

# The Contributions of Takaful Industry towards Economic Growth, Savings and Investment in Malaysia

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**Abstract:** *Takaful has made significant contributions to the Islamic financial market in Malaysia, of which the three leading indicators of economic growth include savings, investment, and income. The Takaful industry has a positive effect on the economic growth and development in Malaysia through healthy savings, proper allocation of assets (investments) and increasing national income. The market penetration of Malaysian Islamic insurance in 2020 is expected to surpass 16% and continue to grow in future. Given the wealth of individuals has been increasing through greater financial awareness, this has allowed individuals to spend more on Islamic insurance. As compared to conventional insurance, Islamic insurance is a popular instrument for saving among Malaysians, due to its Shariah-compliant characteristic. However, it is not religion-based insurance but inclusive of all races, religions and beliefs. Almost all Takaful products in the financial market have add-on benefits which can be purchased with basic policies. The inclusion of savings and investment elements on Takaful products has made it more complex and positive in providing early preparation (in case of emergency) to policyholders. Takaful has a strong fund pooling capacity, helps to induce investment contributing to the country's Gross Domestic Product (GDP) in boosting the nation's income. Therefore, this paper has investigated the impact of the Takaful industry on the GDP of Malaysia through savings and investment elements. The analysis of Takaful products is also undertaken with the inclusion of investments that are linked and offered by Takaful operators. In conducting this study, a questionnaire was developed and distributed to respondents, thereafter collected and analysed using Smart-PLS, which found a significant relationship between all variables. The results suggest that the savings and investment behaviour of individuals, in addition to investment-linked Takaful, have influenced the demand for Takaful. It is anticipated that the findings and contribution of this study will benefit practitioners and decision-makers to recognise the behaviour of individuals toward savings and investment opportunities and providing further insight towards the many benefits offered by Takaful. Lastly, the results of this study may also help in contributing to the nation's economic growth and development.*

**Keywords:** Islamic insurance, Takaful, investment-linked Takaful, economic growth

## 1. Introduction

Acquiring knowledge and information is essential for financial institutions and is also important for consumers to distinguish between the basic features of insurance products. The fundamental differences between the features of *Takaful* insurance to that of conventional insurance is that conventional insurance firms transfer risk, whereas *Takaful* adopts a risk-sharing approach. The money outlaid by policyholders is offered referred to as a 'premium'

in the conventional sense of the word, while in *Takaful*, it refers to a contribution or donation. The growth of the insurance industry with respect to economic growth (as a measure of GDP) is measured through insurance penetration in respective markets and density (insurance consumption) which accounts for the ratio of total premium divided by GDP (Bhatia & Jain, 2013). The penetration and growth rate of Islamic insurance, however, is relatively weak compared to conventional insurance.

The Bank Negara Malaysia (BNM) financial sector blueprint (2011-2020) reported the market penetration of the insurance industry in 2017 at 14.8%, rising to 15.2% in 2018. This small increase reflects the performance of *Takaful* business in Malaysia as uninspiring, given the goal initially set was 25%. In addition, individuals have limited awareness regarding the benefits associated with insurance protection since the misconception is that *Takaful* is not for non-Muslims. Likewise, the knowledge of financial products, particularly for insurance products, is not well-understood nor well-informed given agents as financial advisers or insurance brokers are responsible for sharing information regarding insurance to the general public, particularly those who are not interested in health protection. *Takaful* has been offered to Muslims in Malaysia since 1984, even though the awareness remains relatively low.

According to Ratchford (2001), knowledge can be defined as information stored in a person's long-term memory. As such, in the context of *Takaful*, people will remain unaware of the information until there is a future need to acquire it. The literature in this field has revealed the several factors contributing to *Takaful* purchase intention that include: education level, religion (Gustina & Abdullah, 2012), price of life insurance (Pan, Chang & Su, 2012), and savings (Zakaria et al., 2016). Some studies were aware that *Takaful* is a savings and protection mechanism aside from the religious aspect (Muhammed, Abdullah, Aziz & Azmi, 2016). Here, the purpose is to have insurance as a protective measure, not because it is a form of Islamic insurance. The market potential for the *Takaful* insurance business is mainly due to 65% of the population in Malaysia are Muslims.

