Financial Literacy and SMEs in APEC

Purpose: Information
Submitted by: Chair
Financial Literacy and SMEs in APEC

14 March 2014

APEC SME Working Group Chair’s Team
I. Introduction

Since the early 2000s, the issue of financial literacy has grown increasingly important in national discourses on education and the economy among international policymaking circles. The issue gained more urgency following the 2008 global financial crisis which was prompted in part by consumers making faulty investments and taking subpar loans that exposed them to heightened risk. Proponents argue that financial education allows citizens to make more informed financial decisions, leading to better personal economic outcomes and, on a macroeconomic level, a more dynamic and higher-growth economy. Seizing on the perceived international momentum on the issue, international bodies like APEC and the OECD have strongly encouraged their economies to create national financial education strategies. However, many of these strategies have emphasized financial education at the individual level, often focusing on young children and adults. There is significant evidence that providing the owners and managers of small and medium enterprises (SMEs) with specialized financial education can provide important economic benefits to their companies, making them more cost-efficient and dynamic.

This paper will explain the need for financial literacy on an individual, organizational and systemic level, and provide information on current financial literacy initiatives in APEC and other international bodies. It will finish by providing recommendations on specific actions that the APEC Small and Medium Enterprises Working Group can take to further encourage financial education for SMEs.

II. The Importance of Financial Literacy

While definitions vary slightly, there is a general consensus that possessing financial literacy implies having a grasp and understanding of basic financial concepts and tools. The United States Financial Literacy and Education Commission defines financial literacy as the

\[
\text{ability to make informed judgments and to take effective actions regarding the current and future use and management of money.}^1
\]

The process of increasing financial literacy – financial education – is defined by the OECD as:

\[
\text{The process by which financial consumers/investors improve their understanding of financial products, concepts and risks and, through information, instruction and/or objective advice, develop the skills and confidence to become more aware of financial risks and opportunities, to make informed choices, to know where to go for help, and to take other effective actions to improve their financial well-being.}^2
\]

In general, financial literacy consists of knowledge of a number of different elements including basic money management, financial planning, and investment. On the most basic level, financial skills include the ability to budget, save and invest money, use financial instruments, and plan for long-term goals. Other more advanced skills include being able to understand the risks and benefits of financial decisions like borrowing, spending and investing, recognizing the trade-offs between risk and return, and make calculations on rates of return on investment and interest rates. A financially literate person should be comfortable in distinguishing and utilizing varying financial products, making short- and long-term investments, and successfully managing credit and debt. Financially literate SMEs possess a

---


comprehensive understanding of the financial tools available to them and are able to use these tools effectively.

The need for financial literacy is based on the premise that financially literate persons are better able to make informed financial decisions that will maximize their economic well-being. Collectively, these decisions will lead to better macroeconomic outcomes, increasing economic growth and promoting innovation, while reducing negative financial outcomes like poverty and debt.

At a roundtable discussion on financial education held in 2005, a representative from the OECD laid out why financial education is needed now more than ever:\(^3\)

- A reduction in the amount and extent of state-supported social security and pension programs around the world mean that more workers are relying on defined contribution pension plans, private investment funds, and personal savings to finance their retirement.
- Deregulation of global financial markets has led to an increase in the number of financial products available to everyday consumers. In particular, the wide availability of credit cards has led to record levels of consumer debt.
- Integration into the global economy increasingly requires making use of a bank account, but a significant portion of persons around the world still lack access to this basic financial instrument, limiting the amount of interaction these persons can have with the formal economy.

The 2008 global financial crisis added an element of urgency to the need for comprehensive financial literacy programs. While blame for the crisis can be attributed to a number of factors including the collapse of the massive real estate bubble that preceded the crisis and the deregulation of financial markets that led to the creation of financial instruments like mortgage-backed securities, a significant component was the limited understanding that many homeowners had of the financial instruments they engaged. The rise in interest rates for consumers who took on adjustable-rate mortgages without fully understanding them, and their subsequent defaults, were the spark that ignited the global crisis.

