



**AN ASSESSMENT OF CUSTOMER'S PREFERENCES
ON THE SELECTION OF TAKAFUL OVER
CONVENTIONAL INSURANCE: A CASE OF SAUDI
ARABIA**

BY

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ABSTRACT

The risks and disasters are the possibilities that can happen to any individual. Among the likely ways of warding them off, especially properties or financial losses, is the risk management service through the purchase of an insurance cover in the form of *Takaful* or Islamic insurance. This research paper aims at examining the differences between *Takaful* and conventional insurance, identifying the customers' information about the *Takaful* products and services as well as assessing the motivational factors that influence the customer's preferences of *Takaful* over conventional insurance. To maintain a thorough analysis of the data collected, the research makes use of a mixed method of data collection. This comprises of questionnaires answered by one hundred and fifty respondents and in-depth interviews with four respondents drawn from the four selected *Takaful* industries in Saudi Arabia. Their answers were coded into the themes centred on the objectives of the research. Based on *Takaful* insurance, donations are established at the pooling system in line with the *Shariah* and they are formed on the bases of *Tabarru'* and escaping from *Gharar*, *Maysir* and *Riba*. However, on the conventional insurance, risks are transferred from the insured to the insurer; there are elements of uncertainty, gambling and interest generated. The customers obtain information about *Takaful* product and services through newspapers, internet, friends and promotion. The result discovers the motivational factors in the selection of *Takaful* over conventional insurance such as *Takaful* product is protected by *Shariah*, there is a brighter future of *Takaful* in Saudi Arabia, no risk incurred or transferred, funds are contributed in the spirit of brotherhood, contributions are invested in non-interest based capitalization, profits are shared according to individual donations and also uncertainty is reduced in *Takaful*. The findings of this research identify the importance of *Takaful* product over conventional insurance.

ملخص البحث

المخاطر والكوارث هي احتمالات يمكن أن تحدث لأي فرد. ومن بين الطرق الممكنة لوقفها وخاصة في الممتلكات أو الخسائر المالية ، هي خدمة إدارة المخاطر من خلال شراء غطاء تأميني في شكل تأمين تكافلي أو إسلامي . تهدف الورقة البحثية إلى دراسة الفروق بين التأمين التكافلي والتقليدي وتحديد معلومات العملاء حول منتجات وخدمات التكافل وكذلك تقييم العوامل التحفيزية التي تؤثر في تفضيل العميل للتأمين التكافلي على التأمين التقليدي . وللحصول على تحليل دقيق للبيانات التي تم جمعها ، أستخدم البحث طريقة مختلطة لجمع البيانات . وتضمنت استبيانات أجاب عليها مائة وخمسون مشاركاً ومقابلات متعمقة مع أربعة مستجيبين من أربع شركات تكافل تم إختيارها في المملكة العربية السعودية. وتم ترميز إجابات المبحوثين في المواضيع المتمحورة أو التي ركزت على أهداف البحث. بناءً على التأمين التكافلي ، تم إنشاء نظام تجميعي للتبرعات بما يتماشى مع الشريعة الإسلامية ، وكونت على أسس التبرع ومن أجل الهروب من الغرر، والميسر والربا. بالرغم ، أنه في التأمين التقليدي ، يتم نقل المخاطر من المؤمن عليه إلى المؤمن ، في ظل وجود عناصر من عدم الثقة ، والمضاربة وخلق الفائدة. العملاء يحصلون على المعلومات حول منتجات وخدمات التكافل من خلال الصحف والإنترنت والأصدقاء والترويج . النتائج تكشف عن العوامل التحفيزية في اختيار التكافل على التأمين التقليدي والمتمثلة في كون منتجات التكافل محمية من قبل الشريعة ولها مستقبل أكثر إشراقاً في المملكة العربية السعودية ، ولا يوجد مخاطر متكبده أو منقوله ، وتساهم الأموال في تشجيع روح الأخوة ، وتستثمر المساهمات دون فوائد على أساس رأسمالي ، ويتم تقاسم الأرباح وفقاً للتبرعات الفردية ، كما يتم استبعاد الغرر في التكافل . نتائج البحث تحدد أهمية منتج التكافل على نظيره من منتج التأمين التقليدي.

