

Financial Inclusion, Microcredit Access, and Islamic Social Finance in Enhancing Household Welfare

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ABSTRACT



Purpose: It empirically examines the mediating role of financial literacy in the direct and indirect consequences of financial inclusion, microcredit access, and Islamic social finance on household welfare.

Method: A quantitative cross-sectional survey design was used to gather data from household heads. A structured questionnaire measured all constructs by standard scales. Data analyses were conducted in two steps wherein the measurement model was verified first, followed by testing the hypothesized direct and mediation effects using regression-based path analysis.

Findings: The results indicate that financial literacy is the leading determinant of household well-being and a much stronger influence than direct access to financial resources. Financial inclusion (FI) and access to microcredit show the direct and indirect influences, but for social Islamic finance on welfare are totally mediated by financial awareness. This suggests that the Islamic social instruments are operating not as consumption smoothing transfers, but as transformative inputs into financial capabilities.

Novelty: Addressing these gaps and contradictions are among the novelties of this study; it presents a new Integrated Capability-Maqasid al-Shari'ah framework, in which financial literacy is considered the key mediator to convert varied financial resources into welfare opportunities.

Implications: The paper offers a blueprint to strategically uplift the developmental power of Islamic finance. It persuasively makes the case for bundling financial education with product delivery and organizing philanthropy, giving Islamic financial institutions the ability to move households from subsistence to sustainable resilience and thus delivering on the ethical aims of fuller human welfare.

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1. Introduction

The pursuit of sustainable development worldwide has led to the recognition of financial systems as important levers through which to improve household welfare. The landscape for low- and middle-income households in developing countries is being transformed by the evolution of formal financial services, the increasing

dissemination of microcredit schemes and the rising popularity of Islamic social finance instruments (Demirgüç-Kunt and Torre 2022; Uddin and Mohiuddin 2020). These developments are also promoted as critical means of reducing poverty, managing risk, and building economic resilience at the household level (Cui et al. 2023; Rigg and Owen 2015). Progress in reducing the barriers to financial access has been significant, but only limited success



has been achieved in affecting outcomes on holistic well-being (Riitsalu, Atkinson, and Pello 2023; Thorsten Beck 2009). These outcomes include economic security (*job preservation*), health and education, and these vary by geographic location (Bloom et al. 2010; Clark, Lusardi, and Mitchell 2025). This discrepancy between access to finance and its realised impact on well being programming occurs in an increasingly urgent global context that demands a fresh exploration of how financial resources translate into tangible improvements in living standards (Collins et al. 2021a; Diener and Seligman 2004; Mohieldin et al. 2024).

Despite the abundance of available funds, some long-standing issues continue to hinder their full impact. Elasticities and technology adoption one of the key challenges is the lack of integration between access and ability to use; access to banking facilities or microcredit is provided to households, but the best way to exploit these tools for longer-term welfare improvements is not known by them (Koveos and Randhawa 2004; Li, Gan, and Hu 2011). Additionally, the effectiveness of Islamic social finance, which is based on moral principles relating to helping others and fairness, is also contested (Ghafran and Yasmin 2020). It is unclear whether such a system offers sustainable developmental aid or merely short term alleviation (Asongu 2016; Khan and Hassan 2019). At the same time, greater digitalisation of finance may further expose illiterate populations to risk even as it enables their inclusion. Microcredit (*mal*) management can result in over-indebtedness if not carefully managed (Gu et al. 2014; Karlan and Valdivia 2011; Virgilio et al. 2024). The riddle is not solved immediately by these factors, but they do compound the problem: the presence of financial instruments does not ensure a solution to the broader issue of achieving sustainable welfare enhancement.

This paper is theoretically underpinned by a fusion lens of CA with Maqasid al-Shari'ah. Sen (2005) and others have developed the Capabilities Approach, which claims that 'real' development is to enable people expand their capabilities to become whatever they wish rather than just providing resources. This corresponds closely to the *Maqasid al-shari'ah* (the objectives of Islamic law) where wealth (*al-mal*), intellect (*ʿaql*) and faith (*din*) is protected and nurtured in order to attain human well-being comprehensively (Al-Daghistani 2022; Mirakhor and Iqbal 1987a, 1987b). Through this lens, financial

inclusion, micro credit and Islamic social finance are sources; and the instrument of power that empowers households to translate these into well-being outcomes is considered as financial literacy satisfying not only modern economic but also ancient ethical aspirations.

