THE EFFECT OF FINANCIAL FACTORS ON GENERAL TAKAFUL DEMAND AMONG SMALL AND MEDIUM ENTERPRISES IN MALAYSIA

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The Effect of Financial Factors on General Banking Demand among Small and Medium Enterprises in Malaysia

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Faculty of Entrepreneurship and Business
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2015
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In the Name of Allah, Most Gracious, Most Merciful.

Praise and Glory to Prophet Muhammad S.A.W.

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ABSTRAK

The Effects of Financial Factors on General Takaful Demand among Small and Medium Enterprises in Malaysia

ABSTRACT

The aim of this study is to investigate the effects of financial factors on general Takaful demand among small and medium-sized enterprises (SMEs) in Malaysia. The examination of the SMEs’ financial factors provide invaluable information to Takaful operators on the fiscal aspects of SMEs that aid the assessment of these factors in order to improve SMEs’ demand for general Takaful products. An exploration of the extended version of the literature had found four main financial factors that could determine corporate insurance demand and describe the available models of general Takaful demand. These four factors are leverage, growth opportunities, expected bankruptcy costs and tax consideration. The survey employed the same framework to review the modelling, perception towards insurable risks and risk-taking propensity in relation to financial factors and general Takaful demand. Theoretically, this study intends to demonstrate that the conventional assumption that financial factors only affects demand for insurance is not sufficient to explain the demand for general Takaful in the context of financial economics. A more natural explanation combining „perception towards insurable risks” and „risk-taking propensity” as potentially influential variables might be helpful. Therefore, this study envisaged to examine the role of mediator (perception towards insurable risks) and moderator (risk-taking propensity) in the relationship between SMEs’ financial factors and general Takaful demand of Malaysian SMEs. The data on Takaful demand were collected from three Takaful operators and financial report from the Companies Commission of Malaysia (SSM), which consists of 278 SMEs. AMOS, a variance-based Structural Equation Modelling (SEM), was used to scrutinize the information and test the research hypotheses comprising 5 main hypotheses with 14 sub-hypotheses. The study found that financial factors (leverage, growth opportunities, bankruptcy costs and tax consideration) are useful and significant predictors of general Takaful demand. All the financial factors tested were found to be strong predictors and advocated the function of general Takaful, arguably with increases in leverage, increased opportunity, expected bankruptcy costs and tax consideration raised the demand for general Takaful. The study also found evidence of „perception towards insurable risk” as a proxy for the general Takaful demand. „Perception towards insurable risk” is a confident „driver” when making decisions since the risk exposes the company’s assets and activities for the same reason, while „risk-taking propensity” moderate the relationship between perception towards insurable risk. Both these findings underscore the importance of healthy behaviour and correct decision-making, which afforded coverage on assets and company activities. By examining the hypothesized relationships, this study produced a conclusive global picture of the antecedents and consequences of general Takaful demand among SMEs in Malaysia.
CHAPTER 1

INTRODUCTION

1.1 Background

Risk management encompasses risk identifying, evaluating, treating, controlling and risk financing inevitably providing a framework and a procedure for managing risk, in which insurance contracts forms an integral part of risk financing (Dorfman, 2008). Insurance is a way to preserve wealth by providing financial security, to repair damaged assets due to accidents or replace property losses due to fire and theft. Accident, fire or theft can occur at any time and no one can predict how, when and where it will occur. Insurance provides the much needed peace of mind to policyholders whereby their assets will be given protection and compensation over the incident. In Malaysia, there are conventional insurance and Islamic insurance (Takaful) products in which Bank Negara Malaysia (BNM) acts as a regulator and supervisor for both types of insurance products. With the existence of the dual system, the public has the opportunity to purchase the conventional or to participate in the Islamic based insurance policies for protection (risk transfer or risk sharing), for investment or both.
Generally, both industries provide protection to the policyholders and compensate the loss of the property due to insured perils. However, the Fatwa Committee Conference of the National Council For Religious Affairs of Malaysia convened on 15 June 1972 has decided that life insurance as run by most insurance companies available today is illegal and as a *fasad muamalah* because the *aqad* is not compatible with the principles of Islam which contains; *gharar*, gambling and usury. As such, from the *Shariah* point of view, insurance is prohibited. This has led to the enactment of the *Takaful* Act and subsequently the first *Takaful* operator namely *Syarikat Takaful Malaysia Berhad* in 1984. Correspondingly general insurance, at the 80th Fatwa Committee of National Council for Religious Affairs of Malaysia which convened at Penang on 3rd February 2008 decided that the law on general insurance is prohibited by Islam (Islamic Banking and Finance Institute Malaysia (IBFIM), 2010).

