



DETERMINANTS ON THE CHOICE OF
INSURANCE PRODUCTS AMONG MALAY
MUSLIMS IN MALAYSIA

BY

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A research paper submitted in fulfilment of
requirement for the degree of Master of Science in
Islamic Banking and Finance

IIUM Institute of Islamic Banking and Finance
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MAY 2014

ABSTRACT

Since Malaysia is considered as a hub for Islamic finance, many Islamic terms were introduced including Islamic insurance called Takaful. Takaful is derived from the Arabic word 'kafalah', which means to guarantee, looking after, to help and to take care of one's needs. Takaful is based on two concepts, which includes "ta'awun"(mutual assistance) and "tabarru"(voluntary contribution). Even though Malaysia is successful in the Islamic financial system, there is still low penetration of Takaful among Malay Muslims in this country. That is the reason why the writer embarked on this study. The objective of this study is to identify the determinant factors which contribute to the choice of insurance between Takaful and conventional insurance among Muslim in Malaysia. Not only that, this study also aims to further understand on the subject of Takaful. Questionnaire is used in this study in order to gain the information. Descriptive statistics used in order to explain the results. The results from descriptive analysis showed that majority of Malay Muslims in Malaysia have awareness and knowledge in Takaful however, it is still low. Meanwhile, price and religiosity are the factors that determine the choice of insurance among Malay Muslim in Malaysia.

ملخص البحث

منذ أن أصبحت ماليزيا مركزا للتمويل الإسلامي أدخلت العديد من المصطلحات الإسلامية بما في ذلك التأمين الإسلامي وهو ما يسمى التكافل. والتكافل كلمة مستمدة من الكلمة العربية "كفالة" وتعني أن تضمن، وتعني، وتساعد وترعى احتياجات أحد. ويستند التكافل على مفهومين إثنين وهما التعاون والتبرع. فعلى الرغم من أن ماليزيا ناجحة في النظام المالي الإسلامي فإنه لا يزال هناك انخفاض في انتشار التكافل بين المسلمين المالايويين في ماليزيا. وهو ما دفع إلى إجراء هذه الدراسة. وتهدف هذه الدراسة إلى تحديد العوامل المساهمة في الاختيار بين التأمين التكافلي والتقليدي عند المسلمين في ماليزيا. غير أن الدراسة لا تكتفي بذلك فقط وإنما تهدف أيضا إلى معرفة فهمهم للتكافل. ولأجل تحقيق هذا الهدف تم إجراء استبيان من أجل الحصول على المعلومات. ولشرح نتائج الاستبيان تم اعتماد الإحصاء الوصفي. وقد أظهرت النتائج أن عاملي الدين والأسعار فقط هي التي تجعل المشاركين يختارون التكافل في حين أن العمر والراتب والمعرفة ليست بين تلك العوامل. يحتوي البحث على خمسة فصول مكونة من الفصل الأول وهو عبارة عن مقدمة للبحث. والثاني مخصص للدراسات السابقة. فيما الثالث لمنهجية البحث ثم يليه تحليل النتائج في الفصل الرابع. والخامس عبارة عن خلاصة للبحث مع اقتراح عناوين لبحوث مستقبلية.

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 dissertation for the degree of Master of Science in Islamic Banking and Finance.

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This dissertation was submitted to the IIUM Institute of Islamic Banking and Finance and is accepted as a partial fulfilment of the requirements for the degree of Master of Science in Islamic Banking and Finance.

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DECLARATION

I hereby declare that this dissertation is the result of my own investigations, 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.

Shahira Abdul Jabar

Signature Date

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For my lovely husband and daughter:

Amirollah Bin Abdul Wahab and Zulaikha Binti Amirollah

For my mother and parents in law:

Hjh Patimah Binti Ali

Rosminah Binti Abdullah and Abdul Wahab Bin Jaafar

*For their love, care, trust, encouragement, continuous support, sacrifices, belief and
confidence.*

ACKNOWLEDGMENTS

Special thanks goes to my helpful supervisor, Dr Sheila Nu Nu Htay lecturer of Institute of Islamic Banking and Finance. The supervision and support that she gave truly help in progress and smootheness of this research. My grateful thanks also to all my friends that give whole support in helping my research. Great deal of appreciation goes to the contribution of my beloved universtiy- Institute of Islamic Banking and Finance (IiBF) especially those who have helped with my research and those who have encouraged and supported me in completing this research successfully.

