

## Factors Influencing Payments Behavior among Customers of Islamic Retail Financing

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### Abstract

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This paper determines factors influencing payments behavior of Islamic retail financing. By using data from 50 questionnaires, two (2) independent variables are tested to investigate the payments behavior. The factors are income per month and percentage of saving. The investigation towards the determining factors is important for the financial institutions to enhance the existing policy and procedure in credit processing and financing supervisions of Islamic retail financing.

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**Keywords:** Payments behavior, Income per month and Percentage of saving

### 1.0 Introduction

Household borrowing is a major composition in a bank lending structure particularly in a developing country like Malaysia. Household borrowing which comprises of various consumers financing has increased substantially in the country and interestingly, the country is among the South East Asia countries with the largest household debt compared to Gross Domestic Products (GDP). Among contributing factors to the rapid growth in household debt are macroeconomic stability, financial sector development, government policies, progressive financial liberalization, deregulation and technological advances. The diversification of retail financing products and competitive banking industry has caused downward pressure on interest rates, consequentially expanding credit coverage and loans amount. The strengthening risks management practice especially in credit portfolio however has enabled financial institutions to lend more to household (Endut & Hua, 2009).

Against adjustment in households spending fueled by increasing costs of living due to implementation of the Government Service Tax (GST) from 1<sup>st</sup> April 2015 and depreciating in Ringgit, it is timely to determine factors influencing payment behavior among customers of Islamic retail financing. The trend of the Malaysian household debt in recent years has indicated that the Malaysian household is very much facing acute financial vulnerabilities. According to the Bank Negara Malaysia (BNM) Annual Report 2015 Malaysia household debt to GDP in 2015 grew to 89.1 % from 86.8% in 2014.

#### 1.0.1 Household income against spending behaviour

An earlier research conducted by Khazanah Research Institute in 2014 on household debt in Malaysia signaled a more alarming outlook. The report concluded that consumerism is relatively high with many households owning discretionary durable goods such as electrical appliances and vehicles despite their low income levels.

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The purchases were made mainly on credits rather than cash and the main reasons are due to low income or insufficient cash. The report concluded that the lower income earners have more desire to consume rather than to save.

Furthermore, according to the report, the low income segments had a borrowing approximately 7 times of their annual income which concluded that the low income household was high level consumerism. This is because low income household with limited financial excess tends to engage in financing based on affordability from monthly or weekly installment. In short, most of household's income will be directly spent to settle borrowing commitments while savings were very unlikely, if not limited or small. The scenario shall worsen if the interest rates and inflation in the financial markets keep increasing.

## **2.0 Literature review**

This section gives an overview of household debt and retail banking in Malaysia as well as a brief analysis on borrowing from an Islamic perspective. This shall be followed by an assessment and analysis of previous studies on the Malaysian retail banking and the payment behavior of its customers. The main objective of the section is to identify the important factors that affect the payment behaviors of the Malaysian retail banking customers.

### **2.1 Household Debt in the Islamic Economic Perspective**

Islam does not forbid debt, instead debt is allowed when it is motivated by either the need to fulfill the basic necessities or to undertake legal business ventures. In Islam, defaulting debtors who have no source of payment are entitled a share from the Muslim public treasury. Personal debts that exhaust one's wealth are either used in dealing with circumstances of exigency such as natural disaster or in acquiring necessities could be paid from zakat or endowment funds (Bensaid, et al, 2013).

In Islam, lenders may be people of virtues as supplying financing to help those in needs is a way to seek Allah S.W.T's blessing. Based on Islamic principle, financing must be motivated by determination to help the needy (Zakaria et al. 2012). But, nowadays, consumers are using debts to purchase luxurious items and unnecessary things while credit providers create more financing products to encourage more debts in order to gain more profits. In summary, Islam does not restrict consumers from lending, borrowing or acquire financing, as long as they are in accordance to the guidelines and conditions as has been determined by the Shariah. Household debt can be defined as the sum of loans for properties, loan for personal use, loan for securities, motor vehicle loans, credit cards, and others (Central Bank of Malaysia, 2015). Van der Walt & Prinsloo (2002) described household debt as the amount of money that a household owes to financial institutions comprising of consumer debt and mortgage loan.

### **2.2 Determinants influencing retail financing payment**

This section examines the factors that influence the customers' payment behavior. Apart from the demographics factors which examine the background details of the borrower, the determinants influencing retail financing payment can be divided into three main categories namely, the financial institutions, customer's psychological factors and attitude.

