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# *Al Wakalah* and its Impact on the Growth and Performance of *Takaful* Companies: A Malaysian Case

## Abstract

Marketing Islamic insurance (takaful) products does not imply exploiting the religious factor alone. Equally important is the marketing channel. As a marketing tool the agency system is vital. Insurance agents who sell policies are not employees of insurance companies. They work on a commission basis and thus are motivated by the volume of sales made. By using agents, insurance companies can cut overhead costs and help expand markets without using or setting up new costly subsidiaries. The first takaful company in Malaysia, Syarikat Takaful Malaysia Berhad (STMB), does not use the agency system (al wakalah), in contrast to the second company, Takaful Nasional Sendirian Berhad (TNSB). The different marketing channel used has a lot to do with both companies following different Islamic scholars' views of the al wakalah contract. It centres upon differences in juristic interpretation (iktilaf) on whether the takaful company, as a manager (mudharib), can use part of the capital, in terms of premiums provided by the policyholders (rabulmal), to pay agents' commissions. This study looks at how this difference in juristic views has impacted the performance of both takaful companies. The study found that TNSB performed better than STMB. In this sense, al wakalah is able to generate greater benefits (manfaat) than the takaful companies while not causing harm (madarrah) to the customers. It is therefore crucial for STMB to review its policy on al wakalah and embrace the system to improve its performance.

## 1. Introduction

There are a number of issues in the *takaful* industry that warrant serious research both in theory and practice. Earlier, attention was mostly focused on questioning the content of uncertainty (*gharar)* and gambling (*maisir*) in *takaful*. *Gharar* can mean many things such as pure or natural risks as well as risks arising from human deliberate action and likewise, gambling and aleotary contracts deal with the outcomes that arise from pure chance. Further debates dwell on the re*takaful* issue and the *takaful* model that uses the principle of *mudharabah* in the investment of *takaful* funds.

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This paper deals with the last issue where *mudharabah* is applied in managing *takaful* funds. Since the promotion of *takaful* products can be carried out by agents as well as owners, Islamic law (*Shariah*) legitimacy depends on the nature of the *takaful* model adopted by the company. If the model is based on *mudharabah,* there is a disagreement over the use of agents in product marketing. However, the agency system (*al wakalah*) is an important aspect of the insurance business as it greatly aids the marketing and distribution network at minimum cost. If juristic differences arising from *iktilaf* have thwarted the function of agents, it is important to see how this has impacted the performance of *takaful* companies that go against the agency system. Likewise, it is also interesting to see the performance of *takaful businesses that apply the system.*

*Two takaful* companies in Malaysia, in which one supports the system of agents while the other rejects it, were chosen for this study. First, by using trend analysis, the study examines the growth of *takaful* funds in these two companies over time. Greater expansion of the *takaful* business may imply more market share. Since they sell similar products, greater market share may be caused by an efficient marketing system that is either through *al wakalah* or a subsidiary network. Second, the study uses financial ratios to measure each company's performance. Profitable operations can be due to lower overhead expenses. Refusal to adopt *al wakalah* may increase capital expenditure, which in turn decreases profit, since the *takaful company is required to set up new subsidiaries across the country to increase distributions.*

*The remainder of this paper is organised as follows. The next section provides a brief introduction of the two companies. The third section begins by examining the concept of takaful* with an illustration of the *takaful* model being used in Malaysia. The section continues by looking into the debates and misconceptions of insurance in Islam as well as highlighting the differences between *takaful* and the conventional insurance. The fourth section deals with the contract of *al wakalah* and the discussions of juristic views on the application of *al wakalah* in *takaful*. In the fifth section, results of trend and financial ratio analysis based on both companies' financial statements are presented. The final section concludes.

## 2. Companies' Background

At the time of the study, there were two *takaful* companies in Malaysia.[1]The first, *Syarikat Takaful Malaysia Berhad* (STMB), is a public listed company and a subsidiary of BIMB Holdings *Berhad* (BIMB Holdings).[2] It was established in 1984 and is the pioneering company in the industry. Its main ob-

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[1] Two new companies, *Takaful Ikhlas* and Mayban *Takaful*, have since been established.
[2] BIMB Holdings also owns Bank Islam Malaysia Berhad (BIMB), the first Islamic Bank in Malaysia to be given the license to operate according to the requirement of the *Shariah*.

jective is to provide *takaful services at the highest standard of efficiency and professionalism to all Muslims and the population in the country.*

*The other is Takaful Nasional Sendirian Berhad* (TNSB), unlisted and a subsidiary of Malaysia National Insurance (MNI) *Berhad*. It began its *takaful* operation in 1993, with the birth of MNI *Takaful Sdn Bhd*.[3] In general, it is set up with the same set of objectives as that of STMB, and in particular, to provide insurance based on the *Shariah principles, as an alternative to the conventional insurance. Also of importance is that it provides the industry with an alternative and the desired level of competition, which was lacking prior to its establishment.*

*The companies' principal activities are in the provision of Family Takaful*, life insurance in the conventional sense and General *Takaful*, equivalent to the conventional general insurance schemes. Apart from having very similar objectives and principal activities, both companies also mirrored one another by having similar organisational structure, target segments and markets and available *takaful* products within the family and general businesses. On the investment front, by being an Islamic Financial Institution (IFIs), their investment portfolios are limited to those that are not against the *Shariah*, such as the *Shariah* approved counters, the Islamic bonds, the Islamic banking investment products and the Government Islamic Investment Certificates.

It can be said that a potential participant[4] would not be able to tell the difference between these two competitors, besides the fact that STMB has been in the market longer.[5] Nonetheless, there is a very distinctive difference in the mode of operation between the two companies, particularly in the area of attracting and servicing *takaful* participants. That distinguishing feature is due to the non-employment of any *takaful* agents by STMB in selling and marketing their *takaful* products. STMB expects any interested potential participants to come personally to its counters to buy its policies (plans). This is in complete contrast to what TNSB does, where it is utilising agents, in a similar mode to that of most conventional insurance companies.

Before the rules and principles of *al wakalah* and its impact on the *takaful* companies are examined, an enlightenment of the *takaful* concept in Islam would ease the understanding of *al wakalah* and its relation to *takaful. This will be reflected in the next section.*

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[3] MNI *Takaful* changed its name to *Takaful* Nasional on the 8th December 1998.

[4] For this paper, the word 'participant' is synonymous with the word customer and/or insured, and they will be used interchangeably. They represent the segment of the public who are present and/or potential owners of the *takaful* plan(s). This remains valid unless a statement to the contrary is made.

[5] This fact was mentioned during interviews conducted with the respective companies' financial managers.

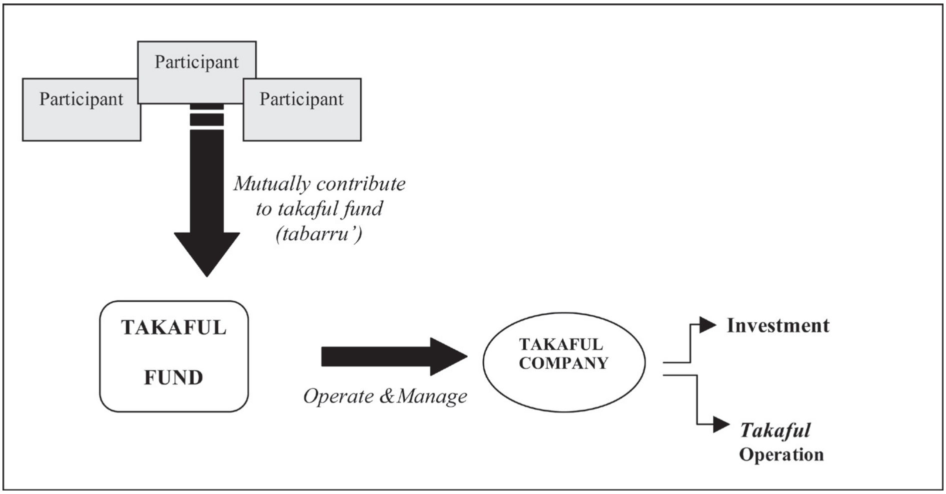
## 3. The Concept of *Takaful*

*Takaful* stems from the Arabic verb *kafal* which literally means to take care of one's needs, and it is the term used to describe insurance that is in compliance with the *Shariah*. The Malaysian *Takaful* Act (1984: 78) defines *takaful* 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 that purpose." In other words, as Rosly (1996) stated, the basic objective of *takaful* is to pay for a defined loss from a defined fund.

The concept of *takaful* had already existed during the time of the Prophet, peace be upon him, where the Muslims contributed to a fund called a*l kanz* under the Islamic system of *aqila* (Billah, 2003). The contribution was for the purpose of helping members of their own community who were liable to pay *diyat*[6]. The system of *aqila* as practised among the *Muhajirin* and *Ansar* tribes in Medina was often said to lay the foundation of *takaful* since *aqila* implies mutual help and support which can also mean to guarantee each other on moral grounds. However, it must be understood that the system of *aqila* is non-commercial in nature and aims to help those in difficulties without demanding contractual payments.

In Malaysia, the modus operandi of the *takaful* system in general is presented in Figure 1. There is a two-tier relationship in the *takaful* contract that is external in nature to the *takaful* company.

*Figure 1.* – ILLUSTRATION OF THE TAKAFUL SYSTEM IN MALAYSIA




*Source*: Nordin and Omar, 2000

[6] Diyat is a system of blood money practised by pagan Arabs but later adopted and refined by Islam.

The first tier is amongst the participants themselves, based on gratuity or donation (*tabarru'*). A certain proportion of the participants' premiums are relocated to pay fellow participants' claims with the balance of the premiums being used for the purpose of savings.

The second tier is amongst the participants as one entity (i.e. the fund) and the *takaful* company. STMB and TNSB apply the *mudharabah* contract besides being the trustee in describing their relationship with the participants. Both these companies regard the operation of *takaful* as a commercial enterprise or *takaful at tijari*.

A slight amendment to Figure 1 is required when one considers TNSB's operation taking into account the agency system in use. This additional entity will come in between the participants and the *takaful* fund as the agents act as the intermediaries. Although the agents present a new entity, the external second tier relationship, as opposed to a new tier relationship, still prevails as the agents are acting only on behalf of the company. However, there still exists an internal relationship between the agents and the company (the principal), and it is the objective of this paper to explore this particular relationship, as will be made clear in the next section.

