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## Factor Analysis of Islamic Financial Literacy and Its Determinants: A Pilot Study

Siti Hafizah Abd. Rahim<sup>a\*</sup>, Rosemaliza Ab. Rashid<sup>b</sup>, Abu Bakar Hamed<sup>c</sup>

\* Corresponding author: Siti Hafizah Abd. Rahim, [sitihafizah90@gmail.com](mailto:sitihafizah90@gmail.com),

<sup>a</sup>Islamic Business School, Universiti Utara Malaysia, 06010 UUM Sintok, Kedah, Malaysia, [sitihafizah90@gmail.com](mailto:sitihafizah90@gmail.com),

<sup>b</sup>Islamic Business School, Universiti Utara Malaysia, 06010 UUM Sintok, Kedah, Malaysia, [liza@uum.edu.my](mailto:liza@uum.edu.my),

<sup>c</sup>Islamic Business School, Universiti Utara Malaysia, 06010 UUM Sintok, Kedah, Malaysia, [abubakarhamed123@gmail.com](mailto:abubakarhamed123@gmail.com),

### Abstract

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Islamic financial literacy has been recognised as an important tool to increase inclusiveness. To date however, the constructs for Islamic financial literacy has not been adequately examined even though they have been calls for such attempt in the literature. Thus, this paper aims to develop the constructs for Islamic financial literacy and its determinants. Structured questionnaires were distributed to 200 students of Universiti Utara Malaysia to determine the level of Islamic financial literacy. The data are quantitatively analyzed through an exploratory factor analysis using SPSS programme. The results show that 4 out of 11 measures failed to load reliably in Islamic financial literacy construct. Specifically, religiosity was found to exhibit the highest variance followed by hopelessness and financial satisfaction. This paper enables the community and researchers to expand the knowledge in the area of Islamic financial literacy by providing a validated constructs to assess the level of Islamic financial literacy.

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**Keywords:** Islamic financial literacy; religiosity; factor analysis.

### 1. Introduction

The increasing attention to the significant role of Islamic financial literacy is attributed to the rising level of indebtedness among the young people. Preferences for lavish lifestyle have led them to spending beyond limits to the point that they are willing to be in debt (Idris, Krishnan & Azmi, 2013). This is contrary to the teachings of Islam which promotes moderation in spending as well as limiting the use of debt only for genuine needs. A hadith narrated by Imam Ahmad, where the Prophet Muhammad (p.b.u.h) was reported to have said: “*Be wary of debts, indeed it is sadness at night and a*



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*disgrace in the day*” stresses that being in debt not only leads to increase in financial burden, but it can also cause emotional burden. This explains why the concept of moderation in spending is highly encouraged in the Quran as stated in chapter Al-Furqan verse 67 which means: “*Those who, when they spend are not extravagant and not niggardly, but hold a just (balance) between those (extremes).*”

In Malaysia, university students are reported to possess low level of financial literacy due to weak money management skills (Ibrahim, Harun & Isa, 2009). Particularly, most of them tend spent aggressively for non-academic purposes and are not likely to save upon receiving their scholarship or student loan (Sabri, MacDonald, Masud, Paim, Hira & Othman, 2008). In view of these concerns, this study was undertaken to focus on the level of Islamic financial literacy among university students. Specifically, Islamic financial literacy is considered a new area with very limited literature. More importantly, the constructs for Islamic financial literacy have not been adequately examined despite calls for such attempt in the literature (Abdullah & Anderson, 2015). Thus, this paper aims to develop the constructs for Islamic financial literacy and its determinants, namely, hopelessness, religiosity and financial satisfaction.

## **2. Literature Review**

### *2.1 Islamic Financial Literacy*

The study on Islamic financial literacy can be considered as a new concept being brought into the area of financial literacy. Due to its novelty, there is currently no commonly accepted meaning of Islamic financial literacy (Abdullah, 2014). Likewise, due to the limited literature in the area, the review of literature in this study is mainly based on contemporary research on financial literacy. Therefore, maintaining its close link with the general definition of financial literacy, this study proposes the conceptual definition of Islamic financial literacy as “the ability of a person to use financial knowledge, skill and attitude (OECD, 2012) in managing financial resources according to the Islamic teachings”. However, it should be noted that there are certain elements in the existing constructs used to assess financial literacy which are not compatible with the underlying philosophy of Islamic finance such as the interest element. Indeed, there is a crucial need to develop the constructs for assessing Islamic financial literacy. Thus, this study attempt to fill this void by developing the appropriate constructs for Islamic financial literacy.

### *2.2 Determinant Factors of Islamic Financial Literacy*

In recent years, numerous studies have been conducted to provide theoretical and empirical evidence on financial literacy. However, most of these studies focused on demographic factors affecting financial literacy. Thus, based on the review of literature, this study has examined other factors affecting Islamic financial literacy, namely hopelessness, religiosity and financial satisfaction. Hopelessness refers to the negative effect on several components of financial behaviour and well-being (Murphy, 2013). In other words, depression among seriously over-indebted individuals often resulted in rash decisions and actions with horrible consequences. Indeed, hopelessness is deemed as one of the

most important problems faced by many people (Bolland, 2003). Previous studies in the USA reveal a negative correlation between hopelessness with financial literacy (Murphy, 2013).

The second determinant factor which is religiosity is defined as the degree to which a person adheres to his or her religious belief, values, and practices, and uses them in daily life (Shukor & Jamal, 2013). Religion often plays an essential role in influencing how individuals cope with financial decision. In other words, a person is actually fundamentally tied to his religious practices whenever he reacts with his own money (Sabri, 2011). This is substantiated in a study among UAE investors which established a positive relationship between religiosity and financial literacy (Al-Tamimi & Kalli, 2009).

