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FINANCIALIZATION OF THE ECONOMY AND THE NEED FOR PERSONAL FINANCE ADVISORY SERVICES

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Abstract

Financialization of households is a result of the growing role of financial systems and instruments in the economy. The increased role of financial phenomena in financial and non-financial decisions taken by households is not proportional to capabilities of their perception and understanding by households which possess basic knowledge in finance. The missing link between institutions and financial markets offering more complex financial solutions and the consumer may be a financial advisor who can perform many important roles with respect to households. The aim of this article is to present financialization of the economy and households and the role that can be played by financial advisors in decreasing the imbalance of information between the consumer and financial institutions, as well as the lack of symmetry in understanding financial information by the consumer.

JEL classification: D14, G23
Keywords: households financialization, personal financial advisor

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Introduction

The aim of this article is to present the issue of financialization of the economy and its effect with regard to personal finance (household finance). One of the results of financialization is the increase in volume and complexity of financial instruments available for households that are offered by ever more diverse financial institutions. Furthermore, when we add to it a significant imbalance of information exchange between consumers and financial institutions and the lack of symmetry in financial information comprehension by the consumers, as a result we get a demand for professional financial advisory services, providing the consumers with reliable and unbiased information that would support decision making in the scope of household finance. Financialization creates the need to manage finance by households and a financial advisor can play an important and positive role in each stage of this process. The hypothesis of this article is included in the following statement: financialization of households creates the demand for independent financial advisory services supporting the process of personal finance management, and the inclusion of a financial advisor within the process of personal finance management leads to the reduction of imbalance of the information exchange between the consumer and financial institutions, as well as the lack of symmetry in terms of financial information comprehension by the consumer.

Financialization of the economy as a process – definition, reasons and effects

Financialization is an English term denoting modern changes in financial and real areas of national economies. The origin of the term *financialization* in the English literature is unclear, however it became used more frequently at the beginning of the 1990s. As Sawyer (2013-2014) points out, Kevin Philips (1993)used this term as a title of a chapter entitled *Financialization of America*, defining it as a long-lasting division between the divergent real and financial economies. Financialization is a phenomenon that extends beyond economic processes. It embraces the whole social life in a given country and in the global economy (Marszałek, 2012). According to P. H. Dembiński (2011), perception of the world through the prism of financial rationality has gradually changed the behavioral pattern, social structures and mechanisms.

The main reasons for financialization are considered to be the liberalization and deregulation of financial markets as an element of the implementation of neoliberal economic policy, including monetary and fiscal policy, the globalization of national economies (Janc, Jurek & Marszałek, 2015), the paradigm of profit and value creation for owners or stakeholders in wider scope in modern concepts of a company's operational activity, the creation of financial instruments that are not backed in the real economy (e.g. derivative instruments) and which generate various risks for issuers and buyers alike. The main source of financialization is money issued by private banks out of nothing (Księżyk, 2013). The crash of the postwar monetary system in Bretton Woods in the 1970s opened an age of symbolic money (off-hand), fiat money - based on trust and managed by monetary powers (central banks). According to E. Gostomski (2014), paper money based solely on trust and the promise of a central bank to keep inflation at a low level gives central banks arbitrary power to manipulate interest rates and allows them to print theoretically infinite amount of banknotes, and for commercial banks it guarantees free opportunities of credit granting, i.e. issuing bank (cash-free) money. The most important effect of financialization is the contemporary financial crisis (2007-2009).

According to K. Jajuga, the process of financialization means the increasing dominant role of financial systems based on financial markets, the growing political and economic strength of rentiers, the boom in new financial instruments and increased share in profit generation through financial channels compared to production and trading channels. K. Jajuga defines financialization generally as the increasing role of financial motivation, financial markets, instruments and institutions in the functioning of national and international economies. It is reflected in the value of financial assets against GDP - whereas in 1980 it was approximately 100%, in 2007 it rose to 356%. Another bit of data allowing the identification of financialization is presented by S. Owsiak (2012) from 1952-2009 the nominal GDP rate in the USA increased by 4000%, and the assets of the financial sector rose by 16,000%.