### 3.1 Misconceptions and debates on the permissibility of insurance and *takaful*

The definitions and concepts of *takaful,* stated previously, are exactly the same with mutual insurance as was practised in the early days of insurance and even today by certain quarters. Due to this, many parties, including conventional practitioners and renowned Islamic scholars, have questioned the assertion that *takaful* and insurance are different and consequently, whether it is acceptable in Islam. A number of people from the conventional insurance industry have remarked that since both schemes are using the concept of the fortunate many, helping the unfortunate few, the difference is rendered to be only superficial in nature, referring only to the difference in the naming of the scheme. However, they fail to realise that the argument goes beyond the concept itself, spanning into the spheres of rules and the nature of contracts in Islam. The majority of Muslim jurists do not argue whether the concept of the common pool is contravening the *Shariah* precepts or not, but are objectionable towards certain elements within the insurance contract, whereas *takaful* is not guilty of the same. Moreover, Muslim jurists are also unconvinced that the conventional insurance, with the exception of mutual insurance, is truly a venture of a cooperative sense based on the notion of brotherhood, solidarity, and mutual assistance. The conventional insurance scheme is seen to be motivated by self-interest and material gain, facets that have no place in *takaful* (Tardmidzi, 2000).

A renowned Islamic scholar aptly sums up the position of the jurists when he says (Qaradawi, 1985: 276):

> "*Our observation that the modern form of insurance companies and their current practices are objectionable Islamically does not mean that Islam is against the concept of insurance itself: not in the least – it only opposes the means and the methods. If other insurance practices are employed which do not conflict with Islamic forms of business transactions, Islam will welcome them.*"

What Qaradawi said above can be interpreted as being that Islam accepts whatever is good and does not go against its teaching, which suggests that certain systems, such as insurance, should not be totally redesigned from scratch in order to be called Islamic. This is also in accordance with the saying of the Prophet, peace be upon him, when he said that "the virtues of the *Jahilliyya* are acted upon in Islam" (Muslehuddin, 1982: 23).

However, there also appears to be differences in opinion and certain misunderstandings on the validity of the concept of insurance and *takaful* among the Islamic jurists. Billah (2003) has identified three different groups as a result of these different views and the classification is reproduced below:

(i) the first group believes that insurance practice is entirely and absolutely lawful provided that it is free from the element of *riba*.

(ii) the second group comprises some Islamic scholars who accept general insurance, but object to life as it involves the element of *maisi*r (gambling) and *gharar* (uncertainty).

(iii) the third group totally rejects any practice of insurance on the grounds that it involves the elements of *riba*, *maisir* and *gharar*.

Apart from the elements of usury, uncertainty and gambling or betting, other elements which have been argued to render insurance invalid include that insurance is contrary to the principles of *tawakkul* (putting trust only in God), *mirath* (inheritance), *wasiyah* (beneficiary) and *takdir* (will of God).

In refuting these misconceptions, Billah (1996) has clearly demonstrated how these misconceptions should be seen from two different angles, in terms of the concept of insurance and in terms of the elements within insurance that make conventional insurance unacceptable to Islam. As discussed earlier, the concept of insurance of the fortunate many, helping the unfortunate few, does not run foul of the *Shariah*. Hence, the attention now turns to the elements which differentiate both schemes. The first element which is being disputed is usury (*riba*). In an insurance scheme, *riba* could occur in two different instances. Firstly, *riba* could occur through the non-*halal* (non-permissible) earnings acquired, such as interest received upon returns from investments in banks or other companies that are not approved by the *Shariah*. In *takaful*, the returns are of *halal* earnings due to the fact that *takaful* companies are allowed to invest only in activities or areas approved by the *Shariah*. The

*Shariah* Advisory Council (SAC), an independent committee of a *takaful* company, made up of people with expertise in the *Shariah*, ensures this governance aspect of *takaful* investments.

Secondly, *riba* could take place at the time when claims payments are made by the company to the claimants. Two types of *riba* occur here, i.e. *riba al-nasiah*, *riba* by virtue of deferment at the time of exchange and *riba al-fadl*, *riba* by virtue in excess in terms of the quantity of one of the counter values. These two definitions of *riba* are based on the *hadith*[7] of the *ribawi* items reported on the authority of 'Ubadah b. al-Samit (as quoted by Bakar, 2000c: 6) that is:

> *"Gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates and salt for salt, like for like, equal for equal, and hand to hand. If the commodities differ, then you (may) sell as you wish provided that (the exchange) is hand to hand."*

Although the *hadith* does not specifically mention money as one of the types of commodities, scholars have agreed that of the six commodities, two (gold and silver) unmistakably represent commodity money (Bakar, 2000c). Consequently, the term 'money' as we know today, either in paper or electronic form, falls under the jurisdiction of this *hadith*. Hence, the insurance scheme, at the time of claims payment, lacks these two conditions. *Riba al-nasiah* occurs because of the lapse in time between periodic premium payments and claim payments, i.e. it is not immediately exchanged (hand to hand). *Riba al-fadl* on the other hand, takes place because of the different counter value between the amount periodically paid as premiums and the total compensation paid in one lump sum.

In this instance, *takaful* works the same way as insurance. However, it does not run foul of *riba al-nasiah* and *riba al-fadl* due to the different terms of the contract entered into between the participants and the company. The fundamental difference lies in the fact that in *takaful*, the premiums are paid on the basis of *tabarru'*.[8] This changed the contract because with *tabarru'*, it is the participants who are carrying the risk and not the company. The company is clearly not the owner of the funds but only its trustees in acting on behalf of the participants in managing the funds. Hence, the company does not have any right to the *takaful* benefits and surpluses and cannot use the premiums except as intended by the participants, which is for mutual help and investments in *Shariah* approved activities. As compensation for managing the funds, the companies will either be paid agency fees or share in the profits made from investments of the funds using the concept of *mudharabah*.[9]

By including the sincere intention of *tabarru'* into the contract, the element of *riba* is eliminated. This is because with *tabarru'*, the contract is no longer

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[7] The sayings of the Prophet, peace be upon him
[8] *Tabarru'* is an Arabic noun that means donation, gift, or contribution.
[9] STMB and TNSB chose the latter.

that of an exchange of goods i.e. money with money – premiums with sums insured – such as the contract of conventional insurance, but that of gratuity or donation. Hence, since the claims payments were derived from the sincere contributions of solidified participants, the differences in the time of exchange and in terms of the counter value become immaterial. In the *takaful* proposal, forms completed by the potential participants for the purpose of evaluation, the word *tabarru'* is clearly mentioned and thus becomes the basis of the contract. One of the functions of the proposal form is to enable those who wish to participate in the *takaful* scheme to offer (*ijab*) themselves for inclusion. If the proposal is accepted (*qabul*) by the company, then a contract (*aqad*) materialises.

The second controversial element refers to the element of *gharar*. Certain scholars, particularly those of the *Shafi'is*, upheld that insurance contains *gharar*, and thus any transactions involving *gharar* would render a contract null and void. *Gharar* could take place in three instances. Firstly, it could mean uncertainty in either the object or the subject matter of insurance. Billah (1996) refuted this contention by making it clear that an insurance contract does not involve the elements of *gharar*, because the subject matter is definite, being either the life or property on which the risk is presumed to be occurring in the future. This is a similar situation facing *takaful* and that would make it lawful as well. The second and the third instances of *gharar* differentiate conventional and *takaful* schemes. The second instance where *gharar* may occur is on the uncertainty of the future occurrence of the risk. This claim can be refuted by basing upon the *tabarru'* factor, explained earlier under *riba*. Other than the *Shafi'is*, other scholars from other schools of Islamic jurisprudence had maintained that for contracts that are based on gratuity, such as *takaful*, *wassiyah* and *hibah*, the element of *gharar* will be eliminated. Thirdly, *gharar* could refer to the uncertainty in the amount that will be paid out when and if the future risk occurs. Unlike insurance, where the compensation amount is determined in advance, in *takaful*, the actual amount will only be known when claims are made. The claims amount will not only depend on the ability of the policyholders to pay the premiums amount, but also on the actual profits or dividend shared during the policy period up to the point of claims. Rather than this being uncertain, it follows an important principle of the *Shariah*, that the future amount is unknown and depends on the will of *Allah* (s.w.t) in determining the luck and destiny of one's life.

The third factor that is being debated is the element of gambling or betting. Gambling is strictly prohibited by *Allah* (s.w.t.) since a gambler hopes upon a chance to obtain a material gain after paying a certain amount of money. According to Billah (2003), some scholars argued that insurance displays a similar attribute, as the insured pays the premiums with the hope of obtaining a handsome return. He argued that what these scholars fail to see is that an insurance policy (and *takaful*) does not contain this element since the scheme is based upon cooperation of participants that are bound together in a spirit of mutual help and goodwill, instead of hoping to beat one another, as is the case with gambling.

Another way that gambling could occur originates from the point of view of the company, which is contrary to the insured point of view given earlier. The company, after receiving the premiums from the insured, would hope that a minimum of claims are made so that they have a bigger surplus and higher profits. This point is true for conventional insurance schemes as the fund's surplus belongs to the company. *Takaful*, however, does not show this characteristic because as was mentioned earlier, the funds' surplus does not belong to the company. It belongs to the participants, with the company simply acting as a trustee in managing the funds. Hence, in *takaful*, the company shares in the returns from investments of the fund but not from the surplus of the funds.

Insurance schemes are also alleged to be inconsistent with the principles of *mirath* and *wasiyah.* In insurance, whoever was nominated by the insured as the nominee is the absolute beneficiary. That means the heirs of the insured, after his death, will be deprived of their rights to inherit a part of the deceased's wealth. Although this may be true for conventional insurance, in *takaful*, the nominee is not the absolute beneficiary, but acts only as a trustee on behalf of the heirs and will only receive part of the wealth if he or she happens to also be a legal heir (Billah, 1996).

Finally, some scholars think that insurance violates the principles of *tawakkul* and *takdir*, and as such should be unacceptable in Islam. However, according to Billah (2003), insurance is neither putting trust in other than *Allah* (s.w.t.) nor superseding His will. Rather, insurance and *takaful* simply means that both the company and the participants mutually agree to work for a compensation or security against an unexpected tragedy. This is carried out in all sincerity with no intention of overcoming the trust placed in *Allah* (s.w.t.).

