THE EFFECT OF FINANCIAL LITERACY AND SOCIAL PHILANTHROPY FUNCTIONS ON ISLAMIC FINANCIAL INCLUSION PRACTICES

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Abstract

Although financial inclusion practices have been widely applied by Islamic banking institutions, the testing of factors affecting Islamic financial inclusion (IFI) is still limited. This study analyses the connections between financial literacy, social philanthropy functions, and IFI. The study sample includes 56 Islamic banks listed on the Indonesia Stock Exchange (IDX) during the 2015 to 2021 period. This study measures Islamic corporate social responsibility (CSR) as viewed based on two approaches: financial literacy and social philanthropy functions. Multivariate regression analyses are utilised for analysing the data and testing the hypotheses. The results showcase that financial literacy does not positively influence financial inclusion; by contrast, social philanthropy has both a positive and significant effect on financial inclusion. This study contributes to the existing literature by providing insights into the influence of Islamic CSR as a means of encouraging IFI. The managerial implications of these results may guide decision-makers, particularly governments and financial institutions when drafting regulations to consider the overall effectiveness of Islamic CSR in promoting improved Islamic financial literacy and inclusiveness within Indonesia.

Keywords: Financial Literacy, Social Philanthropy, Islamic, Corporate Social Responsibility, Financial Inclusion

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1. INTRODUCTION

Financial inclusion is defined as individuals and businesses having access to several financial products (e.g., savings, deposits) and services (e.g., payments, credit, working capital, insurance) to meet their requirements at all times (World Bank, 2022). This financial inclusion has emerged as a key political agenda within developing countries. For example, the G20 International Forum, the Organisation for Economic Co-operation and Development (OECD), and the Asia–Pacific Economic Cooperation (APEC) have agreed that financial inclusion is an important issue that should be of major concern. As a result, the government of Indonesia is committed to continuing to accelerate the expansion of community access or financial inclusion to support improved well-being and encourage national development. One form of this commitment is Indonesia's government integrating massive and sustainable financial inclusion programmes with their goal being to encourage an achievement level of the financial inclusion target of 90% by 2024, as well as supporting the national economic recovery programme. Financial inclusion in Indonesia is continuing to increase (Financial Services Authority [OJK], 2022a). In 2021, Indonesia's level of financial inclusion reached 83.6%. These financial inclusion developments were followed by significant growth in ownership and use of financial accounts, which increased to 65.4% in 2021 (Ministry of Communication and Information Technology, 2022).

One sector that plays a significant role in increasing the level of financial inclusion is the banking industry. The banking sector plays an important strategic role in facilitating the smooth and untroubled flow of monetary policy as an intermediary institution, providing clear access to financial services (intermediation) for all sections of society (Sofilda et al., 2022). In fact, the banking industry has a direct relationship with individuals and society. An effective way to expand the range of banking services available is to engage in social responsibility (Singh et al., 2021). Corporate social responsibility (CSR) is a type of financial inclusion that is widely used by developing countries (Afzal et al., 2023). In recent decades, people in developing countries have still been faced with social and environmental problems (e.g., poverty, income inequality, environmental degradation) as a result of various corporate activities. Because of this, CSR activities are beneficial to the community (Amran et al., 2017). In this case, CSR can function to overcome social and environmental problems through community empowerment activities, providing financial assistance and resources, providing funds for education and environmental conservation.

While previous works have tested the impact CSR has had on business performance, studies covering the impact CSR has made on financial inclusion remain limited (Bhattacharyya et al., 2021; Singh et al., 2021). There is some current empirical evidence to suggest that CSR has a significant influence on financial inclusion (Ramzan et al., 2021; Singh et al., 2021; Vo et al., 2021). This study's objective is to revisit the relationship between CSR and financial inclusion. This study differs from previous ones in several ways. First, this study focuses on both CSR and financial inclusion from an Islamic perspective — whereas Ramzan et al. (2021), Singh et al. (2021), and Vo et al. (2021) consider CSR from the perspective of conventional banks. Indonesia contains one of the largest Muslim populations in the world and has a heterogeneous society, meaning it needs to take the right approach to encouraging financial inclusion. One of Indonesia's main focuses is Islamic financial inclusion (IFI). Islamic banking plays an important role in promoting IFI (Ali et al., 2020). The principle of Islamic financial establishments that do not apply interest is an advantage for Muslim-majority countries like Indonesia.