M. Ratajczak (2014) analyses the process of financialization in two aspects - strict and broad. In a narrow meaning financialization is associated mostly with

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the increasing role of economic activity in the operational activity of economic entities of a non-financial nature. The consequence of this is a change in income streams, which include more and more income generated from financial activity, and not from operational and investment activity understood in a traditional way. In a broad sense financialization is a process of finance becoming more autonomous with respect to the real economy and even putting the former in the first place. Within financialization, financial markets and elites gain increasingly more influence on economic policy and the effects of management.

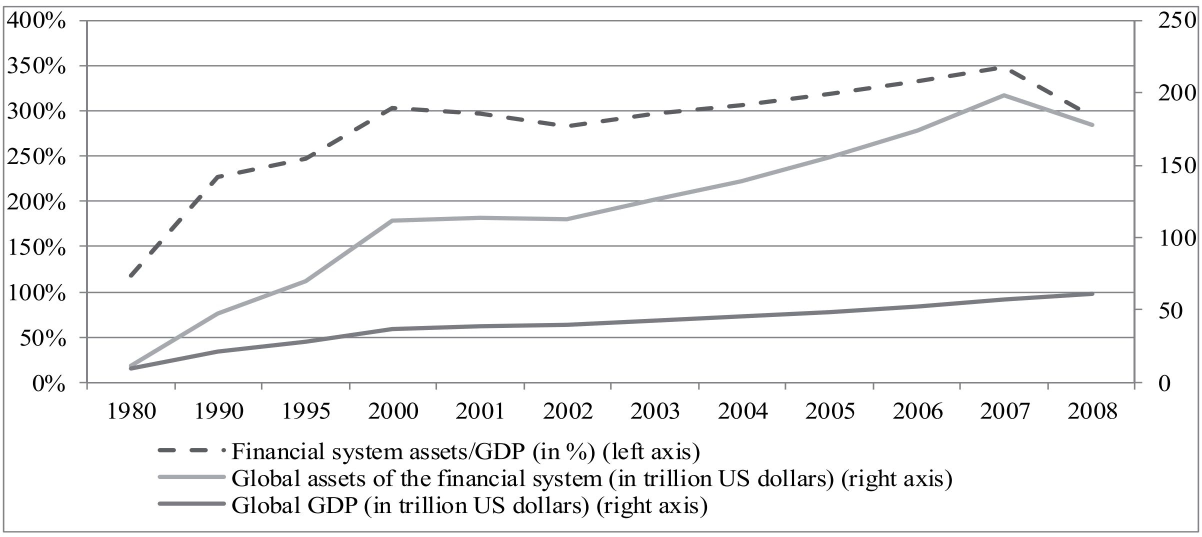
The most frequently quoted definition of financialization was suggested by G. Epstein (2005) in the introduction to his book entitled *Financialization and the World Economy*. He claims that financialization means the increasing role of financial incentives, financial markets, entities and institutions in the functioning of national and international economies. A similar definition is proposed by T. I. Palley (2007), according to whom financialization is a process in which financial markets, institutions and elites gain more influence on economic policy and economic results. J. Toporowski (2008) suggests defining financialization as an inflation of capital markets.

A factor that could describe the financialization process is the ratio between financial system assets and GDP rate in a given year. An important sign of financialisation is the diversification of financial assets through different available financial instruments and tools which are created and acquired by financial institutions and enterprises, which can also be purchased by households and lead to the diversification of their financial assets. According to data gathered over many years by Mc Kinsey, in 1980 the value of global financial assets and global GDP was similar (a rate close to 100%). In the following decades the phenomenon of financialization has been growing - in 1990 this factor was at 226% and in 2000 it was 303%. This data points to "scissors opening" between GDP and financial system assets, a phenomenon which was created by financial instruments and financial operations that have no backing in the real economy. In 2007, which was considered to be the beginning of the global financial crisis (2007-2009), this factor reached maximum value at almost 350% (Chart 1). Undoubtedly, financialization applies most of all to the USA, Japan and the EU but it is also becoming more important for emerging economies.

