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## Financial literacy – the urgent need today

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### Abstract

Many of us understand the inability to read or write under the term of financial literacy. I this a number of areas which summarily called functional literacy, for example cultural literacy, emotional, media, financial, health literacy and so on. A key element in the decision making in all areas of our lives is financial literacy. Ability to understand financial products which normally people come into a contact is a reflection of financial literacy everyone. Global problem is inadequate level of financial literacy, therefore it is appropriate to research this issue in depth. The paper deals with defining literacy in a general way in the first part, further with financial literacy, selected surveys in this area as well as defining the indicators of financial education.

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### 1. Introduction

Education is an important part of our everyday life. It has been available for people in various business, social and economic areas since ancient times. Therefore, adequate attention has to be given to this important issue. At present, in consequence of the dynamically developing society there take place both internal and external changes which companies must respond and adapt to in all the different areas of life, including education, if they want to survive. Financial education is an important type of education. People come into contact and deal with the world of finance on a daily basis. Financial education is becoming a key aspect in decision making on all the issues related to our day-to-day life. The ability to understand financial products offered in a variety of forms or financial behaviour itself both reflects the financial literacy of each of us. The low level of financial literacy is a worldwide problem, and it is more than appropriate that such an in-depth study of this issue be performed. The aim of the present paper is, first of all, to define in general terms financial literacy, deal with financial literacy and selected surveys in this area as well as to define indicators of financial education and financial literacy.

### 2. Financial education and financial literacy

Despite the widespread loss of jobs as a result of the economic crisis there is still lack of qualified workforce in the market. This fact is especially reflected in the area of information and communication technology as well as in the field of research and development. The present-day trend indicates further deepening of the problem. It's also

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necessary to mention the impact of the economic crisis on the ever increasing indebtedness of households in the world. Tab.1 shows indebtedness of households in the Eurozone. According to the latest Eurostat measurements the indebtedness of Slovak households in the year 2011 was the lowest among 17 Eurozone members. Bank lending's to households in proportion to GDP is 24,9 %. Why so? One of the likely factors may be lower incomes of families that in comparison with other Eurozone countries make it impossible for Slovak population to get loans in the same amounts as in the countries with higher average salaries.

*Tab. 1 Indebtedness of households to GDP*

Country/ year 2011	Loans to households (bil. EUR)	Public debt of the country (bil. EUR)	Loans to households / GDP (%)	Public debt /GDP (%)
<b>Slovakia</b>	<b>17,2</b>	<b>29,9</b>	<b>24,9</b>	<b>43,3</b>
Slovenia	9,5	17,0	26,7	47,6
Belgium	108,5	361,7	29,5	98,2
Italy	618,6	1 897,2	39,1	120,1
Estonia	7,0	1,0	43,8	6,0
Austria	144,0	217,4	48,0	72,4
France	1 069,2	1 717,3	53,6	86,0
Germany	1 435,8	2 088,5	55,9	81,2
Finland	110,0	93,0	57,4	48,6
Greece	127,6	355,6	59,3	165,3
Malta	4,0	4,6	62,2	71,6
Holland	419,3	392,5	69,6	65,2
Ireland	112,7	169,3	72,0	108,2
Luxemburg	33,5	7,8	78,2	18,2
Spain	859,7	735,0	80,1	68,5
Portugal	140,6	184,3	82,3	107,8
Cyprus	23,9	12,7	134,6	71,6
<b>Eurozone</b>	<b>5 241,1</b>	<b>8 215,3</b>	<b>55,7</b>	<b>87,3</b>

*Source: Eurostat, ECB, calculations of Poštová banka*

The most part of the debt is incurred by mortgage loans for housing; then they are bank consumer loans and non-bank loans. Indebtedness of households doesn't have to be assessed as a negative phenomenon, as they can increase their consumption alongside uneven development of their incomes. While the level of household indebtedness in relation to GDP in Slovakia is still satisfactory, it is assessed as being high in relation to the financial assets.

Households have not been able to increase the profitability of financial assets for a long time, the reason for which lies in certain models of households' behaviour characterized mainly by conservatism with strong orientation to cash and current or savings bank accounts.

