Subunit 4.4: Financial and Economic Literacy

Learning goals

- To learn about basic financial and economic concepts.
- To be able to make a budget.
- To know the existence of new economic and financial possibilities for a company's creation.

Definition

Financial literacy can be defined as the knowledge, skills and attitudes that allow us to make the correct financial decisions for our personal or professional wellbeing.

Economic literacy refers to the ability to understand and apply economics concepts to explain the main mechanisms of the world in which we live; for example, resources, money, offer and demand etc. This knowledge allows us to make personal decisions with awareness of the main economic factors which affect our modern society.

Basic economic concepts

Economics is the study of how individuals, governments, businesses, and other organisations are organised in society and make choices which affect the allocation and distribution of resources. Remember that resources are scarce and limited.

Economic agents are all the individuals, governments, companies, and other organisations present in the society. Altogether, the relationship they have between them is known as the **economic system**.

The money flow, also called nominal flow, represents the exchange of goods and services for money.

Scarcity of resources is the main problem economics intends to solve, as resources are limited, especially the natural ones.

How do societies allocate and distribute the scarce resources?

It depends on the cost and benefit balance. When talking about cost, we don't only mean price, but also the **cost of opportunity**, which is the benefit you miss when you make a choice. (ie.:1h work vs 1h partying)

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How do markets and prices work?

Market prices influence the choices of both buyers (demand) and sellers (supply). When an increase in the price of a good makes it more expensive for buyers to purchase it, they will tend to buy less. Therefore, for sellers, the increase in the product price results in an extra revenue that makes them willing to sell more of it. In the end, the price will reach a compromise to be attractive both for buyers and sellers (not too cheap, but not too expensive).

Inflation is when prices go up. Usually, when we talk about inflation we’re talking about general inflation, that is, when the prices of all goods tend to go up at the same time. On the contrary, when prices decrease, it is called deflation.

Basic financial concepts

Finance can be defined as the management of money. It includes activities such as investing, borrowing, lending, budgeting, saving, and forecasting. There are three main types of finance: personal, corporate, and public.

What is money?

Money is a wider concept than we might think.

Coins and paper bills are only one form of money, called **currency**. When you think about how much money you have, you probably consider the savings you have in the bank, or the financial assets you own like stocks or bonds.

Money has value because we agree to use it and treat it as valuable; otherwise, it would just be a piece of paper, of metal, or numbers on a page.

So, to summarize, we can say that:

- Money is a medium of exchange to sell, buy, and earn.
- Money is a unit of account. We sell and buy many different things, but money allows us to do it in the same units.
- Money is also used as a store of value.

Asset: An asset is an economic resource with probable future benefits. It is something of value, such as cash, real estate, or property. A company usually has current assets or fixed assets.

Liability: A liability is a financial obligation, such as debt. Liabilities can be current or long-term.

Balance sheet: A balance sheet is a document that shows a company's assets and its liabilities. Subtract the liabilities from the assets to see the firm's **net worth**.

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Income: is the money a person receives in exchanges of their labour, products, or investments. Most of the time wages and salaries are people ´main incomes; but sometimes it can also be, the return on their investments, pension distributions, and other receipts. For businesses, income is the revenue from selling services, products, as well as any interest and dividends received.

Revenue: is the money earned from the sale of goods and services.

Profit: Profit is the money left over after expenses. A profit and loss statement shows how much a business has earned or lost for a particular period.

What is the budget?

A budget is a financial plan which takes into account the income and expenses of a company. It serves to estimate how much you earn and how much you spend over a given period of time.
Before creating your annual budget, it is important to list your incomes and expenses, and to consider your needs and wants.
A budget also helps to see where you could be overspending money and help you to make a decision to save money.
Creating a budget also helps to stick to an objective and reach short- and medium-term financial goals.
It is important to know that budgets can be revisited and reworked if you have financial problems or setbacks, so that it reflects your current situation.

Here are a few concepts which help to understand:

- **Fixed expenses**: expenses that stay the same from month to month, for example rent payments.
- **Flexible expenses**: expenses which change from month to month, for example the amount you spend on inputs.
- **Total expenses:** the total amount of fixed and flexible expenses.
- **Total monthly income**: income from your job or other resources including investment dividends, pensions, rental income and more.
- **Disposable income:** is the money you have left over after you subtract your income taxes from your income.

Find funding

How to find funding?

Usually, small companies have two basic funding options: debt financing and equity financing.

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Debt financing is when you borrow money, often through small business loans, which you repay with interest.

Equity financing is when you take money from an investor in exchange for partial ownership of your company.

Both options provide cash, but each has pros and cons. Debt financing can be expensive, especially if you have bad credit. Nevertheless, equity financing requires giving investors part of the decision making in your company.

Understand taxation

There are different types of taxes, but they all refer to the money collected by a government. It is then used to finance specific facilities or services such as hospitals, schools, museums, libraries, etc. The most common individual taxes are:

- **Income tax**: is a percentage of individual earnings given (wages) to the government.
- **Consumption tax:** is the VAT (Value Added Tax) on goods and services.
- **Property tax**: is based on the value of property assets and lands.
- Customs duties: tax settled on imported goods to support national businesses.
- **Excises**: indirect tax charged on the sale of particular goods (i.e.: tobacco or alcohol).
- **Environmental tax**: additional cost added to the price for buying or using polluting products or activities. It aims to discourage their production and consumption.
- **Capital gains**: when we buy and then sell a good at a higher price, we obtain a financial benefit which is taxed.
- **Inheritance tax**: is a tax paid on the money or property that a person inherits from another person after that second person dies.

The tax collected goes straight into the national budget, whereas tariffs and custom duties are collected nationally but go into the EU budget.

EntreComp's guidelines

EntreComp gives us the following hint:

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"Develop financial and economic know-how."

How?

- Estimate the cost of turning an idea into a value creating activity.
- Plan, put in place and evaluate financial decisions over time.
- Manage financing to make sure your value-creating activity can last over the long term.

Competence step by step

- Understand economic and financial concepts.
- Budget.
- Find founding.
- Understand taxation.

Methodologies and tools

- Budgeting tools.
- Learning videos about economic or financial concepts.

Circular Economy application

When considering financial aspects of your company, such as creating a budget, try to consider circular economy principles and include them. You can make various options considering local purchases versus imports for example, and recycled materials versus new materials, and find out what is the best option financially speaking. Also, remember that the benefits of the Circular economy, apart from the environment, is also the brand image, and this cannot be quantified in a Budget, but can increase the company's incomes.

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Practical activity: ***How to create a budget***

Objective: to create a budget and try to find how much a company should sell to be profitable.

Materials: Computer, paper and pen.

Time: 30-45 minutes.

Methodology:

1. Use one of the many business ideas you brainstormed in the previous practical activities. List all your expenses you think that business entails (10 minutes).

2. Afterwards, list all your incomes (10 minutes).
3. Calculate the income – expenses and see if you have credit or debit balance (10 minutes). This will help you to determine how much you should sell to be profitable as a company.

Food for thoughts:

A budget calculation is a very useful exercise when it comes to give birth to a project or an initiative of yours. Think on your abilities to acknowledge your financial resources and make good use of those.

Learning materials suggestions

A Quick Summary of Supply and Demand:

https://www.econfun.org/en/video?id=a-quick-summary-of-supply-and-demand

What is money?

https://www.ecnmy.org/learn/your-money/thinking-about-money/what-is-money/

What does money do?

https://www.ecnmy.org/learn/your-money/thinking-about-money/what-does-money-do/

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