Financial satisfaction, which is the final determinant factor in this study refers to the amount of wealth earned and owned by an individual to meet his or her living obligation. Recent studies demonstrated a positive correlation between financial satisfaction and financial literacy (Falahati, Sabri & Paim, 2012). A person who is satisfied with his financial position have a tendency to capitalize the surplus money, explore numerous opportunities and also tends to gather more knowledge about various financial opportunities. Thus, greater financial satisfaction improves the level of financial literacy (Bell, 2009).

### **3. Research Methodology**

The data was randomly collected via self-administered questionnaires to 200 university students of Universiti Utara Malaysia. All respondents were Muslims with 58.5 percent of them were female. The data collected were analyzed using Statistical Package of Social Sciences (SPSS20.0). Valid constructs were developed in this study to measure the proposed concepts. The validity of the developed constructs was closely examined using exploratory factor analysis. Then the reliability of the constructs was verified.

To measure Islamic financial literacy, the constructs were fully developed by the researchers as unidimensional variable. The determinant factors were identified based on previous studies which established the relationship between financial literacy and the following three factors, namely hopelessness (Murphy, 2013), religiosity (Alam, Mohd & Hisham, 2011) and financial satisfaction (Ali, Rahman & Bakar, 2013). It should be noted that some improvement on the items were made and added to the constructs to ensure compatibility with the area of Islamic financial literacy as well as the context of the study. Content validity was verified through consultation with area and constructs experts as well as further discussion with respondents. All constructs were measured based on five-point Likert scale ranging from 1 “strongly disagree” to 5 “strongly agree”.

### **4. Findings**

Initially, the items for Islamic financial literacy was developed using eleven items. After performing exploratory factor analysis, it was reduced to seven items. This is because 4 out of 11 measures failed to load reliably in Islamic financial literacy construct. The eigen-value for this factor is

3.014 and explains 43.06 percent of the variance with factor loading between 0.56 and 0.75. The reliability test showed an acceptable level of Cronbach's alpha score at 0.773 level (Table 1).

**Table 1.** Factor Analysis for Islamic Financial Literacy

Items Loading Factors	Loading
I know that I might or might not receive any return when the contract is concluded	0.566
I acknowledge uncertainty on sanctity of financial contract is strictly prohibited in Islam	0.677
I always make sure that there is no element of interest in all financial transactions that I made	0.673
I understand that all Islamic financing must be backed by asset	0.620
I can only invest in permissible activities or services	0.751
I am aware on the availability of Islamic instrument in the market	0.701
In Islam, I only transact with people that I trust	0.586
Eigenvalue	3.014
Percentage of Variance	43.057
Cronbach's Alpha	0.773

On the other hand, the determinant factors of Islamic financial literacy were developed with 21 items. The result of exploratory factor analysis indicated that test of sphericity is significant while the Kaiser-Meyer-Olkin (KMO) measure of sampling adequacy is greater than 0.8. The determinant value of the test is 0.00180 (greater than 0.00001) showed that there is no multi-collinearity among the items. Percentage of cumulative variance for the factors is about 60.67 percent with factor loading between 0.54 and 0.85 (Table 2). Specifically, religiosity was found to exhibit the highest variance followed by hopelessness and financial satisfaction. With respect to the reliability of constructs, all factors show high reliability ranging from Cronbach's Alpha 0.82 to 0.92.

**Table 2.** Rotated Component Matrix of the Independent Variables

	Component		
	1	2	3
	H	R	FS
<b>HOPELESSNESS</b> (Cronbach's Alpha : 0.893)			
I feel it is impossible for me to reach the goals that I would like to strive for	0.541		
The future seems hopeless to me and I can't believe that things are changing for the better	0.778		
I don't expect to get what I really want			
There's no use in really trying to get something I want because I probably won't get it.	0.728		
All I see ahead of me are bad things, and not good things	0.802		
I might as well give up because I can't make things better for myself	0.776		
I never get what I want, so it's dumb to want anything	0.760		
	0.721		
<b>RELIGIOSITY</b> (Cronbach's Alpha : 0.920)			
I believe in a Allah/God who determines pre-destination			
Doing something contrary to Islam is forbidden by Allah/God			
I pray mainly to gain relief and protection			
I find strength and comfort in my religion		0.748	

I try to follow my religious beliefs in all matters of my life	0.854
I always keep myself away from earning through haram (prohibited) means	0.818
I always perform my duties as a servant of Allah/God	0.839
	0.825
	0.745
	0.608
<b>FINANCIAL SATISFACTION (Cronbach's Alpha : 0.820)</b>	
I rarely run short of money	0.746
I am satisfied with my current financial situation	0.750
If I'm having financial difficulties I could manage it for a period of time	0.627
Based on my current financial status, I could easily obtain loans if I need one	
I am satisfied with my ability to meet my financial obligations	0.690
I have an effort to improve my current financial situation	
Sometimes I feel the amount of loans received are sufficient to cover my living costs	0.693
	0.619
	0.721
Eigenvalue	
Percentage of Variance	
Cumulative Percentage	
	3.366
	7.737
	1.673
	20.933
	23.460
	16.277
	20.933
	44.393
	60.67

## 5. Conclusion

This study represents an initial attempt to explore the concept of Islamic financial literacy through an exploratory factor analysis. These findings enhance our understanding of Islamic financial literacy. In particular, this study contributes to the current literature by developing a validated instrument for Islamic financial literacy and its determinants. It is hoped that this study could help other researchers and the community to expand the knowledge in the area of Islamic financial literacy.

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