

**THE RELATIONSHIP BETWEEN FINANCIAL
NUMERACY, RELIGIOSITY AND FINANCIAL
DECISION AMONG ISLAMIC BANKING
CUSTOMERS IN PAKISTAN**

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NUMERACY, RELIGIOSITY AND FINANCIAL
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CUSTOMERS IN PAKISTAN**

by

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Alhamdulillah! All praises to Almighty Allah Who has all the knowledge and wisdom. He is the creator of this universe and everything in it. He created man as His second in this world and gifted knowledge and wisdom from His unlimited treasures. Blessings and peace be upon our Holy Prophet Muhammad (PBUH) and His companions. He is the source of encouragement and trusting on Almighty Allah.

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LIST OF ABBREVIATIONS

FC	Financial Capacity
FK	Financial Knowledge
FN	Financial Numeracy
Rel.	Religiosity
FD	Financial Decision
SBP	State Bank of Pakistan
PKR	Pak Rupees
US\$	US Dollars
ATM	Automated Teller Machine
GDP	Gross Domestic Product
SECP	Securities & Exchange Commission of Pakistan
AAOIFI	Accounting and Auditing Organization for Islamic Financial Institutions
TRA	Theory of Reasoned Action
TPB	Theory of Planned Behavior
TICB	Theory of Islamic Consumer Behavior
SPSS	Statistical Package for Social Sciences
AMOS	Analysis of Moment Structures
SEM	Structural Equation Modeling
EFA	Exploratory Factor Analysis
CFA	Confirmatory Factor Analysis
ANOVA	Analysis of Variance
AVE	Average

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**HUBUNGAN ANTARA NUMERASI KEWANGAN,
KEAGAMAAN DAN KEPUTUSAN KEWANGAN DALAM KALANGAN
PELANGGAN PERBANKAN ISLAM DI PAKISTAN**

ABSTRAK

Konsep numerasi kewangan telah ditakrifkan dalam literatur sebagai gabungan keupayaan kewangan dan pengetahuan kewangan. Perbankan Islam berkembang pesat di dunia kerana ia bebas Riba dan merupakan pengganti sistem perbankan konvensional berasaskan Riba. 96 peratus penduduk Pakistan beragama Islam, majoritinya tidak terlibat dengan sistem perbankan konvensional kerana Riba (Faedah). Atas sebab ini, mereka tidak boleh mengambil keputusan kewangan yang betul untuk menggunakan mana-mana produk kewangan bank konvensional atau bank Islam. Lima bank Islam dan 17 bank konvensional menawarkan produk dan perkhidmatan perbankan Islam di Pakistan sejak tahun 2002, pelanggan masih tidak mengetahui tentang produk dan perkhidmatan ini secara praktikal. Oleh itu, objektif kajian ini adalah untuk mengenal pasti dan menganalisis tahap keupayaan kewangan, tahap pengetahuan kewangan dan tahap keagamaan dalam kalangan pelanggan bank Islam di Pakistan untuk menyertai industri perbankan Islam. Seterusnya, kesan numerasi kewangan dan keagamaan terhadap keputusan kewangan oleh pelanggan perbankan Islam turut dianalisis. 500 responden telah dipilih daripada bank Islam di bandar-bandar utama Pakistan termasuk Islamabad, Rawalpindi, Karachi, Lahore, dan Faisalabad untuk memberikan jawapan mereka dalam soal selidik. Maklum balas telah dianalisis dengan bantuan Statistical Package for Social Sciences (SPSS) dan Analysis of Moment Structures (AMOS).

Selepas analisis respon, dapat disimpulkan bahawa terdapat hubungan yang kukuh dan positif antara numerasi kewangan dan keputusan kewangan dengan peranan pengantara keagamaan yang positif. Memandangkan sistem perbankan Islam mengikut prinsip Syariah, keagamaan memberikan kesan yang kuat dalam membuat keputusan kewangan pelanggan perbankan Islam. Keputusan analisis menunjukkan bahawa kemampuan kewangan mempunyai hubungan positif yang signifikan dengan keputusan kewangan. Begitu juga dengan pengetahuan kewangan mempunyai hubungan positif yang signifikan dengan keputusan kewangan dan keagamaan mempunyai hubungan positif yang signifikan dengan keputusan kewangan. Kemampuan kewangan juga dapat disimpulkan memberi kesan kepada keputusan kewangan apabila menjadikan keagamaan sebagai pengantara dan pengetahuan kewangan juga memberi kesan kepada keputusan kewangan apabila keagamaan dijadikan sebagai pengantara. Analisis- analisis ini menerima semua hipotesis kajian ini dan membuktikan bahawa terdapat kesan positif dan kuat numerasi kewangan dan keagamaan terhadap keputusan kewangan oleh pelanggan perbankan Islam di Pakistan. Memandangkan faktor terpenting dalam keputusan kewangan adalah kemampuan kewangan dan pengetahuan kewangan, keduanya telah dijelaskan dan dibincangkan dalam kajian ini dengan semua dimensi yang merupakan kebaruan penyelidikan ini dan boleh menjadi tambahan yang produktif dalam literatur sedia ada.

