

CONCEPTUAL FRAMEWORK OF THE EFFECT OF ISLAMIC FINANCIAL LITERACY ON PERSONAL FINANCIAL MANAGEMENT

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Abstract: *This conceptual paper aims to explore the effect of Islamic financial literacy on personal financial management, focusing on the role of Islamic financial concepts, principles, and practices in enhancing financial decision-making and management among individuals. Drawing upon existing literature from Islamic finance, financial literacy, and personal financial management, we propose a framework that sheds light on the factors influencing the relationship between Islamic financial literacy and personal financial management. People's financial security is becoming a serious concern in light of the global economic climate. Acquiring expertise and comprehension of financial issues is the essence of financial literacy. This study's goal is to ascertain the financial literacy level of the B40 group, which consists of employees of the Tumpat Area Fishermen Association, as well as the impact of financial literacy on investment decisions, debt management strategies, savings plans, and retirement plans. Four independent variables make up the framework of this study: investment decision, debt planning, retirement plan, and savings plan. We then examine the concept of financial literacy, defining its key elements and highlighting its importance in enabling individuals to make informed financial decisions and manage their finances effectively. Subsequently, we explore the linkages between Islamic financial literacy and personal financial management, analyzing the ways in which Islamic financial concepts, principles, and practices can positively affect personal financial management practices.*

Keywords: *Financial Literacy, Personal Finance, B40, Kelantan*

Introduction

Personal financial management is a critical aspect of an individual's overall financial well-being. It involves making informed financial decisions, managing expenses, saving for the future, and investing wisely (Effendi, Herlianti & Harsuti, 2024). However, many individuals struggle with personal financial management, leading to financial stress, debt, and other negative consequences. Islamic financial literacy can play a crucial role in enhancing personal financial management practices, enabling individuals to make informed financial decisions and manage their finances effectively.

Islamic finance is a rapidly growing field that emphasizes ethical and socially responsible financial practices based on Islamic principles and values. Islamic financial literacy involves understanding the core principles and concepts of Islamic finance, including the prohibition of interest (riba), the concept of risk-sharing (mudarabah), and the importance of social responsibility (zakat). By incorporating these principles into personal financial management practices, individuals can make more informed financial decisions that align with their values and beliefs.

This conceptual paper aims to explore the effect of Islamic financial literacy on personal financial management, focusing on the role of Islamic financial concepts, principles, and practices in enhancing financial decision-making and management among individuals. Drawing upon existing literature from Islamic finance, financial literacy, and personal financial management, we propose a framework that sheds light on the factors influencing the relationship between Islamic financial literacy and personal financial management.

The study will begin by discussing the historical background and evolution of Islamic finance, emphasizing its core principles and characteristics. We will then examine the concept of financial literacy, defining its key elements and highlighting its importance in enabling individuals to make informed financial decisions and manage their finances effectively. Subsequently, we will explore the linkages between Islamic financial literacy and personal financial management, analyzing how Islamic financial concepts, principles, and practices can positively affect personal financial management practices. By exploring the relationship between Islamic financial literacy and personal financial management, this study aims to contribute to the ongoing discourse on financial literacy and management, providing a foundation for further research and practical recommendations to strengthen financial education and management practices among individuals.

As the country's economy continues to grow, more opportunities are created to achieve life goals and financial freedom. The decisions that need to be made every day regarding financial management, whether choosing to save with a certain party or planning for retirement and other financial needs, will have a lasting impact on an individual's well-being. Confidence and the ability to manage finances are important features to achieve and define a good life. Those who are financially literate can make good financial decisions at every stage of their lives to improve their standard of living. Financial capability allows each household to interact responsibly with financial service providers, thereby contributing to their financial resilience. By increasing the ability and desire of Malaysians to determine their financial direction, we can foster a more self-reliant society with a brighter future for all Malaysians.

