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ALTERNATIVE TO CONVENTIONAL INSURANCE

BY

HAJI MOHD AMIM BIN HAJI OTHMAN

A RESEARCH PROJECT PAPER SUBMITTED IN PARTIAL  
FULFILMENT OF THE REQUIREMENT FOR THE DEGREE  
OF MASTER OF MANAGEMENT

MANAGEMENT CENTER  
INTERNATIONAL ISLAMIC UNIVERSITY

3<sup>rd</sup> January 2000

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**FACTORS INFLUENCING THE PERCEPTION OF  
GOVERNMENT SERVANTS TOWARDS TAKAFUL AS AN  
ALTERNATIVE TO CONVENTIONAL INSURANCE**

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## ABSTRACT

The purpose of this research is to study the perception of government servants towards *takaful* as an alternative to conventional insurance. For this purpose, a survey was carried out among 68 individual working in government owned institution Lembaga Tabung Haji and Jabatan Kemajuan Islam Malaysia (*JAKIM*). The study hopes to identify the demographic data and factors influencing the perception of the government servants. The findings reveal that the increasing number of *takaful* policyholders is contributed to the level of Islamic awareness among the respondents. The respondents also agreed that the introduction of *takaful* gave them an alternative to conventional insurance. In addition to this, the most interesting finding is despite the advantage of *takaful* product, the weak advertising efforts made by the *takaful* operators actually contributes to the lower level of understanding by the respondents of *takaful* products. However, they believe that the advertisement efforts are important instruments to promote the *takaful* insurance products. Lastly, the study also provides empirical evidence that would increase our understanding of respondents towards *takaful* as an alternative to conventional insurance. It will be valuable for not only Muslims but also for non-Muslim.



## DECLARATION

I hereby declare that this project paper is a result of my own study. Other sources are acknowledged by reference note and bibliography is appended.

Date: 3<sup>rd</sup> January 2000



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Name: Haji Mohd Amim Bin Haji Othman

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# CHAPTER ONE

## INTRODUCTION

### 1.1 Background of the Study

Malaysia could be considered as the pioneer of the *takaful* industry in the Asian region.

In 1982, Malaysian Government established a special force to study the possibility of introducing Islamic insurance to complement the services of Islamic banking. Following the recommendations of the task force, the Malaysian Parliament passed the Takaful Act in 1984, making Malaysia probably, the only country in the world to have a specific legislation governing *takaful* business (Ali Abul Hassan, 1999). The first *takaful* operator which is mainly known to Malaysians is the Syarikat Takaful Malaysia Berhad (*STMB*) was born in 1984. Later the MNI Takaful Sendirian Berhad (*TNSB*) which later known as Takaful Nasional Sendirian Berhad followed suit.

Throughout the development of the *takaful* industry in Malaysia, the Government and regulatory authorities have been careful to preserve the fundamental of Islamic principles on which *takaful* business is founded. With the commitment of regulators and support of practitioners, *takaful* operators in Malaysia are progressively building up a tool of technical knowledge and expertise to support the development of *takaful* both domestically and abroad. In 1997, Malaysia established a *Syariah* Supervisory Council (SSC) at the Central Bank to act as an authoritative reference point on issues relating to Islamic banking and *takaful* insurance.

Although the *takaful* industry has made its mark and the growth has been significant so far, the industry remains relatively small if compared to conventional insurance. At the end of 1998, *takaful* contribution in Malaysia represented only 2% of conventional insurance premium. While *takaful* assets stood at only 1.6% of conventional insurance assets. If we were to take the total population of Malaysian where half of them are Muslims, then we could see the potential for the Malaysian *takaful* industry to grow is tremendous. Outside Malaysia, there is also an enormous growth potential for the *takaful* industry given that there are nearly 1.7 billion Muslims worldwide, more than a quarter of the world's population.

There is a ready market for *takaful*. The secret in tapping that market lies in creating value. This value can be realized if the right combination of success factors can be created. For *takaful* to be successful, government support, cooperation at the international level, and the development of human capital are essential. In this case, Central Bank is set for the *takaful* industry to achieve over the next five years. The targets include market penetration into family *takaful* (life insurance) of the Malaysian population, and total contribution income from both the general and family *takaful* business to reach 7% of the total premium income of the conventional insurance sector.

