

## **Conceptualisation and Operationalisation of Islamic Financial Literacy Scale**

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### **ABSTRACT**

Small and Medium Enterprise (SMEs) contributed 29.6% of GDP in Malaysia in 2005, and by 2014 its share was 35.9%. The involvement of SMEs in the Halal industry is also increasing and the business owner involved in Halal production should choose Islamic business financing. However, Islamic financing in Malaysia has been declining. This paper looks at the concept of Islamic financial literacy and to measure Islamic financial literacy. The measurement of Islamic financial literacy in this paper is based on the principle of Islamic finance, and includes concepts such as Mudarabah, Musharakah, Ijarah, Murabahah, Istisna and Quard Hassan. Through the Islamic financial intelligent (i-FiQ) the study hopes to advance Islamic finance.

*Keywords:* Financial literacy, halal, Islamic financial intelligent, Islamic financial literacy

### **INTRODUCTION**

In Malaysia, Small and Medium Enterprises (SMEs) contributed 29.6% of GDP in 2005, and increased to 35.9% in 2014, and of

which the Halal sector is among the most significant.

Halal products and services are not only accepted by Muslims but also non-Muslims too. However, while doing Halal business, a business owner should not only focus on the Halal production, they must also adopt Halal financing for their business which commonly known as Islamic financing. SMEs may need financing its business to sustain in the market. Usually, a small business started its business using own capital or from family and friends. However, in a view to expanding the business, there

#### **ARTICLE INFO**

##### *Article history:*

Received: 15 September 2016

Accepted: 30 January 2017

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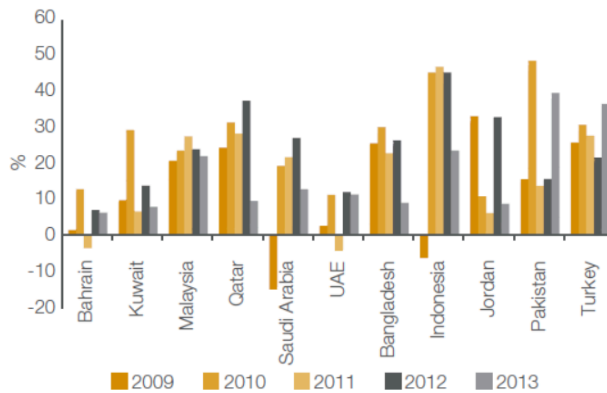
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are times where the company needs new investment. One way they can get money to expand is from business financing.

In Islam, Riba' or interest is not permitted. A business owner involved in Halal production should choose Islamic type business financing.

The global Halal market is projected to be worth USD2.3 trillion annually (HDC, 2014). However, study directed by Reuters found that only 50% of the businesses passed the test from AAOIFI (Accounting and Auditing Organization for Islamic Financial Institutions).

Thus although the Halal food industry maybe expanding Islamic financing in Malaysia is declining (Figure 1). This paper suggests the gap between Halal industry and Islamic financing industry is due to Islamic financial literacy among business owners. This article aims to develop Islamic financial literacy measurements to assess the level of understanding and the level of literacy among SMEs business owners towards Islamic finance. This paper will measure financial literacy from an Islamic perspective.



Source: Islamic banking sample, KFHR

Figure 1. Islamic financing growth trend by country

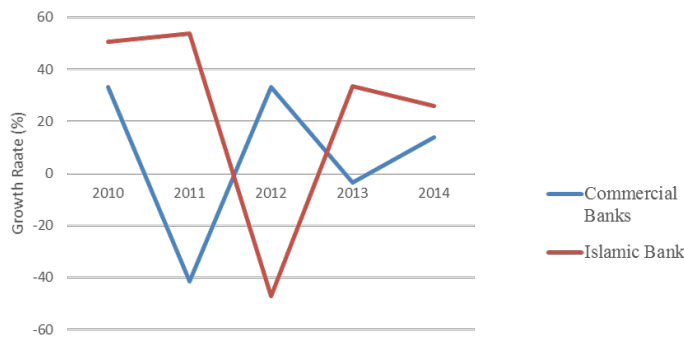


Figure 2. Islamic financing applications (hotel and restaurants)

**LITERATURE REVIEW**

Literacy has been defined earlier as the ability to read and write (Zarcadoolas, Pleasant, and Greer, 2006). From the Islamic perspective, knowledge is necessary for Muslim life. The first word that given to the prophet Iqra, means read learn and understand. The Quran 6:119 also explains that knowledge and literacy is essential for making the differentiation between halal and haram.