From the explanations above, it is very clear that the concept of insurance is very much in line with the teachings of Islam. *Takaful* works on a similar concept and moreover, the elements that make the conventional insurance permissibility to be highly debated among scholars, are absent and hence this would provide Muslims with a way of either protecting themselves or their heirs against losses brought about by unforeseen calamities or savings for old age, without the fear of going against the *Shariah*.

## 4. The Contract of *Al Wakalah*

Before going into the analysis, it is necessary to have a brief and clear understanding of the underlying concept of al wakalah in Islam.

*Al wakalah* is a term built on the root word *wakala*, which appears in the *Qur'an* in several places and bears several meanings. Despite that, they are all used to indicate a representation of a person on behalf of another person in certain dispositions, and as Napiah (1995) stated, it could mean to be either *al hifz* (to preserve or to defend), or *al tafwid* (to entrust) or to be responsible for arranging one's affair. The *Majelle*[10] (2001: 239) provides the definition of agency to be:

> "*…when someone puts business of his on another and makes him stand in his own place in respect of the business.*"

The *Qur'an* contains several verses that deal with the lawfulness of *al wakalah*. None of the verses directly testifies its permissibility though, and it was through the process of *ijtihad* that the Muslim jurists were able to relate the verses to the concept of *al wakalah*. The most significant verse representing its permissibility is the following:

> *"…Now send ye then one of you with this money of yours to the town, let him find out which is the best food (to be had) and bring some to you, that (ye may) satisfy your hunger therewith…"*[11]

This verse relates to the episode whereby one person was appointed among the Companions of the Cave, to go to the city to buy food with their silver coin.

Another verse that proves the legitimacy of *al wakalah* is translated below:

> *"Go with this my shirt, and cast it over the face of my father: he will come to see (clearly). Then come ye (here) to me together with all your family."*[12]

This verse describes the order that came from the Prophet Joseph to his brothers, and to some jurists, which is akin to *al wakalah*. Apart from the *Qur'an*, sources of the legitimacy of *al wakalah* can be found in the s*unnah*[13] and h*adith* of the Prophet, peace be upon him. A*l wakalah* was commonly practised in the early period of Islam. The Prophet, peace be upon him, had in fact been directly and indirectly involved and encouraged the proliferation of the activity.

Napiah (1995) said that a *hadith* reported by Abu Dawud, Al Baihaqi, al Dar Qutni and al San'ani provides further proof of the recognition and approval of the Prophet, peace be upon him, on the legality of the practice of *al wakalah*. The *hadith reported an event whereby the Prophet, peace be upon him, addressed Jabir b. Abdullah who was about to go to Khyber. The Prophet, peace be upon him, said*

> "*If you meet my agent, take or ask from him fifteen wasq*"

*It is known too that the Prophet, peace be upon him, commonly appointed agents to perform certain duties on his behalf. One of the duties is the collec-*

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[10] The Majelle or Majallah al Ahkam al' Adliyyah, the foremost authority on *Shariah*.
[11] Yusuf, A. (1997: 712).
[12] Yusuf (1997: 577).
[13] The actions of the holy Prophet, peace be upon him.

*tion of alms (zakat*), and it was narrated in a *hadith* by Abu Hurairah that the Prophet, peace be upon him, sent Caliph ‘Umar for this purpose. In all these instances, the assistants chosen by the Prophet, peace be upon him, acted out the disposition in the form of *al wakalah (Napiah, 1995).*

*The contract of al wakalah* or agency falls under the realm of the concept of representation or deputation (*al niyabah*). The idea of deputation was established in its complete and comprehensive form in Islamic law, together with the birth of the *Shariah*, whereby in contrast, the same concept of deputation in the west, which is based on Roman law, derives its complete form only in stages (Napiah, 1995). This fact is consistent with other concepts or contracts pertaining to Islamic commercial law and transactions where all regulations and rules must be derived from the *Qur'an* and the *Sunnah. Also, Muslim jurists have deliberated on this matter and have progressed to an advanced level, earlier than other scholars did. Napiah (1995: 40) highlighted a statement by Al Sanhuri to illustrate how definite Islamic law is in this field of deputation. Sanhuri states:*

> “ *Islamic jurisprudence is extremely cautious and can be distinguished from Western jurisprudence by its advancement in promoting the idea of deputation in the formulating of contracts. It excelled over the Roman jurisprudence, which was known for its scarcity in this field, as has been seen.*”

### 4.1 Effect of juristic views on the marketing channel used

IFIs are bound to operate their businesses within the precept of the *Shariah*, the knowledge sourced from divine revelations. The revelations contain two categories of knowledge, which can be classified as either specific or general. Many of the specifics and detailed rulings govern the area of interactions between man and God, whereas many of the general principles are that of between man and man, which include business transactions. The general principles, being not specific, would have to undergo the process of *ijtihad* before they can be utilised according to current times and situations. As there are many ways and methods of understanding the *Qur'an* and *sunnah*, there would inevitably be disagreement among scholars and these varieties are well documented in the legacy of Islamic law particularly in the writings of all major schools of Islamic law. There were several legal systems called *madhab*, corresponding to different methods of conducting jurisprudence, which usually differed with regard to the details of practical application (Bakar, 2000a). Currently there are four *madhabs,* each named after its founder, and all four legal systems impact the strategies and operations of IFIs in Malaysia.[14]

[14] They are, in the order of time (beginning with the oldest), the *Hanafi*, the *Maliki*, the *Shafi'i* and the *Hanbali*. Results of the interpretation between them vary, from total disagreement to total conformity. With regards to areas of disagreement, the differences are in the application and not the roots of the *Shariah*, hence all views are considered right and none is to be question, which gives rise to *iktilaf.*

Within the *takaful* circle, many of those involved in the industry have heard various reasons, which tried to explain the rationale behind STMB's decision of not using agents. Not much concrete evidence can be found to clearly explain STMB's stand, making the issue vague and not as clear-cut. A significant indication to represent STMB's decision is best derived from a book on *takaful* that it published (Yusof, 1996: 20).

> *"According to the Encyclopaedia On The Theory and Practice Of Islamic Banking (al-Mausu'ah al-Ilmiyah Wal-Amaliyah Lil-Bunuk al-Islamiyah), published by the International Association of Islamic Banks, it is prohibited to deduct management expenses from the al-Mudharabah capital or its realised profit. The takaful contribution is the Mudharabah capital provided by the participant, therefore the capital or its investment profit cannot be used to pay for financing the agency system (al wakalah) in view of the fact that agency cost is a component of the management expenses which should be borne by the operator."*

A couple of things emerge from the statement above. Firstly, the main contention lies in management expenses, where the agency cost in the form of agents' commissions, are part of the expenses. As such, the stand that STMB took resulted not from the employment of agents or directly due to the agency per se, as an agency is permissible in Islam as explained earlier, but rather on the treatment of the cost of the agency, i.e. who should bear the costs. STMB argues that because of the prevailing *mudharabah* contract that governs the relationship between the company and the participants, it cannot use the capital, in the form of premiums, as well as the profits made through investments of the capital, to remunerate the agents.

Secondly, by referring to the encyclopaedia instead of to divine primary sources of knowledge, this issue is thus an issue of interpretation (*fiqh*) of the *Shariah*, which is *ijtihadi* in nature. By following a certain juridical interpretation or ruling governing management expenses, STMB has decided to forgo the implementation of *al wakalah*. This is a classic example whereby the operating strategy of a company is constrained by adherence to a particular ruling of one of the legal schools of Islamic jurisprudence. Comparatively, this would mean that TNSB, in employing the agency system, complies with the ruling of other legal schools, for it would be constrained too, if it were to follow in the footsteps of STMB.

Muslim jurists are divided over the issue of the management expenses incurred in a business. According to Bakar (2000b), the *Shafi'is* view is that covering such expenses from the *mudharabah* capital or its realised profit will lead to the element of *gharar* (uncertainty) and the presence of *gharar* makes the contract void. It is apparent that the concept of STMB on management expenses is based on this view. On the other hand, the other schools of law have held the view that expenses can be deducted from the business account or realised profits depending on the nature of the expenses. The *Hanafis* and

*Malikis* would confine the permissibility to the case of journey and its related expenses to cover both the lodging and food. The *Hanbalis*, on the other hand, does not limit it to the case of a journey whereby the manager (*mudharib*) may deduct his management expenses from the account even during his stay in his hometown. These expenses are related to necessary expenses such as food, clothing, lodging, salaries of employees and the like, but must be at the standard norms of the society or industry. Also according to the *Hanbalis*, all expenses must be deducted from the gross profit, if any, and in the event of no profit, it could be reimbursed from the capital. Therefore, it is clear that TNSB concurs with the other schools besides the *Shafi'is*.

The effect of the above can be seen from the annual reports of the companies. In the case of STMB, all expenses other than the *takaful* funds common expenses[15] are solely borne by the company. In contrast, TNSB charges agents' commissions and those expenses that are directly attributable to the *takaful* funds, against the *takaful* funds. These expenses are other than the funds' common expenses. That leaves only those expenses not directly attributable to the *takaful* funds to be borne by the company in the profit and loss accounts.

In Malaysia, the majority of Muslims usually conform to the *Shafi'is* view on devotional matters. However, on matters which concern business transactions (*muamalat*)**,** Muslims tend to take various views including from the other schools. According to Bakar (2000a), the legal theory developed by the *Shafi'is* is best for areas of law which are fixed such as devotional matters because this school of law was never involved in areas of law which are flexible and worldly-oriented such as that of business transactions. Consequently, STMB can adopt other views for the implementation of *al wakalah***.**

Having raised these points, the question would be why STMB should implement the system, as it is all right, at least by the *Shafi'is* interpretation, if it decides not to use agents. The answer to this question is that agents improve the performance and growth of a company as shall be shown in the following section.

## 5. Accounting Standards for Insurance and *Takaful* Companies

In Malaysia, the Malaysian Accounting Standards Board (MASB) principally governs the financial reporting of insurance companies.[16] However, since standards for *takaful* companies are still under construction, both TNSB and

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[15] *Takaful* funds common expenses include claims, maturity and surrender values of certificates. The balance left after deducting these expenses is called surplus and unlike conventional insurance, it belongs to the participants, not the company.