**THE RELATIONSHIP BETWEEN FINANCIAL
NUMERACY, RELIGIOSITY AND FINANCIAL DECISION AMONG
ISLAMIC BANKING CUSTOMERS IN PAKISTAN**

ABSTRACT

The concept of financial numeracy has been defined in literature as the combination of financial capacity and financial knowledge. Islamic banking is growing rapidly in the world as it is *Riba*-free and is the alternate of *Riba*-based conventional banking system. 96 percent population is Muslim in Pakistan, majority of them did not join conventional banking system due to *Riba* (Interest). Due to this reason, they could not take their right financial decision to avail any financial product of conventional or Islamic bank. 5 Islamic and 17 conventional banks are offering Islamic banking products and services in Pakistan since 2002, the customers are still unaware about the practicality of these products and services. Therefore, the objectives of this study are to identify and analyze the level of financial capacity, level of financial knowledge and level of religiosity among customers of Islamic banks in Pakistan for joining Islamic banking industry. Further, the impact of financial numeracy and religiosity on financial decision by Islamic banking customers is also analyzed. 500 respondents were selected from Islamic banks in major cities of Pakistan including Islamabad, Rawalpindi, Karachi, Lahore, and Faisalabad to give their answers of a questionnaire. The responses were analyzed with the help of Statistical Package for Social Sciences (SPSS) and Analysis of Moment Structures (AMOS). After the analysis of responses, it is concluded that there is a strong and positive relationship between financial numeracy and financial

decision with the positive mediating role of religiosity. As Islamic banking system follows *Sharia'h* principles, religiosity strongly impacts financial decision-making of Islamic banking customers. Results of the analysis show that financial capacity has a significant positive relation with financial decision. Similarly, financial knowledge has a significant positive relation with financial decision and religiosity has a significant positive relation with financial decision. It is also concluded that financial capacity impacts financial decision while taking religiosity as a mediator and financial knowledge also impacts financial decision while taking religiosity as a mediator. These analyses accept all hypothesis of this study and proved that there is a positive and strong impact of financial numeracy and religiosity on financial decision by Islamic banking customers in Pakistan. As the most important factors of financial decision are financial capacity and financial knowledge, both have been explained and discussed in this study with all their dimensions which is the novelty of this research and could be a productive addition in the existing literature.

CHAPTER 1

INTRODUCTION

1.1 Introduction

Islamic banking is growing rapidly in Muslim and non-Muslim countries with a current growth rate of 12.7 percent in 2020 (Islamic Financial Services Board, 2020). As Islam allows trade but prohibits *Riba* (Interest), the basis of Islamic trade is profit sharing and risk sharing. Islamic banks operate on these principles whereas conventional banks operate on *Riba* (Interest). Due to the prohibition of *Riba* and other *Sharia'h* binding reasons, majority of Muslim banking customers in Pakistan are not availing conventional banking services and they are more inclined towards Islamic banks (Islamic Banking Bulletin, SBP, 2020). The primary reason of joining Islamic banking by customers is the religion. However, there are still more reasons for joining Islamic banks including profit rates, attractive banking products and fast bank operations, but the customers are very much confused about these reasons. They have so many questions in their minds about the practical approaches of Islamic banks which include types of Islamic banking products, mechanism of Islamic banking system and difference from conventional banks, which must be addressed so that they can take their financial decisions for buying products or services offered by Islamic banks.

Similarly, financial numeracy, which includes financial capacity and financial knowledge (Huhmann & McQuitty, 2009), plays vital role in the process of taking their financial decisions by Islamic banking customers which is lacking in them and is the reason of their confusion. As Islamic banking system is very much related with *Sharia'h*

principles, religiosity also plays very important role in financial decision process as it provides complete guidelines about financial and banking system (Usmani, I. A., 2015). Therefore, financial numeracy and religiosity can play important role in making financial decisions by Islamic banking customers in Pakistan.

The basic purpose of this study is to identify the major reasons how and why these customers joined Islamic banking in Pakistan and to find the answers to all those questions which are in the minds of the customers which will be explored from them. The level of their financial numeracy, including financial capacity and financial knowledge and the mediating role of religiosity will also be checked in this study.

In this chapter, introduction of the study, background of the study, development of Islamic banking, and development of Islamic banking in Pakistan will be discussed. Further, problem statement, research objectives and research questions will also be discussed in this chapter. Operational definitions of financial numeracy, financial capacity, financial knowledge and religiosity will also be explained. Finally, scope and limitations of the study, significance of the study and organization of the thesis will be discussed.

1.2 Background of the Study

Customer behavior is very important in taking buying decision of any product or service. Several factors impact customer's behavior for the purchase of products and services including mode of initiation, efficacy of communication, brand perception, time constraints, financial limitations, social norms, and purchase motivations (Naghavi and

Sharif, 2020). There are several theories which explain different behavioral aspects of customers. These include Theory of Reasoned Action (TRA), Theory of Planned Behavior (TPB) and Theory of Islamic Consumer Behavior (TICB).