The benefits of a population with a high level of financial literacy reach individual and systemic levels. On an individual level, the ability of a person to make an informed financial decision will lead to a better economic outcome.\(^4\) For low-income populations, learning how to budget, save and plan is a key factor in escaping the poverty trap. And as governments shift the burden of retirement planning to the individual, the ability to make intelligent decisions on long term investments is more critical than ever.\(^5\)

Benefits of financial literacy extend to the system-level. As consumers become more informed about the financial instruments available to them, financial institutions begin to offer more innovative products, leading to a more dynamic financial sector. According to a report by Reserve Bank of New Zealand, better informed investment decisions maximize risk-adjusted rates of return on investments, meaning more money goes to more productive use relative to risk. The cumulative effect of better financial decisions at the personal level leads to a higher growth rate and a more dynamic economy.\(^6\)

Despite the stated importance of financial education, and the move by many countries to enact national strategies to promote it, many individuals lack an understanding of basic financial skills. A 2005 OECD-funded study on financial literacy found significant gaps in knowledge levels in even highly developed economies. For example, in Japan, 71 percent of respondents lacked knowledge of equities and bonds, 57

\(^{3}\) Hecklinger  
\(^{4}\) Hailwood and Widdowson  
\(^{5}\) Hecklinger  
\(^{6}\) Hailwood and Widdowson
percent lacked knowledge of financial products in general, and 29 percent lacked knowledge of insurance and pensions. In the United States, 40 percent of workers are not saving for retirement. Surveying high school students in South Korea, the study found that most students answered fewer than 60 percent of questions correctly on a test asking questions like how to manage a credit card and save and invest for retirement.7

Research into financial literacy also finds that people tend to overestimate their understanding of financial issues. According to the OECD survey, 67 percent of Australians indicated they understood the concept of compound interest, but only 28 percent were actually able to solve a problem using the concept. Similarly, a Commerzbank AG survey conducted in Germany in 2003 found that although 80 percent of respondents said they were confident in their understanding of financial issues, only 42 percent of them could correctly answer half the questions on a financial literacy test.8

III. Financial Literacy and SMEs

At the organizational level, SMEs benefit from financial education programs by acquiring the skills necessary to make themselves cost-efficient and dynamic. Sound book-keeping practices, the ability to leverage their assets for investment, proficiency in credit management, and other key financial skills are keys to every SME’s survival and growth. A study conducted by researchers at Jomo Kenyatta University of Agriculture and Technology in Kenya found that SMEs whose managers attended a financial literacy program experienced a growth in sales and profits, leading to significantly enhanced business performance.9

SMEs need information beyond what is usually taught in financial education programs directed towards individuals. According to a USAID report on the need for financial literacy programs for SMEs in South Africa, critical information required by SMEs includes:10

- Types of funding and credit products
- Sources of funding, and in particular sources of funding for start-up capital
- Requirements from financial institutions to access products and services
- Other types of financial products, such as savings options for businesses (e.g. money market for business), transactional products (e.g. business credit cards, CFC accounts for international trade); leasing; and commercial property
- Risk management, including insuring stock and business premises, and assuring the life of the SME owner/manager
- Formalizing a business (different legal structures, pros and cons, how to go about it), and the impact on financing options

Beyond providing the skills for better management, financial education is a key component in addressing the most commonly cited challenge to SMEs: access to finance. Without knowing how to properly develop business plans and manage their finances, SMEs will be unable to secure credit. A high level of financial literacy would enable SMEs to explore different options for obtaining financing and how to maximize the financial tools available to them.

---

7 Hecklinger
8 Hailwood and Widdowson
IV. Financial Literacy in APEC

The following data was mined from the World Bank’s Financial Inclusion Index (Findex). It includes all APEC member economies with the exception of Brunei Darussalam and Papua New Guinea where data was not available. Except where indicated, the data presented are averages (avg) and medians (med) for 19 member economies in 2011. A more detailed breakdown is located in Annex A.