Financial literacy is defined as the awareness, knowledge, skills, attitudes and habits needed to make good financial decisions (Syed Zaid Albar, 2018). Based on previous studies, several

factors affect financial literacy. It consists of savings plans (Abere, 2018), retirement plans (Njehia, 2014), debt planning (Javantila, 2017), and investment decisions (Mwathi, 2017). Therefore, in this study, the researcher wants to examine the influence of financial literacy on personal financial management among the workers of the Tumpat Fishermen's Association.

Literature Review

Islamic Financial literacy

Islamic financial literacy refers to the ability to understand and use various financial skills, including personal financial management, budgeting, and investing, in compliance with Islamic law (Nawi, Ab Aziz & Shahwan, 2022). This skill is crucial for Muslims and anyone using Islamic financial services. It helps Muslims make informed decisions about managing their money, investing, and meeting their financial goals while adhering to their religious beliefs and ethical values. Islamic financial literacy promotes financial decision-making aligned with Islamic principles and values, encouraging responsible financial management practices among Muslims and anyone utilizing Islamic financial services. Islamic Financial literacy is defined as the knowledge and skills that allow a person to understand the financial principles required to make accurate financial decisions and financial products that affect a person's financial well-being (Basu, 2005; Choi & Cude, 2021). Therefore, personal financial literacy is the ability to make accurate judgments and make effective decisions about the use and management of money. Islamic Financial literacy is the key to enabling a person to identify financial problems and behaviors to support the effective management of financial resources for lifelong financial well-being (Bialowolski et al., 2022; Hilgert, Hogath & Beverly, 2003). Financial literacy will improve how an individual will examine and appreciate financial problems. For example, when planning to buy a house, pay for education, start a family, and prepare for retirement.

Personal financial management

According to Agarwal, Driscoll, Gabaix, and Laibson (2009), personal financial management has been defined as an individual's ability to choose the best instruments that will benefit them in the long term. Individuals practice how to manage their money in terms of how they plan, spend, and set aside a certain percentage for future use. To manage finances effectively, one needs to plan and research, and consider the objectives to be achieved (Lusardi, Mitchell & Oggero, 2020). Kempson and Finney (2009) stated that personal financial management skills are influenced by an individual's financial control, spending, and planning. The best way to use money properly is to have a budget, take credit that they can afford, and live within their means. This means using finances as planned and reducing unnecessary expenses. Other approaches include financial protection, tax planning, investment, retirement planning, and estate planning (Kempson & Finney, 2009).

Islamic Financial literacy and personal financial management

As a study by Nawi, Ab Aziz, and Shahwan (2022), Islamic financial literacy refers to the ability to understand and use various financial skills, including personal financial management, budgeting, and investing, in compliance with Islamic law. This skill is crucial for Muslims and anyone using Islamic financial services. It helps individuals make informed decisions about managing their money, investing, and meeting their financial goals while adhering to their religious beliefs and ethical values. Research indicates that there is a positive relationship between Islamic financial literacy and personal financial management. Individuals with a good level of Islamic financial literacy tend to exhibit better personal financial planning and management practices. Socio-demographic factors such as age, gender, marital status, education

level, and income can influence the level of Islamic financial literacy and personal financial management. Challenges faced in increasing Islamic financial literacy include limited access to quality Islamic financial education, insufficient integration of Islamic finance into formal curricula, and misconceptions about Islamic finance (Md. Sapir@ Md. Shafik & Wan Ahmad, 2020).

However, opportunities exist to promote Islamic financial literacy through financial education initiatives, collaborations between banks and financial institutions, and the provision of online resources. In summary, Islamic financial literacy plays a crucial role in enhancing personal financial management practices among individuals. Improving Islamic financial literacy can lead to better financial outcomes, reduced financial risks, and increased financial stability and growth. Various efforts, including financial education initiatives, collaborations between banks and financial institutions, and the provision of online resources, can help promote Islamic financial literacy and improve personal financial management practices among individuals.

