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CONSUMER FINANCING: A STUDY ON THE
PERCEPTION OF EDUCATION OFFICERS
TOWARDS INTEREST-FREE FINANCING

BY

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ABSTRACT

The purpose of the study was to investigate the perceptions of education officers towards interest-free financing. By using Factor Analysis, the study has examined the perceptions of education officers and was able to extract and identify 13 factors that may explain the behavior of education officers involved in credit financing. The factors centered on the elements of interest-free financing and the respondents' level of understanding of the concepts involved. Sixty respondents comprising of 60 Muslim education officers were selected to participate in the study. The group is made up of 13 teachers and 47 officers working within the Ministry of Education. The mean scores for every factor was computed. The mean score for Factor 1 is 3.8354. This shows that generally the respondents have a fair degree of understanding of the IFCS concept. The mean score for Factor 2 is 2.7792. This shows the education officers are relatively not sure of the interest-free financing concept. However, it was also found that education officers have a high level of understanding of the purpose of the IFCS (Factor 3). Respondents also indicated that they find it more convenient to purchase items on interest-based terms. The officers showed a mean score of 3.7333 for Factor 5, which measures their agreement that interest is exploitation of customers. However, it was disturbing to see that the respondents scored 3.4750 to the statements that interest is paid because it is legal and that IFCS should go for lower profit. The respondents agreed that IBCS is more accessible to them compared to interest-free credit schemes. The respondents relatively agree that *riba* is the interest charged by chettiahs and loan sharks (3.6750). For Factor 9, the mean score was 2.5583 indicating that respondents are unsure of the statements in Factor 9. Factor 10 also looks at the misconception of *riba*. At a mean score of 3.6333, it shows that the respondents do not really understand the *riba* concept. The score also indicated that they agree with the contention that *riba* is exceedingly high interest and any profit made illegally. The mean score for Factor 1 shows that the respondents agree that measures should be taken to expose customers to Islamic financing. Customers should be made aware of the interest-free products in the market. The mean score for Factor 12 shows that the respondents are rather unsure of the fact that banks and Islamic financing schemes both charges interest on customers. The mean score of 3.1489 shows quite a high level of misconception of the concept. The education officers also show agreement that interest is something that is necessary and not a burden to customers. A mean score of 3.2250 gives rise to the need to address the issue. Education officers, especially teachers need to really understand the concepts in Islamic financing since they are the change agents for the future. They need to prepare the present generation with the pillars and concepts of Islamic financing for the future.

APPROVAL PAGE

TITLE OF PROJECT PAPER: CONSUMER FINANCING: A STUDY ON THE
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DECLARATION

I hereby declare that this project paper is the result of my own investigations, except where otherwise stated. Other sources are acknowledged by reference notes and a bibliography is appended.

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DEDICATION

This project paper is specially dedicated to my late father, Allahyarham Jantan bin Nyamat, my mother, Puan Asmah bt Ali and my wife, Maszlinda bt Mustaffa for their everlasting love and care.

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LIST OF ABBREVIATIONS

IFBS@SPTF	:	Interest-Free Banking Scheme
IFCS	:	Interest-Free Credit Scheme
IBCS	:	Interest-Based Credit Scheme
HP	:	Hire Purchase
BIMB	:	Bank Islam Malaysia Berhad
IAB	:	Institut Aminuddin Baki
SPM	:	Sijil Pelajaran Malaysia
STPM	:	Sijil Tinggi Persekolahan Malaysia

CHAPTER 1

INTRODUCTION

1.0 Background of the Study

It is a cardinal belief of Muslims the world over that Islam provides a complete set of guidelines for organizing human activity in all spheres of life. The basic Islamic precepts of organizing the economic side of life, if put into practice, give rise to an economic system which has an individuality of its own with its main characteristics manifestly different from both the capitalist and socialist forms of economic organization. One of these basic precepts is that all financial transactions based on giving or taking of interest should be avoided. In fact, interest-based transactions are most severely condemned and those who engage in these transactions are warned of severe chastisement in the Hereafter (Ziauddin, 1995).

It is a fact of life that despite the severe condemnation of interest in Islam, Muslim societies are unable to keep away from interest-based transactions when modern banks appeared on the scene. This is also true in the financing of household purchases involving items such as the television, refrigerator, sofas, bedroom set, computers, mini hi-fi, home cinema, gas cookers and other household appliances. Consumers cannot avoid than to indulge in these interest-based financing since most of them could not buy goods on cash terms.