Islamic banking is a system of banking activities which depends upon the practical application of *Sharia'h*. The concept of Islamic banking was based on profit and loss sharing with customers against their funds (investment) (Usmani, I. A., 2015). The Islamic banking was first experimented in Egypt in 1963, which was the beginning of interest free banking. Some people say that concept of Islamic banking, *Riba* free banking and Islamic modes of financing is new, but in fact, it is as old as our religion because *Mudarabah* was practiced in the life of Prophet Muhammad (PBUH) when he agreed to trade with Hazrat Khadija (RAA). In this trade, Hazrat Khadija (RAA) invested her capital while Muhammad (PBUH) offered his services (Safi-ur-Rehman Mubarakpuri, 2000).

Islamic banking works as asset-based banking system and thus, Islamic banks trade only in real assets, partnership-based modes of financing and rental based modes of financing. All these contracts are designed as per the guidelines of *Sharia'h* and are free from Interest (*Riba*) in against of conventional banks which are Interest based (Usmani, I. A., 2015). *Riba* is that amount which is earned in excess to principal amount without due consideration. The borrower becomes bound to pay that amount at any cost whether he got benefit from that loan or not. It is called risk transfer whereas, Islam urges on risk sharing and profit sharing (Usmani, I. A., 2015). Due to these reasons,

Riba is strictly prohibited in Islam as Almighty Allah sent several verses of Holy Quran for its prohibition.

Similarly, there are several *Ahadith* in which Holy Prophet (PBUH) has guided us that *Riba* is not allowed in Islam and all business and trade activities must be *Riba*-free. Holy Prophet Muhammad (PBUH) prohibited *Riba* and explained its harmfulness not only for Muslims but for whole mankind. As products and services of Islamic banks are *Riba*-free, the behavior of the customers of Islamic banks towards these products and services is positive as they believe that these are *Sharia'h* compliant. Therefore, many customers are joining Islamic banking for their financial needs.

As per Huhmann & McQuitty (2009), financial numeracy, which is a combination of financial capacity and financial knowledge, is essential before taking any financial decision by Islamic banking customers. Financial capacity is the basic parameter for the eligibility to purchase any product or service by Islamic bank whereas financial knowledge provides financial information to the customers about the products and services of Islamic financial institutions. The role of religiosity is also very essential in decision-making process as this banking system is associated with the basic principles of Islam (Al-Ajmi, Hussain and Al-Saleh (2009). Therefore, religiosity directly and indirectly impacts financial numeracy of Islamic banking customers which ultimately impacts their financial decision. As Islamic banking is growing rapidly in Pakistan, financial numeracy and religiosity are strongly impacting Islamic banking customers while taking their financial decisions for buying *Sharia'h* compliant products and services.

1.2.1 Development of Islamic Banking

The origin of Islamic banking is as old as the history of Islam. The basic idea of Islamic banking is derived from the business activities of Hazrat Zubair Bin Awam (RAA), who started taking deposits from people as loan and invested that amount in business activities. Profit on those activities was then distributed among all depositors as per their contributions (Ahmad Alharbi, 2015). This is called the basis for modern Islamic banking system. According to various research scholars, different forms of Islamic banks were established in Islamic empire in early history. These were named as *Sarraffeen* or *Sayarifah* (singular *Sarraf*) or *Jahabidhah* (banks called *Dawawin al-Jahabidhah*). The term *Sarraffeen* was used during Abbasi Caliphate for those persons who were experts in coins related matters. They were very skilled coins examiners, government cashiers, treasury receivers, money changers, and merchant bankers to provide financial and banking services to the people (Alharbi, 2015).

However, the idea of modern Islamic banking was started in early 1900s when several Islamic scholars presented its practical application. In the light of these guidelines, the very first Islamic bank was established in Egypt in 1963. Its name was MitGhamr Bank, and it was primarily a local savings bank which was then merged with conventional national bank in 1967 by the government of Egypt (Wilson, 1983). After successful experience of Islamic banking, Naseer Social Bank was established in Egypt in 1971 and Islamic Development Bank (IDB) in Saudi Arabia in 1974. Dubai Islamic Bank was established in 1975 as first private Islamic bank in the world.

The International Association of Islamic Banks (IAIB) was established in 1977 in Saudi Arabia to promote Islamic banking in the world. Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) was established in 1990 with the objectives to prepare accounting, auditing, governance, ethical, and *Sharia'h* standards for Islamic financial institutions and the Islamic finance industry. The Islamic Financial Services Board (IFSB) was established on 3rd November 2002 in Kuala Lumpur, Malaysia which issues guiding principles and standards for the Islamic financial industry to ensure its soundness and stability. World Bank and International Monetary Fund (IMF) are also providing their support for the promotion of Islamic banking industry in the world. After that, several Islamic banks were established throughout the world including Muslim and non-Muslim countries. According to July 2020 report of Islamic Financial Services Board, total worth of Islamic banking is US\$2.44 trillion which is still very small as compare to conventional banking but is growing rapidly in the world.