TABLE OF CONTENTS

Abstract (English).....	ii
Abstract (Arabic).....	iii
Approval	iv
Declaration.....	v
Declaration of Copyright.....	vi
Dedication.....	vii
Acknowledgement.....	viii
Tables of Content.....	ix
List of Table.....	xii
List of Figure.....	xiii
CHAPTER 1: INTRODUCTION.....	1
1.1 Background of Study	1
1.2 Problem Statement	4
1.3 Research Objective	5
1.4 Research Questions	6
1.5 Contribution and Significant of Study	6
1.6 Organization of Study	7
CHAPTER 2: LITERATURE REVIEW.....	7
2.1 Introduction.....	8
2.2 Risk	8
2.3 Methods of Handling Risks	10
2.4 Insurance	11
2.5 History of Insurance.....	14
2.6 Theoretical Framework of Takaful	24
2.7 Comparison between Takaful and Conventional Insurance	52
2.8 Previous Studies on the Customer preference facotrs.....	53
2.9 Conclusion	57
CHAPTER 3: RESEARCH METHODOLOGY	57
3.1 Introduction.....	58
3.2 Research Methodology	58
3.3 Research Design.....	59
3.4 Research Method	59
3.5 Conclusion	62
CHAPTER 4 : DATA ANALYSIS AND FINDINGS.....	63
4.1 Introduction.....	63
4.2 Background of data	63

4.3 Statistical method.....	64
4.4 Profile of respondents	64
4.5 Findings on the Awareness of Respondents	66
4.6 Findings on the Knowledge of Respondents	68
4.7 Findings on the Preference.....	72
4.8 Conclusion.....	81
CHAPTER 5 : SUMMARY AND SUGGESTIONS FOR FUTURE RESEARCH.....	82
5.1 Summary of the Research	82
5.2 Limitation of the research.....	88
5.3 Suggestions for future research.....	84
BIBLIOGRAPHY	85

LIST OF TABLES

Table 2.1 Differences Between Takaful and Conventional	52
Table 4.1 Profile of Respondents	65
Table 4.2 Awareness	67
Table 4.3 Knowledge	70

LIST OF FIGURE

Figure 4.1: Respondents' Level of knowledge	72
Figure 4.2: Life Existence	73
Figure 4.3: Surplus Distribution	74
Figure 4.4: Services	75
Figure 4.5: Agent	76
Figure 4.6: Coverage.....	77
Figure 4.7: Advertisement	78
Figure 4.8: Price.....	79
Figure 4.9: Religion	79
Figure 5.0: Differences between Takaful and Conventional	81

CHAPTER 1

INTRODUCTION

1.1 BACKGROUND OF STUDY

It is normal circumstances that everybody is being exposed to any risks in their daily lives. It can be expected and some can be unexpected. This risk can happen in one's life, business even properties. These circumstances become a question on how to tackle the problems and help the unfortunate people. One of the ways is through taking the insurance. Naturally, the essence of insurance is to risk transfer. The objective of insurance is to spread the liability among the related parties through mutual cooperation and understanding. By doing this, the risks can be avoided and the victims can be saved from covered danger. Not only that, insurance's objective is to protect someone's properties or businesses from any unexpected circumstances. It is very familiar in developed countries especially in the west whereby almost everyone must have insurance.

The first insurance policy was started during the Babylonian times. This has been proved with the insurance monument which was found along with the code of King Hammurabi, which was written on it. The code of Hammurabi is believed to be the first form of written laws. (Billah, 2001) This insurance we called it as conventional insurance. These ancient laws were very great. The debtor did not have to pay back his loans if anything bad or catastrophe happened e.g disability, flooding death etc.

Actually, this conventional insurance is not conforming to Maqasid Syariah or Islamic teaching. Islamic scholars declared that conventional insurance is prohibited. In 1972, the Malaysian national Fatwa council agreed that conventional insurance especially the life insurance is *fasid* as it contains prohibited elements such as gharar, maysir, and riba' as well as other non-syariah compliant practices.