Second, most previous studies have concentrated solely on the practices of Islamic CSR (ICSR) within the Islamic banking sector (Kamla et al., 2006; Said et al., 2018; Tarique et al., 2021; Tashkandi, 2023) or on the measurement of the performance of Islamic financial establishments (Abdallah & Bahloul, 2023; Akbar & Siti-Nabiha, 2022; Sairally, 2013). Testing the relationship between ICSR and IFI, particularly in Indonesia, remains a limited territory. Third, in the context of measurement, this study measures ICSR based on two approaches: financial literacy and social philanthropy functions. Education through the promotion and literacy activities of banking products that are designed with socially responsible practices and community empowerment will have a positive impact on fostering financial inclusion.

This study's important findings will contribute both theoretically and practically to the impact CSR has on the performance of IFI in banking. First, the results of this study will provide insights that may enrich the literature on how the influence of ICSR — as a means of encouraging IFI in Indonesia — can be enhanced. This study will address which of the two functions of ICSR, literacy/educational or social philanthropy, is a determinant of IFI. Second, these results should also provide guidance for decision-makers, particularly governments and financial institutions, when drafting regulations to consider the effectiveness of ICSR in promoting improved Islamic financial literacy and inclusiveness in Indonesia.

This study is organised as follows. Section 2 provides a literature review and details the development of the numerous hypotheses. Section 3 describes the research method. Section 4 presents the results and the following discussion. Finally, Section 5 presents the conclusions and recommendations for future study.

2. LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

2.1. Indonesia's Islamic financial inclusion practices

Bank Indonesia (n.d.) reported that the term financial inclusion began to trend after the 2008 crisis; this was mainly based on the impact the crisis had on low-income and irregular-income groups, those living in remote areas, disabled people, workers who lack legal identity documents, and generally unbanked periphery communities (the bottom of the pyramid) — which are recorded in very high numbers outside developed countries. Different reasons may cause a community to lack bank utilisation, both in terms of supply (service providers) and demand (society); this is namely due to price barriers (being too expensive), information barriers (ignorance), product barrier design (no suitable products) and channel barriers (appropriate means).

In Indonesia, financial inclusion practices are regulated in Presidential Regulation No. 114 of 2020 — which concerns the National Financial Inclusion Strategy (SNKI). In general, SNKI has prioritized the strategy of expanding and facilitating access to formal financial services to all Indonesian people — including productive business actors, small and medium-sized enterprises (SMEs), farmers, fishermen, students, and the community of Islamic boarding schools (OJK, 2022b). Financial inclusion benefits for the community, regulators, government and private sector — among others — include: improving economic efficiency, supporting financial system stability, reducing shadow banking or irresponsible finance, supporting financial market deepening, providing new market potential for banks, supporting the improvement of Indonesia's human development index (HDI), contributing positively to sustainable local and national economic growth, reducing inequality, and lowering the rigidity of low-income traps, to improve the welfare of clients — which would ultimately lead to a decrease in poverty rates.

IFI pertains to the availability of access to various Islamic financial products, services, and establishments for the needs of the community (Afzal et al., 2023; Khmous & Besim, 2020). The concept of financial inclusion in Islamic finance is represented through the topic of risk sharing (Al-Jarhi, 2017; Suseno & Fitriyani, 2018). There are three main areas of risk sharing: exchange contracts and risk-sharing instruments in the financial sector, redistributive risk-sharing instruments from more capable communities to underprivileged segments of society (such as *zakat*, *almsgiving*, *waqf*, etc.), and rules regarding inheritance heirs for intergenerational distribution. In short, IFI explains how people can access Islamic financial products, services and institutions.

According to the OJK (2020a), IFI in Indonesia could only reach 6.5% in early 2021. This means that Indonesia, as the country with the largest Muslim majority in the world, still maintains a weak awareness of Islamic finance. Table 1 presents the development index of Islamic financial literacy and inclusion. Based on Table 1, it is shown that the level of IFI is at the level of 9.10%. The Islamic financial literacy rate only reaches 8.93%. This achievement is lower than conventional financial literacy and inclusion.

