



Al- Wakalah: Impact on the Performance of Takaful Operators.

Abstract

The main distribution channel of insurers has been the agency system. Insurance agents who sell policies are not employees to the insurance operators. They work on commission basis and thus, motivated by the volume of sales made. It reduces overhead costs, and able to expand markets without the need to set up subsidiaries. However, the first Takaful operator in Malaysia, Syarikat Takaful Malaysia Berhad (STMB) did not use the agency system. It claimed that it is against the *Shariah* law to apply the contract of Agency (*al Wakalah*) in the takaful business. This has a lot to do with the *ikhtilaf* on whether the takaful operator (*Mudarib*) can use part of the capital provided by the participants (*Rabulmal*) to pay for management expenses. On the contrary, the second takaful operator, Takaful Nasional Sendirian Berhad (TNSB), applies the agency system since it holds a different view of the *wakalah* contract. It is therefore interesting to see in what way these differences in juristic views have impacted performance of both operators. The study attempts to measure the performance of the two takaful operators by using financial ratios, as well as regression analysis. Data were taken from the 1994 – 2000 annual financial reports. To consolidate data quality, contribution (premium) figures in the financial statements of TNSB were converted from accrual to cash basis. A survey was also undertaken to explore the perception of respondents on the role of agents. The study found that TNSB showed an overall better performance than STMB. It is concluded that the *Wakalah* system was able to generate greater benefits (*manfaat*) to the takaful operators while not putting customers into hardship since no significant difference in premium is evident between STMB and TNSB. It is therefore crucial for STMB to review their policy on *al wakalah* and embrace the agency system to improve performance. Likewise, future takaful operators should take note of this Malaysian experience so as not to repeat the mistake made by STMB.

APPROVAL PAGE

TITLE OF THESIS:

AL WAKALAH: IMPACT ON THE PERFORMANCE OF TAKAFUL OPERATORS

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DECLARATION

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

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DEDICATION

This thesis is specially dedicated to my wife, Nadiah Mayumi Toya bt Abdullah and my son, Firdaus Syakir Reimon b. Hairul Azlan, who without their love, sacrifice, understanding, patience and encouragement, this would not have been possible.

It also goes out to my father, Annuar b. Aroff; my mother, Hajjah Rasinah bt Haji Saidin and my in-laws, Mr. Yoshimi and Mrs. Katsue Toya for their love and care.

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FIGURES

Figure 1.1	Illustration of Takaful System
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LIST OF ABBREVIATIONS

BIMB	:	Bank Islam Malaysia Berhad
B.N.M	:	Bank Negara Malaysia
MNI	:	Malaysia National Insurance
n.d.	:	no date
n.p.	:	no publisher
n.p.n.	:	no page number
n.p.p.	:	no place of publication
Sdn. Bhd.	:	Sendirian Berhad
STMB	:	Syarikat Takaful Malaysia Berhad
TNSB	:	Takaful Nasional Sdn. Bhd.

INTRODUCTION

In Malaysia, there are currently two takaful operators. The first, STMB, is a public listed company and a subsidiary of Kumpulan BIMB Holdings Berhad (BIMB Holdings), the holding company which also owns Bank Islam Malaysia Berhad (BIMB), the first Islamic Bank in Malaysia to be given the license to operate according to the requirement of the Islamic laws or *Shariah*. STMB was established in 1984 and is the pioneering company in the takaful business. Its main objective is to provide takaful (Islamic Insurance) services at the highest standard of efficiency and professionalism to all Muslims and the population in the country.¹

The other is Takaful Nasional Sendirian Berhad (TNSB), a subsidiary of Malaysia National Insurance (MNI) Berhad. It began its takaful operations in 1993, with the birth of MNI Takaful Sdn Bhd². In general, it is set up with the same set of objectives as that of STMB, that is to provide insurance based on the *Shariah* principles to the Malaysian public, as an alternative to conventional insurance³. In particular it will provide the industry with the desired level of competition, which was lacking prior to that and which the industry had longed for.

Both companies' principal activities are the provision of Takaful Keluarga – life insurance in conventional sense - and General Takaful, the equivalent to the conventional general insurance

¹ Syarikat Takaful Malaysia Berhad, *Corporate Profile*, Syarikat Takaful Malaysia, Kuala Lumpur, 1999, p. 2.