So, why mention all this? Because of its close relation to financial literacy, for example, what type of credit to accept, which institution to go for, how to behave in relationship with a credit provider, which model of behaviour to follow, etc. Moreover, financial literacy extends the horizons of our knowledge, it is essential in avoiding the excessive risk in financial investment or when in need of finances. Business liberalisation twenty years ago resulted in revitalization of the economy of post communist countries, but also provided opportunities for speculators and money lenders (Čarnogurský, 2011).

Fraudulent non-banking finance companies duped thousands of people of their money. Then, there were also usurious non-banking institutions that dispossessed people of their houses and flats. The technique of lending money was simple. A non-banking entity lent a certain amount of money to people who had financial shortcomings and its

repayment was secured by the house or flat of the borrower. The value of the house or flat usually exceeded the amount of money lent out two – three – or even tenfold. Another example are the so-called “debt relief agencies” which manipulate their clients into taking out investment life insurance cover, as for instance, a certain Czech company. If a client decides to cancel the contract at some time in the future he or she must be aware that they will have to pay penalty equal to 150 % of the amount of annual insurance. In 2011, it was reported in the media of the Slovak republic that non-banking entities offered loans with annual interest rates of up to 130 %. The release of those items of news was justified because the Commission for Assessment of terms in consumer contracts and unfair business to consumer commercial practices submitted legal claims to the Slovak Trade Inspection as well as to the General Prosecution of the SR and National Bank of Slovakia against two companies that sold such insurance policies to consumers. These are just a few examples to justify the need of financial literacy. The range of the issues it includes is of course much wider.

We have to respond to this fact giving it special attention and modernizing school curricula as well as provide further education to employees in workplaces. The issue that appears simple at first sight has its roots in the term literacy. That doesn't necessarily mean a lack of IQ, but rather the so-called ignorance. For most of us the term literacy refers to the ability to read and write. But that is only part of a whole set of particular skills of literacy. The term encompasses many areas and is called using a general term functional literacy. Functional literacy (Kirsch, 1986) is the ability to use printed and written material to fulfil one's different needs at home, to function in society, to achieve one's personal and professional goals, etc., it is also a tool to broaden knowledge and develop one's potential.

The components of functional literacy include e.g. health, institutional, cartographic, media, emotional, cultural, digital literacy and, naturally, financial literacy which is the focus of our attention in this paper. Financial literacy can be defined as the ability to use knowledge, skills and experience of an individual to make effective decisions regarding the use and management of their own finances to provide life-long financial security for themselves and their families. Therefore, it means having an ability to understand basic financial products people deal with in their everyday lives that considerably affect their economic situation and welfare. Financial literacy is achieved through financial education. Financial education should enable individuals to develop their decision-making competencies related to money, dealing with it as well as with the risks of its investment. Financial literacy as management of one's personal or family finances includes three components, namely: money, price and budget literacy. The importance of good financial education (Pastoráková, 2011) has been acknowledged at the global level. The ECOFIN Council of the EU invites their Member States "to significantly step up their efforts to raise households' awareness on the latter's need to obtain proper information and education, in combination with the financial industry's own responsibilities and initiatives as appropriate, so as to increase households' preparation whilst maintaining adequate investor protection". The ultimate goal of financial education is to educate consumers so that they can make appropriate decisions and be responsible for them, assess their current financial situation and manage their finances in such a way as not to be a burden to their families or society. There are several methods of delivering financial education, e.g.:

- Financial education in the official school curriculum (kindergarten, primary school. Secondary school, higher education institution);
- Financial education training courses and seminars for adults;
- Financial education provided by national or regional institutions as well as non-governmental agencies and the financial services sector;

A financially literate citizen is well-oriented in dealing with money and prices and is capable of responsibly managing his personal/family budget, including managing financial assets and commitments with regard to a changing life situation“ (MČFR, 2007).

Whatever the definition of financial literacy is, its importance is ever growing. Moreover, surveys in the EU (Hlavatý, 2011) show that consumers do not have the required knowledge, have no time or are not able to use the available information correctly, the decisions they make are suggestive without understanding the nature and risks of these financial products and services. The level of financial literacy varies a lot across the EU.

### 3. Selected surveys of financial literacy

Most educational systems surveyed in Great Britain, Germany, Austria, Holland and France are modern and provide high quality education. In spite of that in certain areas they have proved to be inefficient. Poland is by far the most active Member State in Eastern Europe in terms of financial education activities. Bulgaria, Latvia, Luxemburg, Slovenia, Slovakia and Romania seem to be active but only in the areas related to the EU multinational programs. An example of financial education in the Czech Republic is its integration into school curriculum. The main target groups for financial education are now children and young adults. One of the most important tools of financial education is the Internet and every sixth system of financial education is operated by private providers of financial services. They mostly focus on their customers; however, its contents remain disinterested. In Slovakia this issue is dealt with by the inter ministerial expert group which developed draft material in 2008.