As the data suggests, financialization as a phenomenon has increased since the 1980s. The 20th century, and since 2007 when the crisis broke out, caused mainly by the overgrowth of the financial sector beyond the real sphere of the economy, the value of financial system assets and GDP ratio have been decreasing in the global respect due to diminishing financial system assets. The most frequently cited evidence in the literature (distinguishers) of financialization growth, apart from the domination of the financial sphere over the real sphere of the economy includes (Ratajczak, 2012; Marszałek, 2013):

1) the role of so-called invisible transactions and the development of the derivative instruments market (it is estimated that approximately 75-80% of financial turnover on a global scale applies to transactions not connected

Chart 1:The growth of financialization on a global scale



Source: Own study based on the data of the consulting company Mc Kinsey

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with the flow of goods or non-financial services),

2) inflation of financial assets (increase in the price of securities due to the easy availability of cheap money leading to a speculative "bubble" in the financial market) and financial instruments,

3) leveraging of economic activity, including the financial sphere,

4) growing role of financial institutions and their income within economy,

5) growing share of financial assets in household assets, particularly in highly developed countries,

6) ownership changes, particularly concerning large companies, resulting in the growing role of institutional owners from the financial sphere,

7) changes in management related to the widespread concept of shareholder value, which replaced highly exposed previous concept of stakeholder value,

8) the escalation of frequency and strength of financial crises,

9) deregulation of financial systems and individual economies,

10) ever-expanding number of financial instruments,

11) decisions on socio-economic policy beneficial for the development of financial markets,

12) growth in credit-based consumption,

13) common and rising presence of institutions, markets, instruments, financial schemes in economic and social life.

The phenomenon of financialization applies not only to the growth of financial asset value, but also to the more significant role of the financial sector in the economy. The effect of financialization in connection with globalization and labour transfer onto rising markets is the stagnation of earnings in developed countries, causing gradual erosion of middle class purchasing power which has been driving the economic growth in the USA and Western Europe in decades of economic boom following World War II. Financialization with its universal properties seems to "pour" onto other countries, enveloping them within the global capital circulation system (Lewicki, 2014a). Since World War II, the U.S. has become a major market creating innovative financial instruments, which are then subject to diffusion to other developed markets. Chairmanship of the United States in the creation of financial innovations resulted in the contemporary financial crisis (2007-2009), and some of the instruments, which had their source in the U.S. market came to be seen as toxic. Securitization and derivatives, in particular credit-default-swaps and collateralized debt obligations, appear to have played a major role in the increase of leveraging in the U.S. financial sector. Their proliferation has dramatically expanded access to cheap credit, allowing the smooth financing of ventures that otherwise would never thrive. Securitization has boosted economic interdependence and investment levels by financing high risk business ventures via the distribution of risk among a wide range of investors across borders. This resulting 'democratization' of access to financial markets has been widely regarded as one of the drivers of the current wave. But they were not the drivers of the current crisis: in fact, they have received too much blame for it. These changes in the finance structure have dramatically exacerbated the formation of bubbles. These complex financial instruments cut contracts into smaller pieces and combine them with other 'fragmented' loans, and often then are insured against defaults, providing creditors with an (apparently) often false sense of security. Meanwhile, they create complex linkages that are difficult to trace for both regulators and financial actors themselves. In short, these powerful financial tools, based on sophisticated mathematical modeling, appear able to absorb any uncertainties. This maximization of the complexity of financial products conceals the risks from investors (Cognato & Kaminski, 2009).

Chart 2 shows evolution of a financial system assets indicator vs GDP in Poland in 1996-2013. The value of this indicator in the analyzed period rose from about 54% to approximately 126%, whereas 100% was exceeded in 2007. The level of this indicator shows that financialization in Poland did not occur at such a magnitude as in the most developed countries in the world.

Financialization of households

Financialization has also had significant impact on households. The primacy of growth for shareholders as the main objective of company activity influences the reduction of share in added value division generated by the sector of companies belonging to the remaining groups of shareholders, particularly employees. Increase in consumer and mortgage credit value generated by the financial sector has become the substitute for salary growth and the driving force of economic growth. As a result, a high consumption level of households was retained at a mid-run, however not without serious consequences connected with the increase of household