1.2.2 Development of Islamic Banking in Pakistan

The importance and the significance of Islamic banking are obvious from the fact that the functions and operations of Islamic banking are based on Islamic principles whereas the conventional banking system is based on Interest (*Riba*). Islamic banking system encourages banking services on asset-based financing and on commodity-based trading, while conventional banking system is based on money trading and lending. As money is a medium of exchange not a commodity, the trading of money for profit generation is prohibited in Islam. Islamic banking system promotes risk and returns sharing between provider of capital (investor) or lender and user of funds

(entrepreneurs) or borrower, while in conventional banking system, the investor is assured of pre-determined rate of interest (Institute of Islamic Banking and Insurance, 2018).

Conventional banking system aims at maximizing profit without any restrictions, on the other hand the Islamic banking system also aim at maximization of profit but subject to *Sharia'h* restrictions. In Islamic banking, the relationship forms as a partner, investor, trader, buyer, and seller but in conventional banking system there is only creditor-debtor relationship. Islamic banks do not work based on *Riba*, *Gharar* and *Maysir*. Therefore, they cannot enter any transaction which is *Haram* according to *Sharia'h*, includes liquor or pork etc. (Institute of Islamic Banking and Insurance, July-December 2018). The Islamization process of the financial system of Pakistan started with the global evolution of Islamic banking in 1970s. Pakistan was trying to put Islamic banking into practice in the country (Tarek & Kabir, 2001). Article 38 (F) of 1973 Constitution clearly states that “*interest will be eliminated from the country as early as possible*”. In the light of this constitutional requirement, the process began with presidential order to the local Council of Islamic Ideology (CII) on September 29, 1977. The council was asked to prepare the blueprint of free of interest economic system. According to CII, the council was comprising of policy makers, economists and bankers which submitted its report in 1980. The report highlighted enough facts and multiple options to get rid of the Interest from the financial system of the country. This report was a landmark in the efforts for Islamizing the banking system in Pakistan (Tarek & Kabir, 2001).

The first Islamic bank, Meezan Bank was established in 2002 and today, there are five full-fledged Islamic banks working in the country. According to the Quarterly Report of State Bank of Pakistan (SBP), by the end of September 2019, there are five Islamic banks¹ having 1,469 branches and 17 conventional banks² are providing Islamic banking services through their 1,381 branches throughout the country. Further, 129 sub-branches by Islamic and conventional banks are also providing Islamic banking services in Pakistan.

Total assets of Islamic banking industry in Pakistan are PKR 2,995 billion (US\$18.78 billion) and total deposits are PKR 2,407 billion (US\$15.10 billion) by the end of September 2019. Therefore, the proportion of Islamic banking is 13.8 percent in total assets and 16.1 percent in total deposits of overall banking industry in the country (Islamic Banking Bulletin, September 2019, State Bank of Pakistan).

As 96 percent population is Muslim in Pakistan, majority of the people did not join conventional banking system due the prohibition of *Riba* (Khan & Bhatti, 2006). By establishing Islamic banking, these customers are now inclining towards this banking system. According to State Bank of Pakistan (2019), 15 percent of the total population in Pakistan is bank customers. These include those who purchase bank services in the form

¹ **List of Islamic banks in Pakistan:**

Al-Baraka Bank (Pakistan) Limited, Bank Islami Pakistan Limited, Dubai Islamic Bank Pakistan Limited, Meezan Bank Limited, MCB Islamic Bank Limited

² **List of conventional banks offering Islamic banking services:**

Allied Bank Limited, Askari Bank Limited, Bank Al Habib Limited, Bank Alfalah Limited, Faysal Bank Limited, Habib Bank Limited, Habib Metropolitan Bank Limited, National Bank of Pakistan, Silk Bank Limited, Sindh Bank Limited, Soneri Bank Limited, Summit Bank Limited, Standard Chartered Bank (Pakistan) Limited, The Bank of Khyber, The Bank of Punjab, United Bank Limited, Zarai Taraqiati Bank Limited

of using ATM machines or transfer of funds etc. Remaining 85 percent are not banking customers due to the reasons of insufficient financial position, lack of awareness and the factor of Interest (*Riba*). However, large number of these customers is interested in buying any of the products offered by Islamic banks. These could include house financing, auto financing, project financing or import/export financing.

Table 1.1: Industry Progress and Market Share

Table 1: Industry Progress* and Market Share							
Particulars	Industry Progress			YoY Growth (%)	Share in Overall Banking Industry (%)		
	Sep-18	Jun-19	Sep-19	Sep-19	Sep-18	Jun-19	Sep-19
Assets (Rupees in billion)	2,458	2,992	2,995	21.8	13.6	14.4	13.8
Deposits (Rupees in billion)	2,005	2,415	2,407	20.1	14.7	15.9	16.1
Number of Islamic banking institutions	21	22	22	-	-	-	-
Number of Islamic banking branches**	2,709	2,913	2,979	10.0	-	-	-
Source: Data submitted by banks under quarterly Reporting Chart of Accounts (RCOA)							
*Figures in this bulletin are rounded off							
**Including sub-branches							

Source: Islamic Banking Bulletin, State Bank of Pakistan (September, 2019)

