

Exploring the General Knowledge of Islamic Finance Principles: A Factor Analysis Study Among College Students

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Abstract

This study explored the foundational constructs of general knowledge concerning the principles of Islamic Finance, with a specific focus on college students majoring in Business, Finance, and Accountancy. Employing a combination of exploratory factor analysis (EFA) and confirmatory factor analysis (CFA), the research identified and validated three distinct factors shaping this knowledge domain. The first factor, "Risk Tolerance and Permissible Transactions," looks at how well students understand financial risk and which transactions are allowed in Islamic finance. The second, "Shari'ah Foundation and Transparency," highlights the importance of Shari'ah principles and transparency in financial dealings. The third, "Riba Prohibition and Ethical Finance," strongly emphasizes banning Riba (interest) and unethical financial practices in Islamic finance. These factor names were chosen carefully to represent the main ideas in each category. Overall, this research contributes by creating a validated objective knowledge scale for Islamic Finance knowledge among students in Business, Finance, and Accountancy programs.

Keywords: Islamic Finance, Knowledge Assessment, Factor Analysis, College Students, Financial Literacy

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1. Introduction

Islamic Finance (herein referred as "IF") represents a faith-driven financial system, rooted in Shariah law and the principles of Islamic economics (Habib, 2018). Its foundation rests on a fundamental rule: the avoidance of exchanging current money for future money at an additional cost (Al-Jarhi, 2017, p. 118). Moreover, its underlying principles emphasize equity, fairness, compassion, collaboration, entrepreneurship, morality, and the overall welfare of both the environment and society, as opposed to mere profit maximization (Habib, 2018). Among its guiding principles is the avoidance of exchanging current goods or services for future monetary gains at a premium (Bourar & Mouloudi, 2020, referencing Al-Jarhi 2017). Additionally, there is a core prohibition on Riba (interest) due to its inclination towards risk-sharing and profit-and-loss distribution (Khattak & Rehman, 2010), rendering IF an alternative to conventional finance. To attain proficiency in IF, one must acquire, through education and/or experience, knowledge specific to Islamic financial products and concepts (Rahman, Tajudin, & Tajudin, 2018). Notably, IF is not confined solely to Muslims countries; it is increasingly garnering interest and acceptance worldwide (Bourar et al., 2020, citing Khattak & Rehman, 2010).

The demographic and educational landscape in Mindanao, as highlighted by the 2015 Census of Population conducted by the Philippine Statistics Authority (PSA), underscores the significance of Islam as the second largest religion in the region. With 93% of the entire Islamic population of the Philippines residing in Mindanao, this region serves as a crucial hub for the practice and propagation of Islamic faith and culture (PSA, 2017). Notably, Mindanao is also home to Ateneo de Davao University, an institution with a Catholic-Jesuit heritage. This juxtaposition of religious diversity is a testament to the region's commitment to fostering inclusivity and understanding among its diverse student population. Ateneo de Davao University, through its support for organizations like the Al Qalam Institute and the Salaam Movement, plays a pivotal role in nurturing the Muslim student community within its walls (Ateneo de Davao University, 2017).

In line with this inclusive approach, the School of Business and Governance (SBG) at Ateneo de Davao University offers a forward-thinking Bachelor of Science in Finance program that includes a subject titled "Finance in Asia," specifically dedicated to Islamic Finance and Banking (Ateneo de Davao University, 2018). This academic initiative not only reflects the university's commitment to providing a holistic education but also recognizes the importance of Islamic Finance (IF) in the contemporary financial landscape. Graduates from this program are well-positioned to become potential practitioners who can effectively operationalize the principles of IF. This educational endeavor not only equips students with the necessary skills and knowledge to engage with Islamic finance but also contributes to the broader goal of promoting economic inclusivity and diversity in the region.

In essence, the presence of Islam as a significant religious demographic in Mindanao, alongside the efforts of Ateneo de Davao University to promote interfaith understanding and inclusivity, serves as a compelling example of how diverse religious and educational institutions can coexist and collaborate to enrich the educational experience. By offering a specialized finance program in Islamic finance and banking, the university not only empowers its graduates to be effective practitioners in this field but also contributes to the promotion of Islamic finance principles and economic diversity in the region. This multifaceted approach highlights the importance of

recognizing and celebrating religious and cultural diversity within educational institutions to foster mutual respect, understanding, and economic growth.

