Financial Literacy amongst Irish micro, small and medium-sized businesses

FOREWORD

In 2019, the SFA has focused on supporting small businesses to attract talent, empower their staff, adapt flexible work practices and embrace new technologies, all of which are necessary if we are to prepare for the economy of tomorrow. Due to the implications of Brexit and other geopolitical risks, the SFA is focused on supporting small business owners to future proof their businesses in order to maintain sustainable growth and job creation. Furthermore, we are cognisant of the Government's *Future Jobs Ireland* goal of improving SME productivity, a goal we believe will yield long-term dividends for the country.

While innovation and technological advances are critical to deliver increased productivity, more must be done to ensure that owner-managers of small businesses have up-to-date organisational and financial skills to implement such changes. In order to identify some of the roadblocks to increasing productivity, the SFA (together with TU Dublin, Microfinance Ireland, the SBCI and Skillnet Ireland) have commissioned a survey to evaluate the importance of finance and financial planning, self-ranked financial literacy and the utilisation of financial planning in business.

This representative survey was conducted by the independent market research company iReach and the results used in this publication are from 132 Irish micro, small and medium-sized businesses across multiple business sectors and all counties in Ireland.

I would like to thank our project partners TU Dublin, Microfinance Ireland, SBCI and Skillnet Ireland for their collaboration on this publication. I owe Professor Thomas M. Cooney, College of Business, TU Dublin a debt of gratitude for his analysis and concise summary of the survey results. His in-depth knowledge of the Irish small business sector and his extensive experience in business finance have been invaluable.

The recommended actions in this publication aim to improve the financial skills of our owner-managers and strengthen productivity among domestic businesses.

Sven Spollen-Behrens
Director SFA

KEY FINDINGS

- The principal finding of the research was that 81% of respondents said financial literacy was very or extremely important, but only 46% said they had good or expert knowledge of financial literacy. Respondents thought that only 19% of other Irish business owners had good knowledge
- Respondents believed that 0% of Irish business managers generally had expert financial literacy, while 11% rated themselves as having expert knowledge (these had either majored in finance in college or were fully qualified accountants)
- 35% of respondents with low to moderate expertise had received no financial training
- The level of expertise was greater as the size of the business increased
- 51% of business owners do not read their monthly accounts on a monthly basis
- Over half of respondents do not calculate basic financial measurements regularly, including Gross Margin Per Product
- About a quarter of respondents do not produce important financial reports like debtor/creditor lists and sales and expenditure reports, while 16% of respondents do not use monthly reports
- 80% of respondents said that the primary use of monthly financial statements was to inform their banks
- 34% said that they use financial statements to make business decisions and 42% said that they do not understand financial statements
- 58% said they do not utilise financial statements as they believe that is the job of their accountant

SETTING THE CONTEXT

- In recent years, there have been many calls from the Irish government, European Commission and OECD to improve financial literacy and financial management skills amongst SME owner-managers

- According to the OECD (2017), successful development and growth of SMEs depends on the possession of adequate financial knowledge and skills

- The OECD/INFE (2018) defines the financial literacy of adults as: "a combination of awareness, knowledge, skill, attitude and behaviour necessary to make sound financial decisions and ultimately achieve individual financial well-being"

- However, many of the calls to improve the financial management of SMEs have focused on enhanced access to finance and better credit facilities, rather than on expanding the individual skills of owner-managers

- Numerous initiatives aimed at improving the general business management skills of SME owner-managers have also been introduced, but with limited offerings available specifically related to financial management

- While it is widely recognised that an owner-manager should be able to explain, convince and defend their business strategies using current financial information from the business, this publication highlights that owner-managers generally leave all financial matters to their accountants

- Despite recognising the power of financial literacy, this research shows that many owner-managers seem reluctant to develop their understanding of financial statements due to a lack of time, cost of training, inappropriate methods of training or believing that financial management is the responsibility of their accountant

- In the past, no hard evidence was available on the actual level of financial literacy and financial management skills of Irish SME owner-managers

- This study seeks to ascertain the level of financial literacy amongst Irish SME owner-managers and to determine their use of financial accounts when making business decisions

RESPONDENT PROFILE

Role in the Business

Senior Manager	37%
Decision Maker	32%
Owner	23%
Managing Director	5%
Part-Owner	4%
CEO	4%
Finance Director	3%
Senior Director	2%

