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Financial Planning Framework: Empirical Evidence on Muslim Households in Malaysia

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Abstract

This study aims to examine the determinants of financial planning practice and knowledge. The sample of this study is the net deficit and net surplus Muslim households in the Northern Corridor Economic Region of Malaysia. Adopting a positivist paradigm, the research design was drawn from a survey of 200 households; comprising of 100 net surplus and 100 net deficit households. The survey data were analysed using statistical techniques, which include a series of binomial logistic regression models. Results reveal that the hierarchy structure for the net deficit households involves moving individuals from the bottom of the hierarchy to the top. They moved from money management level to emergency planning level and finally to the investing for goals type. Alternatively, the roles of the net surplus households relate to the supply-side of the Islamic financial planning framework. This group contributes to the necessary funds such as zakat and awqaf, to implement the approaches related to three variables; namely money management, emergency planning and investing for goals. Results highlight that both groups appear to have a poor understanding of the concepts of zakat and awqaf. This study makes several important contributions to the existing studies of Islamic financial planning, particularly in the development of a model of Islamic financial planning practice and knowledge. The model integrates factors related to "investing for goals", "emergency planning" and "money management" with the added components of financial inclusion, financial literacy, zakat and awqaf. In addition, this study provides meaningful insights into personal financial planning with relevant implementations to academics, individual households, financial providers and policymakers. The research findings should assist households in making optimal financial decisions. Findings also help policymakers in formulating an appropriate policy on Islamic financing planning.

Key words: Muslim households; NCER; Logistic regression analysis; Money management; Emergency planning; Malaysia

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INTRODUCTION

Various efforts have been undertaken by the government to alleviate poverty and improve the people's quality of living. A lot of studies, as well as initiatives, have been carried out by the authorities to ensure individuals' financial literacy necessary for them to make sound financial decisions. Even though financial knowledge can improve the financial situation of individuals, however; not everyone is able to grasp the complex financial matters or has interest in acquiring the financial knowledge (Ahmed & Salleh, 2016). Thus, the best way to mitigate the poverty is through the introduction of financial planning instead of disseminating the knowledge itself.

Current financial planning context tends to focus more on the net surplus households (i.e. net surplus households) as this group is more likely to consider the financial planning services. On the other hand, the net deficit households (i.e. net deficit households) would find the financial planning as devastating since they do not possess sufficient income or wealth.

Despite the benefits of financial planning, there are few, if any, studies related to financial planning by focusing on low-income households and those living in poverty. One of the main reasons lies with the notion that customers of financial planning are generally those with surplus income or wealth. Some argue that those with a propensity to plan tend to save more, and were able to explain the variation of wealth between planners and non-planners (Lusardi &Mitchell, 2007; Ameriks et al., 2003). If planning one's finances is said to benefit the relatively well-off, one may contend that there is a need to consider whether or not financial planning services for low-income households and those living in poverty can be undertaken.

This research, therefore, considers the possibility of refining the concept of financial planning to include net deficit households, with the intention of mitigating poverty. This, in itself, is relatively significant, especially as few studies view poverty alleviation from the broad perspective of personal financial planning ranging from budgeting to long-term events, such as retirement. Furthermore, there is no known study that is related to the context under study.

Even though the nature of financial planning involves individuals with sufficient income or wealth, the preparation of financial planning is still relevant to net deficit households after considering *zakat* and *awqaf*. Moreover, it can partly be understood from the fact that Islamic financial planning falls under the umbrella of Islamic finance- a field that has only emerged into the contemporary financial scene in the last few decades. Therefore, this study aspires to add to the literature related to Islamic financial planning.

This study also differs from previous studies relating to *zakat* and *awqaf*, as it combines a contemporary financial approach and issue, that is Islamic financial planning and financial exclusion respectively. Generally speaking, this study attempts to incorporate Islamic financial planning, *zakat*, *awqaf*, financial inclusion and financial literacy into an inclusive Islamic financial planning framework in Malaysia.