² MNI Takaful changed its name to Takaful Nasional on the 8th December 1998.

³ Takaful Nasional Sdn. Bhd., *Corporate Profile*, Takaful Nasional, Kuala Lumpur, 1999, p. 2.

schemes. Apart from having the same principal activities and objectives, both companies mirror one another almost exactly by having similar organizational structure, target segments and markets and available takaful products. It can be said that a potential participant⁴ would not be able to tell the difference between these two competitors, besides the fact that STMB has been longer in the market.

Nonetheless, there is a very distinctive difference in the mode of operation of the two companies, particularly in the area of attracting and servicing takaful participants. That distinguishing feature is due to the non-employment of any takaful agents by STMB in selling and marketing their takaful products. STMB expects any interested potential participants to come personally to its counters to buy any one or any combination of its plan(s). This is in complete contrast to what TNSB is doing. TNSB utilizes agents, in similar fashion to which most conventional insurance companies are operating.

Consequently, this has led to considerable interests and curiosity among numerous stakeholders of the industry, whom are either connected directly or indirectly to it. These different stakeholders include the regulators, practitioners, educationalists, students as well as the public in general, whose interests in the subject span across different fields and areas. Questions have been asked and raised that touched upon different aspects of the same subject, some of which extends into the origin and roots of *al wakalah* or agency itself. Hence, unless a thorough understanding of the subject is brought about, no satisfactory conclusions to these questions can be reached.

The research would limit the area of interests to those the researcher believes to be the most dominants, and it will prove to be vital in exploring the solutions to the various questions posed. The research attempts to identify and consequently deliberated upon several issues that will lead to the achievement of the main objective of the research. That objective is to measure the effectiveness and impact of *al wakalah* to the takaful business, in meeting the takaful operator's objective of achieving a high level of performance, which is reflected by the profitability and efficiency of the company.

⁴ For this thesis, the word participant is synonymous with the word customer, and both will be used interchangeably. They represent the segment of the public who are present and potential owners of the takaful plan(s). This remains valid unless a statement to the contrary is made.

Generally, all those interested in the affairs of a company are especially interested in profitability.⁵ The impact of *al wakalah* on company's performance will also be measured by the positive perception of customers on the benefit of it. It is crucial to determine the performance and effectiveness of takaful operations, such that it will bring benefit (*manfaat*) to both customers and operators, in line with a *Shariah* precept of enjoining good deeds (*ma'aruf*). Verse 110 of Surah al-Imran testifies this obligation:

*“Ye are the best of Peoples, evolved for mankind, enjoining what is right, forbidding what is wrong, and believing in Allah.”*⁶

Specifically, consistent with the objective of the study and in view of wide range of interests involved in this area, the research will attempt to analyze these issues; (a) To understand the concept of takaful and the factors that differentiate it from conventional insurance; (b) To investigate the origin and historical background of the theory and concept of *al wakalah* in Islamic law; (c) To put forward arguments that stress the importance of *al wakalah*, and to identify the reasons behind STMB's decision leading to an attempt to reconcile the two opinions; and (d) To study the impact of *al wakalah* on profitability and customers perception.

The literature review to this study involved library research, making use of primary (interpreted) sources and works of past and present scholars of Islam, Islamic and contemporary economists. These documents and materials were obtained from a number of libraries that were either visited or had an access to, which include the International Islamic University Malaysia (IIUM), the Malaysian Insurance Institute (MII) and the Kuala Lumpur Stock Exchange (KLSE). Apart from libraries, other materials were compiled through other forms of information channels. These comprised of the internet, information counters at Syarikat Takaful Malaysia Berhad (STMB), Takaful Nasional Sendirian Berhad (TNSB) and Bank Negara Malaysia (BNM), as well as articles and publications received in the course of pursuing this MBA. In addition to this review, a series of

⁵ Hermanson, Roger H., Edwards, James D. and Maher, Michael W., *Accounting A business Perspective*, Irwin McGraw-Hill, Boston, Massachusetts, 1998, p. 625

⁶ Ali, A. Yusuf, *The Meaning Of The Holy Quran*, Amana Publications, Maryland, 1997, p. 155. This translation will be used throughout the thesis.

discussion were carried out with economists, takaful and insurance practitioners, and educationalists, in order to gain a wider perspective concerning the study.