APPROVAL PAGE

I certify that I have supervised and read this study and that in my opinion; it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a research paper for the degree of Master of Science (Islamic Banking and Finance).

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DECLARATION

I hereby declare that this research paper is the result of my own investigation, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

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To my father and my mother

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CHAPTER ONE

INTRODUCTION

1.1 BACKGROUND OF THE STUDY

Vulnerabilities and disasters are the natural phenomena that may happen to any individual in the society. Some are anticipated, such as retirement, old age and death while others are unexpected such as road accidents, fire, outbreak, flood, hurricane, electrocution, thunder, epidemic, war, disease etc. These hazards can occur to someone's life, his properties or sometimes his business undertakings. The risks frequently affect the lives of many people in the society which at times becomes overwhelming and devastating. The consequences may result into susceptibility and helplessness of these unfortunate people. Similarly, the persistent needs of consumers in the modern world revolve around the need for security, i.e. security for life and properties (Abdul-Hamid, *et al* 2009).

Therefore, Islam encourages the act of taking safety or preventive measures against dangers. For example, in *Suratul Yusuf* chapter 12 verses 43-49 of the Holy Quran clearly explained how Prophet Yusuf (AS) informed the King the meaning of his dream by telling him to amass grains in the store from the surplus of 7 years of bumper harvest as a safety to ensure the availability of incessant food supply during the 7 years of food shortage. As stated below:

... And [subsequently] the king said, "Indeed, I have seen [in a dream] seven fat cows being eaten by seven [that were] lean, and seven green spikes [of grain] and others [that were] dry. O eminent ones, explains to me my vision if you should interpret visions."

They said, "[it is but] a mixture of false dreams, and we are not learned in the interpretation of dreams."

But the one who was freed and remembered after a time said, "I will inform you of its interpretation, so send me forth."

He said], "Joseph, o man of truth, explain to us about seven fat cows eaten by seven [that were] lean, and seven green spikes [of grain] and others [that were] dry – that i may return to the people; perhaps they will know [about you]."

[Joseph] said, "you will plant for seven years consecutively; and what you harvest leave in its spikes, except a few from which you will eat.

Then will come after that seven difficult [years] which will consume what you saved for them, except a few from which you will store.

Then will come after that a year in which the people will be given rain and in which they will press [olives and grapes]." Al-Qur'an chapter 12, verse 43-49

This is a perfect indication that individuals must struggle to escape any form of misfortune, and simultaneously be fully prepared. The main goal of the insurance is to support, between the parties involved, mutual-responsibilities on the foundation of shared cooperation in guarding an individual against unforeseen risks (Matsawali *et al*, 2012).

This necessitates the desires for risk management service that can be acknowledged and utilised by the Saudi Arabian citizens who are mostly businessmen. Therefore, the risk management products at the services for customers, can let them avoid or remove the risk due to lack of security. Amongst the obtainable products that can allow people, particularly members of the business community to transfer and alleviate their risk which has become so pronounced is the insurance services. Customers' patronage of a conventional insurance product and service is a very complex process that involves societal influence. This enables the customers' attitude to be an important factor in influencing the product and service supports mainly the intake of *Takaful* i.e. Islamic Insurance services (Aris, *et al* 2012).