Based on the previous studies which have been conducted, three demographics have been identified such as age, gender, and education levels. Studies that previously examined the relationship between financing payment behavior of borrowers and their socio-economic characteristics are aplenty. Mokhtar et al. (2012) investigate the determinants of microcredit loan repayment among microfinance borrowers in The Economics Fund for National Entrepreneur Group (TEKUN) and Yayasan Usaha Maju (YUM) showed that age and gender are among significant factors that contribute to default payment.

In terms of gender, many studies indicate that gender is significant and have a strong relationship with payment behavior. Mokhtar et al. (2012) found that male borrowers had problems in maintaining good payment track records.

The finding is also supported by Roslan and Karim (2009) which also reveals that the probability to default borrowers among female is lower compared to male borrowers. However, a research conducted by Godquin (2004) shows that female borrowers are not a better pay master compared to male counterparts. The finding is also in line with study by Bassem (2008) who found that female borrowers in Tunisia does not shows a satisfied performance in maintaining good payment track records compared to male who a more dedicated and commitment in debt payments. Education level also has been identified as one factor influencing payment behavior by Wongnaa et al. (2013). The study reveals that education level has positive effects towards borrower's ability to pay. The result is supported by a study conducted by Oni et al. (2006) which also revealed that education level has significantly influence payment performance among farmers in Nigeria.

### 3.0 Hypothesis development

The factors influencing payments behaviour among Islamic retail banking customers in Malaysia used as the independent variables in this study are level of income and percentage of saving. A regression analysis was conducted to reveal how they affect the payment behavior; theoretically,  $y = f(X_1 + X_2)$

Where financing payment behavior = Independent variables selected, where  $X_1$  is Level of Income (LI), and  $X_2$  is Percentage of Saving (SV).

Results: Method: Ordinary Least Squares				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
Level of Income	-3.19E-05	8.26E-05	-0.386404	0.7364
Saving	0.095789	0.125159	0.765341	0.5240
R-squared	0.763728	Mean dependent var		0.250000
Adjusted R-squared	0.645592	S.D. dependent var		0.207525
S.E. of regression	0.123544	Akaike info criterion		-1.037583
Sum squared resid	0.030526	Schwarz criterion		-1.344436
Log likelihood	4.075167	Hannan-Quinn criter.		-1.710949
Durbin-Watson stat	2.901089			

The relationship between Payment Behavior and Level of income and Savings is as follows, Payment behavior = -3.19E-05 Level of income + 0.095789 Savings. There is an adverse relationship between Payment Behaviour and Level of Income whereby if Income Level is increase, good payment behaviour will reduce. The actual reported value is meaningful whereby for each unit increase in payment behaviour, level of income will reduce by -3.19E-05. There is a positive relationship between Payment Behaviour and Savings whereby if Income Level is increase, good payment behaviour also will increase. For each unit increase in payment behaviour, level of income will reduce by 0.0957unit. The Sum Square of Residual (SSE) for this study is 0.030526 which is considered as lower and show that this regression model is good and useful to determine the factors of payment behaviour.

The R-squared and Adjust R-squared measured the in-sample success of the regression equation in forecasting the dependent variable. It is also used to determine "goodness of fit". R-squared to be as close to 1 as possible, but above 0.5 can be considered as good. The Adjusted R-squared is similar but normally it will be smaller than the R-squared. The R-squared and Adjust r-squared for this study is 0.763728 and 0.645592. Since both are greater than 0.5, the regression equation which Payment Behavior = f (Level of Income + Percentage of Savings) is already a good equation.

## 5.0 Conclusions

Based on the analysis and results, we can conclude that the factors contributed to the financing payment behavior are Level of income and Savings. Good financing payment behavior also associated with higher education level age and gender. Female respondents tend to have a better financing payment behavior compared to male respondents. From the coefficient values, there is adverse relationship between Payment Behavior and Level of income while the relationship between Payment Behavior and Savings is positive. The default risk which contributed by this factors can be mitigated by improving the credit evaluation process, securing the financing with appropriate takaful (Islamic insurance) coverage and tightening the financing security of high risk customers by taking additional guarantors and collateral. The study also discovered that payment performance for Islamic retail financing is also influenced by education level. As such, the financial institutions should focus and emphasize on this criteria on the borrowers profiling and enhancing the risk score card assessment while evaluating the credit application. Closed monitoring and mitigation on default risk should be implemented towards high risk borrowers.

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