[16] MASB 18 deals with life insurance business while MASB 17 with the general insurance business. MASB 18 supersedes MASB Approved Accounting Standard MAS 4, Accounting for Life Insurance Business. MASB 17 supersedes MASB Approved Accounting Standard MAS 3, Accounting for General Insurance Business.

STMB prepare their financial statements according to the conventional standards with modifications made to comply with the *Shariah* requirements.

Apart from these, insurance and *takaful* companies in Malaysia are also obliged to follow the Accounting Guidelines issued by the central bank, *Bank Negara Malaysia* (BNM) as well as to comply with the provisions of the Companies Act, 1965. Further references need to be made to the Insurance and *Takaful* Acts and they are also encouraged to adopt the International Accounting Standards (IAS) recommended by the International Accounting Standards Committee (IASC). For *takaful* companies, further recommended standards are the Accounting, Auditing and Governance Standards for Islamic Financial Institutions developed by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI). All of these standards and guidelines set out the proper accounting treatment for various aspects of the insurers' operations in Malaysia, such as premiums (contributions), investments, claims and reinsurance (*retakaful). They also provide guidelines on the general presentation and disclosure in the financial statements of both Islamic and conventional insurance companies.*

One of the most noticeable modifications to the accounting standards and guidelines above is the revenue recognition policy practised by STMB and TNSB. STMB accounts all revenue, including contribution revenue, on a cash basis, i.e. only when payment is received, whereas TNSB recognised contributions using an accruals basis with other revenues, such as the returns on investments, on cash. These practices are in contrast with the practice of recognising premiums and other income, on an accrual basis, as accorded by the accounting standards and guidelines.

The argument to opt for a cash basis is based on the interpretation of the *mudharabah* contract governing the relationship between the company and the participants. STMB contended that profit can only be shared and distributed based on the actual receipts, which can only be done using an accounting practice based on cash (Yusof, 1996).

A written correspondence from a senior official of BNM revealed that BNM allows the use of both a cash or accruals basis in recognising contributions and other revenue, although it is moving towards the accrual basis to be consistent with AAOIFIs and IAS.

### 5.1 Importance of financial statement analysis

Public confidence in the *takaful* companies depends, to a large extent, on the information that they disseminate. AAOIFI (1999) noted that various stakeholders[17] with diverse interests and concerns, common or unique, make up

[17] The main categories of users or stakeholders include equity holders; participants; others who transact with the takaful operators, who are not equity holders or participants; zakah agencies; regulatory agencies, employees and the public at large.

the different segments of the interested public and they rely mostly on the annual financial reports that these companies produced in order to make informed decisions. Financial accounting and reporting plays an important role in directing economic resources in society as a result of the decisions made by the users of the reports, who rank financial accounting and reporting as the basic information required for decision making.

Comparing the performance between the companies presents one of the ways of the process of decision making, by aiding the stakeholders' choice of investing or dealing with one *takaful* company versus the other. To enable comparisons, it is vital that the presentation and reporting practices of the two *takaful* companies be standardised and hence, comparable. According to Elliott and Elliott (2000), besides comparability, standardisation will also result in attaining three other principal qualitative characteristics of financial reporting, namely, relevance, reliability and understandability. Nobes (1998) argued that major differences in the financial reporting practices of companies' will lead to great complications for those preparing, consolidating, auditing and interpreting published financial statements.

This is true when it comes to the annual financial reports of the STMB and TNSB. The main difference lies in the treatment of revenue recognition for the contribution paid by the participants, for both family and general *takaful* funds. Prior to the analysis, adjustments were made to the contribution figures of TNSB. TNSB recognised its contribution based on the accrual basis, while STMB on cash. Hence, for data quality, the contribution figures of TNSB were recast from the accrual to the cash basis of recognition. Recasting TNSB's contribution from an accrual to a cash basis was preferred to recasting STMB's contribution from cash to accrual, for the simple reason that additional data can be easily obtained from TNSB's cash flow statements and in the notes to its accounts.

As stated in the section on companies' backgrounds, the external and internal factors facing both companies are essentially the same, with the only exception being the agency system in place at TNSB. Hence, the results of the financial statement analysis in the following section would provide valid evidence of the impact of the system on the growth and performance of the companies. The results show that overall, TNSB is performing better than STMB, and this can only be due to the agents employed.

### 5.2 Financial statement analysis

For the purpose of the financial statement analysis, the authors went to both companies to obtain the annual reports from 1994 to 2002. The year 1994 was chosen as the starting year, as this was the year that TNSB entered the business. (Lewis and Pendrill, 1996) also pointed out that it is quite usual to look at a series of about 5 years' results as the firm represented in the earlier years in a longer time series bears little resemblance to the firm at the end of the period. This is due to the fact that the company's environment will change over time, with the result that performance which was considered satisfactory in the past may no longer be so. Comparatives for financial analysis can be obtained either through time series analysis or cross sectional analysis Hermanson et al (1998). Such comparisons or relationships may be expressed as:

1. Absolute increases and decreases for an item from one period to the next.
2. Percentage increases and decreases for an item from one period to the next.
3. Percentages of single items to an aggregate total.
4. Trend percentages
5. Ratio Analysis.

The calculation of absolute and percentage of *ringgit* changes in the statement items or totals is called horizontal analysis. This analysis detects changes in a company's performance and highlights trends. Trend percentages are similar to horizontal analysis except that comparisons are made to a selected base year or period. Trend percentages are useful for comparing financial statements over several years because they dislodge changes and trends occurring through time. Frequently, these percentage changes, whether increases or decreases, are more informative than information obtained from comparisons between absolute amounts. For example, by only looking at absolute amounts, it could be seen that the amounts between different years increased, but through percentage changes, the extent of that increased changes, will be highlighted clearly. The changes could either be increasing at an accelerating rate or at a slower pace, or even at a decreasing rate. Finally, no financial analysis is complete without including some degree of ratio analysis. Ratios describe the relationship between different items in the financial statements. The relative usefulness of each ratio depends on what aspects of a company's business affairs are being investigated. This study would use items 2, 4 and 5 from the above expression in the analysis. Items 2 and 4, which represent the trend analysis part of this paper, will show the growth of the two companies while the ratio analysis will reveal their respective performances over the time period chosen, i.e. from 1994 to 2002.

### 5.3 Results of trend analysis

This study combined horizontal analysis and trend percentages into one table, with reference to each items being analysed. In this study, certain items from the family and general *takaful* funds derived from the companies annual reports, will be subjected to the above selected analysis. The items are:

1. Family *Takaful* Contributions
2. General *Takaful* Contributions

*Table 1.1.* – FAMILY *TAKAFUL* CONTRIBUTIONS

| TNSB | 2002 | 2001 | 2000 | 1999 | 1998 | 1997 | 1996 | 1995 | 1994 |
|---|---|---|---|---|---|---|---|---|---|
| Gross Contributions (RM) | 572,100,252 | 734,785,944 | 172,458,980 | 117,601,634 | 82,909,039 | 55,407,197 | 38,709,790 | 9,623,488 | 0 |
| Horizontal Analysis: | | | | | | | | | |
| Changes in absolute amount (RM) | -162,685,692 | 562,326,964 | 54,857,346 | 34,692,595 | 27,501,842 | 16,697,407 | 29,086,302 | 9,623,488 | na |
| Changes in percentage (per cent) | -22.14 | 326.06 | 46.65 | 41.84 | 49.64 | 43.13 | 302.24 | na | na |
| Trend Percentages (per cent) | 5944.83 | 7635.34 | 1792.06 | 1222.03 | 861.53 | 575.75 | 402.24 | 100.00 | na |

| STMB | 2002 | 2001 | 2000 | 1999 | 1998 | 1997 | 1996 | 1995 | 1994 |
|---|---|---|---|---|---|---|---|---|---|
| Gross Contributions (RM) | 278,686,291 | 563,572,408 | 143,035,458 | 116,085,572 | 99,684,112 | 65,835,023 | 48,603,360 | 26,811,934 | 15,557,778 |
| Horizontal Analysis: | | | | | | | | | |
| Changes in absolute amount (RM) | -284,886,117 | 420,536,950 | 26,949,886 | 16,401,460 | 33,849,089 | 17,231,663 | 21,791,426 | 11,254,156 | na |
| Changes in percentage (per cent) | -50.55 | 294.01 | 23.22 | 16.45 | 51.42 | 35.45 | 81.28 | 72.34 | na |
| Trend Percentages (per cent) | 1791.30 | 3622.45 | 919.38 | 746.16 | 640.73 | 423.16 | 312.41 | 172.34 | 100 |

3. Total Assets
4. Operating Expenses,
5. Profit before *Zakat* and Tax.

From the table, it can be seen that the contributions for both companies had increased on a yearly basis. The column that denotes changes from the previous year in absolute amount, with the exception of 2002, indicates the yearly increase. The year 2001 marked a tremendous increase of contributions from the previous year (TNSB: 326 per cent and STMB: 294 per cent). The main reason for these increases was due to the introduction of an annuity scheme, which allows workers to utilise savings from the Employee's Provident Fund (EPF) for the purpose of buying a family coverage plan. This annuity scheme lasted for a year until July 2001, and with the cessation of the scheme, the contributions collected for 2002 decreased, resulting in negative amounts and percentages.

Year by year comparison showed that from 1999 onwards, TNSB had collected more contributions than STMB. This was achieved after only 4 years of starting business. TNSB only began to collect contributions in 1995, a year after being established. The situation was also maintained after the annuity scheme was introduced and subsequently after it was stopped. Analysing further, looking from the column of changes from the previous year in percentage terms, the quantum of percentage changes in TNSB, with the exception of 2002, showed the increase in contribution was at a rate which was more stable than that of STMB. The percentage change exceeds that of STMB in 1999, and even when the annuity scheme was ceased, the decrease in the contribution suffered was lower (TNSB: – 22 per cent and STMB: – 50 per cent). This indicates that not only were the agents able to bring in more contributions, but they were also able to help the company to buffer against a sudden change of policy such as the annuity scheme.

Trend percentages-wise, at the end of the accounting year 2002, the TNSB index indicates a high figure of 5944 points over the base year 1995, which was the year TNSB began to collect the contributions. This indicates the overall higher growth that TNSB enjoyed due to its use of sales agents.

