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Agenda Item: 7

Financial Literacy and SMEs in APEC

Purpose: Information

Submitted by: Chair



**38th Small and Medium Enterprises Working
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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

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:

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

¹ Hailwood, Kim, and Doug Widdowson. "Financial Literacy and its role in promoting a sound financial system. ." Reserve bank of New Zealand Bulletin 70, no. 2 (2007): 37-48.

² Hecklinger, Richard. "Financial Literacy Round Table Discussion." New Statesman. <http://www.newstatesman.com/node/152328> (accessed March 14, 2014).

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

⁹ Siekei, Jacqueline, Juma Wagoki, and Aquilars Kalio. "An Assessment of the role of financial literacy on Performance of Small and Micro Enterprises: Case of Equity Group Foundation Training Program on SMES in Njoro district, Kenya." *World Academic Journal of Business and Applied Sciences* 1, no. 7 (2013): 240-249. [http://archieive.webs.com/OFFICIAL%20PRINT%20VERSION\(HARD%20COPY\)-issues-March-October%202013.pdf#page=250](http://archieive.webs.com/OFFICIAL%20PRINT%20VERSION(HARD%20COPY)-issues-March-October%202013.pdf#page=250) (accessed March 14, 2014).

¹⁰ "Development of Strategy Options for SME Financial Literacy." USAID. http://pdf.usaid.gov/pdf_docs/PNADP093.pdf (accessed March 14, 2014).

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

¹¹ "Global Financial Inclusion Index." World Bank Data and Research. <http://econ.worldbank.org/> (accessed March 14, 2014).

¹² Ibid.

¹³ Choong, Desmond. "MasterCard Index of Financial Literacy Report (2013H1)." MasterCard Intelligence. <http://www.masterintelligence.com/content/intelligence/en/research/reports/2013/mastercard-index-of-financial-literacy-report-2013h1.html> (accessed March 14, 2014).

¹⁴ OECD. "International Gateway for Financial Education." OECD - INFE. <http://www.financial-education.org/> (accessed March 14, 2014).

on financial literacy for the public sector, financial institutions, and financial education programs.¹⁵ 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.¹⁶

APEC leaders have recognized the need for high levels of financial education. The APEC Finance Ministers’ Joint Ministerial Statement for 2013 explicitly targeted¹⁷ 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.¹⁸

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.¹⁹

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

¹⁵ "Recommendation on Principles and Good Practices for Financial Education and Awareness." OECD. <http://www.oecd.org/finance/financial-education/35108560.pdf> (accessed March 13, 2014).

¹⁶ "High Level Principles on National Strategy for Financial Education." OECD. http://www.oecd.org/daf/fin/financial-education/OECD_INFE_High_Level_Principles_National_Strategies_Financial_Education_APEC.pdf (accessed March 12, 2014).

¹⁷ "2013 APEC Finance Ministers' Meeting - Asia-Pacific Economic Cooperation." Asia-Pacific Economic Cooperation. http://www.apec.org/Meeting-Papers/Ministerial-Statements/Finance/2013_finance.aspx (accessed March 14, 2014).

¹⁸ "2012 APEC Finance Ministerial Meeting - Asia-Pacific Economic Cooperation." Asia-Pacific Economic Cooperation. http://apec.org/Meeting-Papers/Ministerial-Statements/Finance/2012_finance.aspx (accessed March 14, 2014).

¹⁹ "Advancing National Strategies for Financial Education: A Joint Publication by Russia's G20 Presidency and the OECD." OECD. http://www.oecd.org/finance/financial-education/G20_OECD_NSFinEd_Summary.pdf (accessed March 14, 2014).

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.*

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

Country Name	Account at a formal financial institution, male (% age 15+)	Account at a formal financial institution, female (% age 15+)	Account at a formal financial institution, bottom 40% (% age 15+)	Saved at a financial institution in the past year (% age 15+)	Loan from a financial institution in the past year (% age 15+)	Loan from a financial institution in the past year, bottom 40% (% age 15+)	Loan from family or friends in the past year (% age 15+)	Debit card, female (% age 15+)	Credit card, female (% age 15+)			
Australia	99.5947	99.06484	98.59229	98.3571	61.92494	16.9835	8.207391	12.59346	79.05435	77.68347	64.23052	67.13805
Canada	94.27522	95.80464	97.23316	92.87665	53.20308	20.30042	17.47081	15.98184	87.9597	91.05261	72.32712	75.2384
Chile	43.44199	42.17929	40.97443	25.8005	12.41675	7.780398	5.311618	9.410056	25.77008	22.42761	22.84936	21.94937
China	67.58479	63.81731	60.00867	47.11938	32.08942	7.256366	7.680004	24.98504	41.02147	38.36354	8.233701	7.064174
Chinese Taipei	86.17018	87.3149	88.42019	82.42992	45.7173	9.587192	8.59023	6.91243	37.03901	40.12969	45.86416	48.91684
Hong Kong, China	88.25115	88.68604	89.07763	83.41736	42.77365	7.926506	3.489466	12.0663	75.76701	75.44276	58.08301	57.3432
Indonesia	19.96724	19.58199	19.20753	10.31118	15.28832	8.547714	6.411661	42.30019	10.53939	9.522401	0.4956684	0.3277563
Japan	95.9716	96.42204	96.8449	95.07358	51.32575	6.096314	3.049349	5.055371	12.9623	13.10575	64.44076	63.15906
Korea, Rep.	92.98253	93.04687	93.10782	89.33324	46.94206	16.57813	13.23778	16.99719	57.9127	55.6359	56.43068	59.45364
Malaysia	69.21938	66.17381	63.09647	50.11819	35.40678	11.19655	1.843052	19.86079	23.13455	20.59996	11.91618	9.923801
Mexico	33.19209	27.42938	21.96588	12.07753	6.725278	7.558856	5.866879	14.76345	22.27542	16.62366	12.96561	9.143559
New Zealand	99.42394	99.43673	99.4483	99.16231	60.43975	26.62319	20.26677	17.14856	93.78894	93.51588	59.20004	58.77287
Peru	23.44542	20.45868	17.56129	7.537345	8.557856	12.74634	8.704276	14.4884	14.13089	11.69476	9.973643	9.53695
Philippines	19.0031	26.55593	33.71373	10.35333	14.71312	10.5146	5.067348	38.96992	13.15578	16.41467	3.157714	3.959437
Russian Federation	48.78087	48.17849	47.70323	40.24802	10.87796	7.689795	6.343302	23.46452	36.96459	36.06926	9.677403	8.389285
Singapore	98.23234	98.22189	98.21179	97.39812	58.4099	9.991625	6.112626	15.55632	28.62926	27.88091	37.34978	37.26514
Thailand	72.70007	72.66644	72.63754	61.29475	42.8026	19.39599	26.94114	7.654822	43.09781	44.68628	4.508161	5.742827
United States	91.98194	87.95786	84.06905	81.89575	50.39787	20.13618	17.63054	17.23961	71.76666	65.83336	61.93681	56.2529
Vietnam	24.00456	21.36949	18.90926	10.56491	7.740848	16.17792	15.36032	30.99015	14.59069	13.28426	1.238515	1.820265
Average	66.7485847	66.0192958	65.3043768	57.6510087	34.6185912	12.7940835	9.87287168	18.233601	41.5558211	40.5245648	31.8357282	31.6525013
Median	72.70007	72.66644	72.63754	61.29475	42.77365	10.5146	7.680004	15.98184	36.96459	36.06926	22.84936	21.94937