There is, however, a limited assessment tool to measure these students' financial knowledge on IF. Existing tools that have been developed are subjective and may be inadequate to objectively measure their knowledge. Further, an assessment tool specific to the said students incidentally assesses the curriculum's effectiveness on ensuring that IF knowledge survives generations. The objective of this research, therefore, was to develop an objective type of questionnaire with an attempt to establish constructs that measure the general knowledge of SBG students from Ateneo de Davao University, regarding the core principles of Islamic Finance.

2. Literature Review

2.1 Core Principles of Islamic Finance

Islamic finance represents an approach to financial activities that operates in accordance with Shariah principles, as founded, regulated and illustrated by Shariah law (Alamad, 2017). The term "IF" is also used to denote a financial service or product that is consistent or principally implemented to adhere to Shariah or Islamic law principles (Gait & Worthington, 2008). Additionally, Islamic Finance constitutes a comprehensive rule-based financial system, with its foundational principles rooted in the Holy Quran and the practices of Prophet Muhammad (Uddin, 2015). Its banking and financial framework are established to provide range of religiously acceptable financial services to Muslim communities (Hassan and Lewis, 2007, citing Chapra, 1985). In contrast to the profit-maximizing focus of interest-based banking systems, its primary objective is to render socio-economic benefits to Muslims (Ahmad and Hassan, 2007). This underscores the importance of comprehending the fundamental rules that set Islamic Finance distinct from Conventional Finance. Velayutham (2014) affirms that the Islamic principles exerting the most profound influence on Islamic Economics encompass the prohibition of interest payments (Riba), the sale of high-risk assets or dealings involving uncertainties (Gharar), and speculative activities like gambling (Maysir).

Riba, an Arabic word (raba), literally means "to grow" or "expand," or "increase" or "inflate" or "excess" and is generally translated as "usury" or "interest" (Ahmad and Hassan, 2007, citing Al-Isfahani, Al-Raghib Al-Husain, 1961). In Shariah, it technically refers to the "premium" that must be paid by the borrower to the lender, along with the principal amount as a condition for the loan or for an extension in its maturity (Ahmad and Hassan, 2007, citing Chapra). The absolute prohibition of Riba in al-Qur'an is a command to establish an economic system from which all forms of exploitation are eliminated, that is, the injustice of the financier being assured of a positive return without sharing the risk, while the entrepreneurs, despite their management and hard work, is not assured of such a positive return (Ahmad and Hassan, 2007). The prohibition of Riba in al-Qur'an is, therefore, a way to establish equity between financiers and entrepreneurs (Id). Riba in Islamic Finance is absolutely prohibited. In practical terms, it signifies the additional amount that borrowers must pay to lenders, in addition to the principal amount, as a requirement for the loan or an extension in its maturity (Iqbal & Mirakhor, 2011).

Meanwhile, the Arabic word Gharar literally means deceit, risk, fraud, uncertainty, or hazard that might lead to destruction or loss (Uddin, 2015). Scholars have defined it as something which its consequence is undetermined or something that is concealed in both its manner and

consequences (Uddin, 2015). Gharar in Islam, therefore, refers to any transaction of probable objects whose existence or description is not certain due to a lack of information and knowledge of the ultimate outcome of the contract or the nature and quality of its subject matter (Id). Gharar occurs in all sorts of transactions where the subject matter, the price, or both are not determined and fixed in advance or there are certain ambiguities in a contract or transaction. Modern financial practices such as speculative activities in the capital market, derivatives instruments, and short-selling contracts often exhibit bright examples of Gharar (Uddin, 2015). In Islamic Finance, the basic principle is avoidance of Gharar, although it is not absolutely prohibited as there are certain exceptions to it in certain cases.