Unlike family *takaful*, there was no annuity scheme in general *takaful*. The contribution figures and the changes from the previous year in absolute amount showed that both companies were able to increase the level of contributions collected on a yearly basis. The analysis also reveals that for all the years under study, the general *takaful* collected by STMB, in absolute amount, were bigger than the sum collected by TNSB. However, TNSB's performance is not too bad either if another vital statistic i.e., the rate or quantum of these changes is taken into consideration.

From the column of changes from the previous year in percentage, the increases in TNSB occurred at a relatively higher and faster rate than STMB with the exception of 2002. The trend percentages also showed the higher

*Table 1.2.* – GENERAL *TAKAFUL* CONTRIBUTIONS

| TNSB | 2002 | 2001 | 2000 | 1999 | 1998 | 1997 | 1996 | 1995 | 1994 |
|---|---|---|---|---|---|---|---|---|---|
| Gross Contributions (RM) | 80,370,387 | 68,792,930 | 36,465,630 | 20,053,156 | 15,046,560 | 5,861,480 | 4,032,126 | 2,149,707 | 0 |
| Horizontal Analysis: | 11,577,457 | 32,327,300 | 16,412,474 | 5,006,596 | 9,185,080 | 1,829,354 | 1,882,419 | 2,149,707 | na |
| Changes in absolute amount (RM) | 16.83 | 88.65 | 81.84 | 33.27 | 156.70 | 45.37 | 87.57 | na | na |
| Changes in percentage (per cent) | 3738.67 | 3200.11 | 1696.31 | 932.83 | 699.94 | 272.66 | 187.57 | 100 | na |
| Trend Percentages (per cent) | | | | | | | | | |

| STMB | 2002 | 2001 | 2000 | 1999 | 1998 | 1997 | 1996 | 1995 | 1994 |
|---|---|---|---|---|---|---|---|---|---|
| Gross Contributions (RM) | 196,416,677 | 150,005,039 | 113,136,975 | 107,602,150 | 99,073,101 | 79,520,690 | 63,379,848 | 56,701,050 | 39,084,889 |
| Horizontal Analysis: | | | | | | | | | |
| Changes in absolute amount (RM) | 46,411,638 | 36,868,064 | 5,534,825 | 8,529,049 | 19,552,411 | 16,140,842 | 6,678,798 | 17,616,161 | na |
| Changes in percentage (per cent) | 30.94 | 32.59 | 5.14 | 8.61 | 24.59 | 25.47 | 11.78 | 45.07 | na |
| Trend Percentages (per cent) | 502.54 | 383.79 | 289.46 | 275.30 | 253.48 | 203.46 | 162.16 | 145.07 | 100 |

*Table 1.3.* – TOTAL ASSETS

| TNSB | 2002 | 2001 | 2000 | 1999 | 1998 | 1997 | 1996 | 1995 | 1994 |
|---|---|---|---|---|---|---|---|---|---|
| Total Assets (RM) | 1,856,421,480 | 1,247,624,459 | 573,540,058 | 371,258,863 | 233,754,564 | 151,745,509 | 82,869,669 | 37,686,753 | 20,727,789 |
| Horizontal Analysis: | | | | | | | | | |
| Changes in absolute amount (RM) | 608,797,021 | 674,084,401 | 202,281,195 | 137,504,299 | 82,009,055 | 68,875,840 | 45,182,916 | 16,958,964 | na |
| Changes in percentage (per cent) | 48.80 | 117.53 | 54.49 | 58.82 | 54.04 | 83.11 | 119.89 | 81.82 | na |
| Trend Percentages (per cent) | 8956.20 | 6019.09 | 2767.01 | 1791.12 | 1127.74 | 732.09 | 399.80 | 181.82 | 100 |

| STMB | 2002 | 2001 | 2000 | 1999 | 1998 | 1997 | 1996 | 1995 | 1994 |
|---|---|---|---|---|---|---|---|---|---|
| Total Assets (RM) | 1,572,180,707 | 1,302,590,765 | 726,596,152 | 589,231,270 | 437,594,201 | 420,296,808 | 298,656,438 | 202,004,299 | 150,437,077 |
| Horizontal Analysis: | | | | | | | | | |
| Changes in absolute amount (RM) | 269,589,942 | 575,994,613 | 137,364,882 | 151,637,069 | 17,297,393 | 121,640,370 | 96,652,139 | 51,567,222 | na |
| Changes in percentage (per cent) | 20.70 | 79.27 | 23.31 | 34.65 | 4.12 | 40.73 | 47.85 | 34.28 | na |
| Trend Percentages (per cent) | 1045.08 | 865.87 | 482.99 | 391.68 | 290.88 | 279.38 | 198.53 | 134.28 | 100 |

*Table 1.4.* – OPERATING EXPENSES

| TNSB | 2002 | 2001 | 2000 | 1999 | 1998 | 1997 | 1996 | 1995 | 1994 |
|---|---|---|---|---|---|---|---|---|---|
| Operating Expenses (RM) | 77,783,630 | 57,922,206 | 39,476,793 | 26,331,888 | 18,557,866 | 13,402,516 | 7,591,043 | 2,467,647 | 42,875 |
| Horizontal Analysis: | | | | | | | | | |
| Changes in absolute amount (RM) | 19,861,424 | 18,445,413 | 13,144,905 | 7,774,022 | 5,155,350 | 5,811,473 | 5,123,396 | 2,424,772 | na |
| Changes in percentage (per cent) | 34.29 | 46.72 | 49.92 | 41.89 | 38.47 | 76.56 | 207.62 | 5655.44 | na |
| Trend Percentages (per cent) | 181419.55 | 135095.52 | 92074.15 | 61415.48 | 43283.65 | 31259.51 | 17705.06 | 5755.44 | 100.00 |

| STMB | 2002 | 2001 | 2000 | 1999 | 1998 | 1997 | 1996 | 1995 | 1994 |
|---|---|---|---|---|---|---|---|---|---|
| Operating Expenses (RM) | 57,387,958.00 | 47,660,771.00 | 34,410,313.00 | 24,964,199.00 | 21,436,479.00 | 16,382,658.00 | 13,003,710.00 | 9,627,344.00 | 6,901,777.00 |
| Horizontal Analysis: | | | | | | | | | |
| Changes in absolute amount (RM) | 9,727,187.00 | 13,250,458.00 | 9,446,114.00 | 3,527,720.00 | 5,053,821.00 | 3,378,948.00 | 3,376,366.00 | 2,725,567.00 | na |
| Changes in percentage (per cent) | 20.41 | 38.51 | 37.84 | 16.46 | 30.85 | 25.98 | 35.07 | 39.49 | na |
| Trend Percentages (per cent) | 831.50 | 690.56 | 498.57 | 361.71 | 310.59 | 237.37 | 188.41 | 139.49 | 100 |

growth in the business that TNSB had achieved. Hence, it can be concluded here that sales agents helped TNSB to keep up with the performance of STMB when it comes to the general *takaful*.

The favourable performance of TNSB in its collection of contributions has a positive impact on its total assets. As at year-end 2002[18], its total assets stood at RM 1.8 million compared to STMB, which was only RM 1.5 million. This was achieved in a period of only 10 years, which was only half the period of time of STMB's existence. The rate of change in total assets from the previous year in percentage term is very much at the upper end of the scale for TNSB. In the same corresponding periods, STMB experienced not only highly volatile changes but the changes were also happening at very low rates, far off from that achieved by TNSB. Except in 2001, when the annuity scheme was available, STMB's rates barely breached the 40 per cent level. Even in 1998, when the Asian economic crisis was at its peak, TNSB managed to grow its assets by more than 50 per cent as compared to only 4.12 per cent for STMB.

The trend percentages also show the tremendous growth that TNSB was experiencing with regard to total assets, while the trend percentages of STMB indicated that it was experiencing a slower growth.

Beginning in 1999 and in terms of the absolute amount, TNSB incurred larger operating expenses than STMB. In terms of percentages, it goes back to 1995. An essential fact emerged from this comparison. Although the operating expenses of TNSB were higher, they were surpassed by the growth, especially in yearly family contributions. This signifies that TNSB was in fact very effective in managing its cost. A high proportion of TNSB's operating expenses consist of commissions paid to the agents who brought in the contributions. The commissions are paid out of a small portion of the contributions and this resulted in the linear relationship between expenses and contributions. Remember that its adoption of a particular juristic view allows some of the expenses to be charged to the contributions. This was unlike STMB. The growth in yearly family contributions was low and it did not match the growth of its operating expenses. In other words, STMB was not cost effective and not only that, it has to bear all of the expenses in its profit and loss accounts. The ratio of family contributions to operating expenses below shows the contribution for every RM1 of operating expenses for the period under review and they slightly favour TNSB.

However, the opposite occurs when the general *takaful* contributions were considered. Table 1.4c below shows that the ratio of general contributions to operating expenses support the walk-in concept more than the agency system. An explanation for this could be due to the nature of general *takaful*. As general coverage is deemed a necessity to protect against losses due to

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18 TNSB's accounting year-end is at 31st March while STMB's is at 30th June.