Table 1.1 shows the industry progress and market share by Islamic banking industry in Pakistan. During the time period from September 2018 to June 2019, total assets of the Islamic banking industry increased from PKR 2,458 billion (US\$15.42 billion) to PKR 2,992 billion (US\$18.76 billion) which is a remarkable increase in 9 months. Further, it increased from PKR 2,992 billion (US\$18.76 billion) in June 2019 to PKR 2,995 billion (US\$18.78 billion) in September 2019 with a growth rate of 21.8%. Deposits of the Islamic banking industry also increased remarkably from PKR 2,005

billion (US\$12.57 billion) in September 2018 to PKR 2,415 billion (US\$15.15 billion) in June 2019 and to PKR 2,407 billion (US\$15.10 billion) in September 2019 with an annual growth rate of 20.1%. In terms of overall banking industry share, assets of Islamic banking industry increased from 13.6% in September 2018 to 14.4% in June 2019 and then decreased to 13.8% in September 2019. Similarly, market share of Islamic banking Industry's deposits in overall banking industry increased from 14.7% in September 2018 to 15.9% in June 2019 and 16.1% in September 2019. These results show the tremendous growth of Islamic banking industry in Pakistan.

1.3 Problem Statement

The selection of buying any product and service is always a difficult task for customers (Floren, *et al.*, 2019). Similarly, if any customer wants to buy any financial product or service, have to be very careful before taking any financial decision (Rizkitysha and Hananto, 2020). Financial capacity and financial knowledge are the basic and essential factors, which are involved in financial decision making by customers, especially bank customers (Sharif and Naghavi, 2020). As conventional banking system is based upon *Riba* (Interest), majority of Muslim customers didn't join it due to this reason. Islamic banking system is *Riba*-free and based upon profit sharing which is permissible in *Sharia'h*. Therefore, this banking system became favorite for Muslim customers and they feel themselves in a better condition to take right financial decision (Nugraheni and Widyani, 2020). It has been proved that majority of the Muslims throughout the world want to switch from conventional banking to Islamic banking, but they don't have proper knowledge of it which is a big hurdle for them

(Fathonih, et al., 2019; Amin, 2017; Polato, et al., 2017; Al-Ajmi, Hussain & Al-Saleh, 2009).

In Pakistan, Islamic banking is flourishing rapidly as it ranked ninth in terms of development of Islamic financial services industry in the world (Global Islamic Finance Report, 2019). Customers are joining Islamic banks due to the reason that it is interest-free banking which is very important (Islamic Banking Bulletin, SBP, 2020). Other than this reason, majority of the customers in Pakistan have not yet accessed Islamic banking due to two main reasons. The first is that most of the customers do not have the required financial capacity which is needed to buy any product or service offered by Islamic banks. As walk-in customers, who use Automated Teller Machines (ATMs) or purchase fee-based banking services including funds transfer etc., are also treated as bank customers, they are lacking in that much financial capacity which is needed to purchase any product offered by Islamic bank (Ayub, 2020). Secondly, majority of the customers do not have awareness about the products and services being offered by Islamic banks (Raza & Azeem, 2014). Therefore, they are lacking in financial knowledge and are unable to decide which financial product they should buy or not (Khan & Asghar, 2012).

Financial capacity and financial knowledge are the basic components of financial numeracy which are essential factors for financial decision-making process (Huhmann & McQuitty, 2009). As financial capacity and financial knowledge are lacking in Islamic banking customers, it reflects that the financial numeracy of Islamic banking customers is very low in Pakistan. Due to which, they cannot take proper financial decision to fulfill their financial needs (Ahmad & Bashir, 2014). On the other

hand, Islamic banks are also not providing enough awareness and information to the customers which could help them for taking right decision. Therefore, there is a need to provide maximum information about Islamic banking products and services to the customers in Pakistan (Tara *et al.*, 2014).

Similarly, religiosity strongly impacts financial decision process as a mediator, its role is very important in financial decision making by Muslim customers (Ustaahmetoglu, E., 2020). Religiosity and service quality of Islamic financial institution has a positive and significant impact on customer satisfaction. Therefore, the customers of Islamic banks are more influenced by religiosity for their satisfaction. This also increases their customer loyalty, and they stick with their financial decisions for selecting products and services offered by Islamic banks (Abror, et al., 2019). Religiosity of an individual and the reasons of saving money in Islamic banks are significantly related with each other. These reasons include *Sharia'h* compliance of Islamic banking products, service quality, recommendations by family members and friends, and bank's location. Purpose of business, especially *Sharia'h* compliant, is also the main reason for making transactions with Islamic banks (Wijaya, et al., 2019). Therefore, the impact of religiosity is very strong on financial decisions of Islamic banking customers while selecting their required products and services.

There are only five full-fledged Islamic banks in Pakistan along with 17 conventional banks offering Islamic banking products and services as compared to 30 conventional banks (State Bank of Pakistan, 2020). Due to less proportion of Islamic banking in overall banking industry, it makes very difficult for the customers to decide

which bank they choose. As 96 percent of the total population is Muslim in Pakistan (Pakistan Bureau of Statistics, 2020), there is a need of Islamic banking industry to fulfill their financial needs in the light of *Sharia'h*. This study is an effort to provide maximum knowledge and information to the customers that before or after joining an Islamic bank, how much financial capacity, and financial knowledge they require.

