (i.e., financial self-efficacy and borrowing behavior) develop over time and how these trajectories of financial capability mediate the linkage between parents' financial socialization and young adults' financial stability in later years. Our specific research questions are as follows:

1. Is parental financial socialization associated with financial instability of young adults in later years after controlling for young adults' sociodemographic characteristics?
2. Is parental financial socialization associated with changes in financial self-efficacy and borrowing behavior of young adults over time?
3. Do young adults develop inter- and intra-individual differences over time in financial self- efficacy and borrowing behavior?
4. Do young adults' trajectories of financial self-efficacy and borrowing behavior play roles as mediators that link parents' financial socialization to the financial instability of young adults?

## Method

### Participants

Data for this study came from a sample of young adults participating in a longitudinal study on young adults' financial behaviors. In 2008, baseline (Wave 1) data were collected from 2,098 respondents (age 18-21). The second (age 21-24), third (age 23-26), and fourth (age 26-29) waves of data were collected in 2010, 2013, and 2016, respectively. We accounted missing data using the full information maximum likelihood procedures, which minimize potential bias that would have influenced the results (Enders, 2001). The study sample included 1,999 respondents.

### Measurement

*Financial socialization (W1)*. Measured with three items to assess respondents' perception of communication quality with their parents regarding financial issues (e.g., I argue a lot with my parent(s) about money matters; reverse coding) (1=strongly disagree to 5=strongly agree).

*Financial self-efficacy (W2-W4)*. Measured with three items (e.g., I am satisfied with the way I pay my bills) (1=very unlikely to 5=very likely).

*Browsing behavior* (*W2-W4*). Measured with two items to indicate how often the respondent had engaged borrowing behaviors (i.e., borrowed money or took cash advance from credit cards; maxed out credit card limit) in the past 6 months (1=never to 5=very often).

*Financial instability (W4)*. Measured with a sum score of nine items to indicate how often the respondent had engaged in a set of activities (e.g., postponed medical or dental care; asked parents for money) within the past 6 months because they did not have enough money (0=never to 2=more than a few times).

*Control variables(W1).* Gender, parental SES (Coleman, 1983), and race/ethnicity were included as covariates in our analyses.

### Analysis Plan

We tested the theoretical model in a bivariate parallel latent growth curve (LGC) model in a structural equation modeling framework to estimate individual trajectories of financial self- efficacy and borrowing behavior using Mplus version 7 (Muthen & Muthen, 1998-2013). The significance of the indirect effects of parental financial socialization on young adults' financial instability were tested via bootstrapping method (Preacher & Hayes, 2008). Bias-corrected 95% confidence intervals (CI) were computed using 10,000 bootstrapped resamples for each indirect estimate. We used the comparative fit index (CFI ≥ .90) and root mean square error of approximation (RMSEA ≤ .06) to evaluate model fit (Enders & Bandalos, 2001).

## Results

Table 1 presents correlations among study variables as well as descriptive statistics of main study variables. As expected, parental financial socialization was positively associated with financial self-efficacy, while it was negative associated with borrowing behavior and financial instability. Financial self-efficacy was negatively associated with borrowing behavior and financial instability. Borrowing behavior was positively associated with financial instability.

Growth parameter estimates for unconditional univariate LGC models of financial self- efficacy and borrowing behavior are presented in Table 2. The results of financial self-efficacy showed significant means and variances of the initial level and a linear increase with adequate model fit. The results of borrowing behavior showed significant means and variances of the initial level and a significant linear decrease over time with acceptable model fit. Overall, young adults showed increases in financial self-efficacy and decreases in borrowing behavior across time.

Before testing our final conceptual model, we tested direct influence of parental financial socialization on young adult financial instability. Results showed early parents' financial socialization predicted lower financial instability among young adults in later years ($\beta = -.17$, $p < .001$). Then, we tested the model presented in Figure 1, the conditional parallel LGC models of the influence of parental financial socialization on young adult financial instability with control variables. Parental financial socialization positively influenced the initial level and slope of financial efficacy, suggesting that individuals whose parents showed higher levels of financial socialization exhibited higher levels of financial self-efficacy and increases in self-efficacy over time. On the other hand, parental financial socialization was negatively associated with the initial level of borrowing behavior but was not significantly associated with the slope of borrowing behavior. The initial level of borrowing behavior, in turn, negatively influenced the increase in financial self-efficacy over time, suggesting that higher initial level of borrowing behavior weakened the growth of financial self-efficacy development. Both higher initial levels and slope of financial self-efficacy contributed to lower financial instability among young adults. Higher initial levels of borrowing behavior contributed to higher financial instability.