1.1 Statement of the Problem

Nowadays, very few people can afford to buy household items in cash. Even though some may afford to buy these household items on cash basis, they prefer to buy the items on credit through installment payments or hire purchase. Normally, a finance company or a bank with which the retailer has business relationships would finance the purchase. For example, if the item were sold for RM 5000 cash, the hire purchase or credit price would be the RM 5000 plus some additional interest rate. Economists say that the difference in price is the opportunity cost forgone by the bank, which is compensated by the purchaser in a form of interest payment.

Interest-free credit schemes have been introduced to cater for the increasing awareness on the part of the government on the need to provide interest-free financing to Muslims in Malaysia. More and more customers are asking whether retailers can provide an interest-free credit scheme for household purchases. Retail outlets such as Jaya Jusco, Courts Mammoth, Catalogue Shop, cooperatives and other retail-based organizations offer normal interest-based facilities to their customers. Fortunately, there are some outlets such as Arastu and Teacher Cooperatives that offer interest-free credit schemes to their customers throughout Malaysia. Islamic banking offers two financial products as alternatives to interest-based installment schemes. Based on the *Murabahah* and *Bai-bithaman-ajil* or *bay'muajjal* contracts, Islamic installment schemes provide a direct line of credit sale

without involving a third party. Thus, when a person purchases a computer system through *Murabahah* and *Bai-bithaman-ajil* facilities, only two parties are involved in the transaction, the seller (retailer) and the purchaser. In a conventional interest-based trading, a complete transaction would involve the retailer, the customer and also the bank that acts as the financier. This is what some retail outlets provide to their customers who may not be comfortable in making interest payments for the purchase of the goods they wanted.

But today more and more people are asking whether present interest-free products deserve to be called Islamic since they are not benefiting from the products except for it being a *halal* transaction. They bought the same object desired and pay approximately the same amount of money.

The question now would be whether consumers are aware of the presently available interest-free credit schemes. Would they go for products, which are interest-based or, interest-free? Are consumers aware of the fact that interest is haram in Islam? Why are not they supporting the interest-free credit schemes? Are they able to differentiate whether a scheme is interest-based or interest-free? Does it matter to them whether they purchase goods on interest-based or interest-free credit?

Education officers represent a big portion of the credit-based sales market. Marketers of credit-based product especially electrical goods and other household appliances segmented the teacher population as a potential segment of the market to be targeted at. Education officers being a part of the government servant population seem to prefer using credit to buy their household appliances. This is because most government servants are middle-class income earners and would not want to commit a large portion of their income on cash purchases. So, they rather buy their household needs on credit terms.

1.2 Purpose of the Study

The main objective of this survey is to find out the perception of education officers towards interest-free financing. The researcher hopes to identify factors affecting decisions made by education officers in their selection of financing facilities of durable goods such as home appliances. This survey hopes to find out:

- a. The levels of understanding of interest-free credit scheme among education officers.
- b. Whether there is any misconception of interest-free credit scheme among education officers.
- c. Whether education officers understand the purpose of interest-free credit scheme.

- d. The reasons for adopting interest-based credit scheme among education officers.
- e. Whether education officers feel that interest imposed on loans is actually an exploitation of customers.
- f. Whether there is a misconception of interest/profit among education officers
- g. The perception of education officers towards the accessibility of interest-based credit scheme
- h. The understanding of the *riba* concept among education officers
- i. Whether there are any misconceptions about *riba* among education officers
- j. The need for exposure to interest-free credit scheme as perceived by education officers
- k. The misconception of the functions of banks
- l. Whether interest is perceived as necessary and not a burden among education officers.

1.3 Significance of the Study

This study will explore and analyze the state of awareness among education officers about interest-free financing schemes. Education officers are agents of change who are responsible in changing the attitudes of the future generations. Education officers, especially teachers, play an important role in helping students become better leaders of tomorrow. They prepare the students

to become better decision-makers and can therefore actively contribute in nation building.

In the study, attempts will be made to see whether education officers are strong supporters of interest-free financing. This finding is hoped to further intensify research in determining why interest-free financing is more or less preferred by consumers in Malaysia.