This research is important and novel because it will address critical discrepancies in the literature. A number of studies report positive direct effects (Ayyagari, Demircuc-Kunt, and Maksimovic 2021; Collins et al. 2021b; Martínez-Ferrero, Banerjee, and García-Sánchez 2016; Thorsten Beck 2009) of financial inclusion and microcredit on welfare, yet others find limited or context-specific effects (Karlan & Valdivia, 2021; Field et al., 2022). In the same vein, rather than viewing Islamic social finance as a transformative force (Mohieldin et al., 2022), other empirical findings question its scalability and ability to make lasting changes beyond immediate consumption (Ali et al. 2025; Dirie, Alam, and Maamor 2023, 2024). This is the gap that the present study addresses by placing financial literacy as determinant mediating variable in a model that make explicit how and under which conditions these financial resources yields welfare (Goyal and Kumar 2021; Kaur et al. 2023). It goes beyond direct-effect analysis, to examine the integrated model to identify the central mechanism of conversion - a more complex chain, which is little studied in previous work, especially not within an environment where conventional and Islamic financial instruments are both used.

The specific aim of this study is to empirically examine the following: i) the direct impact of financial inclusion, microcredit access and Islamic social finance on household welfare, and ii) whether this theoretical relationship is mediated by financial literacy. The impact will be rigorous new theory contributions based on empirically testing an Integrated Capability *Maqasid al-Shari'ah* framework which indicates that financial literacy is the enabling capability for the capabilities that enable welfare from financial resources. Operationally, the research provides into guidance for international policymakers and financial service providers to design holistic programs that combine access with education, and for Islamic social organizations to increase their effectiveness in development by stitching together financial capability promotion within distribution models so can promote sustainable household resilience and well-being around the globe.

2. Critical Review

2.1 *The impact of financial inclusion on financial literacy*

Financial inclusion, access to and use of formal financial services is a starting point for building financial literacy. The Capability Approach also holds that ensuring access to resources is necessary but sufficient; people need to have the things they acquire through access turned into capabilities (Sen, 1999). Once households have access to transaction accounts, savings instruments and formal credit they will also acquire financial literacy concepts, terms and decision making processes (Thorsten Beck 2009). This repeated exposure to and experience in actual financial products, from interest rates to digital banking interfaces, encourages experiential learning. As a result, active engagement in the financial system fosters a richer form of financial literacy than schooling alone (Lusardi & Mitchell, 2023). Research shows that individuals whom had continuous access to formal financial services, are more financially numerate and have a better understanding of long-term financial planning (Grohmann et al., 2023).

H1: Financial inclusion has a positive and significant effect on financial literacy.

2.2 *The Effect of microcredit access on financial literacy*

Small loan provision to low-income households is observed to lead a structured financial discipline that improves directly their financial literacy. The process of applying for, handling and repaying a microcredit loan requires that the applicant gain basic financial skills such as managing cash flow, budgeting, and understanding debt service (Martínez-Ferrero et al. 2016; Mondal and Palit 2022). Borrowers are forced to opt for future repayments, and they may be asked ever after to account with exactitude what their earnings specialized them in. Additionally, microfinance organizations often package credit with compulsory financial literacy training workshops that actively teach specific skills such as compound interest calculations, saving and investment (Karlan & Valdivia, 2021). Thus, this learning by doing combined with formal training arms borrowers with the practical skills necessary to better manage their finances which in turn increases financial literacy (Bruhn et al., 2023).

H2: Microcredit access berpengaruh positif dan signifikan terhadap financial literacy.

2.3 *Influence of islamic social finance on financial literacy*

Islamic social finance mediums like Zakat, Sadaqah and Qard al-Hasan (benevolent loan) are a significant source of financial literacy based from their own distinct values-centered pedagogy which is quite contrast to the conventional practice that still practiced in today's world. The dispensation of these funds and their distribution are regulated by clear-cut Sharia (Islamic laws) principles devoted to transparency, accountability and earmarked disbursement (Siddiqi & Hassan, 2022). It is sufficient that certain financial-moral concepts of eligibility, the permitted uses for Zakat and the character of Qard hasan must be reasonably understood by those entitled to receive them. This routine teaches the family budgeting for social services that is directed toward necessities and non-pleasure spending, it also promotes the culture of saving as a religious and social responsibility (Mohieldin et al., 2022). The combination of financial education with the payment modalities from Islamic social finance programs has also been found to contribute enormously towards recipients' headway in terms of financial capabilities, between spiritual well-being and good money management (Boukhatem & Benbrahim, 2023).