This thesis is divided into six chapters. *Chapter One* discusses briefly of what takaful is all about, its definition and concept, and illustrates a working model of how it is being operated in Malaysia. This chapter also explains the significant factor of *tabarru'* that differentiates takaful from conventional insurance and lists down other differences that are relevant. This discussion is undertaken due to the fact that the thesis would mainly examine the rules and principles of *al wakalah* and its impact on the takaful industry. As such, an enlightenment of the takaful concept itself would ease the understanding of *al wakalah* and its relation to takaful.

The theory and concept underlying the practice of *al wakalah* in general is explored in *Chapter Two*. The origin and roots of *al wakalah* will be examined with reference to its sources of legitimacy, the various opinions of different Islamic schools of law as well as the success of the Islamic practice in this particular area. The chapter also discusses the different categories of *al wakalah* in relation to its type and the rules governing each type, and subsequent comparisons are made with TNSB's agency agreement. For the purpose of this comparison, the family takaful agency agreement of TNSB is utilized.

Chapter Three is divided into three sections. *Section 1* looks into the roles and functions of agents as well as the problems associated with them. It concludes with a discussion on the importance of *al wakalah* and the positive contributions that it delivers to society. This is followed by *Section 2* which attempts to answer the question of why STMB is unwilling to implement the system, giving all the good points that the system brings. A reconciliation of these two opposing views will be tried upon, giving rise to a suggestion that STMB can implement the system if it decides too. *Section 3* gives an illustration of how commissions are paid to an agent and for how long does the agent is entitled to them. Only the plans under TNSB family takaful business are used for the purpose of illustration.

The main discourse of *Chapter Four* will be on an empirical study that consists of analysis of financial statements for the last seven years (1994 – 2000) of the two operators. The chapter begins

with an introduction that emphasized the importance of annual financial statements for the consumption of various factions of interested stakeholders, followed by the accounting standards governing the takaful industry in particular. The section continues with discussion upon the similarities and differences in accounting plan and treatment on certain accounting items, as practiced by both companies. The types of financial analyses to be conducted are explained and these are succeeded by the methodology applied for the analysis. The analyses and the findings conclude the chapter.

Chapter Five contains the methodology and results of another empirical study based on a simple survey of customers' viewpoint on the benefit or non-benefit of *al wakalah*.

Finally, *Chapter Six* concludes with discussion of the most essential points of the thesis.

CHAPTER ONE

TAKAFUL AND ITS DIFFERENCES WITH CONVENTIONAL INSURANCE

1.0 Introduction

Takaful is the term used to describe insurance that is in compliance with the *Shariah* or Islamic Law. Section 2 of the Takaful Act 1984 defines takaful as “ a scheme based on brotherhood, solidarity and mutual assistance which provides for mutual financial aid and assistance to the participants in case of need whereby the participants mutually agree to contribute for that purpose.”

Takaful is a noun stemming from the Arabic verb “*kafal*” meaning to take care of one’s needs. Takaful means mutual help among the group i.e. each member of the group pools effort to support the needy within the group. This is exactly like mutual insurance as was practiced in the early days of insurance even today by certain groups.⁷ The basic objective of takaful is to pay for a defined loss from a defined fund.⁸

The concept of Takaful had already existed during the time of the Prophet, Peace be upon him, where the Muslims contributed to a fund called *Al Kanz* under the system of *aqila*. The contribution was for the purpose of helping members of their own community who were liable to pay *diyat*⁹.

The important aspects of the takaful operation have been summarized by the “*Badan Petugas Khas*” as follows:

- the company is not the one assuming the risk. Rather it is the various participants who are mutually covering each other.

⁷ Nordin, M. Tarmidzi, *Collection Of Articles On Takaful: What Is Takaful?*, The Malaysian Insurance Institute, Kuala Lumpur, 2000, p. 46.

⁸ Rosly, S. Azhar, *Islamic Insurance: Takaful*, The Sun, Kuala Lumpur, March 15 1996, p. 23

⁹ *Ibid.* Diyat is a system of blood money practiced by pagan Arabs but later adopted and refined by Islam. See also Musleh-Ud-Din, M., *Insurance And Islamic Law*, Adam Publishers and Distributors, New Delhi, 1982, p. 16 – 26.