According to Findex, on average 66.02 percent (med: 72.66 percent) of people above the age of 15 in APEC economies have an account at a formal financial institution. Men were slightly more likely to have these accounts (avg: 66.75 percent/med: 72.66 percent) than women (avg: 65.3 percent/med: 72.64 percent). Among the poorest 40 percent of the population, this number drops an average of 57.65 percent (med: 61.29 percent) of people had formal accounts. However, these statistics vary widely among APEC economies – more than 99 percent of people had formal accounts in the top performing economy, while less than 20 percent had them in the lowest performing economy.11

Despite more than 66 percent of people in APEC economies having bank accounts, when asked if they had saved money at one, only 34.62 percent (med: 36.96 percent) had. Similarly, only 12.79 percent (median: 10.51 percent) of respondents had taken out loans in the previous year. Credit and debit card use were also relatively uncommon, with 31.84 percent (med: 22.85 percent) and 41.56 percent (med: 36.96 percent) using them, respectively.12

It should be noted that these figures are not direct indicators of levels of financial literacy, although there is a positive correlation between higher levels of financial education and increased use of formal financial tools like bank accounts and investment funds.

Nor is the level of economic development directly tied to the level of financial literacy in an economy – although more developed economies do tend to be more financially literate, this is not always the case. According to the MasterCard Index of Financial Literacy, which annually measures proficiency in basic money management, financial planning, and investment in the Asia-Pacific region, the top performing economies in the index were New Zealand, Singapore and Chinese Taipei, while Japan was the lowest-performing.13 In a similar vein, according to Findex, Thailand had the highest rate of borrowing among the poorest 40 percent of its population, rather than a more developed economy.

V. Current National and International Initiatives in Promoting Financial Literacy

The OECD has made considerable efforts at promoting financial education among its member states as well through its International Network on Financial Education (OECD/INFE), a platform that serves to collect data, conduct research and develop policy instruments on financial education. OECD/INFE has more than 230 members in over 100 countries and is considered the leading international body promoting financial literacy.14

In addition to adding financial literacy to the Programme for International Student Assessment (PISA), OECD/INFE developed the “Principles and Good Practices for Financial Education and Awareness” which provides a set of seven guiding principles on financial education as well as a list of best practices

---

12 Ibid.
on financial literacy for the public sector, financial institutions, and financial education programs. The platform has also developed a series of guiding documents to assist policymakers in creating financial literacy programs. Chief among these documents is the “High Level Principles on National Strategy for Financial Education,” which lays out the guidelines which countries should follow in creating a national strategy for financial education.

APEC leaders have recognized the need for high levels of financial education. The APEC Finance Ministers’ Joint Ministerial Statement for 2013 explicitly targeted the need for financial education for SMEs, and the 2012 statement called on member economies to take into consideration the OECD/INFE High-level Principles on National Strategies for Financial Education in developing their own national programs for financial education.

APEC projects on financial literacy have been carried out by the Finance Ministers Process (FMP) and the Human Resources Development Working Group (HRDWG). The following projects were carried out:

- **Improving the Efficiency of Domestic Strategies on Financial Literacy (Russia - FMP 01 2012):** the project allowed policymakers to share experiences on domestic strategies and programs on financial literacy and education, prepared recommendations on more comprehensive and efficient strategies to domestic financial literacy strategies, and promoted these recommendations to APEC economies.
- **Education on Financial and Economic Literacy (China - HRD 06 2012A):** the project shared best practices on financial education and developed a framework for it in APEC and issued policy recommendations on integrating financial education into basic education curriculums.
- **Accelerating Financial Inclusion in Asia and the Pacific: An Operational Dialogue on Innovative Financial Inclusion Packages (Philippines - FMP 02 2010):** focused on the broader issue of financial inclusion, the project emphasized the need of financial literacy programs to ensure that low income and disadvantaged people have access to formal financial institutions, instruments and mechanisms.

At the national level, many countries have followed the OECD/INFE lead and set up national strategies for financial education. In many of these countries, a government body has been created to coordinate and implement these strategies, often coordinating with other public organizations such as schools to increase the availability of financial education. Often these organizations also provide financial education materials on their websites and in print.

Financial literacy promotion is not limited to the public sector. Many financial institutions and other private sector organizations provide training courses to individuals as well as SMEs.