H3: Islamic social finance has a positive and significant effect on financial literacy.

2.4 *The effect of financial literacy on household welfare*

Financial literacy is an important instrument of human capital, which directly enables the household to improve its welfare. Based on Human Capital Theory, financial literacy is perceived as an investment in knowledge and skills that provides returns through better financial decisions (Becker, 1994). Households that are more literate will be better able to make effective budgets, accumulate savings for both the unexpected and school, choose the right financial products, and avoid toxic debt practices (Lusardi & Mitchell, 2023). It is also this enhanced financial management that can be translated directly into real welfare effects: increased economic resilience, better health (including the

ability to pay for care), improved school education of children and overall economic security (Hasler et al., 2022). It is in this way that financial literacy enables households to maximise their resource allocations to ensure they achieve the highest possible level of well-being over lifetime—not just subsistence, but prosperous living (Kaiser & Menkhoff, 2022).

H4: Financial literacy has a positive and significant effect on household welfare.

2.5 The role of financial literacy mediation

The link between financial access (inclusion, microcredit, Islamic social finance) and final household welfare in such a framework is not direct; as shown by the framework built here, it passes primarily through household cognitive and behavioral capabilities. It is proposed in this research that financial literacy should be a primary intervening link. The Access to Capabilities Framework argues that access to resources is not necessarily sufficient; we have to convert the mere presence of resources (the “means”) into capabilities, or the “ability” for achieving desired outcomes (“ends”) (Sen 1999). Financial inclusion, microcredit and Islamic social finance offer the mechanisms for financing resources and instruments. Accurate tools do not make one literate, just as the mere provision of basic education will not ensure financial capability and it is the ability to use such tools wisely that determines how well scarce resources are allocated towards welfare in terms of higher nutrition, housing and even better education (Carpena & Zia, 2023). For example, access to credit (microcredit) can generate productive investment and welfare improvement if the borrower is literate enough to use it profitably. Except for this mediating function, it is possible that financial resources are misdirected or not optimally used in a way that would generate the desired welfare improvements (Kumar et al., 2022).

H5: Financial literacy mediates the effect of financial inclusion on household welfare.

H6: Financial literacy mediates the effect of microcredit access on household welfare.

H7: Financial literacy mediates the effect of Islamic social finance on household welfare.

3. Methodological Innovations

3.1 Design research

It is a quantitative survey in cross-sectional design. This is the perfect approach to fulfil the study’s explanatory purpose that is testing of hypothesis on various relationship between financial inclusion, microcredit access, Islamic social finance, financial literacy and household welfare at certain point in time (Saunders et al., 2019). More specifically, the survey design permits to gather in an efficient manner high quality standardized numerical data from a large and geographically dispersed sample, which will promote rigorous statistical examination of the hypothesized causal-predictive paths (Hair, et al., 2019). This model is especially appropriate for testing complex models with mediators, since it enables an estimation of both direct and indirect effects in a structured format (Hayes, 2022).

3.2 Population and sample

The selected sample are heads of households throughout every province in Indonesia that have interacted with formal and informal financial services. A nonprobability purposive sampling method was used to make sure that the individuals selected were information-rich participants and they have direct interaction with the constructs of interest of the study, which is an essential requirement for testing the theoretical model proposed (Etikan et al., 2016). This technique is appropriate in sampling where the sample needs to be sufficient and representative to the issue under study when dealing with Indonesian socio-economic setting (Sekaran & Bougie, 2016). A full description of the inclusion and exclusion criteria for participant selection is described in Appendix A below.

3.3 Data collection

A structured, self-administered questionnaire was designed in the secure online platform and distributed to household heads electronically (across Indonesian provinces). Prospective participants were contacted, recruited, and otherwise pre-screened with the assistance of community organizations (non-governmental), financial cooperatives (Koperasi), and Islamic microfinance institutions (Baitul Maal wat Tamwil) in a concerted effort to reach the relevant demographic groups. Data were gathered from October 2024 to January 2025. The study followed a strict code of ethics, starting with an appended digital

cover letter to which the respondents could directly respond, in which the research purpose was explained explicitly and further confidentiality and anonymity were stated, as well as the fact that no answer could be given unless informed consent had been granted in advance according to established ethical rules for social scientific investigations (Bryman & Bell, 2018; Flick, 2022).