1. LITERATURE REVIEW: THEORETICAL AND EMPIRICAL

1.1 Life-Cycle Theory

Life-cycle theory was initially proposed by Penrose (1952) cited by Mat Nawi (2015), focusing on the development of the firm through growth phases or on individual's consumption and savings behaviours. Building on the work of Penrose, Modigliani and Brumberg (1954) introduced the life-cycle model of asset allocation and accumulation. The model differentiates between the propensity to consume and save at various stages of an individual's life.

In addition, Tin (2000) asserts that the life cycle theory predicts that consumption and savings behaviours change significantly with objective (i.e. income, rates of returns, wealth) and subjective factors (i.e. age, marital status, socio-economic and demographic conditions) during various stages of the individual's life.

1.2 Financial Planning Model

The Certified Financial Planner Board of Standards denotes "Financial Planning" as the "process of determining whether and how an individual can meet life goals through proper management of financial resources". This study follows the financial planning model proposed by Chieffe and Rakes (1999). The model is divided into two dimensions; namely, time period (i.e. current or future period) and predictability of events (i.e. planned/unplanned). This current study includes all major areas in the model except the transference planning (i.e. estate planning). The following sub-sections discuss the components of the financial planning.

1.2.1 Money Management

Money management is related to making a decision in a current period for planned financial events (Chieffe and Rakes, 1999). The decision involves managing cash flow and credit usage (Ahmad & Salleh, 2016). According to Mittra et al. (2016), to achieve one's financial objectives, the individual should know to control over his/her cash flows; instead of emphasising too much attention on good investment or having enough income. Budgeting is the common approach used to manage the cash flow (Ahmad and Salleh, 2016). It involves several processes such as estimation, documentation, and monitoring expenses, savings, credits or expected incomes. Budgeting helps in identifying spending and savings patterns (see Hallman & Rosenbloom, 2003; Chieffe & Rakes, 1999). Ameriks et al. (2003) prove the role of budgeting to assist in controlling spending behaviours. They found that those who create a detailed budget tend to save more compared to those who do not do that.

1.2.2 Emergency Planning

The emergency planning refers to making a decision in a current period for unplanned financial events (Chieffe & Rakes, 1999). The decision involves risk management such as emergency fund, insurance and line of credit. The emergency fund aims to ensure that the intended cash for daily expenses does not get diverted into any unforeseen situations such as loss of job or car breakdown. A common practice of the rule of thumbs in creating emergency funds is the rule of three to six months of household expenses (Altfest, 2016; Hallman & Rosenbloom, 2003).

Despite the above rule of thumbs, Altfest (2016) states that there is no fast rule for emergency planning. The amounts of emergency funds depend on several factors such as outstanding debt, assets' availability and risk. He adds that individuals are advised to invest in liquid assets in order to avoid high exit costs.

Insurance policy's ownership can also be considered as a contingency plan (Hallman & Rosenbloom, 2003). It can be insurance for health as well as property. Health insurance or life insurance may include protection income from disability (Opiela, 2004). Alternatively, property insurance may include protection for both real property and personal property. Previous studies had proved the importance of emergency planning (see Katona, 1975).

1.2.3 Investing for Goals

Investing for goals is related to making a decision in a future period for planned financial events (Chieffe & Rakes, 1999). The investments in the planned events include both related to financial or real assets; for instance, investing for education fees, retirement planning, a down payment on a property, mutual funds, and stocks and bonds. Certified Financial Planner Board of Standards proves that retirement planning is the most important motivation for starting a financial plan or hiring a financial professional. A proper retirement planning is essential to ensure sufficient retirement income. It will make an individual less dependent on social services or any other assistance from the communities. There are various rules of thumb for the level of retirement income. The percentage of pre-retirement income may depend on the income level, marital status or desired standard of living. Some studies set the rule of thumb as a percentage of pre-retirement expenses. For example, Greninger et al. (2000) note 70 to 89 percent of pre-retirement expenses; while, Mittra et al. (2016) note 60 to 70 percent of pre-retirement expenses as being useful estimates.