Gender

Female	51%
Male	49%

Company Size

Micro (1-10)	40%
Small (11-50)	33%
Medium (50+)	27%

Ownership

Irish-Owned	83%
Foreign-Owned	16%
50-50	2%

Business Region

Dublin	42%
Munster	23%
Connaught	16%
Rest of Leinster	14%
Ulster ROI	5%

Sector of Business

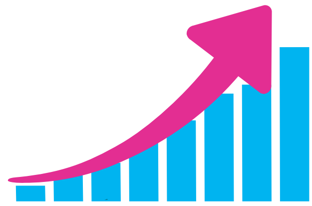
Professional Services/Consultancy	14%
Health Care/Pharmaceutical	12%
Retail	11%
Education	10%
Banking/Finance/Insurance	8%
Construction/Building Materials/ Manufacturing	8%
Government/Local Authority/ Public Services	7%
Other	7%
Entertainment and Media	5%
Transportation	5%
Charity/NGO	4%
Telecommunications/Technology	4%
Travel and Tourism	3%
Consumer Packaged Goods	2%
Energy/Nat. Resources/Agriculture/ Fishing/Forestry	2%
Aviation	1%

The representative survey was targeted at the owners / CEOs of Irish SMEs and it was conducted by the market research company iReach on behalf of the SFA in March 2019. There were 132 valid respondents to the survey consisting of micro, small and medium-sized businesses. Whilst the sample of businesses was relatively small, the results, however, do offer an indication of the current situation in Ireland regarding the financial literacy of business owners.

As can be seen from the various tables, a good balance of company size, business sector, business region, gender, ownership and role in the business was achieved, and therefore the survey offers an equitable reflection of business sentiment relating to financial literacy.

LEVEL OF EXPERTISE

Company Size and Financial Literacy



	MICRO	SMALL	MEDIUM
Expert Knowledge	6%	11%	20%
Little/Some Knowledge	47%	25%	23%

Expertise in Financial Literacy (self-ranked by respondents)

Expert (11%)

- 83% majored in Finance
- 40% are fully qualified accountants

Moderate to Good (55%)

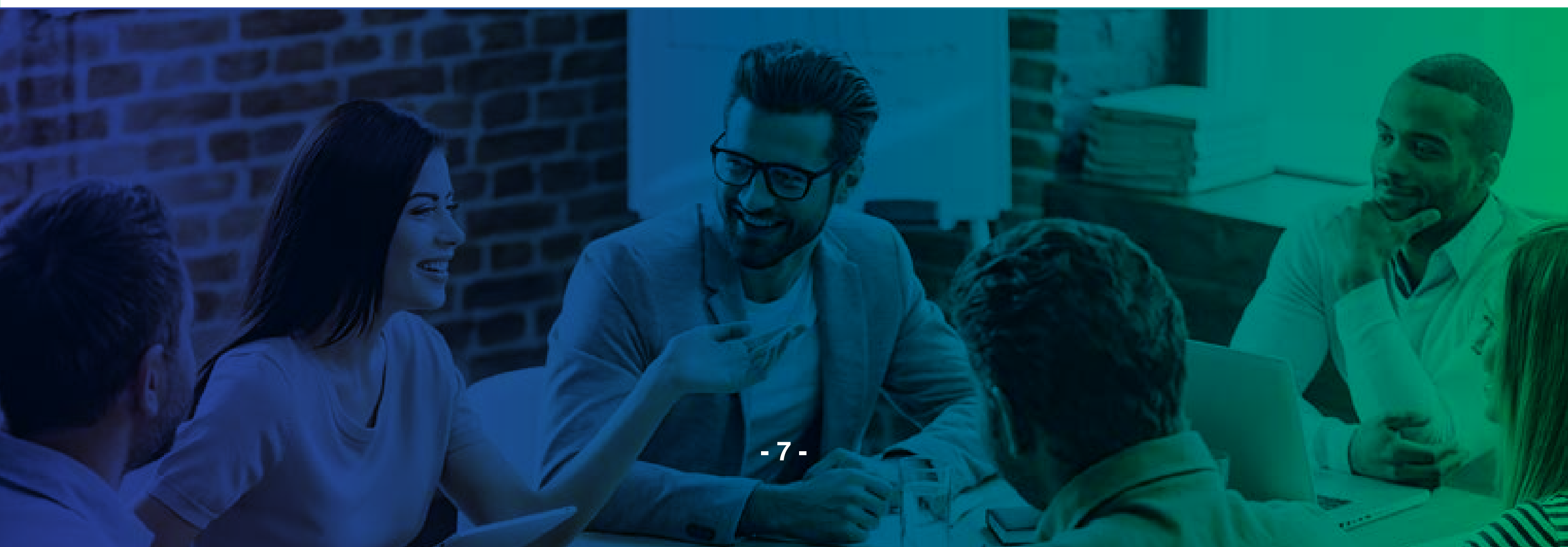
- 82% trained as part of a Leaving Certificate
- 67% took an intensive training course