For this purpose, the level of financial numeracy and the impact of religiosity on financial decision by these customers will be identified and analyzed in the light of their feedback which is missing in past literature. Previously, different dimensions of financial numeracy have been discussed separately by researchers but, this study will cover all dimensions of financial numeracy including financial capacity and financial knowledge. The most important and mediating role of religiosity on financial decision by Islamic banking customers has also not been discussed strongly in past studies, will be discussed in detail in this study. Therefore, this study will provide extensive knowledge about all aspects of financial capacity, financial knowledge, and the mediating role of religiosity on the financial decision of Islamic banking customers in Pakistan. Similarly, this study is an effort to provide the opportunity to the Islamic bank's officials to find out their real customers from the market and give them proper and complete knowledge, which is lacking in them. They will also know the importance of financial numeracy among their customers which is the basis for joining Islamic bank.

Finally, the level of financial capacity, financial knowledge and religiosity of Islamic banking customers will lead them to take better financial decisions and they will

be in good position to decide which Islamic bank they have to choose and which Islamic banking product they purchase to fulfill their financial needs.

1.4 Research Objectives

Following are the research objectives of this study.

1. To identify the level of financial numeracy and religiosity of the customers of Islamic banks in Pakistan.
2. To analyze the impact of financial numeracy and religiosity on financial decision among Islamic banking customers in Pakistan.
3. To check the impact of financial numeracy and religiosity on financial decision of the customers of Islamic banks in Pakistan.

1.5 Research Questions

Following are the research questions of this study.

1. What is the level of financial capacity of Islamic banking customers in Pakistan?
2. What is the level of financial knowledge of Islamic banking customers in Pakistan?
3. What is the level of religiosity among Islamic banking customers in Pakistan?
4. How financial numeracy and religiosity impact directly the financial decision of Islamic banking customers in Pakistan?
5. How religiosity impacts indirectly as a mediating variable to the financial decision of Islamic banking customers in Pakistan?
6. How Islamic banking customers can utilize their financial numeracy during the process of making financial decisions with the impact of religiosity?

Table 1.2: Research Objectives and Research Questions

No.	Research Objectives	Research Questions
1	To identify the level of financial numeracy and religiosity of the customers of Islamic banks in Pakistan.	1. What is the level of financial capacity of Islamic banking customers in Pakistan? 2. What is the level of financial knowledge of Islamic banking customers in Pakistan? 3. What is the level of religiosity among Islamic banking customers in Pakistan?
2	To analyze the impact of financial numeracy and religiosity on financial decision among Islamic banking customers in Pakistan	4. How financial numeracy and religiosity impact directly the financial decision of Islamic banking customers in Pakistan? 5. How religiosity impacts indirectly as a mediating variable to the financial decision of Islamic banking customers in Pakistan?
3	To check the impact of financial numeracy and religiosity on financial decision of the customers of Islamic banks in Pakistan.	6. How Islamic banking customers can utilize their financial numeracy during the process of making financial decisions with the impact of religiosity?

1.6 Operational Definitions

In this section, operational definitions of consumer behavior, financial numeracy, financial capacity, financial knowledge, and religiosity are explained.

1.6.1 Consumer Behavior

Consumer behavior is the actions and decision processes of people who purchase goods or services for their personal uses (Khwaja et al., 2020). Consumer buying behavior is the study of consumers and their behaviors which they exercise during making decision of buying any product and service which satisfy their needs. It is also

the study of consumer's actions which motivate them to buy and use their required product or services. This study deals with different situations of consumers which include, what to buy, why they buy, when do they buy, how often do they buy, and for what reason do they buy. The study of consumer's buying behavior is very important for marketing people as they can become aware about the expectations of their consumers. The study of this behavior also helps them to understand those factors which persuade their consumers to buy any specific product or service. This study also helps business organizations to become aware about the liking of their consumers so that they can supply those products into the market to enhance their sales. Similarly, marketing personnel can understand what their consumers like or dislike, so that they can design their products and services according to the requirements of their consumers (Khwaja et al., 2020).

According to Akhter (2009), there are four basic aspects which are essential in studying consumer behavior. These include overall satisfaction, purchase intention, word-of-mouth advertising, and actual repurchase behavior. All these aspects are very much influential while decision making by consumers. Similarly, some consumers are quality and brand conscious and they firmly buy only those products and services which are made by prominent companies. For these types of consumers, brand name or brand logo is very important. However, this tradition is different in various cultures, societies, and countries due to demographic factors, human capital, socio-economic characteristics, and behavioral and attitudinal traits differences (Goudis and Skuras, 2020). Xiao and Tao (2020) have discussed different dimensions of financial behaviors of those customers who want to purchase financial products and services related with

consumer finance, household finance, personal finance, and family finance. They also discussed that financial consumer behaviors are mostly based upon money management, insurance, financial loan, saving/investment, fintech, and financial capability/literacy. All these are the components of financial capacity and financial knowledge. Beckett, Hewer and Howcroft (2000) have suggested that bank service providers must try to understand their customers in an attempt not only to anticipate but also to influence and determine consumer buying behaviors. This will be helpful for them to enhance their customer's network.