1.3 Financial Literacy and Planning

Individuals who are knowledgeable in finance tend to plan their finances better and it indirectly affects wealth accumulation (Lusardi and Mitchell, 2007). There are quite a number of studies on the financial literacy. However, most of the studies tend to ignore elements of financial planning. Studies by Ameriks et al. (2003) and Lusardi and Mitchell (2007) suggest to include elements of financial planning in assessing the financial literacy.

1.4 Financial Exclusion

Financial exclusion refers to "a process whereby people encounter difficulties accessing and/or using financial services and products in the mainstream market that are appropriate to their needs and enable them to lead a normal social life in the society in which they belong." (European Commission, 2008, p. 9). Ahmed and Salleh (2016) suggest that it is essential to consider the association between low-income households and financial exclusion in the study of poverty or individuals with low-incomes.

The main causes of financial exclusion can be categorised into three perspectives; namely demand, supply and societal. Supply factors include access exclusion (Kempson & Whyley, 1999), condition exclusion (Ibid.), geographical access (Leyshon & Thrift, 1995), marketing exclusion (Kempson & Whyley, 1999), high cost to providers (Hogarth & O'Donnell, 2000) and complexity of choice (European Commission, 2008). Further, demand factors include price exclusion and self-exclusion (Kempson & Whyley, 1999). On the other hand, societal factors comprise of labour market changes, income inequalities, demographic changes and technological gap.

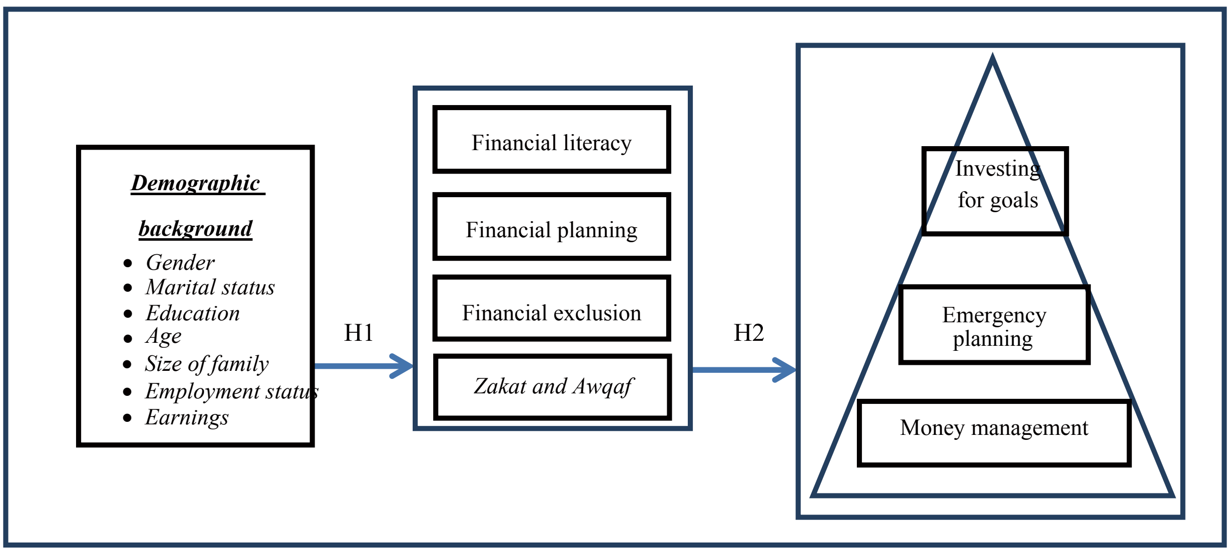

Figure 1
The Framework of Islamic Financial Planning (Developed for This Study)