Now, Malaysia’s *Takaful* industry is 31 years old and thus far has shown significant developments over the past three decades. The progressive development of Malaysia’s *Takaful* industry, which is supported by a holistic and pragmatic framework, has yielded significant progress in the development of Islamic financial landscape in the country. The number of *Takaful* operators in 1984 had increased to twelve and four re*Takaful* operators, thus diversifying the market with *Takaful* products to meet the financial needs of the economy based on the principles of the *Shariah* (BNM, 2013).
The *Takaful* industry in Malaysia initially was stressing on family *Takaful* segment in comparing with the general *Takaful*, but now the former can be seen dominating more than three-quarters of the domestic market share. Currently though, the *Takaful* operators have been seen to diversify general *Takaful* segments, keeping abreast significantly to the diverse and stable economic development of the industry, in particular, manufacturing, agriculture, industrial and others. The rise of a young population made up of Muslim majority make it significant the excellence of the *Takaful* industry (Ernst & Young, 2013).

Malaysia currently holds a 71% ASEAN contributor’s portion of *Takaful*, allowing a strong industry growth of 21%, dominated predominantly by the family and medical *Takaful*. Malaysia’s *Takaful* business is highly focused on the lower risk family *Takaful* segment (about 78%), in comparison to Gulf Cooperation Council (GCC) which has a higher proportion of general *Takaful* business across all markets (Ernst & Young, 2013). Looking at the *Takaful* industry’s performance in Malaysia, the demand for both general and family *Takaful* has risen steadily over the past three decades. This is evident from the increase in contributions towards both *Takaful* products. For example, in 2013, the total gross contribution towards general and family *Takaful* had grown at an average growth rate of 3.6% (RM841.11 million) and 19.7% (RM5046.68), respectively highlighting an 18.69% growth; in tandem with strong economic activities and increased consumer spending (BNM, 2013).
The researcher in this study is keen to examine the behaviour of small medium enterprise (SME) owners in Malaysia in view of the importance of this sector to the national income while at the same time dealing with the risks that lead to business failure. Past research by the British Insurance Brokers Association has shown that one of every five small businesses suffers a major disruption every year and 80% of the businesses affected by a major incident close down within eighteen months, while 90% of those who lose data close down within two years. This is due to the failure of the small businesses to have adequate insurance cover and proper business continuity plans (Cover Sure 2007). These risks include, occurrences of theft, breakages, fires, strikes, the death of the business owner and any other crises that might befall their business (Manning 2004). The researcher intends to shed some insight on the Takaful purchasing behavior of these SME entrepreneurs regarding protection against unwarranted corporate risks as well as evaluating their whole understanding of risk management. Generally, Takaful purchasing behavior among SMEs is often motivated by risk avoidance, but what is not well understood is the tendency of individual entrepreneurs to assume a certain degree of risk associated with their business operations, particularly when making business decisions. The assumption is that different individuals may have different attitudes towards insurable risks (some considered insurable risk as important to their business, while some did not) and risk taking propensities (some are high-risk takers, while others may be risk averse). It is envisaged
that this research will be able to enhance the corpus of knowledge in terms of our understanding of the behavior of small and medium business owners” in purchasing Takaful products as well as identify the factors that contribute to the demand, especially within the context of multicultural Malaysia. Examples of Takaful products that are appropriate for SMEs are SME-Flexi-PLUS by HSBC Amanah Takaful and mySME BizPartner by Takaful Malaysia. These products provide property protection from fire disaster, crime and liability as it gives the freedom to pick and mix a number of options from a range of protection offered by Takaful operators.

1.2 Problem Statement

The Malaysian Takaful industry has developed and grown over recent years and is able to attract individuals and corporations to view Takaful as one of the preferred protection plans as a tool for risk management. Due to present demands for Takaful protection caused by industrial globalization and the development of a more competitive and dynamic financial sector, it has gained the support from the Malaysian government to accommodate the demands of Takaful scheme as a means of reducing the burden of financial losses to individuals or corporations. Currently, the market penetration rate of the Takaful industry is about 15% and that is considered as very low (BNM, 2014). Nonetheless, it has the opportunity and potential to penetrate the market if the
industry manages to exhibit a strong growth and demand in the future. Even though Malaysia is going through a transition of an aging population, there is still plenty of room for family Takaful to develop as a tool for savings and protection against critical financial problems due to sudden deaths, accidents or ill health. Similarly, general Takaful provides protection for property against a range of disasters.

Although the 15% market penetration is for Takaful industry, general Takaful and family Takaful are equally important because both complement each other to the growth of the Takaful industry. Family Takaful has a much higher penetration relative to general Takaful. Table 1.1 shows that general Takaful contributed about 0.1 percent equal to RM6.2045 million, while family Takaful contributed 0.6 percent (RM37.227 million) to the net contribution income (BNM, 2014). This shows distinctly that general Takaful products are still experiencing a low participation by Malaysian society. It is, thus, important to identify and highlight the factors affecting general Takaful demand in order to boost the Takaful industry.

Thus, the two main questions are: (1) why only a small portion of the population is contributing to Takaful and (2) why Takaful products are not considered as the first options in Malaysia, even though Muslims form the majority of the population? Assuming that the level of participation indicates the performance of the sector, the family and general Takaful contributions of 0.6 % and 0.1% respectively to the total net contribution income reflects a low
penetration of the *Takaful* industry principally on general *Takaful*. The general insurance business has a lot of untapped market that could be further penetrated upon by *Takaful* operators. Profit sharing and innovative market penetration strategy could help boost *Takaful* operator’s shares in the general insurance market (Kamil, 2014).

### Table 1.1: The *Takaful* Key Indicators

<table>
<thead>
<tr>
<th></th>
<th><em>Takaful</em></th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Contributions</td>
<td></td>
</tr>
<tr>
<td>Total (RM million)</td>
<td>6,204.5</td>
</tr>
<tr>
<td>Combined Contributions (% of GNI*)</td>
<td>0.7</td>
</tr>
<tr>
<td>Family <em>Takaful</em> (% of GNI)</td>
<td>0.6</td>
</tr>
<tr>
<td>General <em>Takaful</em> (% of GNI)</td>
<td>0.1</td>
</tr>
<tr>
<td>No. of family <em>Takaful</em> in force</td>
<td>4,485,000</td>
</tr>
<tr>
<td>% Penetration (measured by the number of family policies over population – 29.9 million)</td>
<td>15</td>
</tr>
</tbody>
</table>

*GNI- Gross National Income

Source: BNM, (2014)

The discrepancy in the relationship between financial factors and insurance demand demonstrates that existing considerations of the association between the two variables are overly simplistic and lacking in perspective. Hence, this research aims to fill the gap by adding policyholder’s behavior as an influential variable when examining the impact of *Takaful* demand by systematically investigating decision making behaviors and how policyholders make choices, especially in determining their views on *Takaful* and the factors