Table 1. Islamic financial literacy and inclusion

Index	***2019***		***2022***	
	Literacy	***Inclusion***	***Literacy***	***Inclusion***
Conventional	38.03%	76.19%	49.68%	85.10%
Islamic	8.93%	9.10%	9.14%	12.12%

Furthermore, OJK has stated that there are various obstacles faced by IFI and literacy in Indonesia. First, the market share is still low; therefore, Islamic financial establishments are encouraged to have the means to provide financial needs in the development of the halal industry and the development of Islamic financial institutions. Second, increasing the core capital of Islamic financial institutions. Currently, six Islamic banks have a core capital of under 2 trillion rupiahs for a total of 14 Islamic commercial banks as of December 2020. Third, improving Islamic financial literacy. In addition to providing Islamic financial services, Islamic financial institutions also must be required to provide both education and an understanding to the public regarding how Islamic finance runs following the correct Islamic Sharia rules. Finally, increased competitiveness. The level of competition for Islamic financial services is still below conventional. Therefore, the fifth challenge of the OJK for Islamic finance in increasing IFI is to increase its overall competitiveness.

2.2. Concept of Islamic corporate social responsibility

According to Farook (2007), "ICSR stems from the basic principles of the Quran. The three basic tenets of ICSR are the ugliness of humanity on earth, the divine responsibility and the duty of humanity to unite with the good and forbid evil. First, the principle of vicegerency indicates that humanity is the representative of Allah on the earth and as such Allah has entrusted to humanity the stewardship of Allah's possession. Allah states this principle in the holy Qur'an: "I will create a vicegerent on earth"; and Allah further states: "It is he who has made you the inheritors of the earth". Second, the principle of divine responsibility flows from the principle of vicegerence and indicates that individuals will be responsible before Allah for all their actions on the Day of Judgment. This principle is expounded in several verses of the holy Qur'an, two of which are: "Allah takes careful account of everything"; and "Then shall anyone who has done an atom's weight of good shall see it and anyone who has done an atom's weight of evil, shall see it". This divine accountability is the basis for all actions of a Muslim, and in turn the representative organizations of Muslims. Finally, the principle enjoining good and forbidding evil encapsulates the responsibilities that Allah places for Muslims as trustees and vicegerents. Allah says: "The Believers, men and women, are protectors one of another; They enjoin what is just (accepted), and forbid what is unjust (rejected)…", and in another verse, Allah states: "You are the best of peoples, evolved for mankind, enjoining what is just (accepted), forbidding what is unjust (rejected), and believing in Allah". This responsibility is overwhelming and encompasses all aspects of a Muslim's life. It comprises a prescription towards positive (permissible and recommended) actions and a prescription against negative (impermissible and not recommended) actions" (p. 33).

Hanic and Smolo (2023) propose an ICSR approach consisting of four components: economic, philanthropic, global, legal, and ethical responsibility. In the context of economic responsibility, ICSR supports the principle that there is a balance between the returns received by shareholders and their depositors following Sharia principles. Philanthropic responsibility is based on the principles that *zakat* and *sadaqah*, and can be used as tools for poverty reduction, education funding, and community empowerment. Glocal responsibilities emphasise environmental matters. Eco-friendly financial products, such as green Sharia and green bonds, can be a way for investors to invest in green projects. Legal and ethical responsibility exerts pressure on the fulfilment of necessary legal norms and, simultaneously, the demands of Sharia — which comprise the law. Moreover, in the application of ICSR, several principles must be in line with the Sharia principles of the purpose of Islamic Sharia (*maqashid Sharia*); these include *hifdzu din* (protecting religion), *hifdzu nafs* (protecting the soul), *hifdzu aql* (protecting the mind), *hifdzu maal* (protecting property), and *hifdzu nasab* (protecting offspring).