Saudi Arabia is a desert encroached country incorporating the greatest Arabian Peninsula, with Red Sea and Persian Gulf coastlines. It accommodates the two most sacred mosques in the world i.e. *Masjidul Haram* in *Makkatul Mukarramah* and *Masjidul Nabawi*, in *Madinatul Munawwarah*. Saudi Arabia has a population of 32.1 Million according to the 2016 population census (Encyclopaedia Britannica Online, 2011). And the majority of the people are Muslim (99.5%), it is therefore essential to bring another solution to conventional insurance, which is accepted by the Islamic *Shariah* for the purpose of offering economic and social security. *Takaful*, an Islamic insurance is performed based on the principles of *Mudharabah* investment and it should be in accordance with the principles of Islamic inheritance and legacy and must also agree with the teachings of Islam as enshrined in the Holy Qur'an and *Sunnah* of the prophet (Awang and Zakaria 2005).

The word *Takaful* comes from Arabic word called '*Kafalah*' which means to 'help one another' or 'mutual guarantee', has been determined by a desire to overcome these problems and produce an insurance scheme that is completely in accordance with the Islamic *Shariah*. It provides Muslims with a treasured risk management instrument and the major proper substitute to conventional insurance in equally the life and non-life divisions that is suitable for Muslim and their religion of Islam (Abdu *et al*, 2012). *Takaful* is *Shariah* compliance insurance product which holds an idea different from that of the conventional insurance that is totally prohibited by the *Shariah* because of elements of interest (*Riba*), uncertainty (*Gharar*), and gambling (*Maysir*). There is doubt of what the consumer is purchasing or paying for, if there is no loss where the consumer obtains nothing. If loss takes place, the consumer gets compensation in varying amounts. Another element in conventional insurance is the issue of gambling (*Maysir*) and the last one is the

element of *Riba* where insurance funds are usually invested in interest-bearing securities. Consequently, *Takaful* is a substitute for conventional insurance, which manifests itself in the form of shared assistance (*Ta'awun*) in promoting moral virtue by supporting those in needs or in difficulties (Amin 2012).

From the Islamic legal perspectives, whenever there is any harm, effort should be exerted to do away with it. *Takaful* consumers donate money to a *Takaful* fund based on joint assistance. The contribution is prepared through shared and reciprocal donation (*Tabarru'*) which does not constitute a profitable sale of coverage as happening in conventional insurance. *Takaful* involves individual charitable agreement (*Tabarru'*) contrary to the conventional insurance agreement that is a mutual agreement (*Mu'awadat*). However, uncertainty (*Gharar*) is accepted on an individual charitable agreement (Annuar 2004). The idea of *Takaful* is established on three basic philosophies; that is mutual responsibility, cooperation with each other and protecting one another from any type of troubles, tragedies and other calamities whereby the customer's contributions in the form of premium are founded on the notion of donation (*Tabarru'*) (Ayuba 2014).

1.2 STATEMENT OF THE PROBLEM

Takaful in the Kingdom of Saudi Arabia is confronted with some important enquiries in terms of its activities and prospects. There is a shortage of education and awareness about the *Takaful* services rendered based on *Shariah*. Even though Saudi Arabia is an Islamic country and Muslim majority, but some people cannot differentiate *Takaful* and conventional insurance services. In the same direction, the concept of Islamic insurance or *Takaful* is ambiguous to uneducated Saudi Arabian citizens. Therefore, a

clear understanding of the difference between *Takaful* and conventional insurance is of utmost importance. Similarly, the ambiguity makes it very difficult for the uneducated Saudi citizens to explain the factors that influence their preference of *Takaful* products over conventional insurance. Furthermore, since the conventional insurance is progressively becoming the essential commodity of the people of Saudi Arabia, however, it violates the Islamic injunctions on the prohibition of gambling (*Maysir*) and interest (*Riba*).

Therefore, it is imperative for the Saudi citizens to switch to Islamic insurance services in order to have peace of minds as Muslims by obeying Allah's command.

1.3 RESEARCH QUESTIONS

The research questions are as follows:

1. What are the differences between *Takaful* and conventional insurance?
2. How do customers obtain information about the *Takaful* products and services?
3. What are the motivational factors that influence the preference of *Takaful* over conventional insurance?
4. What is the importance of *Takaful* product over conventional insurance?