Low to Moderate (34%)

- 35% have no financial training
- 30% took a short course

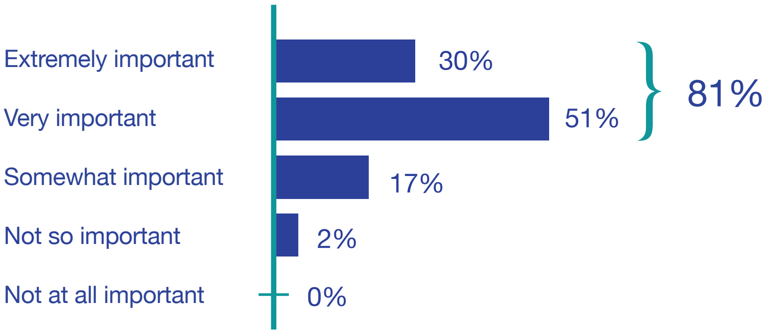
11% of all respondents rated themselves as Experts, with 83% of these having received extensive training and knowledge, while 55% rated themselves as Moderate to Good with the majority of these having some training or education in this area. 35% of respondents who rated themselves as low to moderate have received no financial training, while the deeper data showed that 51% of owner-managers within the micro firm sector have received no financial training.

The research also suggests a correlation between the level of financial literacy and company size: the larger the company, the higher the level of financial expertise.

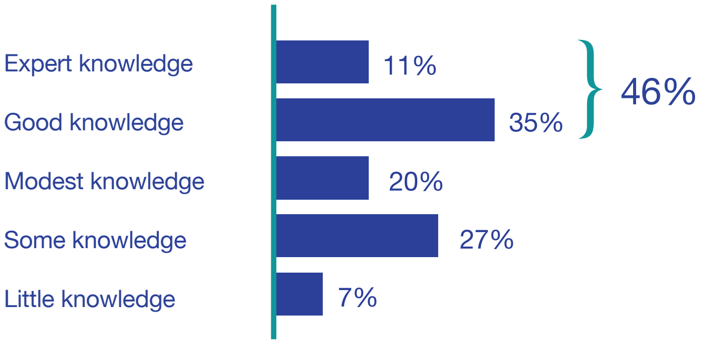


IMPORTANCE OF FINANCIAL LITERACY

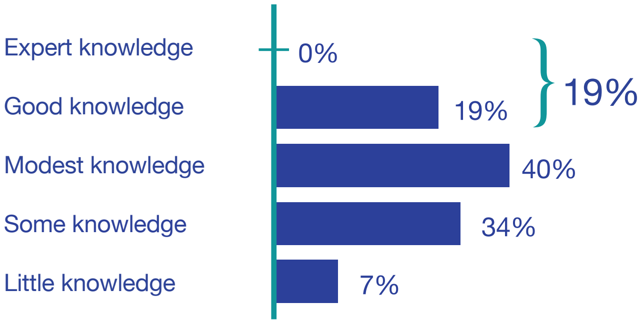
Financial Literacy Importance



Self-Ranked Financial Literacy



Perceived Financial Literacy of Others



81% of respondents said that financial literacy was very or extremely important, but only 46% said they had good or expert knowledge of financial literacy, while they thought that just 19% of Irish business owners have good knowledge.

These results suggest that Irish business owners strongly believe that financial literacy is critically important, that they have an average view of their own abilities regarding financial literacy and they think that the vast majority of other Irish business owners have limited financial literacy skills.

USE OF FINANCIAL INFORMATION

Beliefs about primary use of financial statements in businesses

51% of monthly accounts are not read on a monthly basis

51% do not know the gross margin/ net margin per product/service

26% of the companies surveyed do not produce debtor/creditor lists.