*Table 1.4b* – FAMILY CONTRIBUTIONS TO OPERATING EXPENSES

| TNSB | 2002 | 2001 | 2000 | 1999 | 1998 | 1997 | 1996 | 1995 | 1994 |
|---|---|---|---|---|---|---|---|---|---|
| Family Contributions (RM) | 572,100,252 | 734,785,944 | 172,458,980 | 117,601,634 | 82,909,039 | 55,407,197 | 38,709,790 | 9,623,488 | 0 |
| Operating Expenses (RM) | 77,783,630 | 57,922,206 | 39,476,793 | 26,331,888 | 18,557,866 | 13,402,516 | 7,591,043 | 2,467,647 | 42,875 |
| Contributions to Operating Expenses | 7 | 13 | 4 | 4 | 4 | 4 | 5 | 4 | 0 |

| STMB | 2002 | 2001 | 2000 | 1999 | 1998 | 1997 | 1996 | 1995 | 1994 |
|---|---|---|---|---|---|---|---|---|---|
| Family Contributions (RM) | 278,686,291 | 563,572,408 | 143,035,458 | 116,085,572 | 99,684,112 | 65,835,023 | 48,603,360 | 26,811,934 | 15,557,778 |
| Operating Expenses (RM) | 57,387,958.00 | 47,660,771.00 | 34,410,313.00 | 24,964,199.00 | 21,436,479.00 | 16,382,658.00 | 13,003,710.00 | 9,627,344.00 | 6,901,777.00 |
| Contributions to Operating Expenses | 4.86 | 11.82 | 4.16 | 4.65 | 4.65 | 4.02 | 3.74 | 2.78 | 2.25 |

*Table 1.4c* – GENERAL CONTRIBUTIONS TO OPERATING EXPENSES

| TNSB | 2002 | 2001 | 2000 | 1999 | 1998 | 1997 | 1996 | 1995 | 1994 |
|---|---|---|---|---|---|---|---|---|---|
| General Contributions (RM) | 80,370,387 | 68,792,930 | 36,465,630 | 20,053,156 | 15,046,560 | 5,861,480 | 4,032,126 | 2,149,707 | 0 |
| Operating Expenses (RM) | 77,783,630 | 57,922,206 | 39,476,793 | 26,331,888 | 18,557,866 | 13,402,516 | 7,591,043 | 2,467,647 | 42,875 |
| Contributions to Operating Expenses | 1 | 1 | 1 | 1 | 1 | 0 | 1 | 1 | 0 |

| STMB | 2002 | 2001 | 2000 | 1999 | 1998 | 1997 | 1996 | 1995 | 1994 |
|---|---|---|---|---|---|---|---|---|---|
| General Contributions (RM) | 196,416,677 | 150,005,039 | 113,136,975 | 107,602,150 | 99,073,101 | 79,520,690 | 63,379,848 | 56,701,050 | 39,084,889 |
| Operating Expenses (RM) | 57,387,958.00 | 47,660,771.00 | 34,410,313.00 | 24,964,199.00 | 21,436,479.00 | 16,382,658.00 | 13,003,710.00 | 9,627,344.00 | 6,901,777.00 |
| Contributions to Operating Expenses | 3.42 | 3.15 | 3.29 | 4.31 | 4.62 | 4.85 | 4.87 | 5.89 | 5.66 |

accident, fire or theft, customers do not need that much persuasion to buy the plans. Furthermore, they would be in the know of when the due date of the plans would expire, making them take that extra effort to buy from the nearest branches. Hence, a walk-in concept could still prevail over an agency system, as far as the general *takaful* is concerned.

The impact of the observations from the analysis on contributions and operating expenses will be on the company's profits before *zakat* and tax. For STMB, as a result of lower contributions collected due to non-agents, lesser amounts would be available for investments and thus the returns in the form of shared profits will be lower. Secondly, since it has to continuously open up new branches, a large portion of the contributions would be utilised for and tied up in fixed assets, making the amount available for investments to be even lower.

Thirdly, by not being able to share the expenses with the participants by charging some of the expenses to the contributions, it has put additional burden on the company, and subsequently on its profit before *zakat* and tax.

From the table above, during the economic crisis in 1998, STMB suffered a loss of about RM 7 million while TNSB made a profit. In fact, from that year onwards, with the exception of 1999, TNSB was more profitable than STMB. Its profits before *zakat* and tax nearly doubled that of STMB in the last two years of the analysis. In most of the years under the period of study, the changes from previous years in absolute amount and in percentage showed that STMB's profits demonstrated high fluctuations. In contrast TNSB's profits were more stable, as the biggest decrease in terms of the amount was only about RM 3 million.

The trend percentages proved that TNSB was again outperforming STMB. In just a short number of years, the quantum of changes in the profit before *zakat* and tax of TNSB breached the 9000 points, indicating a high growth in the company's performance.

## 5.4. Results of ratio analysis

The analysis will apply the group of ratios used in the conventional insurance industry, with appropriate modification to the terms used, for the purpose of suitability for the *takaful* industry. The reason for this is that there are no reports or studies before that had tried to compare the performance of *takaful* companies. Dynaquest, a research and consultancy firm based in Kuala Lumpur, developed the group of ratios used for the conventional insurance industry. Their report on the results of the ratios was acquired by the Kuala Lumpur Stock Exchange (KLSE) and made available to the public. The two groups of ratios used were the profitability and financial (solvency) ratios, which were divided into the following ratios.

*Table 1.5* – PROFIT BEFORE *ZAKAT* AND TAX (PBZT)

| TNSB | 2002 | 2001 | 2000 | 1999 | 1998 | 1997 | 1996 | 1995 | 1994 |
|---|---|---|---|---|---|---|---|---|---|
| Profit before *Zakat* and Tax (RM) | 29,382,829 | 13,888,617 | 16,758,301 | 12,865,717 | 4,518,602 | 6,310,156 | 5,905,755 | -766,093 | 321,275 |
| Horizontal Analysis: | | | | | | | | | |
| Changes in absolute amount (RM) | 15,494,212 | -2,869,684 | 3,892,584 | 8,347,115 | -1,791,554 | 404,401 | 6,671,848 | -1,087,368 | na |
| Changes in percentage (per cent) | 111.56 | -17.12 | 30.26 | 184.73 | -28.39 | 6.85 | -870.89 | -338.45 | na |
| Trend Percentages (per cent) | 9145.69 | 4322.97 | 5216.19 | 4004.58 | 1406.46 | 1964.10 | 1838.22 | -238.45 | 100 |

| STMB | 2002 | 2001 | 2000 | 1999 | 1998 | 1997 | 1996 | 1995 | 1994 |
|---|---|---|---|---|---|---|---|---|---|
| Profit before *Zakat* and Tax (RM) | 14,103,430 | 6,735,334 | 13,619,265 | 24,215,010 | -7,057,348 | 18,421,705 | 12,031,980 | 9,384,602 | 7,752,557 |
| Horizontal Analysis: | | | | | | | | | |
| Changes in absolute amount (RM) | 7,368,096 | -6,883,931 | -10,595,745 | 31,272,358 | -25,479,053 | 6,389,725 | 2,647,378 | 1,632,045 | na |
| Changes in percentage (per cent) | 109.39 | -50.55 | -43.76 | -443.12 | -138.31 | 53.11 | 28.21 | 21.05 | na |
| Trend Percentages (per cent) | 181.92 | 86.88 | 175.67 | 312.35 | -91.03 | 237.62 | 155.20 | 121.05 | 100 |

The profitability group of ratios is made up of:

1. Premium Income to Total Assets, which is modified to Contributions to Total Assets;
2. Total Income to Total Assets; which is modified to Investment Income to Total Assets[19];
3. Profit Before Tax to Total Assets, which is modified to Profit Before *Zakat* and Tax to Total Assets and
4. Returns on Equity.

The financial (solvency) group of ratios includes:

1. Investment Assets to Total Assets;
2. Liquid Current Assets to Total Assets;
3. Fixed Assets to Total Assets;
4. Insurance funds to Total Assets, which is modified to *Takaful* funds to Total Assets and
5. Shareholders Funds (Equity) to Total Assets.

The findings of the ratio analysis of the two companies follow.

This ratio indicates what contribution was collected for every one *ringgit* of assets. The contribution figure consists of both the *takaful* business' contributions, namely the family and general *takaful*. The total assets of the companies were made up of current assets such as cash and bank balances, deposits with financial institutions and debtors, investment assets with money bearing securities and fixed assets. Contribution is the *raison d'être* of the *takaful* business, as apart from providing coverage to the participants, it is also the source of revenue for the company through the returns made from investing it.

From the table, TNSB was more profitable than STMB, using this particular profitability ratio. It has consistently outperformed STMB, with the exception of 1995 and 1998. As such, TNSB generated higher contribution per *ringgit* assets, indicating it has utilised its assets better. The comparison made between the companies' total assets earlier indicated that prior to 2002, TNSB had a smaller assets base than STMB. It goes to show that agents' penetration is higher as compared to the concept of walk-in customers.

Apart from the early years of TNSB, there was only one other occasion when STMB performed slightly better. That was in 2001 when its ratio of 0.03 bettered TNSBs' by 1 percent. As previously stated, apart from 2002, TNSB's total assets were always smaller than STMBs'. However, these did not prevent it from doing better than its main rival. Investment income is the main in-

[19] The total income for a conventional insurance company is the premium collected plus the income form investment. In *takaful* this is not possible because the premium (contribution) collected does not belong to the companies.

come of any *takaful* company and it depends very much on the contributions collected, apart from the investment skills of managers. TNSB experienced a higher annual increase of contributions and as it does not have to be concerned with fixed expenditures and operating expenses, TNSB was able to invest much of the contributions collected.

This ratio indicates how much profit before *zakat* and tax was generated per one *ringgit* of assets. Beginning in 1996, TNSB had either been more profitable or at least matched the performance of STMB. STMB had even suffered a negative ratio of –0.02 due to losses it incurred in 1998. TNSB had utilised its smaller assets base efficiently to achieve a similar ratio performance. This is yet another indicator of the positive results that the agency system can bring.

This ratio is calculated by dividing the shareholders funds with profit after *zakat* and tax. Since 1996, TNSB's ROE had bettered the ROE of STMB. Again, this was achieved in a short period of time since its inception. Unless and until STMB changes its policy, its situation as depicted above will continue or even worsen. Without agents, it has to continue with its annual high fixed assets investments or high expenses in the case of renting. It then also has to continue informing participants of its products and services, resulting in higher expenses due to advertisements and promotions. Furthermore, since STMB is unable to split its operating expenses, the smaller revenues are mismatched with the higher operating expenses. All of these would deflate profits.

This is the first ratio under the group of financial solvency ratios. It is interesting to note that since its inception, a very large portion (more than 90 per cent) of TNSB total assets was made up of its investment assets. The contributions collected provided the amount available for investments and with that the main purpose of TNSB, where contribution was concerned, was to invest them in money bearing securities.

Whereas TNSB investment assets had been large, STMB's was on the decline, except for 2001 and 2002 when helped by the annuity scheme, the investment assets made up 86 per cent and 85 per cent of its total assets. In 1994 for instance, investment assets only represented 60 per cent of total assets, while in 1998 it was only 65 per cent. If investment assets constituted only a small percentage of total assets, it will ultimately result in smaller returns on investment. Thus, STMB suffers not only from lower contribution collected, as shown in the analysis of the profitability ratios earlier, but also from the smaller amount that is available for shorter term investments.

The following analysis would show that a big portion of the STMB's contributions is used to part financed the purchase of its fixed assets.