These targets are supported by strategies to enhance the market penetration of *takaful* business by allowing more players into the market. promoting the diversification of marketing channels, encouraging product innovation and instilling a greater public awareness of the benefits of *takaful*. The plan also sets out strategies to strengthen the financial soundness of *takaful* operators and the regulatory framework governing the *takaful* industry.

With regards to the above, to successfully implement these strategies, the general view of the current profile of the Malaysian population should be taken into consideration. Therefore, the study aims at establishing the profile of the respondent and later will identify the factors influencing the perceptions towards *takaful* as an alternative to conventional insurance. Unlike private sectors' employees, the government servants were chosen to be the respondents in this study because their perception to any decision making with regards to buying an insurance policy is not influenced by government decisions. Their perceptions are normally based on their own understanding about the conventional insurance.

The result from this study will be a useful guideline for future research on *takaful* and to those involved in the industry. The result may be used as an input to increase the number of *takaful* policyholders in Malaysia. Therefore, the objective of this study is to look into the factors influencing the perceptions towards *takaful* as an alternative to conventional insurance. The study will also look at the level of understanding of *takaful* among Muslim population in Malaysia.

## **2 Statement of the Problem**

In January 1999, eight Malaysian insurers announced their decision to combine their efforts and offer "Teras Malaysia" a relatively cheap life insurance product, in creating a totally insured society. The move will increase the number of Malaysian citizen covered by insurance. According to Tunku Abdullah, President of the National Insurance Association of Malaysia, only less than 25% of Malaysia's total population of about 20 millions are insured. The fact that such

a large section of the society remains uninsured means that any sudden loss of property or any personal misfortune will have a severe impact upon the country's economy.

With regards to the insurance companies, statistic shows that there is 65 insurance companies registered with 793 branches nationwide. From the total number of the companies, 51 companies inaugurated locally and 14 of them are foreign companies.

Although, the move will give an alternative to lower income group to have insurance policy, we cannot simply forget other factors such as Islamic issues which are widely debated such as whether the product offered is in line with the *Syariah*. Besides that, the majority of the people barely have enough to spend, what more to save. However, we cannot simply reject the idea of promoting *takaful* since the benefit it brings to the people are tremendous.

In tackling the issue of an Islamic product, Malaysia is far ahead in term of *takaful* products offered if compared to other Muslim countries. The first *takaful* insurance companies were launched in 1984. The establishment of these companies provides an alternative insurance product for the Muslims. Aside from that, surprisingly, *takaful* also seems to receive encouraging support from Non-Muslim participants which accounted for more or less 10 percent from the total number of *takaful* participants (Liza Ali, 1998). According to the statistics prepared by Malaysian Institute of Insurance (MII), the total population of Malaysian subscribers for insurance coverage in Malaysia is not more than 2 percent. From this number, Muslim participants were much lower if compared to other Malaysians.

In term of the total number of population insured, Malaysian is far behind from other developed countries such as Japan where 90% of the population are covered by insurance, 55% in Singapore and 70% in Taiwan. However, in Malaysia context, although the *takaful* has been introduced to Malaysian nearly fourteen years ago, the performance of *takaful* if compared to conventional insurance is still far behind. This is rather disappointing seeing that half of Malaysia's populations are Muslims.

Prime Minister Dr. Mahathir (The Star, Sept 1994) states that the situation actually caused by the low level of awareness among Malaysian when relates any matter associated to insurance. While Tunku Abdullah (Asia Insurance Review, Jan 1999), believes that life insurance in Malaysia is important only if it is compulsory by the law. Malaysians generally tend to avoid being insured unless required by law to do so.

With regards to perception towards *takaful* as an alternative to conventional insurance, we found limitation in searching for information since studies on *takaful* has not been widely conducted. Therefore, it difficult to refer to previous studies that relate to *takaful*. However, the previous study on conventional insurance can be used to benchmark with certain issue relating to people's perception towards *takaful*.