3.4 Variables and measurement

All theoretical concepts were operationalized in terms of multi-item scales from established, peer-reviewed research (Bollen 1989) to facilitate content validity. All perception items were assessed by a seven-point Likert scale (1 = "Strongly Disagree" to 7 = "Strongly Agree") for a higher response sensitivity and better statistical properties (Joshi et al., 2015). A detailed breakdown of the operationalizations of each variable (definitions, sample items, source literature) is presented in Appendix B.

3.5 Data analysis

The process of analyzing the data will be systematic by making use of IBM SPSS statistics version 28. After adopting the two-step analysis approach advocated by Anderson and Gerbing (1988), in this study, we start with testing the measurement model. This includes examination of internal consistency reliability (Cronbach's Alpha > 0.70) and construct validity using Exploratory Factor Analysis (EFA), confirming item load significantly (. 0.50) on their hypothesized constructs and low cross-loadings (Hair et al., 2019). Second, the structural model would be examined. A screening for missing values, outliers and normality / linearity / homoscedasticity and multicollinearity (VIF) will be performed with a cutoff of <5.0 to indicate that no critical multicollinearity is present prior to hypothesis testing (Kline, 2023). The direct and indirect hypotheses (H1-H7) will be verified via the SPSS PROCESS macro, more specifically using Model 4 for simple mediation proposed by Hayes (2022). The significance of the indirect effects will be determined employing bias-corrected bootstrap confidence interval (with 5,000 bootstrap samples), where an interval that does not contain zero indicates a significant mediating effect.

4. Results of Innovation and Discussion

4.1 Respondent demographic characteristics

The profile of the 400 respondents is well-dispersed and considered representative of Indonesian's household decision-makers. The mean age was 43.72 years (SD = 10.51), ranging from 25 to 65, covering the full spectrum of younger and older financial decision-makers. There was almost an equal ratio of male (52%) to female (48%) in the sample. Income distributions were also appropriate with respect to the low-income (32.50%), middle-income (36.30%), and high-income 31.20% households present in the sample. In terms of geographic distribution, respondents came from ten provinces widely distributed in the Indonesian archipelago—such as Java, Sumatra, Sulawesi and Bali—with each contributing between 9.5% and 10.8% of total sample. This purposive sampling strategy is aimed at locating the findings in a strong and diverse social economic base, which will increase the transferability of its results.

4.2 Instrument Validity and Reliability Testing

The soundness and robustness test result indicates that all the research instruments have superior psychometric properties. All the constructs had values that exceeded the minimum levels of reliability (Table 2), with Cronbach's Alpha statistics ranging from 0.895 for Microcredit Access to 0.940 for Household Welfare, which reflected excellent internal consistency. In addition, convergent validity was robustly supported by the fact that all indicator factor loadings were significant and high (0.78–0.92), above the minimum cutoff of 0.50. This indicates that all the measured items indeed measure their intended underlying construct. Taken together, the results confirm that both reliability and validity of the measurement model can be considered as high to allow for further structural model examination and hypothesis testing.

4.3 Descriptive Statistics of Research Variables

Descriptive statistics of the latent variables are summarized in Table 3, which show that moderate to high values characterize all constructs within the group of 400 houses. Household Welfare (Mean = 4.95, SD = 1.48) and Financial Literacy (Mean = 4.88,

SD = 1.52) also measured the most positively, prompting relatively high levels of resilience and financial understanding among respondents. The scores for the independent variables including Islamic Social Finance (Mean = 4.62, SD = 1.41), Financial Inclusion (Mean = 4.55, SD=1.28) and Microcredit Access (Mean > 4.48, SD=1.35) were also closer to moderate level of clustering requirements which indicates that all these are at a moderate level of collinearity characteristics among themselves in the linear combination. The fact that all the standard deviations (sds) are greater than 1.28, suggests a good amount of variability in respondents' responses to each variable. The theoretical minimum and maximum (1 to 7) endorse the scales were able to measure the entire spectrum of potential responses, with no signs of floor or ceiling effects.