The above two tables give the breakdown of the composition of the assets other than investment assets. The liquid current assets of both companies were considered sufficient to cover their respective current liabilities.

*Table 1.6* – CONTRIBUTIONS TO TOTAL ASSETS

| TNSB | 2002 | 2001 | 2000 | 1999 | 1998 | 1997 | 1996 | 1995 | 1994 |
|---|---|---|---|---|---|---|---|---|---|
| Total Contribution(RM) | 652,470,639 | 803,578,874 | 208,924,610 | 137,654,790 | 97,955,599 | 61,268,677 | 42,741,916 | 11,773,195 | 0 |
| Total Assets(RM) | 1,856,421,480 | 1,247,624,459 | 573,540,058 | 371,258,863 | 233,754,564 | 151,745,509 | 82,869,669 | 37,686,753 | 20,727,789 |
| Contribution to Total Assets | 0.35 | 0.64 | 0.36 | 0.37 | 0.42 | 0.40 | 0.52 | 0.31 | 0.00 |

| STMB | 2002 | 2001 | 2000 | 1999 | 1998 | 1997 | 1996 | 1995 | 1994 |
|---|---|---|---|---|---|---|---|---|---|
| Total Contribution(RM) | 475,102,968 | 713,577,447 | 256,172,433 | 223,687,722 | 198,757,213 | 145,355,713 | 111,983,208 | 83,512,984 | 54,642,667 |
| Total Assets(RM) | 1,572,180,707 | 1,302,590,765 | 726,596,152 | 589,231,270 | 437,594,201 | 420,296,808 | 298,656,438 | 202,004,299 | 150,437,077 |
| Contribution to Total Assets | 0.30 | 0.55 | 0.35 | 0.38 | 0.45 | 0.35 | 0.37 | 0.41 | 0.36 |

*Table 1.7* – INVESTMENT INCOMES TO TOTAL ASSETS

| TNSB | 2002 | 2001 | 2000 | 1999 | 1998 | 1997 | 1996 | 1995 | 1994 |
|---|---|---|---|---|---|---|---|---|---|
| Investment Income(RM) | 76,043,479 | 30,274,206 | 34,963,930 | 26,494,986 | 5,858,145 | 12,328,502 | 8,085,499 | 211,981 | 385,482 |
| Total Assets(RM) | 1,856,421,480 | 1,247,624,459 | 573,540,058 | 371,258,863 | 233,754,564 | 151,745,509 | 82,869,669 | 37,686,753 | 20,727,789 |
| Investment income to Total Assets | 0.04 | 0.02 | 0.06 | 0.07 | 0.03 | 0.08 | 0.10 | 0.01 | 0.02 |

| STMB | 2002 | 2001 | 2000 | 1999 | 1998 | 1997 | 1996 | 1995 | 1994 |
|---|---|---|---|---|---|---|---|---|---|
| Investment Income (RM) | 54,929,963 | 32,928,608 | 21,872,592 | 33,831,363 | 4,084,049 | 26,649,513 | 17,211,765 | 12,733,781 | 12,310,919 |
| Total Assets (RM) | 1,572,180,707 | 1,302,590,765 | 726,596,152 | 589,231,270 | 437,594,201 | 420,296,808 | 298,656,438 | 202,004,299 | 150,437,077 |
| Investment income to Total Assets | 0.03 | 0.03 | 0.03 | 0.06 | 0.01 | 0.06 | 0.06 | 0.06 | 0.08 |

*Table 1.8* – PROFIT BEFORE *ZAKAT* AND TAX TO TOTAL ASSETS

| TNSB | 2002 | 2001 | 2000 | 1999 | 1998 | 1997 | 1996 | 1995 | 1994 |
|---|---|---|---|---|---|---|---|---|---|
| PBZT (RM) | 29,382,829.00 | 13,888,617.00 | 16,758,301 | 12,865,717 | 4,518,602 | 6,310,156 | 5,905,755 | -766,093 | 321,275 |
| Total Assets (RM) | 1,856,421,480 | 1,247,624,459 | 573,540,058 | 371,258,863 | 233,754,564 | 151,745,509 | 82,869,669 | 37,686,753 | 20,727,789 |
| PBZT to Total Assets | 0.02 | 0.01 | 0.03 | 0.03 | 0.02 | 0.04 | 0.07 | -0.02 | 0.02 |

| STMB | 2002 | 2001 | 2000 | 1999 | 1998 | 1997 | 1996 | 1995 | 1994 |
|---|---|---|---|---|---|---|---|---|---|
| PBZT(RM) | 14,103,430 | 6,735,334 | 13,619,265 | 24,215,010 | -7,057,348 | 18,421,705 | 12,031,980 | 9,384,602 | 7,752,557 |
| Total Assets (RM) | 1,572,180,707 | 1,302,590,765 | 726,596,152 | 589,231,270 | 437,594,201 | 420,296,808 | 298,656,438 | 202,004,299 | 150,437,077 |
| PBZT to Total Assets | 0.01 | 0.01 | 0.02 | 0.04 | -0.02 | 0.04 | 0.04 | 0.05 | 0.05 |

*Table 1.9* – RETURNS ON EQUITY (ROE)

| TNSB | 2002 | 2001 | 2000 | 1999 | 1998 | 1997 | 1996 | 1995 | 1994 |
|---|---|---|---|---|---|---|---|---|---|
| PBZT(RM) | 29,382,829 | 13,888,617 | 16,758,301 | 12,865,717 | 4,518,602 | 6,310,156 | 5,905,755 | -766,093 | 321,275 |
| Shareholders funds(RM) | 73,253,753 | 55,497,802 | 49,762,206 | 41,856,710 | 30,754,287 | 28,854,091 | 25,766,935 | 23,507,073 | 20,265,275 |
| Returns on Equity | 0.40 | 0.25 | 0.34 | 0.31 | 0.15 | 0.22 | 0.23 | -0.03 | 0.02 |

| STMB | 2002 | 2001 | 2000 | 1999 | 1998 | 1997 | 1996 | 1995 | 1994 |
|---|---|---|---|---|---|---|---|---|---|
| PBZT(RM) | 14,103,430 | 6,735,334 | 13,619,265 | 24,215,010 | -7,057,348 | 18,421,705 | 12,031,980 | 9,384,602 | 7,752,557 |
| Shareholders funds(RM) | 111,001,381 | 99,013,065 | 98,286,786.00 | 92,629,082.00 | 77,108,602.00 | 86,459,743.00 | 54,351,043.00 | 25,871,215.00 | 22,006,017.00 |
| Returns on Equity | 0.13 | 0.07 | 0.14 | 0.26 | -0.09 | 0.21 | 0.22 | 0.36 | 0.35 |

*Table 1.10* – INVESTMENT ASSETS TO TOTAL ASSETS

| TNSB | 2002 | 2001 | 2000 | 1999 | 1998 | 1997 | 1996 | 1995 | 1994 |
|---|---|---|---|---|---|---|---|---|---|
| Investment Assets(RM) | 1,803,630,065 | 1,177,107,242 | 538,739,449 | 350,225,966 | 225,427,424 | 145,006,464 | 77,859,913 | 36,983,901 | 20,529,093 |
| Total Assets(RM) | 1,856,421,480 | 1,247,624,459 | 573,540,058 | 371,258,863 | 233,754,564 | 151,745,509 | 82,869,669 | 37,686,753 | 20,727,789 |
| Investment Assets to Total Assets | 0.97 | 0.94 | 0.94 | 0.94 | 0.96 | 0.96 | 0.94 | 0.98 | 0.99 |

| STMB | 2002 | 2001 | 2000 | 1999 | 1998 | 1997 | 1996 | 1995 | 1994 |
|---|---|---|---|---|---|---|---|---|---|
| Investment Assets(RM) | 1,338,179,035 | 1,113,996,593 | 587,555,577 | 463,433,947 | 286,489,960 | 294,503,149 | 244,521,640 | 182,210,078 | 90,532,091 |
| Total Assets(RM) | 1,572,180,707 | 1,302,590,765 | 726,596,152 | 589,231,270 | 437,594,201 | 420,296,808 | 298,656,438 | 202,004,299 | 150,437,077 |
| Investment Assets to Total Assets | 0.85 | 0.86 | 0.81 | 0.79 | 0.65 | 0.70 | 0.82 | 0.90 | 0.60 |

*Table 1.11* – LIQUID CURRENT ASSETS TO TOTAL ASSETS

| TNSB | 2002 | 2001 | 2000 | 1999 | 1998 | 1997 | 1996 | 1995 | 1994 |
|---|---|---|---|---|---|---|---|---|---|
| Liquid Current assets(RM) | 45,851,916 | 63,525,509 | 29,370,396 | 16,181,492 | 4,739,212 | 4,939,180 | 3,392,049 | 529,282 | 110,074 |
| Total Assets(RM) | 1,856,421,480 | 1,247,624,459 | 573,540,058 | 371,258,863 | 233,754,564 | 151,745,509 | 82,869,669 | 37,686,753 | 20,727,789 |
| Liquid Current Assets to Total Assets | 0.02 | 0.05 | 0.05 | 0.04 | 0.02 | 0.03 | 0.04 | 0.01 | 0.01 |

| STMB | 2002 | 2001 | 2000 | 1999 | 1998 | 1997 | 1996 | 1995 | 1994 |
|---|---|---|---|---|---|---|---|---|---|
| Liquid Current assets(RM) | 92,926,244 | 51,797,261 | 19,096,110 | 13,391,434 | 42,438,109 | 94,411,674 | 38,470,873 | 16,021,151 | 56,143,727 |
| Total Assets(RM) | 1,572,180,707 | 1,302,590,765 | 726,596,152 | 589,231,270 | 437,594,201 | 420,296,808 | 298,656,438 | 202,004,299 | 150,437,077 |
| Liquid Current Assets to Total Assets | 0.06 | 0.04 | 0.03 | 0.02 | 0.10 | 0.22 | 0.13 | 0.08 | 0.37 |