A majority of the national strategies and programs that promote financial literacy do so at the individual level; the most-common strategy is to integrate financial education into school curriculums so that students become familiar with these concepts at a young age. However, managers and owners of SMEs require a different and more advanced financial skill set than the personal finance skills taught by more
generic programs. To address this need, some APEC economies have moved to provide SMEs with specialized financial education packages. For example, the US Small Business Association offers “Money Smart for Small Business,” a training curriculum for SME owners and managers on financial issues relating to their enterprise, and Singapore offers regular training sessions on financial literacy for SME managers.

VI. Recommendations on Financial Literacy Programs for SMEs*

Given the pronounced need for financial education for SMEs, APEC economies should consider the following:

- Conducting an assessment of the financial literacy of SMEs in their economy to gauge their needs.
- Conducting an assessment of existing financial education programs for SMEs offered by public and private sector organizations.
- Developing and implementing a national strategy for financial education. If one already exists, developing a framework for providing financial education for SMEs within the strategy.
- Developing a financial education package tailored to SMEs that is easily distributable and available online.
- Working with financial institutions and other organizations to provide financial literacy trainings for SMEs.
- Share best practices on financial literacy programs for SMEs among member economies.

* Please note that these are preliminary recommendations based on an initial assessment of financial education for SMEs in APEC.
Works Cited


Annex A: World Bank Financial Inclusion Index for APEC Economies (excluding Brunei Darussalam and Papua New Guinea)

<table>
<thead>
<tr>
<th>Country Name</th>
<th>Account at a financial institution, male (%)</th>
<th>Account at a financial institution, female (%)</th>
<th>Account at a financial institution, income, 40% age</th>
<th>Saved at a financial institution, bottom</th>
<th>Loan from a financial institution in the past year, income, bottom</th>
<th>Loan from a financial institution in the past year, friends in the past year</th>
<th>Debit card, male (%)</th>
<th>Debit card, female (%)</th>
<th>Credit card, male (%)</th>
<th>Credit card, female (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>99.5947</td>
<td>99.0648</td>
<td>98.59229</td>
<td>98.3571</td>
<td>61.92494</td>
<td>16.9835</td>
<td>8.207391</td>
<td>12.59346</td>
<td>79.05435</td>
<td>77.68347</td>
</tr>
<tr>
<td>Canada</td>
<td>94.27522</td>
<td>95.8046</td>
<td>97.23316</td>
<td>92.87665</td>
<td>53.20308</td>
<td>20.30042</td>
<td>17.47081</td>
<td>15.98184</td>
<td>87.9597</td>
<td>91.05261</td>
</tr>
<tr>
<td>China</td>
<td>67.5847</td>
<td>63.8171</td>
<td>60.00867</td>
<td>47.11938</td>
<td>32.08942</td>
<td>7.256366</td>
<td>7.680044</td>
<td>24.98504</td>
<td>41.02147</td>
<td>38.36354</td>
</tr>
<tr>
<td>Chinese Taipei</td>
<td>86.17018</td>
<td>87.3149</td>
<td>88.42019</td>
<td>82.42992</td>
<td>45.7173</td>
<td>9.587192</td>
<td>8.59023</td>
<td>6.91243</td>
<td>37.03901</td>
<td>40.12969</td>
</tr>
<tr>
<td>Hong Kong, China</td>
<td>88.25115</td>
<td>88.68604</td>
<td>89.07763</td>
<td>83.41736</td>
<td>42.77365</td>
<td>7.926506</td>
<td>3.489466</td>
<td>12.0663</td>
<td>75.76701</td>
<td>75.44726</td>
</tr>
<tr>
<td>Japan</td>
<td>95.9716</td>
<td>96.42204</td>
<td>96.8449</td>
<td>95.07358</td>
<td>51.32575</td>
<td>6.096314</td>
<td>3.049349</td>
<td>5.055371</td>
<td>12.9623</td>
<td>13.10575</td>
</tr>
<tr>
<td>Korea, Rep.</td>
<td>92.98253</td>
<td>93.04687</td>
<td>93.10782</td>
<td>89.33324</td>
<td>46.94206</td>
<td>16.57813</td>
<td>13.23778</td>
<td>16.99719</td>
<td>57.9127</td>
<td>55.6359</td>
</tr>
<tr>
<td>Malaysia</td>
<td>69.21398</td>
<td>66.17818</td>
<td>63.06947</td>
<td>50.11819</td>
<td>35.40678</td>
<td>11.19655</td>
<td>1.843052</td>
<td>19.86079</td>
<td>23.13455</td>
<td>20.59996</td>
</tr>
<tr>
<td>Thailand</td>
<td>72.70007</td>
<td>72.66644</td>
<td>72.63754</td>
<td>61.29475</td>
<td>42.8026</td>
<td>19.39599</td>
<td>26.94114</td>
<td>7.654822</td>
<td>43.09781</td>
<td>44.68628</td>
</tr>
<tr>
<td>United States</td>
<td>91.68194</td>
<td>87.95786</td>
<td>84.06905</td>
<td>81.89575</td>
<td>50.39787</td>
<td>20.13618</td>
<td>17.63054</td>
<td>17.23961</td>
<td>71.76666</td>
<td>65.83336</td>
</tr>
<tr>
<td>Average</td>
<td>66.7485847</td>
<td>66.0192958</td>
<td>65.3043768</td>
<td>57.6510087</td>
<td>34.6185912</td>
<td>12.7940835</td>
<td>9.87287168</td>
<td>18.23601</td>
<td>41.5558211</td>
<td>40.5245648</td>
</tr>
<tr>
<td>Median</td>
<td>72.70007</td>
<td>72.66644</td>
<td>72.63754</td>
<td>61.29475</td>
<td>42.77365</td>
<td>10.5146</td>
<td>7.680044</td>
<td>15.98184</td>
<td>36.96459</td>
<td>36.06926</td>
</tr>
</tbody>
</table>
Defining Financial Literacy