There are at least two reasons for Islamic banking's role in a social responsibility context. First, Islamic banking is obliged to fulfil collective religious obligations (*fard kifayah*) for Muslims that cannot be fulfilled by individuals. Second, as an institution, Islamic banking can be an example for the community by developing a standard structure of CSR obligations (Farook, 2007). Ali Aribi and Arun (2015) argue that the core of the Sharia principles that are reflected in ICSR is the existence of social justice and community well-being. The existence of such principles is different from conventional financial principles.

2.3. Hypotheses development

Financial inclusion, as an indicator of equitable access to formal financial institution services, has become an important concern for practitioners, academics, governments, and other key collaborators (Afzal et al., 2023; Ali et al., 2020; Er & Mutlu, 2017; Khan et al., 2022). Affordable access to services like payments, remittance facilities, savings, insurance, and credit loans has been institutionally regulated (Zhang & Posso, 2019). A number of previous studies have emphasised that financial inclusion is an important indicator for both rural economics and social development (Bozkurt et al., 2018). Singh et al. (2021) explain that one of the mechanisms for equitable access to services is social responsibility activities. As an important sector in the economy, the banking sector participates directly by expanding financial products and services to those who require them — while also improving the welfare of those who have not participated (Abdallah & Bahloul, 2023).

Islamic financial literacy is defined as a person's ability to utilise financial knowledge in order to manage their own funds in accordance with Sharia principles, as well as implementing them in Islamic financial attitudes and behaviours to achieve future prosperity (OJK, 2016). One example of implementing Islamic financial attitudes and behaviour involves an individual choosing financing that remains in accordance with Sharia principles and deciding to become a customer at a Sharia bank that does not use an interest system (Ozdemir et al., 2023). Previous studies have noted financial literacy as an important factor in financial inclusion. Financial literacy has a proportionate impact on financial inclusion, in which low literacy rates are associated with low financial inclusiveness (Adetunji & David-West, 2019; Birochi & Pozzebon, 2016; Bongomin et al., 2018; Khan et al., 2022). Ali et al. (2020) contend that IFI in Indonesia is driven by two primary factors: demand and supply. With respect to demand, financial literacy is the main driving force behind IFI.

H1: There is a positive relationship between literacy functions in Islamic corporate social responsibility and Islamic financial inclusion practices.

The role that philanthropy tends to play also has the same characteristics as Islamic finance. The corporate social role is a plan for achieving the principle of business balance (Asiyah et al., 2019). ICSR can be interpreted as an expenditure used for the benefit of the people. *Zakat* is included in social activities that are aimed at ensuring the prosperity of the people. It emphasises social priorities over economic value. As a result, the best way to conduct business in Islam is through fiduciary capital. Trust capital will increase client satisfaction and promote corporate social relationships (Rashid et al., 2013). In the Islamic context, *waqf* is the inflow of income from property for continued charitable purposes. *Waqf*-based charities can have a significant impact in helping Muslim communities increase financial inclusion, reduce income inequality, and increase economic prosperity (Zauro et al., 2020).

H2: There appears to be a positive relationship between social philanthropy functions in Islamic corporate social responsibility and Islamic financial inclusion practices.

3. RESEARCH METHOD

The type of research utilised in this study is explanatory research for identifying a causal relationship between variables. The method of research used in this study is the quantitative method approach. The sample selection method used in this study was purposive sampling. The purposive sampling method is a sample selection method that uses certain considerations, which are generally designed to the purpose or problem of the study.

3.1. Data

The data used in this study is secondary data that was sourced from the annual reports of Islamic banks listed on the Indonesia Stock Exchange (IDX) from 2015 to 2021. Data on company characteristics are collected from the financial statements and the Bloomberg database. In accordance with the study's objective, the sample used included eight Islamic banks. The number of observations for seven years was 56 Islamic banks. The unit of analysis in this study is banking companies that are registered as public companies.

3.2. Variable measurement

Table 2 showcases the measurement of variables that are used in this study. The *ICSR* variables were measured in two dimensions: *financial literacy* and *social philanthropy*. The measurement of *ICSR* using these two dimensions is based on Bank Indonesia's Regulation No. 9/1/PBS/2007, which concerns the Health Level Assessment System of commercial banks that is based on Sharia principles. The *IFI* variables were adopted from the studies by Afzal et al. (2023) and Ramzan et al. (2021), which were also measured based on dimensions, number of branches, and automated teller machines (ATMs).