2. METHODOLOGY

This research is a positivist study. The research design was based on a survey methodology. The study used a convenience random sampling as it is convenient, quick and less expensive. The researchers used several methods of survey for collecting data such as postal, Internet, telephone and face-to-face structured interviews. All accessible respondents were chosen as subjects. The empirical works for this research were undertaken in the Northern Corridor Economic Region (NCER) of Malaysia. The lists of the net deficit households were taken from the Majlis Agama Islam, Lembaga Zakat and Jabatan Agama Islam of three states (i.e. Perak, Kedah & Perlis). The study had received 200 usable responses, giving a response rate of 97 percent. In terms of analysis, a pilot test had been undertaken prior to the main survey to ensure no issues of reliability and to clarify the questionnaire. No data had been excluded from the data screening with regard to the data from the main survey. The study then proceeds with Cross-tabulation and Logistic Regression analyses. The Cross-tabulation was used for the descriptive analysis; specifically to compare responses between net deficit and net surplus households. Alternatively, the logistic regression analysis is used to find out the association between dependent and independent variables. The study used a logistic regression as dependent variables were measured using dichotomous items (see Pallant, 2010).

3. RESULTS

The results of the descriptive analysis indicate that the low-income earners are more likely to save for daily expenses, goods and services, and education for their children. They are more likely to be excluded from accessing bank accounts and credit facilities. In contrast, the high-income earners tend to save more for retirement, emergencies and purchase of assets. The finding is consistent with the study of Xiao and Noring (1994).

The following findings then deal with logistic regression analysis. In terms of saving motives, non-home owners were found to save less for emergencies; instead, they prefer to save for assets. Conversely, homeowners are more likely to have high scores in emergency planning.

With regard to savings for retirement, two main factors, namely employment and earnings can significantly stabilise the household's short-term finances. Once the short-term finances of net deficit households are stable, only then can any retirement or long-term financial planning approach be effectively undertaken.

Meanwhile, in terms of financial exclusion from credit facilities, the associations between marital status and credit facilities portray the importance of evaluating the financial needs of households, so as to better understand their households and credit priorities. In addition, by controlling other variables, size of family and education were found to be significantly financially excluded from credit facilities. Moreover, the analysis indicates that earnings and age were significantly associated with the financial exclusion from investment products.

In addition, logistic regression results discover the determinants of financial planning practice and financial planning knowledge. The results show a significant positive association between earnings and financial planning as well as financial planning knowledge. High-income households were found to be more knowledgeable and highly engaged in financial planning.

In determining the variables that significantly affect money management practices, the results of logistic regression indicate that three variables (i.e. gender, age and earnings) are statistically significant in determining the likelihood of applying money management practices. Female households are more likely to undertake money management practices than male households. The result indicates that the odds of undertaking the budgeting practices are 3 times higher for females than males.

Moreover, young households, especially those aged less than 35 years old; prefer to perform money management practices. They prefer to use the budget in managing their personal finances. The main reasons could be because of the exposure of younger households to financial planning. In another aspect, the likelihood that the elderly are less likely to be engaged in money management practices should be understood further, for it may highlight issues of financial planning openness amongst the elderly.

From the perspective of earnings, it was found that high-income earners are 3.5 and 6 times more likely to opt for money management practices and perform money management practices, respectively. Another interesting result relates to education. The odds ratio indicates that respondents with a tertiary education are 2.5 times more likely to undertake money management practices than those with a primary school education.

In relation to the variables that significantly determine emergency planning practices, the logistic regression results show that three variables (i.e. size of family, earnings and home-ownership) are found to be statistically significant when it comes to determining those engaged in emergency planning practices. Findings show that the odds of engaging in emergency planning increase by 1.7 times as the size of family increases. In terms of earnings, it was found that high-income earners are 2.9 times more likely to undertake emergency planning practices. Another interesting finding relates to home-ownership. Homeowners are more likely to engage in emergency planning practices. They prefer to save for emergencies and life insurance policies.

Conversely, the logistic regression results show that earnings are the only significant variable in determining the practice of retirement planning. The odds ratio indicates that high-income earners are 2 and 2.2 times more likely to plan for retirement, compared to middle-income and low-income earners, respectively.

As for the money management scenario, earnings were found to be statistically significant in determining those who are more likely to possess relevant financial planning knowledge on money management aspect. High-income households prefer to have related knowledge on the subject compared to middle- and low-income earners.

