Since its inception in 1979, the *takaful* industry has rapidly grown particularly in Muslim regions, namely the Middle East, North Africa and South East Asia. Presently, its double-digit growth rate continues though at a decremental rate.[1] Quite the reverse, other components of the Islamic financial system (i.e. Islamic banking and Islamic capital market) maintain an incremental growth trend. In terms of Islamic financial assets, Islamic banking comes first in terms of both size and growth whilst *takaful* lags behind.[2] Theoretically, within this system, general *takaful* products are complementary to the Islamic banking debt-based financing products that constitute the major share of Islamic banking offerings. For instance, home *takaful* and motor *takaful* provide *shariah*-compliant protection schemes to *murabahah* home financing and vehicle financing, respectively. Yet, the global *takaful* industry is not growing in parallel with Islamic banking.

Takaful growth is dependent upon a stable increment in the profitability levels of companies. Considering the major impact of investment results on a company's balance sheet and profitability consequently, the management of these investments is a key function. High levels of investment returns add up to the accumulated capital of companies. In dire scenarios where claims exceed premiums, such a capital plays a vital role as it provides companies with a cushion against unexpected severe losses. In a competitive environment, extraordinary investment returns enabled insurance companies to reduce premiums and increase dividends and bonuses (Oppenheimer and Schlarbaum, 1983; Smith, 1989; Cummins and Grace, 1994).

We empirically identify the determinants of performance of global *takaful* companies, namely those operating in Malaysia, Pakistan, Qatar, Saudi Arabia and UAE. The companies operating in these countries account for more than three quarters of the global gross *takaful* contributions.[3] Considering that the general *takaful* business is more dominant than the family/life *takaful* business in the developing economies,[4] we prioritize focusing on the general *takaful* sector. The factors influencing financial performance are segregated into internal and external factors. The former group relates to four company-specific factors, i.e. size, liquidity, re*takaful* dependence and gross contributions, which fall under the *takaful* operator's control and may vary from a company to another accordingly. The latter group relates to three economic factors, i.e. GDP per capita, interest rate and equity returns, which are determined by the economic environment.