The idea of financial literacy is not something new; many researchers have studied it, and most studies found that financial literacy can influence a person’s behaviour in financial matters (Xiao, Ahn, Serido and Shim, 2014). Kim (2001) defines financial literacy as a basic knowledge an

individual needs to survive. On the other hand, Bhabha, Khan, Qureshi, Naeem and Khan (2014) defined financial literacy as a mishmash of awareness, knowledge, skill, attitude and behavior essential to make sound financial decisions and also finally achieve individual financial wellbeing. Huston (2010) divided financial literacy into four main categories. It includes personal finance basics (time value of money, planning, economy), borrowing (credit cards, loans, mortgages), saving/investing (stock, bond, mutual fund, retirement savings) and protection (insurance, estate and tax planning, identity safety). He also conceptualised financial literacy as having two dimensions: understanding (personal financial knowledge) and use (personal financial application) (Figure 3).

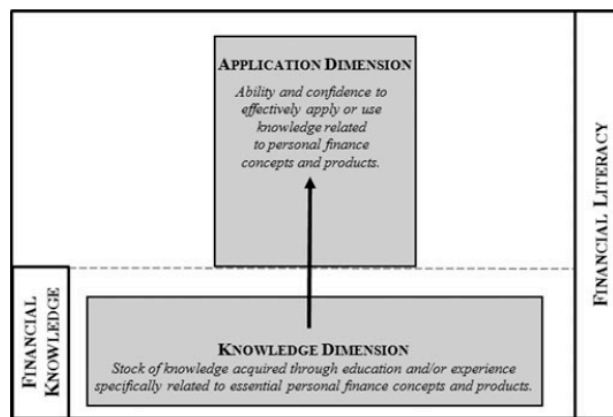


Figure 3. Concept of financial literacy by Huston (2009)

There are only a few studies that focus on Islamic financing. Jaafar and Musa (2013) said that the level of awareness and

knowledge of Islamic financing can affect the attitude towards Islamic financing. To show the relationship between Islamic

financial literacy and individual behaviour towards Islamic financing the Integrative Model of Behavioural Prediction (Fishbein,

2000; Fishbein & Yzer, 2003) theory was used. The proposed framework is as follows:

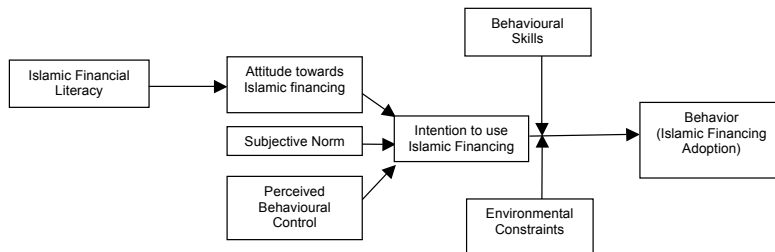


Figure 4. The proposed conceptual framework with hypothesis

**METHODS**

The measurement for Islamic financial literacy developed in this paper focuses on Islamic finance method such as Mudarabah, Musharakah, Ijarah, Murabahah, Istisna and Qard Hassan.

Since the measurements for Islamic financial literacy developed for this study had to be tested Churchill (1979) structured framework was used. The steps are as follows:

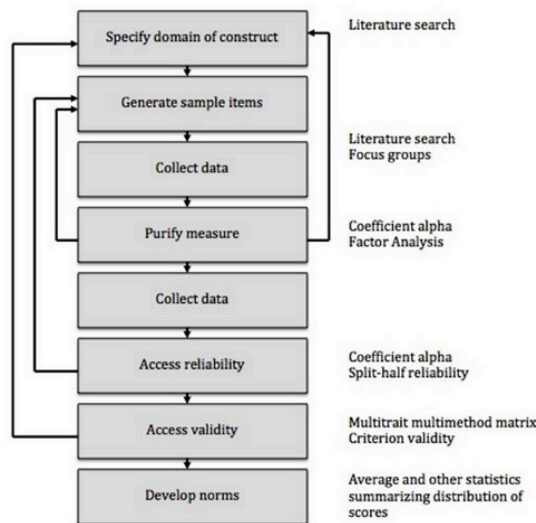


Figure 5. Churchill's 8 steps scale development process

This process of scale development by Churchill (1979) chosen because of its rigorous recursive cycle of steps that based on reliability and validity assessment of the instrument.

A set of questionnaires were developed for this study and 30 respondents chosen for the pilot test. For data collection 200 respondents generated using G\*Power 3 of food service operators. . Since this study involves Halal food service business in Malaysia a sampling technique was used taking into consideration location, registration, owner’s status, and status related to adoption of Islamic financing.

Data analysis will use Smart-PLS software for Partial Least Squares Structural Equation Modeling (PLS-SEM).