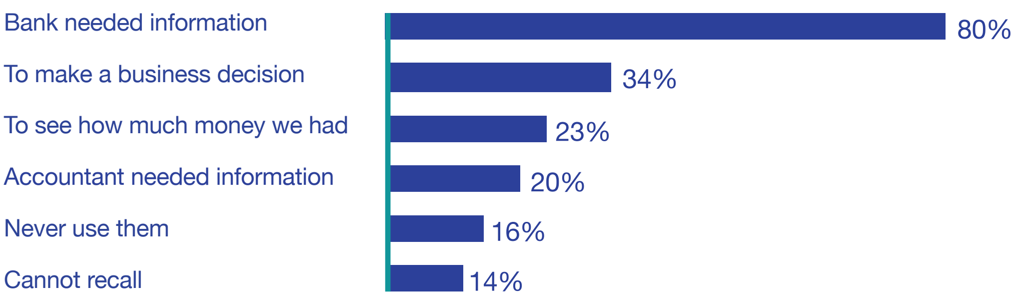
More Likely

- To understand their situation on a month-by-month basis
- To submit accounts to Revenue

Less Likely

- To get funding from sources other than a bank
- To get a bank loan

How monthly accounts are used



Why business owners don’t use financial statements to inform business decisions

Why business owners don’t spend more time learning to read and utilise Financial Statements

The survey examined the use of financial information by SME owner-managers and found that a majority believe that financial statements are used to understand their situation on a month-by-month basis. However, 51% of respondents answered that they do not read their monthly accounts on a monthly basis. It was also interesting to note that 55% believe that the primary use of financial statements is to submit accounts.

Deeper analysis of the survey data also found that 49% believe that financial accounts can be used to understand the year-end situation, 52% to know their business situation at any time and 51% to make better business decisions. Gross/net margin per product/service were unknown to 51% of respondents and 26% do not produce debtor/creditor lists.

The survey also found that 80% of business owners primarily generate monthly accounts because of bank requests and 42% believe that it is their accountant’s responsibility to interpret the data. A substantial 42% do not understand financial statements and 39% stated that they do not value understanding financial statements.

The survey very clearly highlights that business owners do not use the financial information available to them on a regular basis and believe that it is the accountant’s job to take care of all matters relating to the finances of the company.

LEVELS OF FINANCIAL LITERACY

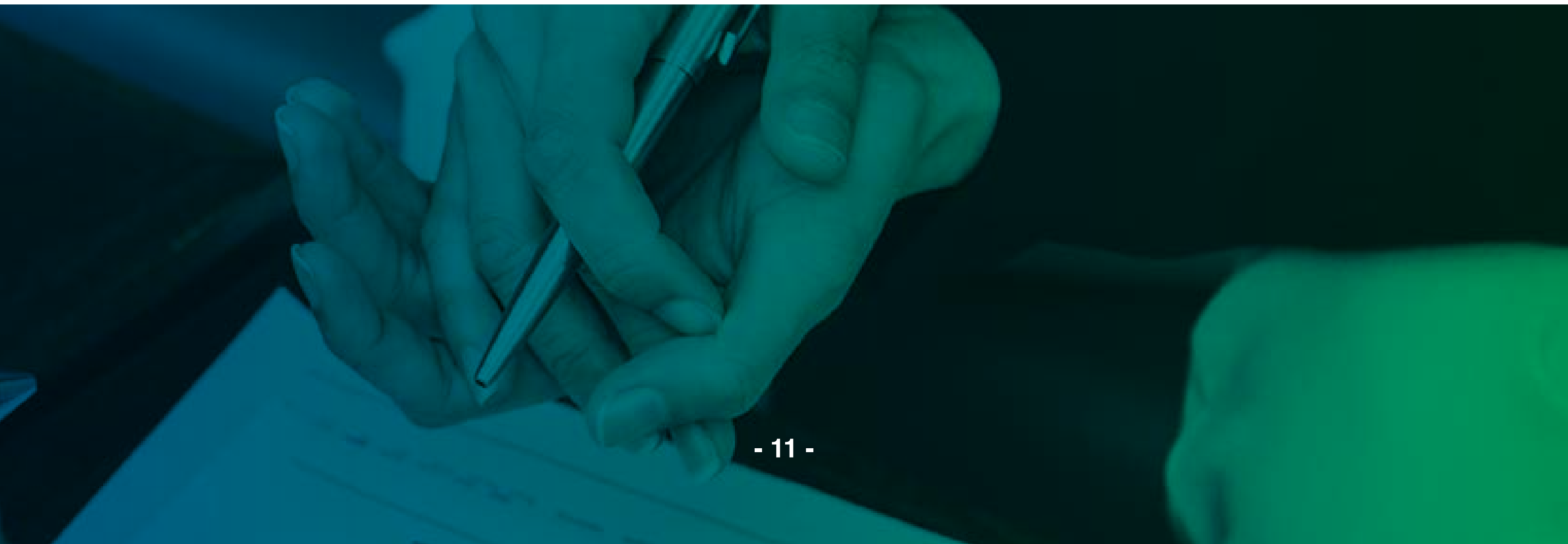
Percentage of Correct Answers by Self-Ranked Financial Literacy	Little-Same Knowledge	Moderate Knowledge	Good-Expert Knowledge
Fixed Assets Definition	27%	41%	46%
Cost of Sales Definition	50%	63%	61%
Purpose of Balance Sheet	36%	44%	46%
Reason of Difference in Profit	36%	52%	59%
Debtor Days Ratio	48%	56%	64%
Liquidity Definition	27%	37%	36%
Current Asset Definition	39%	44%	49%
Average Score	38%	48%	52%