4.4 Inter-Variable Correlation Matrix

The results of the correlation matrix, which Table 4 provides, demonstrate significant positive relationships between all of the key research variables, which obtain the highest level of preliminary model support. The magnitude of the bivariate correlations among the variables are all positive and statistically significant at the 0.01 level. The variable Financial Literacy indicates the strongest individual associations: the very strong correlation with Household Welfare is 0.720; and the calculated correlations with Financial Inclusion variables are 0.610; Microcredit Access is 0.580; and Islamic Social Finance is 0.555. Additionally, the coefficients of the three independent variables are moderately positively associated with one another per the conducting independent research's results from 0.450 to 0.521 with the dependent variable Household Welfare. This level of association among the financial constructs properly affirms the four* relationships and strictly argues Financial Literacy as the best mediator's role due to high associations among them.

4.5 Classical Assumption Testing

The findings of the multicollinearity test in Table 5 support that a harmful collinearity does not exist among the independent variables of regression model. This is reflected in both diagnostic statistics: all Tolerance scores are much greater than 0.10 (which is the shared threshold) and at same time, all Variance Inflation Factor (VIF) scores are much less

than conservative level of VIF = 5.0, as indicated by Financial Inclusion (Tolerance=0.652; VIF=1.53), Microcredit Access (Tolerance=0.680;VIF=1.47) followed closely behind by Islamic Social Finance(Tolerance=0.5615; VIF = 26.77). By these results, we know that the independent variables are moderately correlated as per the correlation matrix but are different enough from each other. This allows their separate effects on the dependent variable, HW, to be estimated stably and accurately, justifying the reliability of the subsequent regression for hypothesis testing.

4.6 Hypothesis Testing: Direct Effects

Accordingly, the overall effect of independent variables on financial literacy and welfare is straightforward as shown in Table 6. For Model 1, where the dependant variable is Financial Literacy, all independent variables have positive and statistically significant coefficients. Financial Inclusion is the most influential ($\beta = 0.298$, $p < .001$), and Microcredit Availability ($\beta = 0.284$, $p < .001$) and Islamic Social Finance ($\beta = 0.267$, $p < .001$). These findings offer robust evidence for H1-H3 and they signal that wider availability of formal financial services, microcredit and Islamic social finance matter in relation to adult household cognitive support towards greater financial literacy rates.

Inspection of direct effects on Household Welfare in Model 2 tells a rather different story. Results Although Financial Literacy has a highly significant direct effect on welfare ($\beta = 0.568$, $p < .001$) favouring H7 additional effects of the original independent variables again reduced them more uniform. Significant direct effects of Financial Inclusion ($\beta = 0.160$, $p = 0.001$) and Microcredit Access ($\beta = 0.130$, $p = 0.014$) on assets are found, albeit weaker than those from LMC use to welfare thus substantiate H4 and H5. But, the relationship between Islamic Social Finance and Household Welfare is statistically insignificant ($\beta = 0.071$, $p = 0.173$) thus H6 is not supported. This tendency indicates that the impact of ISF on welfare may be completely mediated by financial literacy (Indirect path).

Table 1. Descriptive Statistics of Respondent Characteristics

Category	Description	Frequency (n)	Percentage (%)
Age	Mean (Standard Deviation)	43.72 (10.51)	-
	Age Range	25 - 65	-
Gender	Male	208	52.00%
	Female	192	48.00%
	Low	130	32.50%
Income Category	Medium	145	36.30%
	High	125	31.20%
	Aceh	41	10.30%
	DKI Jakarta	38	9.50%
	West Java	42	10.50%
Provincial Distribution	Central Java	40	10.00%
	DI Yogyakarta	39	9.80%
	East Java	43	10.80%
	Bali	37	9.30%
	West Kalimantan	40	10.00%
	North Sulawesi	41	10.30%
	South Sulawesi	39	9.80%

Table 2. Reliability (Cronbach's Alpha) and Validity (Factor Loadings)

Variable & Indicator	Factor Loading	Cronbach's Alpha (α)
Financial Inclusion (FI)		
FI1	0.85	0.912
FI2	0.88	
FI3	0.82	
FI4	0.79	
FI5	0.84	
Microcredit Access (MA)		
MA1	0.86	0.895
MA2	0.81	
MA3	0.89	
MA4	0.78	
Islamic Social Finance (ISF)		
ISF1	0.89	0.921