**PROPOSED MEASUREMENT ITEMS FOR ISLAMIC FINANCIAL LITERACY**

This study will adapt the categories of financial literacy by Huston (2010) for an Islamic financing perspective. The items and questions were on Bank Negara Malaysia Shariah Resolutions in Islamic Finance. Table 1 below shows the summary of categories and items for the proposed measurement.

Table 1  
*Islamic Financial Literacy Scale Items*

Category	No.	Items	Test-based Question	Answer
Basic Concepts	IFL01	Prohibition of Riba’	You lend RM50 to your friend, and after one month you want the person to repay you RM60 including interest. This situation consists element of: A. Maysir B. Riba’ C. Gharar D. Do not know	B
	IFL02	Prohibition of Gharar	In Islamic finance perspective, the terms of uncertainty and deception referred to: A. Riba’ B. Gharar C. Musyarakah D. Do not know	B
	IFL03	Prohibition of Maysir	In Islamic finance perspective, buying shares on a short-term price fluctuation is one elements of: A. Maysir B. Riba’ C. Mudarabah D. Do not know	A

Table 1 (continue)

Borrowing Concepts	IFL04	Mudarabah	In Mudarabah, the capital provider is the only party that born the losses A. True B. False C. Do not know	A
	IFL05	Musyarakah	In Musharakah, a partner who invest RM1,000 of investment capital has right to specify from beginning that his/her profit should be RM1,000 per year A. True B. False C. Do not know	B
	IFL06	Ijarah	In Ijarah, the asset usually not returned to the lessor A. True B. False C. Do not know	B
	IFL07	Murabahah	Borrower is the person who buys the goods in an Islamic finance trade credit management A. True B. False C. Do not know	B
	IFL08	Istisna	In Istisna concept, the price must be fixed: A. From the beginning B. At the end of contract C. At the middle of contract D. Do not know	A
	IFL09	Qard al Hassan	In Qard al Hassan, when you borrow RM100, what amount you need to repay? A. RM95 B. RM100 C. RM110 D. Do not know	B
	IFL10	Rahn	A contract that makes something as a guarantee to the completion of settlement of debt is a concept of: A. Ujrah B. Wadi'ah C. Rahn (Al Rahn) D. Do not know	C

Table 1 (continue)

	IFL11	Ujrah	Islamic Credit Card based on the concept of Ujrah can offer cash back rebate to the cardholder A. True B. False C. Do not know	B
Saving / Investment Concepts	IFL12	Wadi'ah	In Wadi'ah saving account, Islamic bank can hold your deposit when you want to use your money A. True B. False C. Do not know	B
	IFL13	Waqf	Once you make a waqf of an asset, the asset can not be sold. A. True B. False C. Do not know	A
Protection Concepts	IFL14	Takaful	Which of the following is not the elements of Takaful A. Risk-sharing B. Profit-sharing C. Fixed Return D. Do not know	C

### ISLAMIC FINANCIAL INTELLIGENT (I-FIQ)

Lusardi (2008) divides two type of financial literacy: basic and advanced literacy. Basic financial literacy not only evaluates the level of financial knowledge but also its link with household financial behaviour. However, to make saving and investment decisions, a person needs more than fundamental financial concepts. Lusardi includes several concepts for the advanced financial literacy including the relationship between risk and return; how bonds, stocks, and mutual funds work; and basic asset pricing.

On the other hand, Nik Kamil, Musa & Sahak (2014) propose financial intelligent in their study. Financial intelligent introduced by Nik Kamil et al. (2014) covers a broad range of contexts suggests adequate knowledge and aptitude of basic financial concepts and their application. This paper wants introduces the concept of Islamic financial intelligent that is having an adequate set of knowledge and aptitude of Islamic finance concepts and their application in making financial decisions.

A set of the questionnaire will be distributed to a group of the business owner

to see the level of Islamic financial literacy among them. The answer then will be scored and calculated to see whether the business owner is illiterate (low) or literate (medium) or intelligent (high) in Islamic finance.

## CONCLUSION

It assumed that when a business owner is a literate on Islamic finance they will adopt Islamic financing, thus allowing Islamic finance to develop and create strong links in the Halal industry. This paper proposes 14 items to measure Islamic financial literacy. This paper also suggests three different group which are the illiterate person on Islamic finance, a person which literate on the Islamic finance and person which intelligent on the Islamic finance aspects. It helps to measure the different level of literacy among person, particularly for the business owner. By differentiating those group, it may assist the government or policy maker and also banking institution to create policy or marketing approach differently for those different groups.

## ACKNOWLEDGEMENTS

The authors would like to thank the Ministry of Education of Malaysia (MOE) for funding under the Fundamental Research Grant Scheme (FRGS), and Universiti Teknologi MARA (UiTM) especially Institute of Business Excellence (IBE) for providing assistance in assisting this research.

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