In general, Personal financial literacy promotes knowledge and skills that may result in effective and efficient personal financial management (Lusardi & Mitchell, 2007; Lusardi, 2019). Different individuals have different responsibilities, values, wants, needs, and resources. With the ability to make accurate judgments and effective decisions about the use and management of money, it becomes easier to focus on the most important areas of financial management (Bialowolski et al., 2022; Hilgert, Hogath & Beverly, 2003). An individual and household need to understand their financial position involving net worth and household cash flow (Klapper & Lusardi, 2020; Lusardi & Tufano 2009). A person's net worth involves a person's assets against liabilities at a given time. A household's cash flow includes all of their income in a given year taking into account their expected expenses in the same year. This analysis helps to identify financial goals to be achieved and make an accurate financial plan.

Saving planning

A savings plan can be defined as a financial practice where individuals ignore their current needs to spend and set aside some of their money to invest in business opportunities or take care of future needs. Individuals need to save due to several factors. Life cycle savings theory predicts that a person takes several steps in life that will determine success and failure in every decision made by them (Bengi & Njenje, 2016; Bulla, Maronga & Ngacho, 2019). Modigliani and Brumberg (1985), put forward a theory of expenditure based on the general idea that a person makes choices about their expenditure at every age, limited only by the resources they have throughout their lives. This theory suggests that individuals follow a hump-shaped savings pattern throughout their lives. Therefore, planning to save money for future purposes is very important based on these theories.

Retirement planning

Evans, Orszag, and Piggott (2008) stated that people who are not financially literate tend to live by borrowing to meet their daily needs. They care less about their tomorrow and future and are not active in the workforce. Some make loans from banks and other financial institutions to pay off other loans. Greenspans (2002) revealed that people in the same age group and financial level directly or indirectly influence what individuals decide with their money to meet their future needs. Some individuals are observed not to be free in the choices they make but are instructed by their friends to save their money and do so without considering their merits and demerits. In this arrangement, individuals are seen to spend their money to have the same social status as their peers even though their income levels are not the same.

Debt planning

This practice is related to the individual skills of how to borrow and pay back the loan with the amount accrued after charging interest (Allam & Khalil, 2023; Cole, Zia, Abel, Crowley, Pauliac & Postal, 2014). Because of the difficult economic situation, few are able to finance all their financial needs and those of their families and dependents. Although individuals have to borrow to survive, they need to have good control over their loans so that they do not overspend and fail to repay the loan. The choice of how much money an individual can get from a friend, family member or bank is not easy to explain, but it is necessary to be careful about the amount borrowed and the amount that must be paid in addition to the interest charged (Chen & Volpe, 2002). As a result, individuals find themselves in a difficult situation to borrow which requires them to negotiate to be mentally prepared before taking action to make any loan or debt.

Investment decisions

This practice is related to saving part of an individual's income in equity, debentures, securities, or assets that will generate income in the future (Ghatak, 2013). The most agreed way to generate profit or dividend is to buy shares in the securities market, bonds from the government, save in banks to earn interest and invest money in income generating activities. With good financial knowledge, a person can obtain credit from banks and other financial institutions to start a business and increase their income (Hieltjes & Petrova, 2013). However, one of the biggest mistakes made when obtaining credit and investing money into a business is that they expect immediate profits. A business run has a cycle of profit and loss and an individual needs financial skill to make the right decisions so that the resources are not wasted (Grohmann & Menkhoff, 2021).

Therefore, based on previous studies, this study was conducted to examine the effect of financial literacy on personal financial management among the respondents. Four independent variables were identified in this research, and they are shown in Figure 1. Figure 1 shows the independent variables which are savings plans, retirement plans, debt planning and investment decisions, while the dependent variables are financial literacy and personal financial management.