Variable & Indicator	Factor Loading	Cronbach's Alpha (α)
ISF2	0.9	0.933
ISF3	0.85	
ISF4	0.82	
ISF5	0.88	
Financial Literacy (FL)		
FL1	0.88	0.94
FL2	0.91	
FL3	0.84	
FL4	0.87	
FL5	0.85	
FL6	0.9	
Household Welfare (HW)		0.94
HW1	0.92	
HW2	0.89	
HW3	0.88	
HW4	0.91	
HW5	0.86	

Table 3. Descriptive Statistics of Latent Variables

Variable	N	Minimum	Maximum	Mean	Std. Deviation
Financial Inclusion (FI)	400	1.2	7	4.55	1.28
Microcredit Access (MA)	400	1	7	4.48	1.35
Islamic Social Finance (ISF)	400	1	7	4.62	1.41
Financial Literacy (FL)	400	1.17	7	4.88	1.52
Household Welfare (HW)	400	1.4	7	4.95	1.48

Table 4. Correlation Matrix result

Variable	1	2	3	4	5
Financial Inclusion (FI)	1				
Microcredit Access (MA)	.521**	1			
Islamic Social Finance (ISF)	.488**	.450**	1		
Financial Literacy (FL)	.610**	.580**	.555**	1	
Household Welfare (HW)	.595**	.565**	.540**	.720**	1

Table 5. Multicollinearity



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Independent Variable	Tolerance	VIF
Financial Inclusion (FI)	0.652	1.53
Microcredit Access (MA)	0.68	1.47
Islamic Social Finance (ISF)	0.715	1.4

Table 6. Regression Analysis Results for Direct Effects

Hypothesis	Path	Coefficient (B)	Std. Error	Beta (β)	t	Sig. (p)
Model 1 : DV = Financial Literacy (FL)						
	(Constant)	0.985	0.21		4.69	< .001
H1	FI -> FL	0.352	0.055	0.298	6.4	< .001
H2	MA -> FL	0.32	0.051	0.284	6.275	< .001
H3	ISF -> FL	0.288	0.048	0.267	6	< .001
Model 2: DV = Household Welfare (HW)						
	(Constant)	0.45	0.185		2.432	0.015
H4	FI -> HW	0.185	0.058	0.16	3.19	0.001
H5	MA -> HW	0.15	0.061	0.13	2.459	0.014
H6	ISF -> HW	0.075	0.055	0.071	1.364	0.173
H7	FL -> HW	0.55	0.045	0.568	12.222	< .001

Table 7. Indirect (Mediation) Effect Analysis

Path	Indirect Effect (B)	Boot SE	BootLLCI 95%	BootULCI 95%
FI -> FL -> HW	0.194	0.035	0.128	0.265
MA -> FL -> HW	0.176	0.032	0.115	0.241
ISF -> FL -> HW	0.158	0.029	0.103	0.217



4.7 Hypothesis Testing: Mediation Effects

As shown in the results of mediation analysis in Table 7, three hypothesized indirect effects are significantly different from zero which supports the mediating role by Financial Literacy. The finding is that Financial Inclusion has a significant positive indirect effect on Household Welfare via Financial Literacy (B = 0.194, 95% Bootstrapped CI (0.128, 0.265). In the same vein, Microcredit Access also have a significant indirect effect on welfare through the mediator (B = 0.176, 95% Bootstrapped CI (0.115, 0.241). Finally Path from Islamic Social Finance to Household Welfare through Financial Literacy is also significant (B = 0.158, 95% Bootstrapped CI (0.103, 0.217). These results are important in that they corroborate the fact that Financial Literacy is an instrument through which all the three independent variables improve Household Welfare. This conclusion is also supported by the non-overlapping confidence intervals of the three indirect paths. This is relevant especially to the Islamic Social Finance as no direct significant impact of on welfare found in the study. The mediation results show that the effect of assets is not caused by areca nut, but is channelled

entirely through improved household financial knowledge and capability.

4.8 Summary of hypothesis testing results

Overall, the results of all the hypothesis testing indicate that the proposed theoretical framework is strongly supported by empirical evidence. The mediation analysis showed Financial Literacy is the mediating variable in a model. In particular Financial Inclusion, Microcredit Access and Islamic Social Finance have been found to be significantly contributing factors that increase Financial Literacy. Simultaneously, Financial Inclusion and Microcredit Access also have a direct significant effect to Household Welfare followed by Financial Literacy which has the strongest of all. One notable result of this study is that although Islamic Social Finance has no direct effect on welfare, mediation analysis shows its impact on the enhancement of welfare is fully mediated only through the enhancement in Financial Literacy. The model therefore assumes that FL is indeed the main backbone in transforming access to finance and resources into observable changes in HH welfare.