Historical data indicates that in 2009, the majority of people chose conventional insurance because, during that period, conventional insurance was stable, given its level of maturity in the market. Present statistics suggest that 70.2% of people are aware and understand that *Takaful* is a *Shariah*-compliant product (Hassan, Salman, Kassim & Majdi, 2018). Research has also shown that Muslim consumers have acquired a positive attitude towards *Takaful* based on the religious factor. As such, it becomes an advantage for *Takaful* agents in attracting Muslim consumers, especially the young generation (Mansor, Masduki, Muhamad, Zulkarnain & Aziz 2015).

*Takaful* differs in a number of dimensions from conventional institutions in this field. Although in the context of investment, productivity, and consumption, both industries have a similar impact to a certain extent. For instance, *Takaful* is extremely stable and productive regarding its fiscal nature and striving to attain a strong market position and proposition to increase its market share in boosting economic growth. Accordingly, this study aims to analyse the features of *Takaful* that could contribute to economic growth. In other words, knowing about the savings and investment features and opportunities and the demand of consumers for investments-link *Takaful* and other factors that attract consumers to purchase *Takaful*.

### **Issues 1: *Takaful* demand impacts economic growth through savings and investment**

As mentioned earlier, Islamic insurance is seen as a valuable source for boosting economic growth and development. Although, on the other hand, some researchers have suggested

there are different reasons for the nexus of insurance and economic development in which *Takaful* could contribute through ‘supply-leading’ (Wobb et al., 2002; Boon, 2005; Han et al., 2010). Moreover, insurance development in this industry could help to induce economic growth, plus the growth in investments by insurance companies could also help to induce economic growth. At the macro level, variables such as *Wakalah* practice affects economic growth through employment and regulatory requirements by increasing the demand to buy insurance.

In Malaysia, most *Takaful* operators practise the *Wakalah* model, which is a practice where policyholders provide capital in the form of contributions. While at the same time, the *Takaful* operator can manage contributed funds with a fixed fee called a *Wakalah* fee; a charge for providing its services (Whear & Western, 2006). Indeed, the *Takaful* operator under the *Wakalah* model provides a fixed and steady income stream since the fees paid by policyholders can be collected in advance, able to support the acquisition cost (Frenz & Soualhi, 2010). The literature also mentions that by directly improving savings in the form of financial assets, likewise capital formation would increase, consequently boosting real sector growth, including the insurance sector (Quartey & Prah 2008).

The reason behind some individuals purchasing *Takaful* is not only for the purpose of saving but also for death protection and disability benefits (Syadiyah, 2018). Here, agents could help to promote *Takaful* to enable broader access to services for the public as a major marketing channel. The level of awareness could also be enhanced through this channel, given that many people are unaware that *Takaful* offers protection, savings, and investment. Additionally, *Takaful* motivates people to save and encourages them to acquire well-planned and well-organised savings plans along with contributions/donation schemes. Some literature has revealed that *Takaful* contributes in the form bi-directional causality or reverse causality as well, where both economic growth and insurance market activities can interact positively (Alhassan & Biekpe, 2016; Pradhan et al., 2016; Guochen & Wei, 2012; Kugler & Ofoghi; 2005). Likewise, purchasing *Takaful* can reduce the need to save for emergencies and mobilising domestic savings from many small investors which is where the insurance market and economic growth guide each other.

At the country level, life insurance also inspires economic growth in which *Takaful* offers broad support and protection against the loss of goods and property and transforming capital into wealth. The accumulation of capital from those insured makes use of capital for further expansion of the nation. Besides the individual benefits, *Takaful* addresses all essential needs and demands towards economic growth through savings and investment. As an institution, *Takaful* may contribute to economic growth in many ways that include, promoting financial deepening, which can be realised through investment activities on capital market equity, bonds, and real estate. With the situation around financial deepening (increasing provision of financial services), *Takaful* can potentially improve the effectiveness of the financial market and increase the efficiency of capital market mobilisation. As an individual, *Takaful* products such as life insurance encourage long-term savings, whereas the reinvestment of these substantial funds in public and private sector projects will help to enhance and promote economic growth (Beck & Webb, 2003). Thus, the following hypothesis is presented:

*H1: There is a significant correlation between saving and investment behaviour toward Takaful decision making*

## Issue 2: Analysis of *Takaful* products with the inclusion of an investment-link

With the unique attributes afforded by the insurance sector, it is worth considering those services that are not provided by other financial institutions. In the period surrounding 2010, the *Takaful* industry was said to be less competitive compared to conventional insurance. Here, *Takaful* was bought only for protection and for the purpose of small savings due to limited availability of *Shariah* compliance investments at that time. Some researchers suggest that the positive contribution of *Takaful* to economic growth is mainly through policyholder funds to other institutions (known as the financial intermediation cycle) and in mobilising long-term investments, particularly for life insurance holders.