## Discussion and Implications

Our findings showed increase in financial self-efficacy and decrease in borrowing behavior over time which allowed us to preserve the continuity of change in financial capability over time. We treated changes in financial capability as continuous processes unfolding over time and examined the associations between different factors of trajectories (i.e., initial level and slope) with earlier parental financial socialization and later financial instability. Parental financial socialization significantly influenced the development of financial capability. Policy makers should understand the carry-over effect of early parents' role to influence young adults' financial capability development and later financial stability. The results also indicated that the trajectory in financial self-efficacy contributed to later financial stability. Although changes in borrowing behavior was not significantly associated with financial instability, higher initial levels of borrowing behavior deteriorated the self-efficacy development and increased financial instability. Financial education programs designed to target early years of college students with topics of practical skills and knowledge for better "credit card use" may be effective to help young adults' financial self-efficacy development and later financial stability.

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Table 1. Descriptives and correlations of study variables

| Variables | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 1. Financial socialization | - | | | | | | | | | | |
| 2. Financial self-efficacy W2 | .20** | - | | | | | | | | | |
| 3. Financial self-efficacy W3 | .23** | .51** | - | | | | | | | | |
| 4. Financial self-efficacy W4 | .19** | .44** | .59** | - | | | | | | | |
| 5. Borrowing W2 | -.13** | -.27** | -.18** | -.13** | - | | | | | | |
| 6. Borrowing W3 | -.20** | -.11** | -.23** | -.12** | .27** | - | | | | | |
| 7. Borrowing W4 | -.12** | -.09** | -.12** | -.29** | .21** | .28** | - | | | | |
| 8. Financial instability | -.17** | -.17** | -.24** | -.29** | .12** | .19** | .28** | - | | | |
| 9. Gender (1=Female, 0=Male) | .08** | -.05 | -.05 | -.10** | -.06* | -.12** | -.05 | .09* | - | | |
| 10. Race (1=White, 0=Non-white) | .04 | .06* | .11** | .13** | -.10** | -.12** | -.17** | -.10** | .04 | - | |
| 11. Parental SES | .02 | -.01 | .04 | .08* | -.06* | -.08* | -.14** | -.07* | -.06** | .24** | - |
| Mean (SD) | 4.23 (.85) | 3.53 (.88) | 3.65 (.85) | 3.65 (.92) | 1.70 (.91) | 1.47 (.82) | 1.39 (.74) | 14.49 (3.72) | 62% | 68% | 9.71 (2.78) |
| Range | 1-5 | 1-5 | 1-5 | 1-5 | 1-5 | 1-5 | 1-5 | 8-26 | 0-1 | 0-1 | 2-17 |

*Note*. W = Wave. * $p < .05$. ** $p < .01$.

Table 2. Parameter estimates and model fit indices of unconditional and conditional LGC models of young adult financial instability

| | Unconditional financial self-efficacy | Unconditional borrowing behavior |
|---|---|---|
| | Mean (Variance) | Mean (Variance) |
| Financial self-efficacy initial level | 3.54*** (.42***) | - |
| Financial self-efficacy linear slope | .02** (.01**) | - |
| Borrowing behavior initial level | - | 1.68*** (.30***) |
| Borrowing behavior linear slope | - | -.05*** (.01*) |
| $\chi 2$ (*df*) | 5.11 (1) | 6.41 (1) |
| CFI | .993 | .96 |
| RMSEA | .052 | .06 |

*Note*. Unstandardized parameter estimates shown. CFI = comparative fit index; RMSEA = root mean square error of approximation.
* $p < .05$, ** $p < .01$, *** $p < .001$