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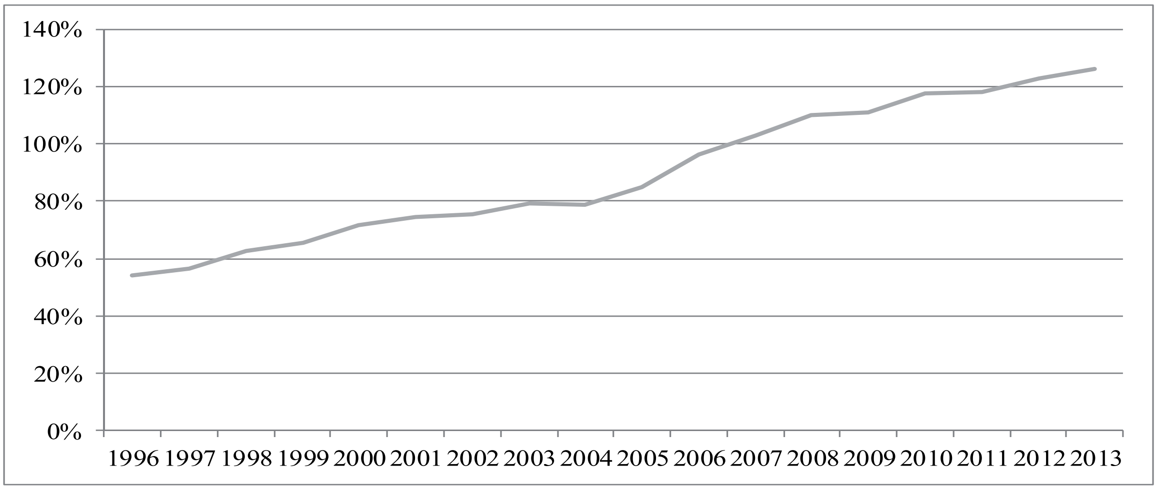
Chart 2: Financial system assets in Poland vs GDP (in %)



Source: Financial System Development Reports, NBP, Warsaw

debt (Wrzesiński, 2014).

Financialization of households means that people use financial services to fulfill a growing number of needs. Such needs can be grouped into two areas (Borcuch, 2013):

1) the need to gain money and make payments (more often in electronic form) to lead a normal life,

2) the need to engage relations occurring in time and related to promotion and protection - promotion denotes the improvement of the material life of an individual, whereas protection relates to the needs that avoid decreasing the lifestyle level in individual situations.

Chart 3 presents Structure of financial assets of households in a global perspective on the basis of *Economic Research*. In the period 2000-2014 that structure was relatively stable. The share of banking deposits increased from 26% to 28%, share of securities decreased from 42% to 39% and share of insurance increased from 30% to 31%.

The specification of financialization factors that influence households is as follows:

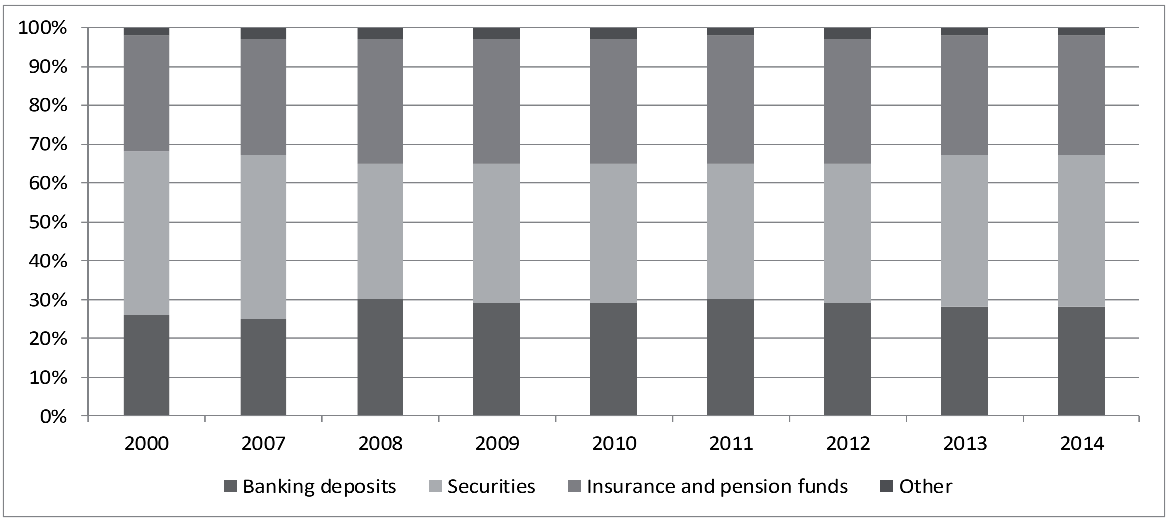
1) the increase in financial needs within households,