Social media is playing very important role in impacting consumers' buying behavior throughout the world, especially in Pakistan. The two main factors involved in this impact is word of mouth and content credibility. Demographically, those Pakistani consumers who are below the age of 40, possess more complex buying behavior, which alerts entrepreneurs to consider it for their marketing strategies (Palalic, et al. 2020). Similarly, the consumer's attitude of Muslim consumers to purchase *Halal* products and services depends on their personal norms and religiosity. The role of consumer attitudes and religiosity on *Halal* buying behavior of consumers is significant. However, consumer attitudes mediate the relationships between personal norms and *Halal* buying behavior, as well as religiosity and *Halal* buying behavior (Tuhin, et al. 2020).

The definition, consumer behavior is the actions and decision processes of people who purchase goods or services for their personal uses, given by Khwaja et al., (2020) is the most suitable definition with the context of this study.

1.6.2 Islamic Banking Customers

Several characteristics of Islamic banking customers have been discussed in literature. These are those people who either have their accounts in Islamic banks or they avail any product or service of Islamic banks. These products and services include fee-based services (ATMs, money transfer, pay orders, bank drafts etc.) and partnership-based products including house financing, auto financing, business financing etc. According to Amin and Isa (2008), Islamic banking customers are those people who visit Islamic bank counters. Similarly, they must have an account with one of the full-fledged Islamic banks. Ali and Puaah (2017) have treated only those customers as Islamic banking customers who deal with only full-fledged Islamic banks in Pakistan. They also defined that full-fledged Islamic banking customers and window Islamic banking customers have different characteristics.

Shamsudheen, Mahomed and Mohamad (2020) have categorized Islamic banking customers in three types, retail customers of banking products and services, Institutional clients or corporate entities, and the practitioners used in Islamic banks in the UAE. Islamic banking products and services selection criteria for retail customers is *Sharia'h* compliance. Whereas the selection criteria for Islamic banking products and services for Institutional clients and practitioners is more towards “cost and affordability” and “rates and return” as compared to *Sharia'h* compliance. Saqib, Aitizam, Aliya and Zafar (2016) have treated only those customers as Islamic banking customers who have their accounts in full-fledged Islamic banks and Islamic Banking Branches (IBBs) of conventional commercial banks in Pakistan. The selection of Islamic banks of these customers is strongly based upon *Sharia'h* compliance along with service

quality and customer satisfaction. Janahi and Almubarak (2017) have emphasized that service quality of Islamic banks is very important for customer satisfaction. Those customers will be loyal with Islamic banks who will be satisfied with *Sharia'h* compliance of products and services along with the main dimensions of customer service quality (compliance, assurance, reliability, tangibility, empathy and responsiveness). Khamis and AbRashid (2018) also measured customer satisfaction level by CARTER model in Tanzania. They found that Islamic banking customers are satisfied with the Islamic banking products and services. However, these customers are more attracted by compliance, tangibility and reliability of Islamic banks. Mulia, Usman and Parwanto (2020) have discussed that customer intimacy encourages customers loyalty towards Islamic banks. Similarly, perceived usefulness, perceived ease of use, perceived risk, trust, *Sharia'h* compliance and satisfaction also play major role in customer satisfaction of Islamic banks. It means that customer intimacy has a direct and indirect influence on loyalty.

The definition of Islamic banking customers, those people who visit Islamic bank counters and they must have an account with one of the full-fledged Islamic banks, given by Amin and Isa (2008) is the most suitable definition with the context of this study.

1.6.3 Financial Numeracy

The diversified definition of financial numeracy has been discussed in literature. The definition of financial numeracy, it includes various factors such as financial education, financial information, and financial awareness, given by Ganesan, Pitchay

and Naseer in 2020 is best describing the concept of financial numeracy. Similarly, its definition, financial knowledge (or financial literacy), abilities, skills, behavior, financial decision, and experience are used to refer to financial numeracy, given by Ouachani, Belhassine and Kammoun in 2021 is also very much associated with financial numeracy. Financial numeracy is referred to managing money, retirement planning, choosing financial products and to have the proper knowledge about conventional and Islamic financial services (Atkinson et al., 2006). Therefore, it can be said that financial numeracy is the combination of financial capacity and financial knowledge (or financial literacy) of bank customers (Fox *et al.*, 2005; Hill & Kozup, 2007). Financial numeracy is helpful to the customers for Islamic banks to evaluate their financial requirements in the light of their financial capacity and help them to take better financial decisions based on financial knowledge.

Financial numeracy is the combination of financial capacity and financial knowledge. Financial capacity is the financial ability of the customers which enables them to choose a financial product offered by a financial institution (Huhmann, & McQuitty, 2009). Before going to choose any financial product, one must investigate his financial capacity whether he has the enough funds for that product or not. The limitation of funds guides the customer to take the correct financial decision (Faisal *et al.*, 2014). As soon as the financial capacity enhances, the customer then becomes able to change his financial decision. Financial knowledge is referred to the in-depth information and knowledge about the financial services offered by the financial institutions (Huhmann & McQuitty, 2009). As conventional and Islamic banks offered different types of financial products, the customers should have the proper knowledge

about the difference between them. Financial knowledge also includes the financial strength of the banks which indicates the profitability, productivity, and liquidity of financial institutions (Sages & Grable, 2010 and Smith *et.al.*, 2010). Proper financial knowledge provides best opportunity to the customers to decide about the best suitable financial product offered by Islamic banks.