Financial Literacy and SMEs

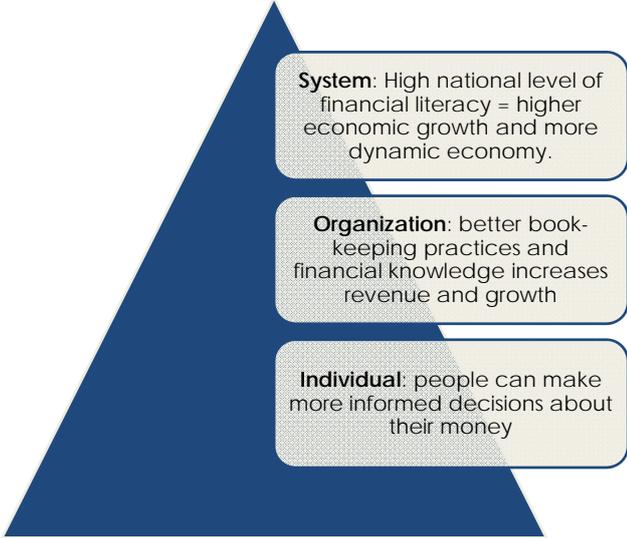
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Defining Financial Literacy

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.

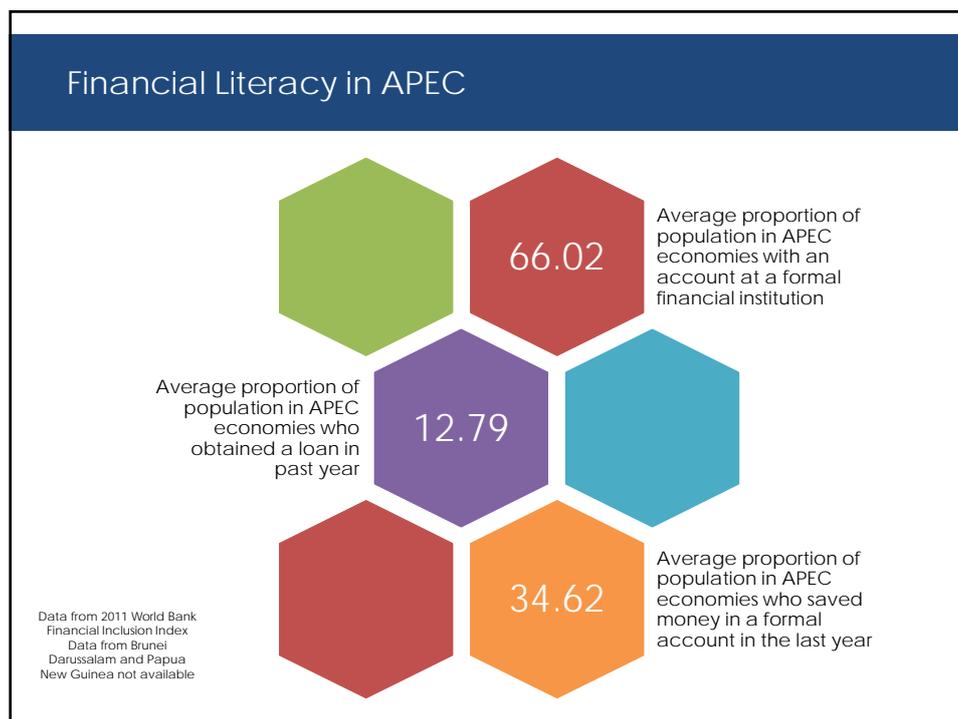
Organization: better book-keeping practices and financial knowledge increases revenue and growth

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



- ## 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)
 - Finance Ministers' Endorsement of OECD "High Level Principles on National Strategy for Financial Education"

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