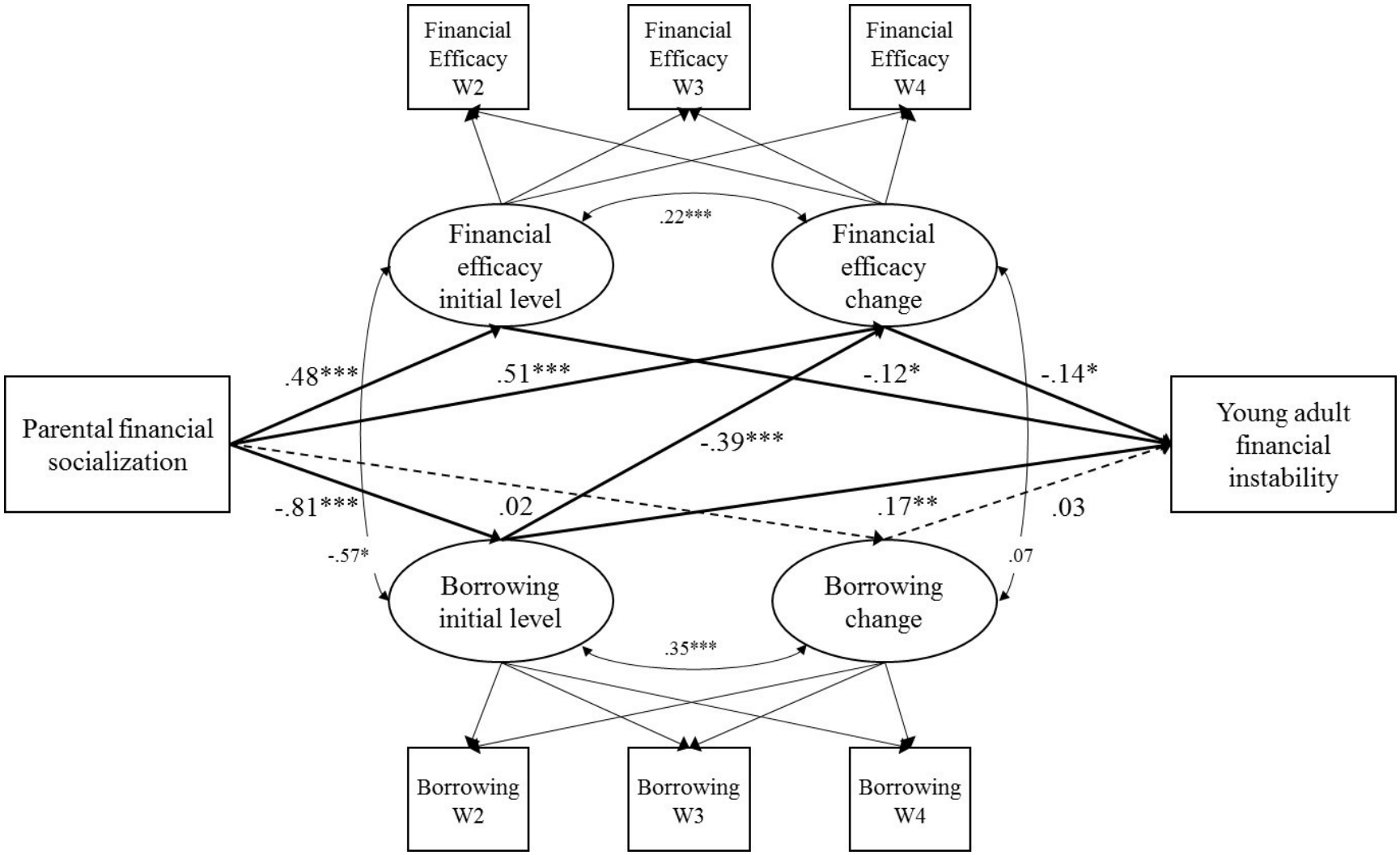


Figure 1. Bivariate latent growth curve of parental financial socialization, young adult financial self-efficacy, borrowing behavior, and financial instability. Standardized parameter coefficients shown. Young adults' gender, SES, and race/ethnicity were controlled, but pathways of control variables are not shown for the sake of clarity. Dashed paths indicate nonsignificant associations. Model fit indices: $\chi^2(df) = 125.31(25)$; CFI = .937; RMSEA = .045. * $p < .05$, ** $p < .01$, *** $p < .00$