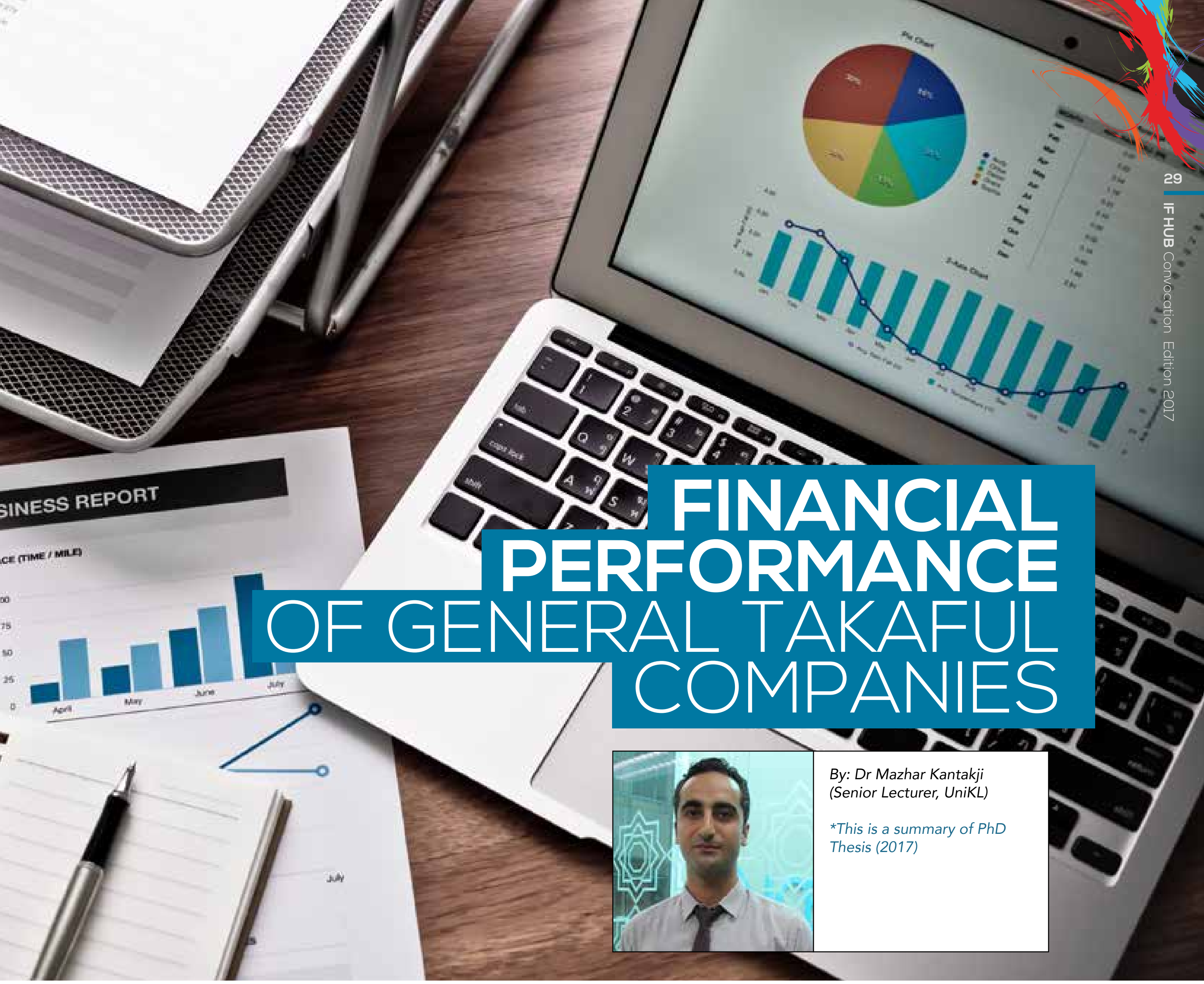
We collect primary data of 53 global general *takaful* companies from their audited annual

1 The year-over-year compound annual growth rate (CAGR) of global gross takaful contributions was 14% over 2012 to 2014, compared to 22% over 2007 to 2011 (Ernst and Young Global Takaful Insights, 2013).

2 In 2014, the Islamic banking industry's share was approximately 80% of the global Islamic financial assets whilst the takaful industry's was only 1% (Malaysian International Islamic Financial Centre). In terms of growth, the year-over-year CAGR of global Islamic banking was 16.1% over 2010 to 2014 (World Islamic Banking Competitiveness Report, 2016)

3 The share of these countries excluding Pakistan represents 77% of the global market share of total gross contributions.

4 The general takaful business accounts for the majority of takaful business in the Middle and Far East markets. General takaful accounts for 96% and 78% of total contributions in Saudi Arabia and the United Arab Emirates, respectively.



FINANCIAL PERFORMANCE OF GENERAL TAKAFUL COMPANIES

By: Dr Mazhar Kantakji
(Senior Lecturer, UniKL)

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> To ensure the credence of the results, the best models of the three alternative regression specifications for each of the three research questions.

financial reports. An ordinary least squares regression model and two panel data models (i.e. fixed effects and random effects) are estimated. To ensure the credence of the results, the best models of the three alternative regression specifications for each of the three research questions are chosen based on the results of Lagrange Multiplier (LM) test and Hausman test. The study results of the three alternative regression specifications are largely consistent in terms of their significance and direction.

Based on empirical evidence, we find that the economic factors are positively related to financial performance of general *takaful* companies. Hence, when GDP per capita increases, the demand on *takaful* products increases resulting in higher contributions and investment allocations accordingly. Since *takaful* companies allocate a proportion of their investments to government securities and stock markets, an increase in interest rates and equity returns leads to an increase in investment returns. As for the company-specific factors, we find that, firstly, large companies are more profitable than small ones, secondly, holding cash is costly and, thirdly, an increase in the share of contribution ceded to re*takaful* leads to a decrease in investment allocations and financial performance accordingly.