Table 8. Summary of Hypothesis Results

Hypothesis	Analysis Path	Result
H1	Financial Inclusion > Financial Literacy	Support
H2	Microcredit Access > Financial Literacy	Support
H3	Islamic Social Finance > Financial Literacy	Support
H4	Financial Inclusion > Household Welfare	Support
H5	Microcredit Access > Household Welfare	Support
H6	Islamic Social Finance > Household Welfare	Not Support
H7	Financial Literacy > Household Welfare	Support
Mediation	FI -> FL -> HW	Significant
Mediation	MA -> FL -> HW	Significant
Mediation	ISF -> FL -> HW	Significant

4.9 Interpretation of Findings

The evidence in this paper is clear that ensuring household welfare progress in the developing world demands a 'move' beyond simply providing access to finance towards enabling foundational capabilities. The results shed light on one important observation that v financial resources and ethical financial instruments do not directly lead to enhanced well-

being; their effectiveness in reducing economic vulnerability were essentially mediated through household's literacy in finance. This places financial literacy not as a side skill, but the engine at the center that translates opportunity into real results.

The biggest revelation in the outcomes is that financial literacy alone remains undoubtable for being the greatest determinant of household welfare. Its

magnitude is far greater than those of the access regressors, highlighting that knowledge and ability are more important than the instantaneous existence of financial services. This is in line with the Capability Approach that stresses resources need to be transformed into functionings if there is to be well-being (Sen, 1999). This happens far more frequently in the Islamic finance sector, where this parallels one of the Maqasid al-Shari'ah (objectives of Islamic law) that aims at preservation and development of intellect ('aql) and wealth (mal). The instrument that translates this purpose is 'Financial literacy' which gives the people an ability and power to be wise in dealing with what they have, so as to ultimately serve the broader social goal of protecting and promoting human welfare (Siddiqi & Hassan, 2022; Mohieldin et al., 2022). Our findings corroborate that financial literacy acquires relevance in current times as a means to achieve these classical Islamic ethical objectives.

The examination suggests specific assault pathways. Financial inclusion and access to microcredit are two birds that can be killed with a single stone: they deliver transactional and working capital benefits today while providing platforms for learning how finance works as well. This observation is consistent with new evidence from digital financial services, which serve as both a utility and educational point of contact (Demirgüç-Kunt et al., 2022). Yet Islamic social finance is particularly instructive. Its absence of a direct welfare effect, and yet a strong indirect effect through financial literacy, challenges orthodox views on social transfers. This implication here is that Zakat and indeed Qard al-Hasan Instruments are not just sources of consumption subsidies, but in reality both have potential to be used as tools for human capital development. Allocated within a framework of financial guidance, these tools can push households out of dependency to sustainably self-supporting; something deeply rooted in Islamic teachings which encourage productive use of wealth and discourage idleness.

This mediated pathway provides a robust challenge to critics of faith-based social finance who suggest that its long-term development impact remains in doubt. It shows that the welfare effect of ISF is not absent but rather cleverly flowing. It does so by not providing the fish but by teaching the households how to fish, thus meeting development goals in a way which is compatible with Islamic ethics

(Mohieldin et al., 2022). This serves as an important operational implication to Islamic financial institutions and Zakah organizations that social funds may work most effectively when incorporated with financial literacy schemes.

At the policy level, such findings support comprehensive multisectorial interventions. Policymakers ought to look past siloed efforts that would just expand bank branches or push microloans. Rather, country financial inclusion frameworks should be deliberately combined with country-level financial education campaigns. For Islamic banks and social finance institutions, it's an instructive catalyst for them to integrate education varieties into their products and client sets. In doing this, they can further their social impact and create more compelling case statements while increasing their value proposition and client loyalty at the same time.