*Takaful* operators in Malaysia offer investment products aside from their own core business services in providing protection through general and family *Takaful*, known as an investment-linked *Takaful*; it is a unique innovation in Islamic finance since it is a combination of protection and investment. However, investment-linked insurance does not promise high return, but under this plan, at least money can be invested. Parveen, Razali & Salleh (2019) found that the fees charged by *Takaful* operators are not affected by the investment-linked *Takaful* preference. Individuals, however, consider the investment type and the plan expiry before buying investment-linked products.

The literature in the field of insurance does not discuss much on investment-linked *Takaful*. While this study sees the importance of giving attention to the area of investment-linked as a *Takaful* tool to promote economic growth, these features could attract individuals to procure *Takaful*, given the benefits from this investment. Thus, the following hypothesis is presented:  
*H2: There is a significant correlation between investment-link products and Takaful decision making*

## 2. Methodology

In conducting the fieldwork for this study, a questionnaire was developed and distributed to individuals having some knowledge of *Takaful*, in order to understand the reasons and benefits in purchasing *Takaful* and their awareness regarding investment-linked products offered by *Takaful*. Accordingly, a total of 107 respondents returned the questionnaire in which all were usable in proceeding with analysing the data collected. Figure 1 below illustrates the conceptual framework of the relationship of variables that may influence individuals to purchase *Takaful*.

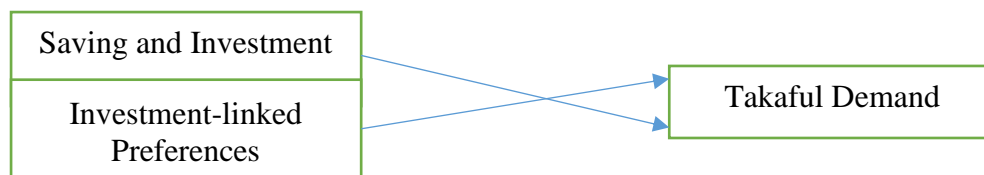


Figure 1: Conceptual framework

## Respondents' profile

Table 1 below displays the background of the respondents, in which the majority were female, with ages of respondents ranging between 26 and 39 years. At this stage in life, individuals enter the working environment and begin planning for growing their income upon reaching the age between 35 and 40 years. Those who fall within this age group consider this stage in life is important in planning for the future. The income of respondents at this stage ranged between RM 5000 and RM 10000 monthly and is one of the reasons why they can

afford to purchase insurance. Indeed, many have surplus income each month and have sufficient income to manage their expenses, before considering the need to buy insurance or make an investment. Interestingly, it was surprising to see that individuals in the low-income category of less than RM 1500 were also able to buy Takaful.

**Table 1: Demographic profile of respondents**

<b>Respondents' profile</b>	<b>Frequency</b>	<b>Percent (%)</b>
<b>Gender</b>		
Male	32	30
Female	75	70
<b>Age</b>		
Below 26	2	1.9
26 – 39	86	80.4
40 – 59	17	15.8
Over 60	2	1.9
<b>Income</b>		
Less than RM 1500	6	5.6
RM 1500 – RM 3000	11	10.3
RM 3001 – RM 5000	41	38.3
RM 5001 – RM 10 000	43	40.2
RM 10 001 – RM 15 000	5	4.7
More than 15 000	1	0.9