Table 2. Variable measurement

Variable	*Measurement*	*Reference*
$ICSR_{Literacy}$	Public education function: promotion costs divided by operational costs	Bank Indonesia Regulation No. 9/1/PBS/2007
$ICSR_{Social\ philanthropy}$	Social function of philanthropy: the amount of *zakat* and charitable funds divided by the base capital	Bank Indonesia Regulation No. 9/1/PBS/2007
IFI_{Branch}	Number of branch offices/100.000 population	Afzal et al. (2023), Ramzan et al. (2021)
IFI_{ATM}	Number of ATMs/100.000 population	Afzal et al. (2023), Ramzan et al. (2021)
Age	Number of years in operation	Ramzan et al. (2021)
Size	Total asset	Ramzan et al. (2021)

3.3. Analysis of data

Descriptive statistics are used to show the distribution of data by mean, standard deviation and range of each variable. Multivariate regression analysis with the Stata 17 test tool is used to analyse data and test hypotheses. This study strives to examine the effect of the independent variable on the dependent. A multivariate regression analysis is used to calculate the direction and effect the independent variable has on the dependent variable. The regression equation is as follows.

$$IFI_{Branch} = \alpha + \beta_1 ICSR_{Literacy} + \beta_2 Size + \beta_3 Age + \varepsilon \quad (1)$$

$$IFI_{ATM} = \alpha + \beta_1 ICSR_{Social\ philantrophy} + \beta_2 Size + \beta_3 Age + \varepsilon \quad (2)$$

4. RESULTS AND DISCUSSION

Table 3 displays the descriptive statistical findings. The average values of the $ICSR_{Literacy}$ variables are below the average value of $ICSR_{Social\ philanthropy}$. These findings suggest a stronger relationship between educational *ICSR* and *IFI* than social *ICSR*. Similarly, the average IFI_{ATM} value is shown to be higher than the IFI_{Branch}'s value. Furthermore, it can also be deduced that most of the companies sampled are large companies and have been operating for a relatively long time (around 20 years).

Table 3. Descriptive statistics of the variables

Variable	*n*	*Mean*	*Std. dev.*	*Min.*	*Max.*
$ICSR_{Literacy}$	56	-4.429	1.310	-6.849	-1.163
$ICSR_{Social\ philanthropy}$	56	-6.507	1.303	-9.471	-3.440
IFI_{Branch}	56	-7.508	1.212	-9.028	-4.387
IFI_{ATM}	56	-6.088	2.517	-9.316	-1.718
Size	56	30.897	1.238	29.278	33.212
Age	56	20	13	12	53

Table 4 provides the results of the matrix correlation tests between the variables. From these results, several conclusions can be drawn. First, the correlation coefficient between the independent variables is less than 0.80. This shows that there is no issue with multicollinearity. This result corresponds to a variance inflation factor (VIF) < 10 and a tolerance factor for all the variables > 0.10 (see Table 5). This also applies to heteroscedasticity tests. The Breusch-Pagan/Cook-Weisberg test results show a significance of > 0.05, meaning that there were no problems with the heteroscedasticity assumption.

Table 4. Matrix correlation

Variable	*1*	*2*	*3*	*4*	*5*	*6*
(1) $ICSR_{Literacy}$	1.000					
(2) $ICSR_{Social\ philanthropy}$	0.074	1.000				
(3) IFI_{Branch}	-0.290	0.537	1.000			
(4) IFI_{ATM}	0.080	0.606	0.397	1.000		
(5) Size	0.296	0.413	0.364	0.811	1.000	
(6) Age	0.002	0.472	0.844	0.210	0.261	1.000

*Note: **, * statistically significant at 0.01 (two-tailed) and 0.05 (two-tailed).*

The regression test results are provided in Table 5. *H1* test's results demonstrate that the *ICSR* measured by financial literacy has coefficients (p-value) -0.343 (0.000) and -0.324 (0.015). Based on these findings, it can be determined that *H1* — which indicates a positive relationship between $ICSR_{Literacy}$ and *IFI* — is rejected.