There is a need therefore to study why many Muslim and Malays still reluctant to subscribe to *takaful* although a lot of incentive has been provided by the government.

### 1.3 Purpose of the Study

Most of Malays Muslim are government servants, this research attempts to study government servants' perception towards *takaful* which narrowly specified into only two institutions under the government administration. Furthermore, this research attempts to explore the level of understanding of Muslim Malaysian about *takaful*, and to find out what are the factors that influence their perceptions towards *takaful* as an alternative to conventional insurance.

### 1.4 Significance of the Study

The study has been embarked on to identify the factors why *takaful* is unable to capture the market. It is the researcher's hope that the findings of this study will:

- a) provide some insight to Director General, of Takaful and those interested on the understanding, perceptions and beliefs of government servants towards *takaful* as an alternative to conventional insurance.
- b) provide the distinct characteristic between *takaful* and conventional insurance that directly relates to the activities permitted by the *syariah* law.

- c) provide policy makers the basis for decision making in improving the level of understanding on *takaful* among government servants, in order to inculcate a positive response towards the need for *takaful* as a means of protection.
- d) provide a platform for further study on *takaful* in the future especially in helping the *takaful* industry to prosper.

### 1.5 Hypothesis Statement

Based on general knowledge, informal observations and the literature reviewed, the following hypotheses will be tested.

- H<sub>1</sub> There is no difference in the level of perception towards *takaful* as an alternative and age of the government servants
- H<sub>2</sub> There is no difference in the level of perception towards *takaful* as an alternative and marital status of the government servants
- H<sub>3</sub> There is no difference in the level of perception towards *takaful* as an alternative and income factor of government servants
- H<sub>4</sub> There is no difference in the level of perception towards *takaful* as an alternative and educational level of government servants

- H<sub>5</sub> There is no difference in the level of perception towards *takaful* as an alternative and advertisement effort by the insurance company
- H<sub>6</sub> There is no difference in the level of perception towards *takaful* as an alternative and Islamic awareness among government servants

## 1.6 Limitations of the Study

In carrying out this study, the researcher faced a significant problem in the amount of available literature and research on this subject. This is mainly due to the fact that the study on *takaful* has not generated much interest in the past and is still in its introductory stage. Consequently, a few guidelines are taken from conventional insurance to give direction to this study. The researcher had to follow guidelines from these studies and from research carried out abroad.

## 1.7 Organization of the Project Paper

This study is organized into five chapters. Chapter One provides an outline of the introduction of the study, the background of the study, the statement of the problem, the purpose of the study, the significance of the study and the limitations of the study.

Chapter two contains five main sections. The first section gives the history on both conventional insurance and *takaful*. The second section provides the definitions of *takaful*, its principles, benefits and advantages

Chapter three outlines the research methodology that will be used in collecting and analyzing the data. It is divided into five sections that consists of the sample size, composition and its rationale, the instrument used, the data collection method and the statistical techniques that were used for hypothesis testing.

Chapter four contains the results of the data collection and analyses. It reports the demographic characteristics of respondents and the results of the hypotheses testing.

In Chapter five, there is a discussion of the study's major findings, limitations of the study and implications for both practitioners and academicians. The chapter concludes with some suggestion for future research direction in this field.

## CHAPTER TWO

### REVIEW OF LITERATURE

#### 2.1 History

The concept of insurance originated from the ancient tribal custom of the Babylonians during the years 4000-3000 BC. This concept is based on monetary dealings based on contractual understanding to provide a securing and protection against unexpected risk (Britannica, 1989).

According to the *Al-Quran*, the prophet of Yusuf taught the Egyptians to store the extra crops reaped from a good harvest as a precaution against the bad years (Yusuf: 43). This was continued by ancient Greeks whereby monthly payments were collected from temple members. Those who paid consistently were assured of a good burial. The Romans and medieval guilds followed suit and used the money they collected to take care of losses incurred during a fire or a robbery (Bilingual, 1975). This is the basis of conventional insurance.