### 3. Findings and analysis

After running the bootstrapping, the outer loadings having a value of less than 0.7 were discarded. The benchmark or threshold for loadings in this study was greater than 0.7, which is in the acceptable range for all variables except investment-linked preferences in which the loading was set at 0.683. However, the composite reliability for investment-linked preferences was higher than 0.7, at 0.775. Composite reliability deals with internal reliability, in which the range between 0.5 and 0.7 is acceptable. Here, the value for the reliability of less than 0.7 shows the items have less than half of the common variance attributed to the latent factor. Composite reliability, on the other hand, is a better measurement compared to Cronbach's Alpha, in terms of an internal consistency assessment since it retains the standardised loadings of the observed variables. Notably, Cronbach's Alpha is often criticised for its lower bound value which underestimates the true reliability (Peterson & Kim, 2013). In this study, Composite reliability was used as an alternative since this value is slightly higher than that of Cronbach Alpha, and the difference is relatively inconsequential (Peterson & Kim, 2013). However, the average variance must be at/or greater than 0.5, which for this study, was acceptable. Hence, the convergent validity was measured by factor loadings (Outer loading), Composite reliability and Average variance extracted (AVE) were confirmed.



**Table 2: Summary of test criteria and reliability measures**

	<b>Cronbach Alpha</b>	<b>Composite reliability</b>	<b>AVE</b>	<b>(A)</b>	<b>(B)</b>	<b>(C)</b>
Takaful demand (A)	0.005	0.474	0.500	<b>0.707</b>		
Saving and Investment Behavior (B)	0.373	0.576	0.582	0.526	<b>0.763</b>	
Investment-linked preferences (C)	0.240	0.775	0.467	0.289	0.015	<b>0.683</b>

### Path coefficient

In comparing the strength of the relationships, path coefficients are used to determine to what extent independent variables affect a dependent variable, while the bootstrapping algorithm analyses the significance of relationships. Table 2 shows the T-statistic value in the path coefficient that describes whether the hypothesis is rejected or accepted. This current study has not applied a directional hypothesis (positive/negative) but rather stating that there is a relationship between the variables. Therefore, two-tailed tests were employed, with a 95% significance level, giving a t-value of 1.96. The p-value of two independent variables in this study supported both hypotheses [H1] and [H2]. The values were significant at the 0.05 level, which was deemed acceptable. The coefficient of determination, also known as the R<sup>2</sup> value, is only applicable to the dependent variable, indicating how well all independent variables explain the dependent variable.

Accordingly, this study found that the value of 0.35 indicated that 35% of the variance in Takaful demand was explained by the factors of savings and investment behaviour and investment-linked preferences. On the other hand, the value of f<sup>2</sup> indicates to what extent the independent variables contribute to the strength and explanation of a dependent variable. The f<sup>2</sup> for this study showed a value of 0.423 (behaviour to demand) and 0.122 (investment-link to demand).

**Table 3: Summary of Structural Model**

	<b>Standard dev.</b>	<b>T-stats</b>	<b>P-values</b>	<b>Results</b>
Saving and Investment Behavior	0.169	3.588	0.002	Supported
Investment-linked preferences	0.110	2.564	0.011	Supported

## 4. Conclusion

Both variables tested in this study were found to support the dependent variable. It is also interesting to observe that the measurement for Takaful demand was measured by the construct of an individual's consciousness, which agreed that aside from other investment products, health insurance constituted a person's major life expenses. As such, individuals were more concerned about saving for healthcare expenses. Likewise, the savings and investment behaviour of individuals was related to their preferences towards buying Takaful. For instance, self-awareness is where individuals are acutely aware of diversifying their monthly income into various investments since one's attitude towards investments is not an inherent habit or attribute that one is born with.

Additionally, individuals are even prepared to reduce expenses to invest and save. Therefore, it can be concluded that Takaful products (including insurance) are able to contribute to economic growth through the savings and investment behaviour of individuals. This study also found that the investment-link products offered by Takaful are a means of saving that

accumulate into future investments. Individuals who recognised this benefit were aware that accumulated savings over time benefiting from Takaful would lead to investment opportunities, even if only a small percentage was offered. Additionally, this study also revealed that individuals who bought Takaful noticed that they indirectly made an investment.

Another finding was that those individuals in the low-income range were also interested in buying Takaful which may be due to their self-awareness about Takaful and their financial planning abilities in balancing their needs, investments, savings, and health. In other words, if one's awareness is high, those at the low-income level are also able to think about their future health preparations. As such, two goals are accomplished through Takaful, namely health protection and investment.

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