Lastly, "Maysir" refers to speculation or the easy acquisition of wealth by chance, whether or not it deprives others of their rights (Uddin, 2015). In the Qur'an, the term "Maysir" is mentioned three times, while the specific term "Qimar," referring to betting, is not found within its verses (Abdullah, 2017). Engaging in Maysir and Qimar can lead to consequences such as hostility, cursing and disagreement among participants, and harm to economic growth, in addition to diverting people from remembering Allah and performing prayers (Abdullah, 2017, citing Al-Razi, 1981). Participation in betting associated with Qimar and Maysir can also create an insatiable desire to win, especially after experiencing losses, potentially leading to the depletion of all one's assets. This inevitably results in significant social problems and disrupts the socio-economic fabric of society (Abdullah, 2017). In the context of business activities, Maysir involves deriving monetary gains solely through chance, speculation, or guesswork (Uddin, 2015, citing Hameed, 2009). What makes Gharar illegal is not just the degree of uncertainty but also the absence of risk-sharing between the contracting parties (Uddin, 2015).

2.2 Studies on Islamic Financial Knowledge

Abdullahi and Shahrudin (2016) conducted a study to assess the extent of knowledge and awareness among the Muslim population in Macedonia, a country where approximately 50% of the population practices Islam, regarding Islamic banking services. The research outcomes revealed that a substantial portion of the Muslim community in Macedonia is well-informed about the prohibition of interest (Riba) and consequently refrains from engaging with conventional banks. However, the study also found that their comprehension of Islamic banking principles and services is at a moderate level. In essence, this research illustrates that while many Macedonian Muslims are cognizant of the importance of avoiding interest-based transactions, there is room for further education and awareness-building regarding the intricacies of Islamic banking concepts and services within this demographic.

Alfarisi (2020) conducted a comprehensive analysis of the influence of courses related to Islamic economics and finance on the level of Islamic Financial Literacy (IFL) among university students. The findings of this study unveiled a significant impact of these specialized courses on enhancing the level of Islamic financial knowledge or literacy among the students. This observation aligns with a similar study conducted by Md and Ahmad (2020), which revealed that courses specifically designed for Muslim undergraduate students in Malaysia had a substantial positive effect on their overall financial literacy scores.

Additionally, Rahim, Rashid and Hamed (2016) identified key factors that play a pivotal role in shaping IFL among university students. These factors encompass religiosity, financial

satisfaction, and hopelessness, highlighting the multifaceted nature of IFL development. Interestingly, a study concentrating on a sample group of students enrolled in the faculty of Islamic economics and business found that, among these factors, "age" was the sole determinant influencing the level of financial literacy (Hisan, 2019). However, it's important to note that the existing literature on IFL seems to have gaps when it comes to exploring other potential contributors to this concept, suggesting the need for further research in this domain to gain a more comprehensive understanding of the determinants and dynamics of Islamic financial literacy.

Widityani, Faturhman, Rahado and Yulianti (2020) put forth a framework comprising three key variables—attitude, perception, and knowledge and behavior—that contribute to the development of Islamic Financial Literacy (IFL) among college students. Their research also highlighted that the IFL index varies depending on the level of education and gender, with students who have taken Islamic finance-related courses tending to exhibit higher IFL indices. Furthermore, students with a higher IFL index demonstrated a greater preference for Islamic financial products. This underscores the significance of education and awareness in fostering IFL among students.

Antara and Musa (2020) took a different approach by employing Rasch analysis to create a reliable and valid instrument for measuring IFL among Muslim urban millennial (MUM) generations. Their study successfully resulted in the development of a robust measurement scale. However, it did reveal gender-based biases in the responses to three specific items, emphasizing the need for addressing potential biases when assessing IFL.

In a related context, Nawi, Daud, Ghazali, Yazid and Shamsuddin (2018) delved into the IFL concept and suggested suitable items for its measurement. Their research led to the creation of proposed measurement items for IFL, along with the formulation of various questions related to topics such as Islamic banking, fundamental financial principles, Shariah-compliant investments, and takaful. These contributions in the literature are crucial for advancing our understanding of IFL and providing the tools to effectively measure and nurture this essential financial literacy concept among various demographic groups.

3. Research Method

3.1 Design and Measurement

In this study, an exploratory quantitative research approach was employed to establish constructs for measuring the general knowledge of Principles of Islamic Finance (PIF) among students majoring in business management, accountancy, and finance at Ateneo de Davao University (AdDU) during the second semester of the academic year 2022-2023. The instrument for this research took the form of an objective questionnaire featuring statements with binary responses (true or false).