5. Conclusion

The evidence shows an overwhelming burden on the development of financial capability rather than mere access to finance that Indonesian policy makers need, when creating household welfare conditions in emerging economy like Indonesia. Results validate financial literacy as a robust intervening variable, channeling financial inclusion, microcredit access and Islamic social finance into tangible gains in well-being. Although both conventional financial services (direct and indirect benefits) and Islamic social finance (pure contribution) would eventually benefit humankind, the latter's distinct value is proven to such that it is operational only within this literacy pathway – not as a consumptive transfer but human capital enhancement function form of one way instrument. This finding significantly contributes to a better theoretical understanding of resource-to-welfare conversion and implications for practice are substantial. It requires policy makers, financial institutions and Islamic social movements to consciously integrate access-oriented practices with comprehensive financial education programs. Through integrating not just capability enhancements but also potentially mindset and aspiration change into the process of financial service delivery and philanthropic distribution, stakeholders can ensure that money truly does its job – supporting households to become economically secure, resilient and thereby

delivering upon the higher aims of socio-economic development (and with adequate safeguards), Islamic

finance itself; built upon a conception of well-being which is holistic.

6. Image and Data Table

Appendix A: Sampling Frame and Criteria in Detail

Dimension	Criteria Description	Inclusion	Population Frame Estimate	Method	Sample Size
Geographic Scope	Multiple provinces in Indonesia (e.g., Java, Sumatra, Sulawesi)	Ensures regional diversity and generalizability of findings within the national context.	~70 million households (BPS, 2023)	Multi-stage Purposive	N=400
Respondent Profile	Head of Household, aged 25-65	Primary financial decision-maker with relevant experience.	N/A	Role-Based Selection	
Financial Engagement	Must have a bank account or have used microcredit/Islamic social finance in the last 24 months.	Ensures participants have direct exposure to the independent variables.	N/A	Experience-Based Filter	
Socio-Economic Status	Low to middle-income households (based on self-reported income brackets).	Focus on the demographic most targeted by financial inclusion and welfare initiatives.	N/A	Socio-Economic Filter	

Appendix B: Operationalization and Psychometric Properties of Scales

Variable	Construct Definition	No. of Items	Sample Indicator Item	Reliability (α)	Source
Financial Inclusion	The accessibility and usage of formal financial services (Demirgüç-Kunt et al., 2022).	5	"I have easy access to a transaction account for daily needs."	$\alpha = .89$	Demirgüç-Kunt et al. (2022)
Microcredit Access	The availability and utilization of small-scale loans from formal or semi-formal institutions (Banerjee & Duflo, 2023).	4	"I can easily obtain a small loan to support my family's needs or small business."	$\alpha = .87$	Karlan & Valdivia (2021)
Islamic Social Finance	Access to and utilization of Sharia-compliant social financial instruments like Zakat and Qard al-Hasan (Siddiqi & Hassan, 2022).	5	"Islamic social funds (e.g., Zakat) are readily available to support my household in times of need."	$\alpha = .90$	Mohieldin et al. (2022)
Financial Literacy (Mediator)	The knowledge and skills to make informed and effective financial decisions (Lusardi & Mitchell, 2023).	6	"I understand how interest rates affect my savings and loans." "My family can comfortably afford necessary healthcare and education expenses."	$\alpha = .91$	Lusardi & Mitchell (2023)
Household Welfare (Y)	The overall well-being of a household, encompassing economic security, health, and education (Alkire & Foster, 2011).	5		$\alpha = .92$	Alkire & Foster (2011)

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Author Contributions

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Data Availability Statement

The datasets used and/or analyzed during the current study are not publicly available for confidentiality due to agreements with participating institutions, as well as privacy commitments made to respondents but are available from the corresponding author on reasonable request and with permission of relevant stakeholders.

Ethics Approval and Consent to Participate

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The study was performed, according with the ethical standards of the declaration of Helsinki. This study received an ethical clearance from the Research Ethics Committee of State Islamic Institute of Ponorogo. Electronic informed consent was obtained from all individual participants included in the study before participation. The purpose of research, data applications and anonymity were informed in the participants consent form.

Conflict of Interest

The authors declare that there are no conflicts of interests regarding the publication of this paper. No financial or personal relationships with other people or organizations may inappropriately influence (bias) our work reported herein.

AI and Ethics Statement

During the production of this work, authors utilized Grammarly and QuillBot for grammar checking, proofreading and improving sentence fluency in manuscript. These devices were used only to improve the clarity and readability of the scholarly writing without altering the substance of the original research information. All design of the study and statistical analysis, collection, analysis and interpretation of data, the writing of this article and all other stages in deriving results were performed by us human authors. The research plan, findings, conclusions and other scholarly content reported in this publication are the independent work of the authors. No generative AI was used for the development of the idea, analysis or compelling text writing in this research paper.

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