Muhammad Nejatullah Siddiqi (1985) has explained in his writing on how the conventional insurance practices prohibited the elements and makes some differences and comparison between Takaful and conventional insurance: (1) *Al-Gharar*, it means uncertainty or unknown. In conventional it profits does not mention on how the profits is being distributed and where they invest the money. Meanwhile in Takaful, the policyholder will be informed on the ratio of profits according to the concept of Mudharabah. (2) *Al-Maisir*, means gambling. In conventional insurance the policyholder will lose their premium in case of no risk occurred. On the other hand, Takaful policyholder will receive what have they contributed. In the case of risk occurred, they only received the amount that they paid plus with pool of funds "donation" from other participants. (3) *Riba'*, it means interest which is gained from investment activities from conventional firms. In conventional insurance, it is based on loan basis, where it seems like selling and buying money. Meanwhile, Takaful is based on the concept of Tabarru' or donation and the policyholder will received the profits when there is profitable investment.

Since Muslim's population become wider, Syariah compliant products is demanded. Due to that, alternative had been developed in order to cater the Muslims

population called Takaful. Takaful is an Arabic term, derived from the word 'kafalah' which means to guarantee, looking after, to help and to take care of one's needs or on the other meanings is "guaranteeing each other" or joint guarantee. Takaful is based on two concepts; "ta'awun" (mutual assistance) and "tabarru" (voluntary contribution). These two concepts are the core to Takaful which is purely without any elements of gambling and uncertainty (Naseer & Jamil, 2011). Basically, the nature of the latter is same with the conventional insurance that is to protect individuals and corporate bodies from any contingencies.

As a multicultural society with Islam as the dominant religion, Malaysia took the initiative to become a successful player in the Islamic financial system and uphold the Islamic Insurance (Takaful). From time to time, the Islamic financial system together with Takaful flourishes rapidly.

As experienced in 2007, total assets of Takaful industry in Malaysia amounted to USD2.8 billion, with market penetration of 7.2%. Takaful assets and net contributions experienced growth with an average annual growth rate of 27% and 19% respectively from 2003 to 2007. However, the number of penetration showed is still low. Not only that, there are also limited study focuses on Takaful especially the determinant factors contributed to the choice between Takaful and conventional insurance among Malay Muslims in Malaysia.

1.2 PROBLEM STATEMENTS

In recent year, Islamic finance and Takaful are considered as one of the fastest growing areas in the International finance. Their expansion growth rapidly not only in the Gulf but also in the non-Muslims country. The span in Takaful business has been robust in recent times (Keat, 2009).

Malaysia, Indonesia, Saudi Arabia, Bahrain are Muslims country that lead Islamic financial system. Australia, United Kingdom and Singapore are the example of non-Muslims countries that adopted Islamic finance in their economy. (Salman.S.A, 2012) However, Saudi and Malaysia are the two biggest markets in the world which have considerably higher populations and gross written contributions (GWC) per operator. (Earnest & Young, 2013).

Eventhough Malaysia is the one of the biggest markets with experienced a 30-year long track record of building succesful domestic Islamic financial industry, (4th Annual World Takaful Conference, 2013), Takaful is still new and has low penetration among people compared to the conventional. Looking at the information reported by the Malaysia Takaful Association, only 13% of penetration rate for Family Takaful compared to the 55% penetration rate for conventional life insurance. However, globally, in 2015 the industry is expected to grow by 15-20% annually, which is expected to reach USD7.4 billion of contributions.

As experienced in 2007, total assets of Takaful industry in Malaysia has amounted to USD2.8 billion, with market penetration of 7.2%. Takaful assets and net

contributions experienced growth with an average annual growth rate of 27% and 19% respectively from 2003 to 2007.

Due to the above problems, this study will attempt to identify the awareness and understanding of Takaful and conventional insurance among Malay people in Malaysia. A clear understanding on the difference between the Takaful and Conventional Insurance is very important due to the fact that majority population in Malaysia is Muslims and Malaysia is the hub for the Islamic financial industries. However, the concept of Takaful is still hazy and the penetration among Malay Muslims is low since it is still new in this country. In addition, there are very limited study which focuses on this issue in Malaysia (Matsawali et al., 2012). Only a few study which focused on the determinant factors to choose between Takaful and conventional insurance. In addition, there are also a few study which focused on the family Takaful. As far as the knowledge of the writer, there is no existing study that focuses on the determinant factors to choose between Islamic Takaful or vice versa among Malay Muslims in Malaysia.