To assess PIF knowledge, the researchers crafted 30 statements grounded in the fundamental principles of Islamic Finance. These constructs were then rigorously analyzed through exploratory factor analysis, followed by validation through confirmatory factor analysis. This methodological framework enabled a systematic and comprehensive evaluation of the students' understanding of PIF, contributing to a better grasp of the state of Islamic financial literacy

within this academic cohort.

3.2 Sample, Data Collection and Statistical Analysis

The study involved a sample of 201 respondents, consisting of college students enrolled in the School of Business and Governance at Ateneo de Davao University. These students were specifically from academic programs such as Business Management, Finance, and Accountancy. Data collection was carried out through an online survey conducted via Google Forms, with the survey link distributed to the intended respondents via email.

The collected data were subsequently subjected to a series of statistical analyses. Initially, Exploratory Factor Analysis (EFA) was employed, using methods like Principal Axis factoring and Varimax rotation, to identify and extract underlying factors within the dataset. Following this, Confirmatory Factor Analysis (CFA) was conducted to assess the validity of the factor structure that had been derived from the EFA results. Several fit indices, including χ^2/df , TLI, and CFI, were utilized to evaluate the goodness of fit. The entire statistical analysis process was facilitated using a dedicated statistical software known as JAMOMI 2.2.5 (The Jamomi Project, 2022). This comprehensive methodological approach ensured the rigorous examination and validation of the constructs underlying the study's objectives.

4. Findings and Discussions

4.1 Exploratory Factor Analysis

Exploratory Factor Analysis (EFA) is a statistical technique used to uncover the underlying structure or latent factors within a set of observed variables or items. In this specific case, the researchers employed Principal Axis Factoring (PAF) with varimax rotation, a common EFA method. The goal of EFA is to reduce the complexity of data by identifying patterns or relationships among the items, allowing for a more straightforward interpretation of the data.

The results of the analysis, as shown in Table 1, reveal two important indicators: the Kaiser-Meyer-Olkin (KMO) test and the Bartlett test of sphericity. The KMO test assesses the adequacy of the sample size for factor analysis, with a value above 0.5 indicating that the data are suitable for factor analysis. In this case, the KMO value meets this criterion, indicating adequate sample size. The Bartlett test of sphericity, which tests the null hypothesis that the correlation matrix is an identity matrix (meaning there are no underlying factors), becomes significant when there is evidence of a meaningful factor structure in the data. The fact that the Bartlett test is significant ($P < 0.001$) suggests that underlying factors are present in the data, further validating the appropriateness of conducting factor analysis. These results collectively indicate that the dataset is suitable for EFA, allowing for the identification of latent factors among the items in the scale.

Table 1: KMO and Bartlett's test

Test	Value
KMO measure of sampling Adequacy	0.636
Bartlett's test of sphericity approximately Chi-square	248
Degrees of freedom (df)	66
Significant	0.000

To determine the number of dominant factors in the dataset, the researchers conducted a Parallel Analysis using a Monte Carlo Simulator. This analysis involved comparing the actual data to simulated data. In Figure 1, the analysis showed that there were three factors based on the number of points where the data intersected with the simulated lines. Following this determination, the data analysis was rerun with three factors, and a threshold of factorial saturation at 0.4 or higher was applied. This criterion was used to assess the strength of the relationship between each item and its respective factor. As a result of this analysis, a total of 18 items were removed from the factors because their factor loadings were below the 0.4 threshold. This step was crucial for refining the factor structure and retaining only those items that demonstrated a strong association with their respective factors, ensuring the validity of the factor analysis results.