Initially, no one was interested in enduring themselves with the insurance business. This was due to great risks involved. Despite this, encouraging attitudes towards the first insurance company began in Flanders in 1310 in order to protect cargoes (Bilingual, 1975). Gradually, different types of insurance coverage were later introduced in order to provide protection against an unexpected risk and resulting losses. For

example, the accident insurance was formed in 1849 when the introduction of express trains resulted in an increase in accident rates. Thus inevitably encouraged more people seek for insurance coverage.

Islam too recognizes basis insurance concepts. Under Islamic law *takaful* practices originated from the ancient Arab tribal custom of *al-'Aqilah* (Hughes, 1982). The doctrine of *al-'Aqilah* used to be practiced based on a mutual agreement between the tribes. If any member of a tribe were killed by a member of different tribe, the heirs of the deceased would be paid by the paternal relatives of the accused with an amount of blood-money (*diyyah*) as compensation. Thus, the word of *'Aqilah* is actually refers to paternal relatives of the accused (Hughes, 1982). Literally, its mean that, members of the accused's paternal relatives used to agreed to be mutually bound by financial contribution for the purpose of protecting the accused from financial liability arising out of causing some offences accountable for *diyyah*.

When the prophet Muhammad migrated to Madinah, this form of insurance was allowed to continue in practice. Under this concept Madinan society agreed to form one group or fund for pooling money called *al-kanz*. The purpose of *al-kanz* is to provide assistance for any member who was found guilty for unintentional murder or to bail the prisoner of war from war enemies (Mohd Fadzli, 1996). Another type of fund formed by Madinan society is the system of *al-Qasamah*. The purpose of this fund was to pay for the heirs of the victim if the actual murderer cannot be identified or the eligible witness cannot be found to identify the murderer (Mohd Fadzli, 1996).

However, it seemed that the system of *'Aqilah* was so prevalent during the early days of Islam to the effect that the early Muslim jurists were not compelled to devise another system to meet the requirements of mutual help and joint indemnity (Mohd Daud, 1997). In addition, the real practice of *takaful* did not come into existence until the era of Ottoman Caliphates. It is believe that the Ottoman was the first Islamic regime to introduce the western concept of insurance within an Islamic jurisdiction via its Maritime Code of 1863. (Mohd Daud, 1997).

## 2.2 Definition of Important Concept

The word *takaful* is an infinitive noun which is derived from the root word *Kaf* which means guarantee or responsibility. Meanwhile, *takaful* whose chief characteristic is *Al-Musharakah* which means sharing. Brings the word *takaful* to mean a shared responsibility, shared-guarantee, collective assurance, mutual undertakings (Mohd Ma'sum, 1999). According to Mohd Fadzli (1996), *takaful* can be understood as one method by which a group of people agreed to collect and deploy efforts and resources for establishing a pact to mutually help each other if an unexpected event happened at one time. From economic point of view, *takaful* means a mutual guarantee or assurance based on the principles of *al-aqd* (contract) provided by a group of people living in the same society against a defined-risk or catastrophe befalling one's life, property or any form of valuable thing (Mohd Ma'sum, 1999).

According to Takaful Act (1984), *takaful* can be defined 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 the purpose. It is obvious that the key words used in this brief but comprehensive definition are mutual participant acts of the resulting in mutual participant acts of the resulting in mutual assistance. The definition starts by explaining the very aim of *takaful* that is to provide mutual financial aid to participants in case of need. Of course, the participants will effect this mutual financial aid only through mutual contribution. (Mohd Fadzli, 1996).

Needless to say that the definition gives a very clear impression that under *takaful*, the participants are both the insurers and insureds. They mutually contribute to help each other in the same manner as they would be mutually protected by the mutual contribution. The term 'mutuality' indeed implies the above framework. No other meaning is possible and the Arabic term of *takaful* i.e mutual guarantee, reinforces the same meaning. This concept is very distinct from the conventional insurance concept as the party who provides the insurance coverage or protection under the latter concept is the insurer, an insurance company. The insured party i.e the policyholder, is and shall not be obliged to provide any help and assistance to the insurer as there is no mutual contribution as well as mutual protection in that framework. (Mohd Ma'sum, 1999)