2) the increase in the importance of financial services in meeting households' needs as an element of a broader process- servitization of households, i.e. broader use of various services by those households,

3) bigger importance of individual consumption supported by consumer credit (development of *consumer finance*),

4) the expansion of mortgage debt of households in absolute values as well as with respect to GDP,

Chart 3: Structure of financial assets of households in global perspective



Source: Global financial assets of private households, Economic Research, Munich, October 2015

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5) general increase of financial assets within household assets,

6) institutionalization of household savings,

7) the rising importance of cash-free settlements in households,

8) the rising insurance awareness and the volume of voluntary insurances concluded by households,

9) the increase of pension awareness and voluntary capital accumulation by households as a solution to an inefficient state pension system.

In the savings and investment areas financialization, through financial innovations, has led to a situation, where a household can choose from a plethora of savings and investment instruments that differ in terms of risk level, liquidity and profitability. The financial market allows for diversification of savings and investments portfolios of households, and consequently for optimization of the risk/reward ratio. Institutionalization of household savings means a decrease in cash share, bigger significance of indirect (allocating the capital in financial instruments issued by financial agents – banks, investment funds, insurance companies, pension funds) or direct (investments in monetary market or capital market) savings and investment instruments.

The growing complexity of financial instruments is a result of the increased complexity of financial systems that was the main reason for the contemporary financial crisis (2007-2009). The complexity of financial instruments relates to the structure, mechanisms instrument valuation and marketing tools, as well as to the level of the specific risks associated with the instrument (credit risk, liquidity risk, interest rate risk). Increase in complexity/ financialisation, means (A) the need for more sophisticated control systems and (B) navigation aid in the form of financial counseling. Such complexity of financial solutions accompanied by a significant risk of making wrong investment decision boosts demand for professional help, for example of independent investment (financial) advisors. The involvement of professional financiers increases the accuracy of investment decisions and reduces risk, provided that the financial adviser is qualified by proven knowledge, experience, certification, compliance with the rules of ethics. Practical examples point out (also in the Polish reality), that there are numerous pathologies in the sales of long-term savings products and lack of making the purchasers of these products aware of the risks and the fees charged in the case of premature termination of the deposit. This was not related to the performance by external entities to the household by the foregoing financial advisors. In the context of pathology in the market for financial services the state and authorities should support a reliable, professional and ethical advisory system.

A large role in credit issuing was played by an increasingly more popular "living on credit" culture, with its particularly strong presence in Anglo-Saxon countries - the USA and United Kingdom and continental states of Western Europe. It has also been gaining popularity among countries that underwent system transformation (Eastern Europe, including Poland). Transformation of the economic system exposed the gap between the quality of life in countries belonging to the USSR block and Western Europe, but the potential demand of households for durable goods - mainly household and electronic equipment - due to low income could not cover effective demand, which provided an opportunity for the development of consumer credits and dynamic growth of *consumer finance*. *Consumer finance* is defined as "the spectrum of financial instruments available to individual customers to serve their financing needs. In a broad sense these are instruments offered by banks, insurance companies, investment societies. In a more narrow sense these are instruments typical for retail banking: cash, consumer and installment credits as well as various loans. Such products are offered - apart from banks and savings and credit unions subject to specific laws - also by entities conducting para-banking activity pursuant to the Civil Code (Ancyparowicz & Rutkowska, 2014).

Simultaneously, the poor housing situation brought the need to renovate and adapt decapitalized housing assets built in the years following WW II, and it was also a driving force behind real-estate developer growth. The expansion of universal banks and mortgage banks products addressed to individual customers in the scope of financing the purchase of a plot of land, an apartment or building a house with a bank loan along with diminishing interest rates and with the help of the state in the form of preferential programs paved the way for credit expansion in real-estate financing. By acquiring long-term mortgage credit in an individual bank, the household becomes sort of a product of a bank, starting from the bank account, through debit or credit card, cash or installment credit, credit insurance, and up to long-term savings programs. Mortgage credit becomes an element of household financialization (Lewicki, 2014b). Due to the long-term