*Table 1.12* – FIXED ASSETS TO TOTAL ASSETS

| TNSB | 2002 | 2001 | 2000 | 1999 | 1998 | 1997 | 1996 | 1995 | 1994 |
|---|---|---|---|---|---|---|---|---|---|
| Fixed Assets(RM) | 6,939,499 | 6,991,708 | 5,430,213 | 4,851,403 | 3,587,928 | 1,799,865 | 1,617,707 | 173,570 | 88,622 |
| Total Assets(RM) | 1,856,421,480 | 1,247,624,459 | 573,540,058 | 371,258,863 | 233,754,564 | 151,745,509 | 82,869,669 | 37,686,753 | 20,727,789 |
| Fixed Assets to Total Assets | 0.004 | 0.006 | 0.009 | 0.013 | 0.015 | 0.012 | 0.020 | 0.005 | 0.004 |

| STMB | 2002 | 2001 | 2000 | 1999 | 1998 | 1997 | 1996 | 1995 | 1994 |
|---|---|---|---|---|---|---|---|---|---|
| Fixed Assets(RM) | 141,075,428 | 136,796,911 | 128,024,119 | 119,558,086 | 108,722,304 | 31,381,985 | 15,663,925 | 3,773,070 | 3,761,259 |
| Total Assets(RM) | 1,572,180,707 | 1,302,590,765 | 726,596,152 | 589,231,270 | 437,594,201 | 420,296,808 | 298,656,438 | 202,004,299 | 150,437,077 |
| Fixed Assets to Total Assets | 0.09 | 0.11 | 0.18 | 0.20 | 0.25 | 0.07 | 0.05 | 0.02 | 0.03 |

*Table 1.12b* – *TAKAFUL* AND SHAREHOLDERS FUNDS TO TOTAL ASSETS

| STMB | 2000 | 1999 | 1998 | 1997 |
|---|---|---|---|---|
| From *takaful* funds (RM) | 83,105,613 | 76,792,507 | 70,092,835 | 16,932,483 |
| From Shareholders funds (RM) | 44,918,506 | 42,765,579 | 38,629,469 | 14,449,502 |
| Fixed Assets (RM) | 128,024,119 | 119,558,086 | 108,722,304 | 31,381,985 |
| *Takaful* funds to Fixed Assets | 0.65 | 0.64 | 0.64 | 0.54 |
| Shareholders funds to Fixed Assets | 0.35 | 0.36 | 0.36 | 0.46 |

*Table 1.12c* – CHANGES IN *TAKAFUL* AND SHAREHOLDERS FUNDS TO CHANGES IN FIXED ASSETS

| STMB | 2000 | 1999 | 1998 |
|---|---|---|---|
| Changes in *takaful* funds financing Fixed Assets (RM) | 6,313,106.00 | 6,699,672.00 | 53,160,352.00 |
| Changes in shareholders funds financing Fixed Assets (RM) | 2,152,927.00 | 4,136,110.00 | 24,179,967.00 |
| Changes in Fixed Assets (RM) | 8,466,033.00 | 10,835,782.00 | 77,340,319.00 |
| Changes in *takaful* funds to changes in Fixed Assets | 0.75 | 0.62 | 0.69 |
| Changes in shareholders funds to changes in fixed Assets | 0.25 | 0.38 | 0.31 |

Fixed assets constituted a large percentage of all assets as far as STMB is concerned. From 1998 to 2001, the ratios stood at more than 10 per cent. The lowest that STMB recorded was in 1995 when its fixed assets formed 2 percent of total assets. TNSB's fixed assets to total assets were dwarfed in comparison to STMBs', where for all the years under investigation, its ratios barely exceeded 1 percent.

Table 1.12b shows how STMB financed its yearly total fixed assets. For example, in the year 2000, total fixed assets amounted to RM128, 024,119. Out of this amount, approximately RM83 million or 65 per cent were financed using the *takaful* funds, in other words from the accumulated contributions collected from the participants. Only RM44 million or 35 per cent came from the shareholders funds. Similar percentages were derived in 1998 and 1999.

Table 1.12c extends the analysis from the preceding table. In 2000, additions to the fixed assets, after depreciation, came to over RM8 million. Out of this, over RM6 million (75 per cent) was used from the *takaful* funds, while only RM 2.1 million or 25 per cent from the shareholders funds.

From these observations, STMB needed a substantial amount from contributions collected to part finance its continuous expansion through the opening up of branches and *takaful* counters. Fixed asset investments would also yield some returns in terms of gains due to appreciation of values and from rental income. However, the gains are not as immediate as shorter-term investments, and it would require something extraordinary for STMB to vacate its servicing branches. As for rental, the majority of the income is made up of inter company transactions, instead of rental received from outsiders. The Chairman's Statement of STMB's annual reports specifically stated that the main sources of STMB's income are the returns of investment of shareholders' funds and the share of profits of both *takaful* businesses, and not from returns from fixed assets.

Hence, a large portion of contributions (e.g. year 2000 – RM83 million) is tied up in fixed assets. This is unlike TNSB, where its main objective of the contributions collected is to put them in money bearing securities and investments. To show the degree of spending of fixed assets of both companies, the balance sheet for 2000 and 1999 will be taken as an example. The annual reports of STMB indicate that its fixed assets were valued at RM128, 024,119 and RM119, 558,086 respectively. Its cash outflow from investing activities in the purchase of fixed assets for the 2 years were RM11, 974,260 and RM13, 506,662 respectively. In contrast, the balance sheet figures of TNSB for its fixed assets for the 2 years were RM5, 430,253 for 2000 and RM4, 851,403 for 1999. Its cash outflow from investing activities in the purchase of fixed assets were only RM2, 392,888 for 2000 and RM2, 725,258 for 1999. These TNSB's assets include the purchase of a limited number of office space to cater for the purpose of administering the agency systems, throughout the country.

All of these continuous acquisitions of fixed assets would not be necessary for STMB if agents were used instead. More contributions will be freed to be channelled into shorter-term investments and consequently raise the performance of the company.

## 6. Conclusions

Both companies offered very similar products with very similar benefits, and operating in the same market, in fact targeting the same market segment of the majority Malaysian Muslims. This leads to them having to compete in the same environment, facing the same political, economical, legal and social-cultural forces. Both companies have very similar organisational structures and operate in accordance to the rules and regulations of Islamic law derived from the pretext of *Sharia*h. Each company's Shariah Supervisory Council ensures that the activities of the companies comply with the *Shariah* requirements, activities that include investments in *halal* or permissible securities. Hence, the investment portfolios of both companies will mirror one another and include among others, investments in the green counters listed in KLSE, Islamic bonds market and Government Islamic Investments (GII).

Yet, even with so many similarities between them, when it comes to performance and consequently profitability of the companies, they differ considerably. Results from the analysis have shown that overall, TNSB had outperformed or at least matched STMB in almost all areas that were subject to comparison by demonstrating higher profitability and better financial solvency.

The better performance of TNSB could be attributed to its ability to leverage its internal strengths in order to be more competitively advantageous. Since the external opportunities and threats facing both companies are the same, it is obvious that differences in internal operations could be the main reason. Again, internally, the structure of the organisations for both companies does not remarkably differ. What could be the difference that led to such diversity in performances? The answer lies in the strategy of procuring and soliciting contributions from participants – the strategy of utilising agents against the strategy of opening up branches in order to reach the participants.

The results of the studies have shown that STMB should consider their policy of not employing agents. There are no barriers to its implementation, either from the *Shariah*, or from other perspectives. It should consider stopping the opening up of new branches and instead use the current branches to facilitate the agency system. STMB has more offices than TNSB and a direct changeover to the agency system would not only be possible, but would provide them with an immediate advantage.

Perhaps it could also consider another alternative to the usage of the current offices to just merely facilitating the agency system after the changeover. It could look into the strategy of separating the two *takaful* business' marketing channel. For the family *takaful* business, it must utilise agents, for agents have been proven by the study to be the important factor in influencing customers' purchase decisions. As for the general *takaful* business, it can use the current branches to partly cater for the business, or to own higher business volumes than agents. In general, hazard *takaful* plans such as motor, fire etc. are necessary coverage and usually do not need a higher level of influence from agents in order for customers to purchase. This remark is supported by the analyses on general *takaful* from the above. This is where the concept of walk-in customers would be better off and the agents could be used to promote the general *takaful* plans during their meetings with customers. These strategies should be evaluated and consequently implemented if STMB wishes to continue to be a major player in the *takaful* industry. With the advent of globalisation leading to increased competition domestically and internationally, STMB has to do this expeditiously.

STMB should not equate the principle of *mudharabah* with total prohibition of the agency system. Interestingly enough, even if it decides to continue with *mudharabah* and at the same time implement the system, it can still avoid going against the definition given in the encyclopaedia. The reason for this is because the issue of non-permissibility will only arise if the payment to the agents, which is perceived as management costs, is taken from the capital or deducted from the gross profit. Should the payment be taken from the share of profit of the *mudharib*, i.e. the company's share after paying the share attributable to participants, the issue will no longer be relevant. If there is no profit made, the expenses can be covered by the company by utilising the shareholders' fund. This reasoning means that management expenses will always be borne by the company which is in fact consistent with the last line given in the definition. However, profits will be further depressed if STMB bears all expenses. For this reason, it is imperative that it should adopt the interpretation of other schools of thoughts so that it can charge the agents' commissions and part of the management expenses related to *takaful* funds to the *takaful* funds.

Adoption of views from other school of laws will not be inconsistent with STMB's plan or that of its related company, BIMB, as they have adopted the views of other schools besides *Shafi'is* in other spheres concerning their operations. Examples of these are given below:

1. *Takaful* is permissible in Islam, because it is based on the contract of *tabarru'*. Consequently, as this contract is unilateral in nature, the element of *gharar* is tolerable from the Islamic perspective. This view of *gharar* being tolerable in unilateral contracts is that of the *Maliki* school of law and not the *Shafi'is*. The *Shafi'is* are of the opinion that *gharar* is not tolerable under any contractual circumstances and unilateral contracts must be free of it. Hence, STMB would not have been able to implement the *takaful* business if it had followed the *Shafi'is* view.

2. BIMB is operating a parallel or two-tier *mudharabah* in its *mudharabah* transactions. A two-tier *mudharabah* involves three parties that include the capital providers (i.e. the depositors in *mudharabah* savings account), the intermediate *mudharib* (i.e. BIMB) and the final *mudharib* (the entrepreneur in *mudharabah* financing). This parallel *mudharabah* or *mudharib yudarib* is only acceptable according to the *Hanafis* in contrast to the majority of the scholars.

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