1.4 Definition of Terms

In this study, four main terms will be used to explain the position and analysis of findings, namely (a) consumer financing, (b) perception, (c) education officers, and (d) interest-free financing.

a. Consumer Financing

Consumer financing refers to the types of consumer financing that teachers prefer to use in making household purchases, namely the interest-based and interest-free schemes offered by retail outlets in the market.

b. Perception

Perception refers to what the respondents feel about interest-free schemes. It also refers to the reasons given for making the choice between interest-based or interest-free financing schemes.

c. Education Officers

Education officers would refer to the school principals, headmasters, senior assistants, teachers and officers within the Ministry of Education who would be sampled in this study.

d. Interest-Free Financing

It refers to the interest-free schemes offered as an alternative to the conventional financing schemes. It also refers to the *murabahah* and *the bai bithaman ajil* schemes available in Islamic financing.

1.5 Assumptions

It is assumed that all the respondents in this study has taken either interest based or interest free financing before. It is also assumed that they know the nature of interest-free financing. Since all respondents are in the Ministry of Education, the researcher assumed that they have heard about all the financing schemes available in the market. The researcher also assumed that they understood all the Islamic financing terms used in the questionnaire. Any misunderstandings of the terms would be clarified during the administration of the questionnaires to the respondents.

Another assumption made in this study is that all the respondents had the same purchasing power regardless of their gender. That is why there is no request made to the respondents to state their gender in the questionnaire.

CHAPTER 2

LITERATURE REVIEW

2.0 Islamic Banking and Finance in Malaysia

The introduction of Skim Perbankan Tanpa Faedah (SPTF) or Interest-Free Banking Scheme (IFBS) in 1993 provided a boon to banking institutions providing Islamic banking services. The rapid economic growth provided a strong platform for banking institutions to accelerate the development of Islamic banking which, in turn, assisted banks to be better prepared to meet rising competition by meeting banking needs on Islamic principles.¹ At the end of 1996, a total of 49 financial institutions participated in the SPTF. The number comprised 25 commercial banks, 21 finance companies and three merchant banks. Bank Islam Malaysia Berhad (BIMB) remained as the sole Islamic bank. Nonetheless, the share of Islamic banking in the total financial system is still small. The proportion of Islamic banking deposits and financing accounted for only 2% and 2.2% respectively of the total deposits and loans of the banking system. Islamic banking resources expanded by 63.5% at end-1996. Deposits remained the primary source of funds. The other major sources of funds are shareholders funds, interest-free banking funds and amounts due to other financial institutions. The Islamic Bank had a significant portion of total deposits mobilized under Islamic banking. However, banking institutions providing SPTF facilities recorded a growth of 85.7% by the end of 1996. Financing rose by 75.9% from RM3.5

¹ Bank Negara Annual Report, 1996, BNM, pp.103

billion at end-1995 to RM6.1 billion at end-1996. From the amount, 39.1% emanated from the Islamic Bank. The increase of financing through Islamic banking was evident in all sectors of the economy. This can be seen in the Table below.

Table 2.1: Islamic Banking: Direction of Financing

	Annual Change		At end 1996
	1995	1996	
	RM Million		
Agriculture	-0.7	112.6	152.2
Mining and quarrying	-0.4	2.0	4.7
Manufacturing	457.5	167.6	924.3
Electricity	57.2	25.7	88.5
Real estate and construction	319.6	537.4	1,116.2
Housing	177.6	531.9	984.5
General commerce	34.6	150.2	329.2
Transportation and storage	51.2	185.5	258.7
Financial, insurance and business services	246.1	246.5	535.9
Purchase of stocks and shares	143.6	-102.1	502.9
Consumption credit	124.2	339.9	508.3
Others	143.3	453.7	737.2
Total	1,753.8	2,650.9	6,142.6

Source: Bank Negara Annual Report, 1996

In 1996, 34.2% of total financing was channeled to the property sector. Credit to this sector recorded an increase of 103.7% in 1996. An increase of 117.5% was recorded in the financing extended to individuals for the purchase of residential properties. The financing to real estate, construction and other property subsectors recorded an increase of 92.8%. The manufacturing sector accounted for 15% of the total outstanding financing at the end of 1996. Bank Negara has already put in place the relevant infrastructure, such as specific guidelines on SPTF and an Islamic money market to enable Islamic banking to take-off on a sustained growth path. It also implemented a number of new measures like the