“The National standard of financial literacy” (MESR, MFSR, 2008), version 1.0 determines the extent of knowledge, skills and experience in the area of financial education and management of personal finances. The Slovak Banking Association (Slovak Banking Association, 2007) conducted a survey of financial literacy of the Slovak citizens on a poll of 1107 respondents in the first decade of September 2007. The data were collected through on-site face-to-face interviews in the respondents’ households by trained interviewers of the MVK polling agency. The survey showed that there existed a relatively close relationship between the respondents’ real level of financial literacy and their self-assessment: the lower was their financial literacy the more negative was their self-assessment (and vice-versa). The average index value of financial literacy scored by the survey respondents was 0.56 points which reflects average knowledge about personal finances.

In August 2012 „ Partners Group „, in cooperation with the Focus agency conducted a survey of financial literacy among Slovaks (720 respondents over age 18) which confirmed that the level of our financial knowledge is the same problem as in many countries worldwide. It was focused again on basic financial knowledge in the area of economics and finances based on common financial terms we deal with on a daily basis. According to this survey the average level of financial literacy of Slovaks was 62, 5%. Investment and bank products were identified as the weakest areas; better results were obtained in the areas of pensions and insurance. More than half of the respondents were not able to judge if a loan was worth taking or not and did not know that the amount of gains was dependant on the size of the risk.

Furthermore, over 70% had a problem to differentiate between various types of investment and the risks associated with them and almost half of the interviewed did not save absolutely anything from their monthly salaries. Comparison of the results of surveys carried out in the year 2007 and 2012 shows that financial literacy has somewhat improved (scores rose from 56% to 62,5%) as well as the trend of financial education and more responsible approach of consumers themselves. In spite of that fact the level of financial education in the Slovak republic is below European average (approx. 75%).

### 4. Indicators of financial literacy

The level of financial literacy can be measured not only using the financial literacy index. To identify its level it is necessary to determine indicators (Sovics, 2012) that will be used as a benchmark on which to compare what consumers should know to effectively manage their finances. Most educational programmes test four aspects:

- a) **Management of finances** – to be able to develop a family budget and check income and expenses categories;
- b) **Planning of financial income and expenses** – to incorporate future needs, both expected and unexpected, into the budget;
- c) **Choice of suitable banking products** – every now and again to monitor products, analyze them and choose the right ones to suit particular needs and circumstances ;
- d) **Database of product providers** – a consumer should be informed about the provider of the service he or she is interested in and under what circumstances it’s possible to make a request and what service package will the given provider offer within a particular category management.

Apart from these indicators we recommend to master the relationship between the necessities of life and finances, learn basic ethical relationship between wealth and poverty, understand the issues relating to an individual and family in the economic sphere, learn what it means to live economically as well as to understand the term risk and be able to identify its basic types. By educating a person in the above-mentioned areas, he or she will be able to acquire competencies essential for financial literacy such as:

- Be able to assess life's priorities and determine basic resources to provide the necessities of life,
- Have the competency to differentiate between reliable and unreliable information about decision-making processes in the financial area,
- Have competencies to manage finances,
- Have the competence to organize personal finances, use the budget, and borrow money with the lowest risk rate as well as to assess directions of investment.

## 5. Conclusions

Financial literacy is not an absolute state; it is a continuum of abilities that is subject to variables such as age, family, culture, and residence. It refers to an evolving state of competency that enables each individual to respond effectively to new personal events and ever-changing economic environment. In today's modern world it plays an important role being a gate pass to education, ability to gain and process necessary information or deal with a variety of other everyday life issues. The results of surveys conducted at home and abroad show that the level of knowledge and expertise in this area is still about average. Besides having the right to access transparent information, it is also a person's responsibility to get familiar with it as well as to transform it into their day-to-day life. Even though various institutions are interested in educating clients in this area, the ability to make a correct choice among a new wide range of products and services offered by a whole lot of their providers as well as their implementation in practice depends to a great extent on consumer's motivation to train. This is the only way to increase the financial literacy index.

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