	Answered Correctly	Answered Incorrectly
Fixed Assets Definition	39%	61%
Cost of Sales Definition	57%	43%
Balance Sheet	33%	67%
Profit and Loss	34%	66%
Profit Vs Cash Position	50%	50%
Debtors Ratio	57%	43%
Viability	36%	64%
Liquidity	52%	48%
Accounts Payable	51%	49%
Current Asset	45%	55%
Average	46%	54%

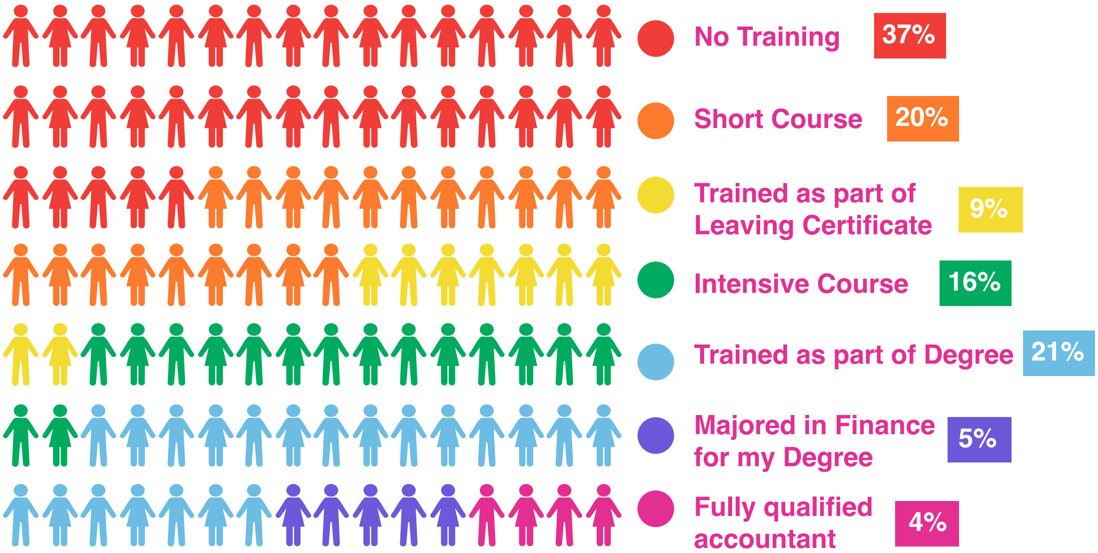
As part of the survey, a number of specific financial knowledge questions were offered to give respondents the opportunity to test their levels of financial literacy.

The average number of correct answers was 46%, with the highest correct responses being received for Questions 2 and 6 with 57%. One question only received a correct response rate of 33%. The 10 questions that were asked (and the correct answers) can be found at the end of this publication.

The correct response rate for respondents who rated themselves as good/expert averaged was 52%, only 4% better than respondents who rated themselves as having moderate knowledge. These findings demonstrate that financial literacy is a serious issue amongst Irish SMEs and effective initiatives must be introduced to tackle the problem.



FINANCIAL LITERACY TRAINING



Preferred Training Method

1. Combination of online and workshops 24%
2. 6-month program and 1-day workshops 16%
3. Mentorship-based training 15%
4. Peer-to-peer learning 10%
5. Online only 7%
6. Webinar 7%
7. All other options 21%

57% of respondents had received either a short course or no training in financial management, while just 9% of respondents could be said to have received significant training. This demonstrates that there is a significant need in the market for such training.