1.3 RESEARCH OBJECTIVE

The objective of this study is to identify the determinant factors which contribute to the choice of insurance between Takaful and conventional among Muslim in Malaysia. Hence, this study will help to identify the preferences and level of knowledge for Malay policyholder.

1.4 RESEARCH QUESTIONS

According to Bryman (2008), research questions will guide the research towards its need to be developed. The specific research objectives have been mentioned on the previous subtopics. In order to achieve the mentioned research objectives, the following questions will guide the research:

1. Do the Malay policyholder aware on Takaful?
2. Do Malay policyholder possessed knowledge regarding Takaful?
3. What factors are being considered by Malays in choosing insurance?

1.5 CONTRIBUTION AND SIGNIFICANCE OF STUDY

It is expected that this research is able to determine the factors which persuade policyholder to choose between Takaful and conventional insurance. At the same time, it will determine the awareness and level of knowledge among Muslims policyholder towards Takaful. This study might help Takaful agents to find out what are the factors that lead people to choose Takaful instead of conventional insurance. This also might reveal the opportunity to the Takaful operators to attract many policy holder not only the Muslims but also the non-Muslims. They also can expand their marketing effectively.

The significance of the study is to bring awareness about Takaful to Malaysian citizen especially Malays as they are the Muslims to support Islamic products. It is also to enlighten people about the prospect of Takaful which will protect them from Riba', Gharar and Maysir which are forbidden by Allah.

1.6 ORGANIZATION OF STUDY

The study is organized into five chapters: Chapter one acts as a brief introduction to the study and provides its background, problem statement, research objectives, research questions, contribution and significance of the study as well as its limitations faced by the researcher throughout this study.

Chapter two provides the literature forming the theoretical foundation of this study. This literature consists of five major headings (1) development of takaful and conventional Insurance in Malaysia. (2) Overview of Takaful products and conventional products (3) Overview of Takaful Model that have been discussed by the popular models which are Wakalah, Mudharabah, Waqf and Hybrid models. (4) comparison between conventional and takaful, and lastly (5) Previous studies on the demand of Insurance (Takaful and conventional insurance). At this point the writer discussed on the findings from previous studies pertaining to the factors which contribute to the choice of insurance.

Chapter three is dedicated to the research methodology employed in this study. It includes a description of research instrument used, sample selection and data collection procedures. It also explains the tools to analyze the collected data.

Chapter four presents the analysis and findings of this study. To begin with, it discusses the response rate followed by a descriptive analysis including a demographic profile as well as Takaful knowledge profile of the respondents and last but not least chapter five is the conclusion of the study. It also concludes the limitations and suggestions for future study.

CHAPTER 2

LITERATURE REVIEW

2.1 INTRODUCTION

The objective of this study is to find out the factors which determine the choice of Malay Muslims in choosing between Takaful and conventional insurance. This chapter is organized starting with the risks and its types, methods of handling the risks, overview on insurance, development of insurance industry in Malaysia, theoretical framework of Takaful, model of Takaful, comparison between Takaful and conventional insurance, and lastly previous studies on customer preference which is discussed on the variable and its results in previous studies.

2.2 RISK

Risk is a condition in which there is an exposure to diversity. This word is often used in connection with insurance. Traditionally, it also defines in terms of uncertainty. In order to understand insurance and Takaful, risk is defined as “uncertainty concerning the occurrence of loss.” Meanwhile, in (Nasser Yassin et.al, 2011), defined risk as firstly, possibility of harm, injury or loss: and secondly, exposure to danger or suffering or harm.

Looking at the definition given by (Vaughan et.al, 2009) there are two key words in the definition of risk, which are uncertainty and loss. *Uncertainty* refers to a state of mind characterized by doubt, due to a lack of knowledge about what will or

will not happen in the future. It occurs if at least two possible outcomes can arise out of an event. If only one event comes, it is considered as certain, so there is no risk.

Meanwhile for the word *loss* used in insurance specifically refers to insurable loss. Insurable losses are those losses that can be insured. To be insurable, a loss must meet certain characteristics; its occurrence must be unintentional and based on chance, it is undesirable, and it results in a reduction of economics value or financial loss. Examples of insurable losses are losses arising from the death of family's bread earner and those arising from damage of one's property like car or house. There are several classification of risk, however, the major concern are pure risk and speculative risk.