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nature of mortgage credit and its form of debt – a mortgage on property occupied by the debtor with their family may pose many risks to a household, including currency risk, interest rate risk, devaluation of credit security, lowered income or losing a job by the main debtor. As practical situations show, including Polish reality, foreign currency credits have been a source of numerous pathologies both from sales services of banks and "pseudo-advisors" looking after sufficient commission and only caring for their own business. The process of credit expansion has led to lowering the indebtedness of households due to consumer credits and mortgage credits in absolute values, *per capita* and with relation to GDP. Both in the sphere of consumption financing and mortgage financing of properties, in order to take responsible decisions concerning credits through *responsible borrowing* principles, a number of elements is required, including expertise, knowledge of the financial services market in terms of available solutions and often subtle differences between them, as well as time needed to compare the offers and select the best one. Here a financial advisor may also prove to be helpful. In consumer financing there is a trend showing a rising protection level through more complex information obligations imposed on financial institutions and specific consumer rights, e.g. withdrawal from agreement, full payment of credit before the deadline. However, protecting consumers by providing information and granting consumer rights alone is insufficient, as it is assumed that the consumer possesses good knowledge and is able to comprehend the information that they read. In practice such an assumption is unreal. We can also observe the prominent role of an agent handing over reliable information on the rights and obligations of a consumer and the consequences resulting from individual provisions of financial agreements. Many countries still lack transparency - a standard, uniform presentation on costs and benefits, fair rules of *consumer finance* services, e.g. associating various financial services within package deals or tying, therefore also the opportunity for comparing credit and loan offers (Szpringer, 2014). This shows that the role of credit advisors should gain importance.

Financialization of households with respect to satisfying needs related to making payments is expressed in growth of cash-free payments and electronic banking, as well as more common use of electronic payments - mobile, proximity and *on-line*. Traditional cash payments are losing their prominent role. The popularity of pay cards used for making payments in shops lowers average transaction value, and the increasingly more common availability of ATMs with more and more diverse features make it comfortable to use cash as well.

Nowadays, household pension needs are becoming more important. Demographic changes and problems with public finances are the evidence of rising ineffectiveness of state pension systems. It would be rational to accumulate pension capital individually by a household, but to do so pension awareness and personal finance management are a necessity. It is worth noting that the longer the saving period, the lower the individual amount of savings, e.g. lower amount saved every month in order to collect pension capital at an appropriate level in the future.

The need for financial counseling services for households as a result of the increase in complexity of financial systems and financial instruments

In order to fully participate in the financial services market and take advantage of financialization, a household must have a certain level of so-called financial literacy which embraces knowledge, skills and competency in the field of finances. Holding economic knowledge, skills and competency within personal finance management is an indispensable element to take on this crucial and difficult process. Financialization has led to diversification of available financial instruments never seen before - savings, investment, credit, insurance, settlement, rendered by ever more diverse financial agency institutions. The importance of financial education underlines an adaptive approach within decision-making theory in a particular way. According to a classification suggested by T. Potocki (2014), economic education is meaningless in economic and behavioral approaches. Taking into account an adaptive approach, the decision-makers take decisions that are satisfactory only by a minimal margin, using heuristic models adapted to the surroundings in which a certain decision is being taken. Financial education contributes to improving the effectiveness of financial decisions.

The rising importance of finance in social and economic life means also the need to create theories explaining financial phenomena, which allow us to distinguish finance as an independent discipline within

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economic sciences (in Poland in 2010) and within financial sciences - household finance and personal finance. Household financialization creates the necessity to manage personal and household finances. B. Świecka (2014) suggests introducing two definitions of personal finance:

1) personal finance *in the strict sense* is a field of science dealing with collecting financial resources, their accumulation and expenditure by natural persons,