1.4 OBJECTIVES OF THE STUDY

The objectives of this study are as follows:

1. To examine the differences between *Takaful* and conventional insurance
2. To identify the customers' information about the *Takaful* products and services

3. To assess the motivational factors that influence the preference of *Takaful* over conventional insurance
4. To determine the importance of *Takaful* product over conventional insurance

1.5 SIGNIFICANCE OF THE RESEARCH

The present study investigates the factors that influence Saudi Arabian citizens buy *Takaful* products based on in-depth exploration of the features of *Takaful* product, the study also inquires about the perception of *Takaful* services, the knowledge of religiosity of the customers, the promotion of *Takaful* products to customers, the quality of services provided by *Takaful* operators and the product benefits to the customers. On the other hand, the findings of the study assist *Takaful* operators in developing the quality of their products and services, to fascinate more people to purchase their products.

Similarly, the study enables the Saudi Arabian citizens to clearly understand the difference between *Takaful* and conventional insurance, by examining the customer's preferences concerning the two products and also to discover some elements that contradicted the conventional insurance with the *Shariah* rules. Besides, this study enables the researcher to discover the Islamic *Shariah* literatures in order to develop the necessary insurance framework, which complies with the *Shariah* injunctions as laid down in the *Quran* and *Sunnah*.

1.6 OPERATIONAL DEFINITION OF TERMS

Takaful:

Takaful Insurance can be defined as an Islamic insurance system that complies with the *Shariah* principles where compensation in the event of loss of a business is reimbursed from a *Takaful* fund where consumers reach an agreement to donate small fixed '*Tabarru*' or contributions. Therefore, *Takaful* is an alternative to conventional insurance. The insurance companies emphasised on *Riba* (interest), *Maysir* (gambling), and *Gharar* (uncertainty) principles that are forbidden in *Shariah* (Bello and Ayuba 2014).

According to Bank Negara Malaysia (2011), *Takaful* is a *Shariah* compliant insurance whereby a group of consumers jointly decides between themselves to guarantee each other in contrast to defined damage or loss that may lie on any of them by contributing a '*Tabarru*' (donation) in the *Takaful* fund. A provision is made by the group of people where each person single-handedly, who is at risk of any loss, the occurrence of which cannot be predicted, donate funds. The arrangement concludes that, should a loss occur on any of the contributors, the donated funds would be shared with the entire group (Razak *et al.* 2013).

Based on this research, *Takaful* is an Islamic system of insurance built on donations (*Tabarru*') and mutual cooperation (*Ta'awun*), where the risk is shared together willingly by the group of contributors.

Insurance:

According to the Business Dictionary, insurance is defined as “an instrument of risk-transfer that ensures full or part of the financial payment for the damage or loss caused by events outside the control of the insured party. Under an insurance contract, the

insurer guarantees the insured against a stated amount of loss, arising from specified risks in a specified time, provided money called premium is paid. At large, insurance compensation is usually proportional to the loss incurred, while in life insurance a fixed sum is paid regularly. Some types of insurance, for example, are product liability insurance are which are vital parts of risk management, and are compulsory in numerous countries” (Billah 2001).

Similarly, Insurance is a way of fortification for the commercial loss. It is a kind of risk management mainly used to kick against the risk of a dependent, unknown loss. The insurance transaction comprises the insured or policyholder supposing certain and identified reasonably small loss in the form of payment to the insurance company or the insurer in exchange for the insurance company's responsibility to recompense the policy holder in the result of a covered loss. The loss may or may not be monetary, but it must be reduced to monetary terms and must involve something in which the policyholder has an insurable interest recognised by possession or previous relationship. The policy holder obtains a contract, called the insurance policy, which provide the circumstances and conditions under which the policy holder will be monetarily compensated. The amount of cash charged by the insurance company to the policyholder for the coverage submitted in the insurance policy is referred to as premium. If the policyholder is involved in a loss which is possibly covered by the insurance policy, the insured or policyholder tender a claim to the insurance company for special consideration by a claims adjuster (Chua Abdallah 2000).