The ability to make informed judgments and to take effective actions regarding the current and future use and management of money.

- US Financial Literacy and Education Commission
Why We Need It

System: High national level of financial literacy = higher economic growth and more dynamic economy.


Individual: People can make more informed decisions about their money.

Financial Literacy and SMEs

SMEs need additional financial education beyond what is provided to individuals:

- Types of funding and credit products
- Sources of funding, and in particular sources of funding for start-up capital
- Requirements from financial institutions to access products and services
- Other types of financial products, such as savings options for businesses (e.g. money market for business), transactional products (e.g. business credit cards, CFC accounts for international trade); leasing; and commercial property
- Risk management, including insuring stock and business premises, and assuring the life of the SME owner/manager
- Formalizing a business (different legal structures, pros and cons, how to go about it), and the impact on financing options
Financial Literacy in APEC

- Average proportion of population in APEC economies with an account at a formal financial institution: 66.02%
- Average proportion of population in APEC economies who obtained a loan in past year: 12.79%
- Average proportion of population in APEC economies who saved money in a formal account in the last year: 34.62%

Data from 2011 World Bank Financial Inclusion Index. Data from Brunei Darussalam and Papua New Guinea not available.

APEC Work on Financial Literacy

- 2012 and 2013 Finance Ministers’ Joint Statement call for need for financial education for SMEs
- 3 APEC projects on financial literacy carried out in 2012 and 2010 by HRDWG and FMP
  - Improving the Efficiency of Domestic Strategies on Financial Literacy (Russia - FMP 01 2012)
  - Education on Financial and Economic Literacy (China - HRD 06 2012A)
  - Accelerating Financial Inclusion in Asia and the Pacific: An Operational Dialogue on Innovative Financial Inclusion Packages (Philippines - FMP 02 2010)
Recommendations*

- Conducting an assessment of the financial literacy of SMEs in their economy to gauge their needs.
- Conducting an assessment of existing financial education programs for SMEs offered by public and private sector organizations.
- Developing and implementing a national strategy for financial education. If one already exists, developing a framework for providing financial education for SMEs within the strategy.
- Developing a financial education package tailored to SMEs that is easily distributable and available online.
- Working with financial institutions and other organizations to provide financial literacy trainings for SMEs.
- Share best practices on financial literacy programs for SMEs among member economies.

*Based on a preliminary study only

Next Steps

- Survey on APEC SMEs Financial Literacy Status
  - Gauges the need for financial education by SMEs in APEC
  - To be carried out inter-sessionally
  - Will inform need for further work on financial literacy for APEC SMEs