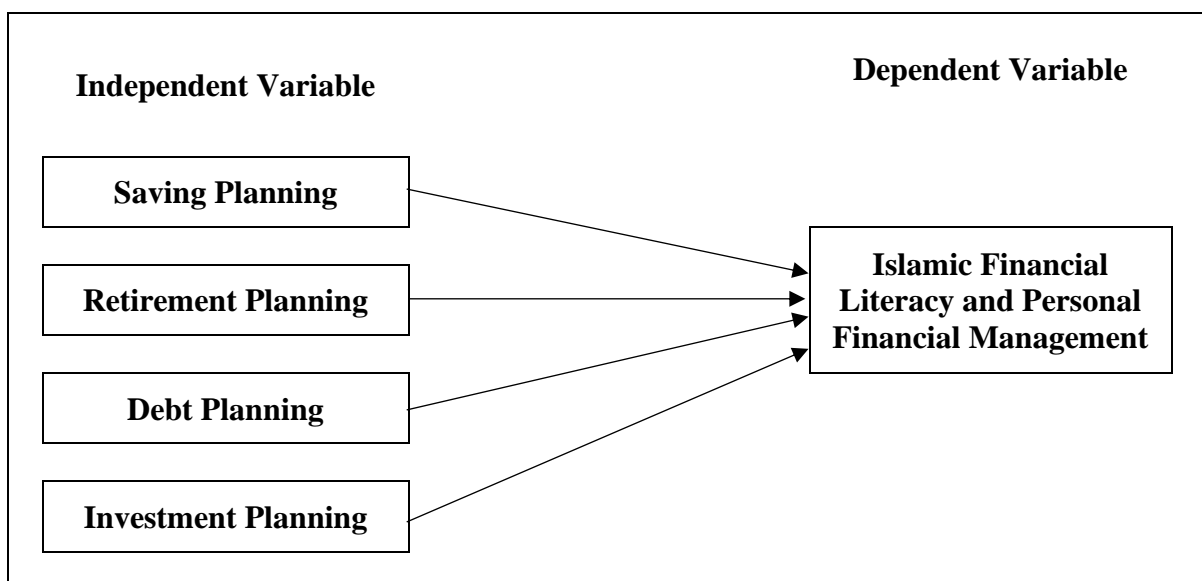


Figure 1: Theoretical Framework of the Effect of Financial Literacy on Personal Financial Management

Methodology

For this research, the population of the study will be referred to the entire community where the researcher wants to generalize the results to the study population (Mugenda, 2003). For this report, the researcher intends to distribute the questionnaire to all Tumpat Area Fishermen's Association (PNKT) members. For the sample, it will refer to the number of respondents that will be included in the study. The required sample size will be 50. The researcher will distribute 50 sets of questionnaires to PNKT members. Data will be collected using a self-administered questionnaire through Google Forms. Advances in technology will benefit researchers in ways that enable faster data acquisition. The URL of the online questionnaire will be sent via social media such as WhatsApp to all PNKT members. Respondents will be informed that their answers are used for academic purposes only.

Conclusion and Recommendation

Based on the research that has been conducted, the researchers will suggest that employers make plans to bring their employees through an annual financial literacy training program. This is because, it is not only beneficial for the personal life of employees, but also contributes to the organization. Employees who are in a better financial position will be able to manage the organization better. Researchers also recommend that all employees be encouraged to invest their finances in business opportunities that have good returns. For example, investors earn high returns compared to those who hold their assets and wait until they are sure they will make a profit before investing. In addition, financial institutions should collaborate with interested parties such as universities and colleges to provide personal financial literacy courses. The role of financial institutions is to ensure that the courses offered have appropriate content, especially those related to personal financial management practices.

The importance and contribution of the study

With the results of this research, employers will be able to determine the true financial literacy of their employees. Employers will also find the results of this study important in developing a culture of prudent financial management among their employees because employees who face personal financial problems will often bring those problems to the workplace and ultimately have a negative impact on the employer. In addition, the contribution of this study to individuals is that someone will understand the impact of financial literacy on the choices they make regarding their investments. This will motivate them to acquire more knowledge about personal financial management and personal investments so that they can make rational decisions about their finances to increase their wealth in the future. Finally, this study has formed the right foundation and can help future researchers who may want to conduct research in the field of financial literacy and personal financial management. This study still has many shortcomings, and it is hoped that future researchers can try to improve this study.

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