2.2.1 *Pure Risk*

Pure risk can be defined as a situation in which there are only possibilities of loss or no loss. There is no potential of gain from exposure to pure risk. Pure risk can be directly affect an individual by a complete loss or reduction of income due to several factors such as premature death, poor health, retirement and unemployment. It may also result in the possibility of the loss which surrounds the ownership of a property such as house or car. The property may become damaged or destroyed by various perils such as fire, earthquake or flood. If a property is damaged, the owner suffers financial loss. If there is no damage to the property, there is no potential gain from this situation.

2.2.2 Speculative Risk

Speculative risk describes a situation in which there is a possibility of loss, but also a possibility of gain. It is a situation in which either profit or loss is possible. Examples of speculative risk is investing in stocks or in real estate, or gambling. In this circumstance, the outcomes are either profit or loss.

The different between pure and speculative risks is that most pure risks are insurable, while speculative risks are not. Pure risk is prevalent in the everyday activities of human and it cannot be completely avoided. Unexpected economic losses resulting from pure risk have occurred throughout human history. Such losses would occur even if insurance system had never been developed. On the contrary, most activities with speculative risks are voluntarily accepted because of the possibility of a gain.

2.3 METHODS OF HANDLING RISKS

Risk is a burden not only to the individual but also to the society. Since risk resulted in losses, it should be managed properly to reduce potential losses that may occur. There are 4 major ways or methods of handling the risks which are avoidance, loss control, retention and transfer. However, in this study will only focus on transfer as it is related to insurance.

2.3.1 Transfer

Risk transfer refers to the activities in which the risk is transferred to either insurance companies (insurance transfer) or to other parties (non-insurance transfer). Insurance transfer is a very important risk management technique that is being adopted by

individuals and business organizations. It involves transfer of risk and financial losses from an individual and business company. Non-insurance transfer involves risk that is transferred to a party other than an insurance company. It can occur through transfer of risk by contract or by hedging. For example, a lease may state that the tenant will be responsible for any damage to the rented property. In this case, the risk of property damage is transferred from the owner to the tenant. The following topic will be discussed about insurance for a better understanding on Takaful.

2.4 INSURANCE

According to Siddiqui (1984) and (Vaughan & Vaughan, 2001) defined insurance as,

“insurance is based on the discovery of a useful social scientific principle, according to which after a small investment, individuals can be freed from incurring financial losses as a result of perils and accidents whose incidence can be measured fairly accurately in relation to large human groups”

“A financial arrangement an individual substitutes a small cost (the premium) for a large uncertainty financial loss (the contingency insured against)”(Vaughan & Vaughan, 2001).

Insurance is a procedure or contract securing, assuring compensation for loss, damage, injury or death on payment of premium. Conceptually, insurance is a form of risk management whereby it is used to protect against the risk of loss. For most people and businesses, insurance is the most practical method of handling a major pure risk. Through insurance system, pure risk which is faced by an individual or a business is transferred to the insurance company for premium payment. The insurance company

is known as insurer while the insurance buyer is known as the policyholder or insured. An insured is required to pay the premium during the inception of contract. Premium is the price of insurance protection and service rendered from the insurer. In the event of a loss occurring, insurance company is obligated to pay compensation as specified under the insurance policy. The compensation which is paid out to the insured or to his beneficiaries is called insurance benefits.

2.4.1 *How Insurance Works*

Insurance is an arrangement whereby an insured purchase a plan that covers specified risks and losses. When an insured purchased insurance, he is required to make premium payments. In return, he receives an insurance protection. Insurance protection is essentially a promise made by the insurer that in the event of loss, the insurer shall compensate the insured or his beneficiary, a sum not exceeding the amount of the loss or as specified in the insurance contract. The insurer is required by the law to fulfill the obligation to pay insurance benefit should the insured loss occurs. An insurance arrangement typically includes three distinct characteristics, which are risk transfer, risk reduction and loss sharing.

2.4.2 *Important of Insurance*

Insurance benefits to all people, from individual up to society.

- a) Insurance provides compensation loss.

Through compensation, individuals, and business organization can be restored to the same level of financial position as before a loss occur.