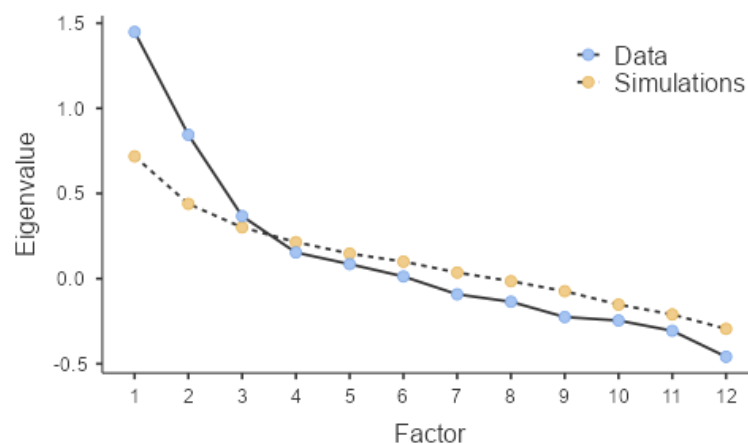


Figure 1. Parallel Analysis using Monte Carlo Simulator

The development of the Principles of Islamic Finance (PIF) General Knowledge scale involved several steps to refine the questionnaire. Initially, it comprised 30 items designed to assess participants' understanding of Islamic finance principles. Following the first exploratory factor analysis, the scale was refined, reducing the number of items to 12. Subsequently, a factor analysis was conducted on these 12 selected items. The results of this analysis, as presented in Table 2, revealed a categorization of these items into three distinct factors.

Factor 1 encompasses 5 items, each demonstrating factor loadings ranging from 0.39 to 0.66. These factor loadings indicate the strength of the relationship between each item and Factor 1, with higher loadings suggesting a more significant contribution to this factor. Factor 2 comprises 3 items, and their factor loadings range from 0.35 to 0.54. Similarly, Factor 3 encompasses 4 items with factor loadings between 0.34 and 0.49. These factor loadings indicate how well each item aligns with its respective factor. Altogether, this factor analysis resulted in classifying the 12 items into three distinct factors, helping simplify and structure the PIF General Knowledge scale for assessing participants' knowledge of Islamic finance principles.

Table 2. Extracted Factors with Factor Loadings

Factor	Item Number	Item Statement	Factor Loading
1	IF15	It is permissible for a person to speculate or spend money on an undertaking with a high risk or probability of failure.	0.66
	IF11	Acquisition of wealth by chance such as lotteries is permissible.	0.61
	IF16	Riba means interest, which is allowed in Islamic law.	0.50
	IF9	Option derivatives are permitted because there is no certainty whether a transaction will take place because the option buyer has the right but not the obligation to transact.	0.47
	IF2	It is permitted to pay the principal borrowed with pre-agreed additional commodities of different kinds.	0.39
2	IF22	Islamic finance prohibits dealing in liquor, pork, gambling, pornography and anything else that Shari'a (Islamic law) deems haram (unlawful).	0.54
	IF18	The Shari'ah teachings are considered to be the bedrock of the Islamic financial system as the Shari'ah teachings are not confined only to the boundaries of law.	0.54
	IF24	In certain Islamic financial contract, the bank should inform the customer of the cost/capital outlay which is the history of the acquisition and the profit/added value margin of the transaction.	0.35
3	IF17	Any risk-free or guaranteed interest on a loan is considered a Riba.	0.49
	IF20	A misconception of riba is that it is often translated as usury because in modern times usury normally refers to exorbitant rates of interest.	0.47
	IF13	The prices in a derivative are based on the fluctuations of underlying assets such as stocks and bonds which makes it prohibited.	0.42
	IF26	Any form of interest-free banking based on ethical ideals of financial transactions will be recognized as Shariah -compliant.	0.34

4.2 Confirmatory Factor Analysis

After establishing the factor structure through the exploratory factor analysis (EFA), the researchers conducted a confirmatory factor analysis (CFA) to validate the obtained model. The CFA aims to assess how well the data align with the hypothesized factor structure. As indicated in Table 3, the results of this analysis demonstrated that the 3-factor scale exhibited a good fit with the data based on several fit indices.

The χ^2/df ratio, which measures the goodness of fit, was found to be 1.241. A value close to 1 suggests a good fit, and in this case, it indicates a relatively good fit of the model to the data. The p-value associated with the χ^2 test was 0.115, indicating that the model's fit was not significantly different from the observed data. Additionally, the Comparative Fit Index (CFI) and the Tucker-Lewis Index (TLI) were both reported as 0.916 and 0.935, respectively. These indices measure the model's fit in comparison to a baseline model. Values closer to 1 for both

CFI and TLI indicate a better fit, and in this case, they suggest a reasonably strong fit of the 3-factor model. Lastly, the Root Mean Square Error of Approximation (RMSEA), which assesses the discrepancy between the model and the observed data, was reported as 0.035. An RMSEA value below 0.08 is typically considered a good fit, and here, the RMSEA falls well within this criterion. Collectively, the results of the confirmatory factor analysis (CFA) suggest that the 3-factor scale is a good fit for the data, providing validation for the proposed factor structure of the Principles of Islamic Finance (PIF) General Knowledge scale.