From the perspective of the emergency planning scenario, the result of the logistic regression was not included as the probability for the residual chi-square, as it is statistically insignificant. Meanwhile, for retirement planning, home-ownership and earnings were found to be significant. For home-ownership, the odds ratio indicates that by owning a house, the odds of answering the retirement planning scenario correctly decreases by 0.52. As for earnings, high-income earners are 4.4 times more likely to possess more retirement planning knowledge than low-income earners.

In addition to financial exclusion and emergency approaches, certain aspects of the current *zakat* disbursement process and opinions of *zakat* recipients were analysed within a personal finance context. With regard to *zakat* and *awqaf*, findings showed that there is a relatively poor understanding of *zakat* and *awqaf* by the respondents. Findings revealed that it is quite challenging to facilitate the net deficit households to move from each hierarchical level. Alternatively, the net surplus households need to fulfill their *zakat* obligations and create *awqaf* assets.

Table 1
Summary of Logistic Regression Results

		A	B	C	D	E	F	G	H
1	Saving for Emergencies			X					X
2	Saving for Asset Purchases			X	X*			X*	X
3	Saving for Retirement		X		X	X	X	X	
4	Financial exclusion – Credit Facilities		X		X	X			
5	Financial exclusion – Investment Products			X				X*	
6	Financial Planning Practice – Money Management	X		X	X*			X	
7	Financial Planning Practice – Emergency Planning					X		X	X
8	Financial Planning Practice – Retirement Planning							X	
9	Financial Planning Knowledge – Money Management							X	X
10	Financial Planning Knowledge – Retirement Planning							X	X

Note:
A=Gender; B=Marital status; C=Age; D=Education; E=Size of family; F=Employment status; G=Earnings; H=Home-ownership
'X' signifies there is an association between the socioeconomic variable and the respective saving motive/financial product/financial planning practice or knowledge.
**The baseline category of this variable is not statistically significant, even though differences between the baseline category and a non-baseline category are found to be statistically significant.*

CONCLUSION AND RECOMMENDATIONS

This study combines contemporary (i.e. financial planning, financial exclusion and financial literacy-saving motives) and historical (i.e. *zakat* and *awqaf*) aspects of personal finance. The study contributes to the knowledge development and literature of financial planning. It also adds to the development of knowledge towards incorporating *zakat* and *awqaf* with contemporary issues such as financial exclusion. Moreover, this study provides a foundation for the development of a model of Islamic financial planning practice and knowledge.

Evidence shows that Islamic financial planning should be viewed as providing a different perspective towards mitigating poverty

This study suggests that the above-mentioned five aspects of personal finance should be included in the financial planning framework. Evidence also portrays that the net deficit households were found to face difficulties in enhancing their money management capabilities before moving on to emergency planning and planning for long-term goals. In addition, contributions from the net surplus households in the forms of *zakat* and *awqaf* were found to be important within the financial planning framework. In other words, *zakat* and *awqaf* play a vital role within the framework, essentially by providing appropriate funds to the net deficit households.

The overall results signify that any financial programmes aimed at poverty alleviation should consider the incorporation of financial planning and knowledge-related activities. Efforts to ensure an inclusive IFP framework should take into consideration the challenge to construct a framework in which net deficit households have a stable source of income and steady financial capacity to improve their money management capabilities.

Markedly, this study has also highlighted a relatively poor understanding of *zakat* and *awqaf* amongst the respondents. Thus, there is a need to enhance the level of knowledge of the less well-known types of *zakatable* assets and philanthropic *awqaf*, with the role of Islamic financial planners as catalysts in encouraging the creation of philanthropic *awqaf* and providing a comprehensive *zakat* planning service.

Future research may consider the extension of the scope of the sample to other economic regions in Malaysia. Future studies may also identify the complexity of households' needs, such as households' expenses. This is done so as to gain an understanding on the rationale of the net deficit households' inability to save for retirement and the nature of their exclusion from credit facilities. Further, it may also shed some lights on the differing perspectives on exclusion towards credit between single and married heads of households. Another area that may be considered for future research is home-ownership. Future research related to personal finance in Malaysia may want to consider the role and importance of home-ownership, and its relationship with savings, debt and investment.

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