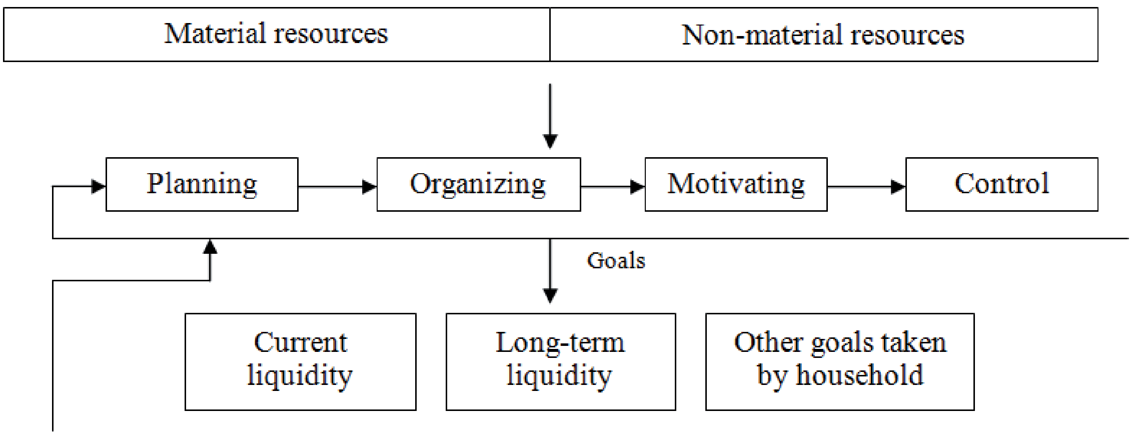
2) personal finance *in the broad sense* is a field of study belonging to economic sciences related to financial resources disposition (management) by family members in a given household. In other words, personal finance is, on the one hand, based on collecting money, and on the other hand, on spending money, but it also denotes saving and investing financial resources by household members. In this case, the term "personal finance in the broad sense" can be equivalent to "household finance".

Personal finance management is defined as a process that rests on increasing income on the one hand and its appropriate spending on the other, in order to increase household wealth and standard of life (Świecka, 2014). Personal finance management is a deliberate activity and the main financial goals of households are: reaching a required amount of pension capital, purchasing a real-estate property (a house or a flat) and securing the future of children (Jajuga, 2013). In order to manage personal finance and household finance one needs to be aware of the benefits granted by this process to a household. An entity responsible for making a household aware of the above mentioned issues can also be a financial advisor. Apart from raising awareness and providing information, a financial advisor can also actively participate in the process on each management stage (Scheme 1).

The need for financial counseling to households is caused by the rising complexity of financial services and plethora of various parameters on the one hand, which must be taken into consideration when choosing optimal solutions, and on the other hand, the lack of time to make one's own comparison, insufficient individual knowledge in the area of finance, insufficient understanding of the retail financial services market, as well as the will to engage a financial advisor as an expert in the process of personal finance management.

The last decade gave rise to a new phenomenon which is lack of symmetry in understanding information. Just gaining access to information is a necessary condition, but it is not enough to become useful for the recipient. Information must be, most of all, understandable. It applies to user's manuals, medical brochures, insurance agreements and a retirement fund prospectus. Comprehension of information is not just a simple feature of the knowledge of its recipient. It also depends on the complexity level of the "matter" it relates to as well as the will of an author with respect to their "intention" to present clear, understandable and unambiguous information (Hamrol, 2013). The lack of symmetry in understanding information is particularly visible in households, as economic and financial education does not require or is unable to catch up with rapidly

Scheme 1: The essence and the process of personal finance management



Support from financial advisors

Source: Barembruch, A. (2012). Zarządzanie finansami osobistymi - teoria i praktyka. In D. Zarzecki (ed.), Zarządzanie finansami. Upowszechnianie i transfer wyników badań, Zeszyty Naukowe Uniwersytetu Szczecińskiego nr 689, Finanse, rynki finansowe, ubezpieczenia nr 50

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progressing changes on financial services markets. Such imbalance can be diminished by households with the help of financial advisors who can explain details concerning financial instruments and agreements.

Moreover, household financialization means the need to perform risk management by households. Variability of market factors, including currency rates, interest rates, share and investments fund unit prices in relation with growing level of indebtedness of households, generates significant risks which must be managed by a household. Risk management conducted by households rests on risk identification, risk assessment, as well as risk appraisal (quantification), control and monitoring. Financial advisors can provide support in the risk management process conducted by a household at every stage of this process.

The possible and diverse features of a financial advisor within personal finance in times of household financialization are presented in Scheme 2.