Table 3. Fit Measures of the 3-Factor Scale

Fit Index	Criterion	Values
χ^2/df	$1 < <2$	1.241
p-value	>0.05	0.115
CFI	>0.90	0.916
TLI	>0.90	0.935
RMSEA	<0.05	0.035

The confirmatory factor analysis (CFA) results, as presented in Table 4, provide further validation for the proposed 3-factor structure of the scale developed through the exploratory factor analysis. Specifically, the CFA results demonstrate that all item factor loadings for each of the three factors were highly significant ($p < 0.001$). This statistical significance confirms the strength of the relationships between the individual items and their respective factors.

To delve deeper into the specifics, the CFA analysis revealed that Factor 1 is significantly influenced by the IF11, IF16, IF2, IF9, and IF15 indicators. Factor 2 is significantly measured by IF18, IF24, and IF22, while Factor 3 is significantly accounted for by IF13, IF26, IF20, and IF17. These findings reinforce the validity of the 3-factor structure and provide insights into which specific items contribute most significantly to each factor, offering a deeper understanding of the scale's underlying constructs. Overall, the CFA results underscore the robustness of the scale and its ability to effectively measure the Principles of Islamic Finance (PIF) General Knowledge across these three distinct factors.

Following the comprehensive analysis of both the EFA and CFA results, the researchers thoroughly examined the statements associated with each factor. This examination aimed to discern the prevalent themes or underlying concepts conveyed by these statements. It involved a meticulous interpretation of the factor contents and a systematic approach to the naming process. Consequently, the final factor names, namely "Risk Tolerance and Permissible Transactions," "Shari'ah Foundation and Transparency," and "Riba Prohibition and Ethical Finance," were thoughtfully selected to aptly encapsulate the fundamental concepts embodied by the statements within each respective factor.

Table 4. Significance of the Item Factor Loadings

Factor	Indicator	Unstandardized Estimate	Standardized Estimate	SE	Z	p
Factor 1	IF11	0.314	0.631	0.0411	7.63	< .001
	IF16	0.253	0.506	0.041	6.16	< .001
	IF2	0.169	0.377	0.0375	4.52	< .001
	IF9	0.213	0.470	0.0373	5.7	< .001
	IF15	0.312	0.634	0.0404	7.72	< .001
Factor 2	IF18	0.139	0.402	0.035	3.96	< .001
	IF24	0.119	0.375	0.0354	3.37	< .001
	IF22	0.208	0.682	0.0447	4.66	< .001
Factor 3	IF13	0.168	0.372	0.0477	3.52	< .001
	IF26	0.204	0.456	0.0484	4.22	< .001
	IF20	0.221	0.536	0.0469	4.72	< .001
	IF17	0.154	0.349	0.0457	3.36	< .001

5. Conclusions

This study represents an initial endeavor to investigate the fundamental constructs related to general knowledge concerning the core principles of Islamic Finance. Through exploratory factor analysis, three distinct factors were identified. Subsequently, a confirmatory factor analysis was conducted to validate these three factors, each of which is characterized as follows:

Factor 1, termed "Risk Tolerance and Permissible Transactions," centers on the willingness to accept financial risk and the permissibility of specific transactions within the domain of Islamic finance.

Factor 2, denominated "Shari'ah Foundation and Transparency," underscores the pivotal role of Shari'ah principles in Islamic finance and highlights the significance of transparency in financial transactions.

Factor 3, labeled "Riba Prohibition and Ethical Finance," emphasizes the prohibition of Riba (interest) and other unethical financial practices, accentuating Islamic finance's ethical underpinnings.

These findings offer valuable insights into the underlying dimensions that constitute the Principles of Islamic Finance. However, it is essential to recognize that this study's scope is restricted to evaluating the general knowledge of core principles of Islamic finance, utilizing a researcher-developed true-or-false questionnaire to gauge the perceived knowledge of college students majoring in Finance, Accountancy, and Business Management. In sum, this research makes a noteworthy contribution to the existing literature by creating a validated objective knowledge scale for Islamic Finance, which holds promise for future research endeavors.

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