The preferred training method for respondents was a combination of online training and workshops, but less than a quarter suggested this option. The broad spread of responses underlines the challenge of developing a singular approach to providing financial management training, but it does emphasise that a multi-dimensional approach will need to be adopted.

KEY ACTIONS

1. **Ensure that the development of financial literacy amongst owner-managers in SMEs is a priority for government by including it in the forthcoming policy on SMEs and Entrepreneurship under *Future Jobs Ireland***
   Lead: Department of Business, Enterprise and Innovation

2. **Develop financial literacy in our young people by exploring the primary and secondary school curricula to see where financial literacy could be included in a more meaningful way**
   Lead: Department of Education

3. **Develop a blended learning financial literacy programme aimed specifically at SMEs to support a higher level of financial literacy expertise**
   Lead: Skillnet Ireland

4. **Create a digital platform and campaign to increase financial literacy expertise among small business owners**
   Lead: SFA, Microfinance Ireland, SBCI, Skillnet Ireland, TU Dublin

5. **Raise awareness amongst education and training providers and professional bodies on the importance of integrating financial literacy within existing training and professional development courses targeting SMEs**
   Lead: SFA, Local Enterprise Offices

It is the intention of the project partners to repeat the survey in 2021 to assess the level of improvement in the financial literacy of Irish SMEs.

FINANCIAL LITERACY -
Test your Knowledge

1. Which one of the following best describes a Fixed Asset?

   A) An asset that cannot be moved
   B) An asset which will help generate revenues for the business for a number of years
   C) An item in the product range which delivers the same sales volume year after year
   D) A cost that does not change

2. Which one of the following best defines the meaning of the term Cost of Sales?

   A) The costs of advertising, marketing and promotion incurred in generating sales
   B) The total costs that can be directly traced to sales. It includes all costs of purchase, costs of conversion and other costs incurred in bringing the goods to their present location and condition
   C) All costs, including overhead expenses incurred in the period
   D) The value added or sales tax incurred on sales

3. Which one of the following best describes the purpose of the Balance Sheet?

   A) A financial statement showing the assets, liabilities and net worth of a business at a specific point in time
   B) A financial statement showing the assets, liabilities and net worth of a business over a period of time
   C) A financial statement showing the balances outstanding on customer's accounts
   D) A comprehensive statement of the financial performance of the business over the year

4. Which one of the following business activities belongs in the Profit and Loss Account?

   A) The cost of purchasing building premises to house large scale manufacturing operations
   B) The cost of insuring business premises against fire
   C)The value of money outstanding from customers
   D) The value of new money invested in the business by the owners

5. Which one of the following would most significantly account for a difference between the profit for the year and the cash position at year end?

   A) Changes in the sales mix
   B) Increases in selling prices during the year
   C) Timing – i.e. sales will be applied in calculating profits when invoiced but the cash may not be received for weeks or months later
   D) Seasonal variations in sales demand

6. Debtor days ratio is debtors divided by...

   A) Owners' equity
   B) Sales on credit
   C) Total Liabilities
   D) Total Assets

7. Which of the following would pose the lowest risk to the viability of the business?

   A) A cash injection of €50,000 through the issue of new ordinary shares
   B) Drawing down a new-long term loan of €50,000 from a bank
   C) Indefinitely deferring €50,000 payments to short term creditors
   D) Pledging a marketable asset in return for an overdraft facility of €50,000

8. Which one of the following best defines the meaning of the term Liquidity?

   A) The surplus of current assets over current liabilities existing in a business
   B) The amount of cash held by a business
   C) The relationship between owners' funds and borrowings
   D) Money owed to the business by customers (Debtors)

9. Which one of the following best defines the meaning of the terms Accounts Payable or Creditors?

   A) The money owed to people who have lent money to the business
   B) Any excess of current liabilities over current assets
   C) The difference between Total Assets and Current Liabilities
   D) The money owed by the business to suppliers which is due to be paid within the next twelve months

10. Which one of the following best describes a Current Asset?

    A) An asset which the business expects to convert to cash within a year
    B) An asset which has been acquired within the last year
    C)A sales order to be delivered within the next year
    D) A delivery truck just bought in the last month

Answers - 1b, 2b, 3a, 4b, 5c, 6b, 7a, 8a, 9d, 10a

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