The definition of financial numeracy, it is a combination of financial capacity and financial knowledge. Financial capacity is the financial ability of the customers which enables them to choose a financial product offered by a financial institution, given by Huhmann & McQuitty in 2009 is the most suitable definition with the context of this study.

1.6.4 Financial Capacity

Financial capacity is defined as a concept of different components which include perceived financial capacity, desirable financial behavior and objective and subjective financial knowledge (Xiao & O'Neill, 2016). In developing countries, social network positively and strongly mediates the relationship between financial numeracy and financial capacity of poor people by microfinance banks. Additionally, financial numeracy also has a direct significant and positive effect on financial capacity which includes income, savings, and expenses (Bongomin, et al., 2020). Financial capacity development is very important to motivate individuals to practice healthy financial behaviors, consistently (Serido et al., 2013). Therefore, different components of financial capacity significantly and positively interacted with each other, and together improved the overall level of financial capacity (Xiao, Tang, Serido, and Shim, 2011).

Similarly, capacity, skills, and mode of understanding issues emerge with the passage of time and by contacting and communicating with different people in the society. This process enables individuals to recognize information and to develop their skills in their adult life which they obtained in their childhood (King, 2009).

Financial capacity is the first element of financial numeracy which determines the eligibility or requirement for banking services by a customer. If a customer has not the enough financial capacity, he is not a potential customer of the bank (Huhmann & McQuitty, 2009). Similarly, there are some customers who join Islamic banks only due to the reason that their corporate accounts are there, and they are bound to receive their salaries through those banks, or they are just walking customers who use ATM machines or funds transfer etc. It doesn't mean that they fulfill the basic requirements of financial capacity (Al-Eisa & Alhemoud, 2009). The definition of financial capacity, it is the first element of financial numeracy which determines the eligibility or requirement for banking services by a customer. If a customer has not the enough financial capacity, he is not a potential customer of the bank, given by Huhmann & McQuitty in 2009 is the most suitable with the context of this study.

The definition of financial capacity, it is the first element of financial numeracy which determines the eligibility or requirement for banking services by a customer, given by Huhmann & McQuitty (2009) is the most suitable definition with the context of this study.

1.6.5 Financial Knowledge

The term financial literacy or financial knowledge was introduced in USA by the Jump\$tart Coalition for Personal Financial Literacy in 1997, defining the concept as an expertise to use the knowledge and skills to manage an individual's financial resources very effectively to avail long term financial security. Later, also in USA., this characterization was adopted in a universal definition provided by the President's Advisory Council on Financial literacy (PACFL 2008). Financial knowledge has a stronger relation with financial well-being of the consumers. Financial behavior score and income level also correlate with financial well-being of banking customers (Riitsalu and Murakas, 2019).

However, Hung (2009), in his review of competing financial literacy concepts, explored that there are several definitions which are proposed in literature, but all are lacking to establish a universally accepted theory of what financial literacy or financial knowledge really means. He gathered large number of conceptual definitions and proved that each of them stresses different dimensions of financial literacy, i.e., actual and perceived knowledge of financial matters as well as the ability to apply that knowledge, but also individual financial experience and even sound financial behavior. During operationalizations the concept of financial literacy, Huston (2010) urges that financial literacy should be conceptualized as having two dimensions; understanding (personal finance knowledge) and use (personal finance application). A similar understanding was also given by Hung (2009), who consolidate the various definitions they review and proposed a new concept which specifies financial literacy as the knowledge of basic economic and financial concepts. Additionally, it is the ability to use that knowledge and

other financial skills to manage financial resources effectively for a lifetime of financial wellbeing.

The definition of financial knowledge which was included in the 2012 Program for International Student Assessment (PISA) and has been provided by the Organization for Economic Cooperation and Development (OECD, 2014), consists both the knowledge and application domains. As per this definition, financial literacy comprises of the knowledge and understanding of financial risks, skills, concepts, motivation, and the confidence which is applied to make effective financial decisions by consumers. Further, it improves the financial well-being of individuals and the society to prepare them for participation in their economic life.

If a customer has the financial capacity and want to get the services from an Islamic bank, feels hesitate because he doesn't have the proper financial knowledge about the system. Financial knowledge covers the financial strength of the bank as well as the knowledge about the financial products offered by Islamic banks. Its constructs include the knowledge about *Halal* and *Haram* sources of earnings. Similarly, for taking any financial decision, Islamic banking customer must have the proper knowledge about Equity Financing Modes (*Musharakah*, *Mudarabah*, and *Diminishing Musharakah*) and Debt Financing Modes (*Murabahah*, *Ijarah*, and *Bai' Salam*). As selection of an Islamic bank to avail any of these products or services is strongly impacts by religiosity as a mediator, the impact of religiosity is very much important in this process (Nugraheni and Widyani, 2020). Without having proper financial knowledge, a customer cannot decide which Islamic bank to choose and in which product to invest.