Table 5. Regression analysis results

Variable	*IFI*		*Conclusion*	*Multicollinearity*	
	Branch	*ATM*		*Tolerance*	*VIF*
$ICSR_{Literacy}$	-0.343 0.000 ***	-0.324 0.015 ***	Reject	0.905	1.100
$ICSR_{Social\ philanthropy}$	0.117 0.041 **	0.754 0.000 ***	Accept	0.685	1.460
Size	0.227 0.000 ***	1.512 0.000 ***	Significant	0.750	1.330
Age	0.064 0.000 ***	-0.031 0.025 **	Significant	0.768	1.300
Breusch-Pagan/Cook-Weisberg test for heteroscedasticity Chi-square = 0.05 Prob > Chi-square = 0.824					

*Note: **, * statistically significant at 0.01 (two-tailed) and 0.05 (two-tailed).*

These findings may be explained in the following way. First, the failure of this study to support *H1* is probably due to the limited funds used for education and promoting Islamic financial products. Evidence (see Table 3) that shows lower average costs incurred in these activities supports this claim. Furthermore, these results are supported by a survey that concluded that the financial literacy rate for Islamic banking ranged from 8% to 9% between 2019 and 2022 (see Table 1). However, the Islamic banking financial literacy index is very different from the financial literacy index of conventional banks (38%–49%). Fernandes et al. (2014) reported that financial knowledge contributed only 0.1% to financial behaviour. That is, financial literacy has not been strong enough to encourage behavioural change in improving financial inclusion. The results of this study showcase that financial literacy has not been a significant vehicle for the demand for Islamic finance products. Theoretically, the higher the financial literacy level becomes, the greater the necessity for services at

Islamic banks and financial establishments is. Therefore, the availability of more intensive financial literacy interventions by governments and financial service providers should increase access to Islamic financial services.

As previously discussed, the Islamic financial literacy index's low level when compared to conventional financial literacy levels is also likely due to literacy approaches that have not fully led to social change (e.g., approaches that may result in a limited understanding of new technologies in financial processes and systems). This can certainly lead to a suboptimal social transformation in the financial system. Obviously, this will lead to implications for the sustainability of financial inclusion programmes. Another possible explanation is that, in a developing country context (like Indonesia, for example), financial literacy has not been perceived as a mechanism for improving well-being. Moreover, society continues to believe that financial literacy is only limited to financial services and has not been seen as a mechanism for risk sharing, intermediation, and reducing economic volatility.

The *H2* test results showed that the ICSR measured by social philanthropy had coefficients (p-values) of 0.117 (0.041) and 0.754 (0.000). These results support *H2*, which indicates a positive relationship between the social philanthropy of ICSR and IFI — both in the number of branches and ATMs. Amran et al. (2017) state that Indonesian and Malaysian Islamic banks have differences in their operations compared to Western countries' CSR approaches. These differences include the fact that Islamic principles demand that Islamic banks promote community development, promote social well-being, and protect the needs of society. As a result, Islamic banks can provide social protection and CSR as required by the government. Providing social security can grow a new economy, increasing the ability for clients to transact with Islamic banks. This is only a part of the social responsibility that Islamic banks associate with human relationships with the environment (Asiyah et al., 2019).

5. CONCLUSION

This study's purpose was to examine the influence of the ICSR and IFI on banking companies in Indonesia. The findings show that financial literacy did not significantly impact the increase in IFI. Conversely, social philanthropy activities left a positive effect on the performance of financial inclusion within the sector of Islamic banking. This shows that a country with a majority Muslim population, like Indonesia, has tremendous potential for Islamic economic development.

However, limitations are present in this study. First, this study only bases ICSR practice on two dimensions: financial literacy and social philanthropy. Future studies should measure ICSR from multiple dimensions to provide a more comprehensive picture of other factors that may affect ICSR practices. Second, ICSR practices in Indonesia may not be fully described here because this study only focuses on eight Islamic banks. Future studies may expand the scope of the sample by considering Islamic banks located across Asia. The resulting findings are expected to be more generalisable. The practical implications of these results are that the state should be able to provide comprehensive support to foster IFI policies through the development of the ICSR. Hence, IFI is on the Indonesian government's agenda.

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