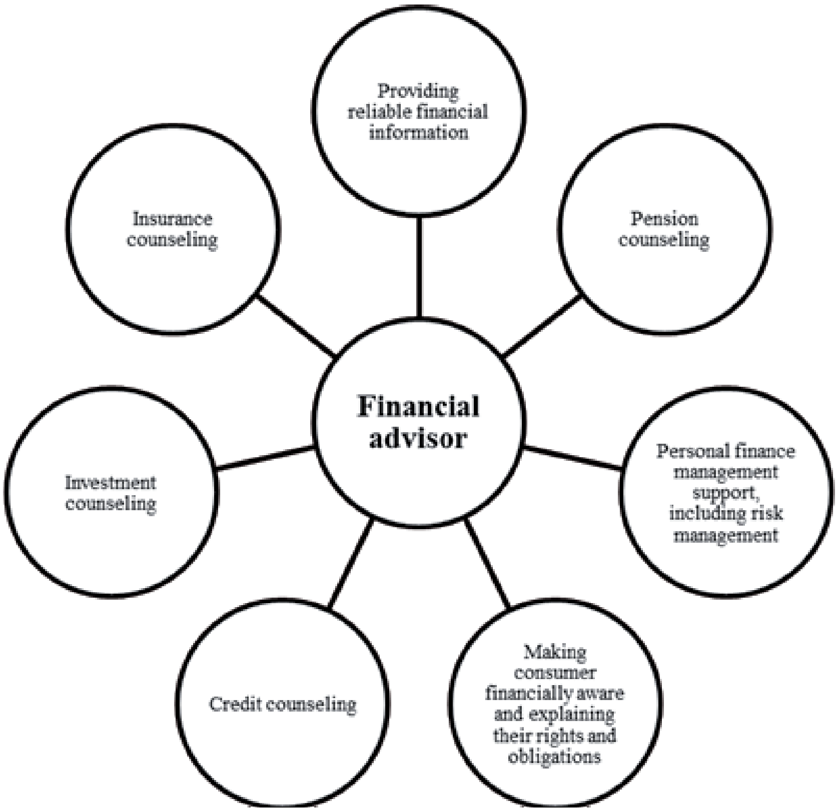
As a profession, the role of financial advisor is over 40 years old and its origins are considered to be the United States (the profession first emerged in 1969). The profession is most developed in its country of origin, and the number of households using financial advisors' services is the largest there as well - according to data collected in 2013, it was 29% (Waliszewski, 2014).

The growing importance of the role of financial advisor in the sphere of personal finance is very likely to continue in the future. The catalysts for this process will be: societies getting wealthier, further increase in complexity of financial instruments and solutions, insufficient knowledge and time needed for making one's own comparison of offers, ineffectiveness of state pension systems and demographic changes meaning the need to accumulate pension capital on our own. In countries such as Poland, it is indicated that there is a large potential for the growth of consumer and mortgage indebtedness of households which may lead to new demand for credit counseling.

Conclusions

Financialization is one of the most fundamental processes that are occurring in economic systems of highly developed and developing countries. One of its symptoms is household financialization leading to an increased role

Scheme 2: The role of financial advisor in the area of personal finance in times of household financialization



Source: Own study

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of monetary instruments (finance) in the functioning of contemporary households and meeting their collective needs as well as individual needs of each household member. Household financialization is escalated by financial institution strategies treating a retail customer as a customer showing high income potential and business appeal. A household with insufficient knowledge, competency and financial skills faces the risk posed by financial services - their product variety, entity diversity - and it faces a dilemma of choosing the most beneficial solution. A natural resolution is to employ a professional in the decision-making and realization process, who will provide support with respect to personal finance management in its many aspects presented herein. An important issue for the development of financial counseling is its independence from financial instrument providers, the model of regulation and supervision over financial advisors, the model of remuneration and the obligation to apply an ethics code in the work of a financial advisor, as well as the duty to standardize the cooperation between the financial advisor and the client. If the many requirements proposed by academics and clients of these institutions are met by financial advisors, their activity will reduce the existing imbalance of information between the consumer and financial institution and the lack of symmetry with regard to understanding information by the consumer. The benefits resulting from financial counseling can be gained at a microeconomic level, i.e. in individual households using financial advisory services, as well as with respect to an entire economy (Waliszewski, 2014). So far, no legal regulations have been introduced in Poland regarding an educational system, examination form, granting of licenses or monitoring of financial advisors (Wyszkowska-Kaniewska & Dębniewska, 2011), although since March 2016 it is about to change, as new mortgage directives concerning mortgage credit advisors and agents is coming into force. The change consists in introducing supervision over them by KNF, entering them into a special register, implementing compulsory civil insurance policy on activity performed, the obligation to demonstrate an appropriate level of competency and knowledge by personnel and people managing agents and credit advisors, as well as their appointed representatives (Waliszewski, 2015).

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