Based on the above definition, insurance is a process by which a company or government agency offers an assurance of reimbursement for a stated damage, loss, illness, or death in response to the payment of a premium.

Customer:

The customer is an individual that obtains products in the forms of goods or services and has the capability to select among various products and suppliers (Maiyaki and Ayuba, 2015). In another definition, customer is an individual or business that buys the goods or services made by a business. Attracting customers is the main objective of many individual businesses, since it is the consumer who makes a request for goods and services. Businesses regularly compete via announcements or lowered prices to attract a large amount of customer base (Business Dictionary, 2016).

Based on this research, customer is a person that purchases goods or services.

CHAPTER TWO

LITERATURE REVIEW

2.1 THE TRENDS OF TAKAFUL INSURANCE IN SAUDI ARABIA

Takaful insurance emerged in Saudi Arabia more than thirty years ago. The Islamic Insurance Company (*Takaful* insurer) was established in Saudi Arabia in 1979. It was the second established *Takaful* Company in the world after the first created *Takaful* Company in Sudan. From that year, the *Takaful* operations have grown in Saudi Arabia and regarded as the forefront among the Arab countries in *Takaful* development. On the other hand, major investment is needed to contest with the conventional insurance industry (Fisher and Taylor, 2000). However, *Takaful* industries in Saudi Arabia are less developed when equating with other Islamic countries like Malaysia and UAE. Many *Takaful* industries in Saudi Arabia have fruitfully grown at 10% or less per annum, while Dubai and Malaysia have grown at 60% or more per annum. In contrast to conventional insurance, most Saudi citizens are not buying insurance. May be because of the fact that, conventional insurance is against Islamic *Shariah*. However, despite the long existence of *Takaful* products in Saudi Arabia, people are reluctant to buy and similarly, *Takaful* operators are in short supply (Hamid *et al*, 2009).

The *Takaful* companies have been supplying Islamic insurance products connecting to individual lines in restricted amounts. Therefore, on the mutual basis, *Takaful* operators are unable to indemnify massive commercial risks involving large amounts of capital because these risks will need insurance companies with massive amounts of capital. Consequently, the Saudi Arabian Monetary Agency (SAMA) has

increased the share capital limit of *Takaful* company to the tune of one hundred million Saudi Riyals (SR100 million) and two hundred million Saudi Riyals (SR200 million) for re-*Takaful* companies in the Kingdom. Currently, there are six major *Takaful* industries in Saudi Arabia. They include *Sabb Takaful*, *Al-Rajhi Takaful*, *Weqaya Takaful* located in Riyadh and *Al-Ahli Takaful*, International Islamic Insurance Company and Islamic Arab Insurance Company located in Jeddah (Jacky Lim, 2010).

2.2 ISLAMIC PERSPECTIVES OF TAKAFUL

Takaful from the Islamic perspective is a pooling system of community members who dwell on the principles of shared assistance and brotherhood in which participants donate money to support people who are in need, especially in times of financial problems. Practically, *Takaful* is a tool for alleviating any eventuality or danger on the life, property or business ventures of Muslim and even non-Muslims. It is regarded as a substitute for conventional insurance (Kadir, 2011).

Takaful operation exists during the time of Prophet Muhammad (saw). Some verses of the holy Qur'an and hadith of the prophet talk about the concept of *Takaful*. Muslims are directed to collaborate with one another on the issue of righteousness and piety. The foundation of *Takaful* is stated in *Suratul Ma'idah* chapter 5, verse 2 of the holy Quran in which almighty Allah said:

... and cooperate (Ta'awun) in righteousness (Birr) and piety (Taqwa), but do not cooperate in sin and aggression. And fear Allah; indeed, Allah is severe in penalty.

Similarly, the holy Qur'an talks about the concept of the Muslim brotherhood, which is also another foundation of *Takafull*. Almighty Allah said in *Suratul Hujurat* chapter 49, verse 10: