The development of the Takaful industry in Malaysia has been encouraged by three main factors. First, the Malaysian Muslim population of more than 60% of the country's population cannot be ignored. Statistics have shown that the Muslims in Malaysia now have greater affluence and are educated; and have developed greater skills. The per capita income of the Malays has grown from 60% of the average per capita income in Malaysia in 1970 to 80% of the average per capita in 2000, attributed mainly to the implementation of the New Economic Policy (NEP) which was designed to eradicate poverty and restructure society, put in place in 1971. Takaful is necessary for Muslims as a replacement for conventional insurance. Having said that, one must hasten to add that Takaful is beneficial not only for the Muslims but also non-Muslims, as it adds variety and widens the choices. There is strong evidence to suggest that Takaful customers are aware of the relationship between insurance and religion in contemporary business and they have a clear concept of Takaful and the requirements for Shariah compliance.

Nonetheless, after more than 30 years, the penetration rates of Takaful still lags far behind conventional insurance, for example, 14.5% in family takaful versus 41% in life insurance. Net contributions of Takaful operators' accounted for only 13.3% of the total net premiums and contributions in the total insurance sector in 2014. Challenges faced by the industry are abound, as for any 'newcomer' even so; there is a large untapped natural market of about 18 million Muslims in Malaysia. There is also still a strong linkage of Takaful to the Shariah compliant supply chain, including Islamic banks.

Research Highlights:

Takaful Is Not Disruptive Enough

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Why is this? The answer may be found if one scrutinizes the operative procedures of the Takaful operators, as to whether they have done things differently from their competing insurance companies. In other words has the Takaful industry been disruptive enough?

The theory of disruptive innovation has proved to be a powerful way of thinking about innovation-driven growth. Many leaders of small, entrepreneurial companies praise it as their guiding star; so do many executives at large, well-established organizations. A quick recap of the idea: "Disruption" describes a process whereby a smaller company with fewer resources is able to successfully challenge established incumbent businesses. Specifically, as incumbents focus on improving their products and services for their most demanding (and usually most profitable) customers, they exceed the needs of some segments and ignore the needs of others. Entrants that prove disruptive begin by successfully targeting those overlooked segments, gaining a foothold by delivering more-suitable functionality—frequently at a lower price. Incumbents, chasing higher profitability in more-demanding segments, tend not to respond vigorously. Entrants then move upmarket, delivering the performance that incumbents' mainstream customers require, while preserving the advantages that drove their early success. When mainstream customers start adopting the entrants' offerings in volume, disruption has occurred .

Takaful initially focused on the Muslim market which was subjected to much neglect. Insurers in Malaysia view

the Muslim market (which corresponds to the Malay or Bumiputera market) as not having the propensity to spend and Insurance was "haram" to the Muslims to begin with. Takaful business models differ significantly to insurance as the Takaful operators' income is primarily derived from fees for services as oppose to insurers whose primary source of income are actuarial surpluses (premiums less claims less expenses and reserves in short). A Takaful operator also has to pay for all management expenses utilizing their shareholders funds whereas insurers levy management expenses to the policyholders' funds. Under the theory of "disruptive innovation, disrupters typically originate in low-end or new-market footholds and disrupters often build business models that are very different from those of incumbents. Takaful can thus qualify to be a "disruptive innovation" based on these two counts.

However, success is not guaranteed just because one is described as an innovative disruption: a disruptive route does not ensure victory, and not every victorious 'newcomer' had necessarily followed a disruptive route. Disruption has to be a process and this should not be overlooked. The fact that disruption can take time helps to explain why incumbents frequently overlook disrupters. The progress of a product or service will take time but during this time the disrupter must ensure that it has created appeal and value for their customers. Takaful operators should not end up like many internet-based retailers who have pursued the disruptive routes in the early 21st century but have not prospered. They have failed because they have disregarded the boundary indicators for the theory's application. Takaful operators must be smart disrupters not only to improve the appeal of their products and services but still focus on their initial markets (low-end or insurance non-consumers Muslims) rather than moving upmarket almost immediately. The lure of high margins and large markets with accustomed customers may just be a trap for newcomers.

Takaful operators in Malaysia adopt the "surplus sharing" approach as a mean to attract potential participants. Admittedly this financial manoeuvre has worked to some extent but raises the Shariah conflict of taking back one's own "tabarru" (donations) and some critics have gone beyond to say that it's a ploy by Takaful operators to justify being paid an actuarial surplus from the scheme.

Takaful operators must endeavour to reduce operational costs to be really disruptive, especially for its low end markets. Takaful operators in Malaysia compete for the same distribution channel as insurers even it is a known fact that these channels especially the tied agency has high costs. Another major cost component is staff compensation. Also, Takaful operators compete for insurance staff by offering higher than normal pay. One wonders what the Shariah Board would say when their company is not able to attract such movers where under Islam a move from a non- permissible occupation to a permissible one even without a salary increase in itself a 360 degrees turnaround of benefits. After all Takaful is also in the business of promoting transcendental benefits; why not apply for the staff.

Another issue is new enabling technology, which are normally embraced by disruptors seem not to be apparent in the Takaful industry. Enabling technology permits companies to lower average cost of operations and also enhances engagement of its consumers. The online learning capability in education for example, has enabled small colleges to disrupt the established universities.

"Takaful is beneficial not only for the Muslims but also non Muslims"

South New Hampshire University (SNHU) in New England, USA has succeeded in the online space by leveraging technology and providing well-constructed courses and Amazon-like customer service to mostly elder working students at a cost they can afford and at the pace that suited them. Tuition and fees for SNHU's online BA is about one-third of what students pay to earn the same degree at the university's leafy brick-and-mortar campus, not including housing and meals. Also, students earn credentials on the merit of what they know, not seat time or earned credits. There is less emphasis on content delivery, and more on outcomes. Via SNHU platform learning takes place at anytime and anywhere. SNHU's College of Online and Continuing Education (COCE) enrols 25,000 students in 36 US States, generates annual revenues of $200 million and has double-digit profit margins.

Another high-profile example of using enabling technology and an innovative business model to effect a disruption is Apple's iPhone. Apple iPhones were able to disrupt personal computers by building a facilitated network connecting application developers with phone users thus; Apple like SNHU had changed the rules of the game.

"It will not be a surprise that incumbents are able to maintain their positions and not threatened by the newcomers"

If both Takaful (newcomers) and Insurance (incumbents) are following the same strategy, it will not be a surprise that incumbents are able to maintain their positions and not threatened by the newcomers. The question now is whether there is a novel technology or business model that allows Takaful operators to be sustainable and having any remote chance to move upmarket without emulating the incumbents' high costs—that is, to follow a disruptive path. The answer seems to be there as in the example of Lemonade of New York. Lemonade's model involved small groups of policyholders who pay premiums into a claims pool. Where surplus arises in the pool at the end of the policy period, members get a refund. Not all that different from a small mutual insurance company or self-insurance group or takaful.

Lemonade looks like another effort to bring efficiencies to inefficient, bloated and antique business models by going back to basics for insurance carriers.

"We are a full-stack insurance company," Lemonade CEO Daniel Schreiber said. "We're reinventing the very plumbing of insurance." And, Schreiber said, that's because the current incentives for both the end user and the policy originator are badly misaligned. He said the industry has suffered from a crisis of consumer confidence, in part because the business model of so many companies is predicated on ways to avoid paying out a claim, instead of satisfying customers. "If you were to set out to create a system with the intent, with the design, to bring out the worst in human beings, it would look a lot like insurance," he said. He referred to studies showing almost a quarter of policyholders think it is acceptable to improperly inflate claims. He added that the firm has hired technologists, designers, actuaries and other insurance professionals (whose names he said will be recognized within insurance circles) and has been able to attract an "eclectic" group of people that the insurance industry has trouble recruiting. Lemonade has 20 employees, Schreiber said, and he's not looking to add staff. Compared to the traditional insurance business, which did more than $1 trillion in business in 2014 and depends on thousands of agents who interact with consumers, there's cause for industry incumbents to worry.

Besides Lemonade there is Germany has Friendsurance, whilst the United Kingdom has Guevara, New Zealand has PeerCover and China has TongJuBao. But those were broker arrangements- Lemonade is the first to register to operate as a carrier.

Takaful operators, heads up please.