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Determinants of Composite *Takaful* Operators' Financial Performance

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Abstract
Purpose: This study assessed the determinants that influence *takaful* operators' financial performance because *takaful* operators need to consider the determinants so that the companies able to fulfil their roles without serious financial problems.
Design/methodology/approach: This study used secondary data to assess the financial information from 2007-2016 of the composite *takaful* operators gathered from the Central Bank of Malaysia.
Findings: All determinants displayed positive relationship except profit rate and re*takaful*.
Research limitations/implications: Limitation of the study is that the data should be separated into the line of businesses either family or general *takaful* business. Accordingly, the limitation can be future area of research that can be executed in order to understand and perhaps produce a model that will be unique for *takaful* operators.

Keywords: *takaful*, composite, family *takaful*, general *takaful*, insurance

Introduction

There are numerous studies focused on performance of *takaful* operators especially in Malaysia. Nevertheless, such performance was demarcated into several components such as financial performance (Ismail, 2013), corporate social performance (Muhamat, Jaafar & Basri, 2017) and agents' performance (Muhamat et al, 2018). Ismail (2013) advised that studies on *takaful* operator's financial performance is limited due to the lack of data and empirical evidence on this area.
Therefore, this study focused on the recent *takaful* operator's financial reports specifically for the family *takaful* operators in order to assess the determinants that influence the financial performance. Previous studies had discussed in-depth on the general *takaful* operator's financial performance, moreover, family *takaful* is a lucrative segment for the composite *takaful* operators (before the requirement of the Central Bank to split the composite *takaful* business into family and general *takaful*).

Literature Review

This study has extensively reviewed previous studies on the financial performance of *takaful* operators.

i. Return on investment, return on equity (ROE) and return on assets (ROA) are amongst the popular proxies being used to asses company's financial performance (Malik, 2011). Ismail (2013) used investment yield is as the proxy since it reflects one of the major activities of the composite *takaful* businesses. Investment is the main function of *takaful* and insurance companies in order to mobilise the contribution and premium that received from the participants or policyholders.

ii. Profit rate: Ismail (2013) suggest that profit rate contributes to the performance of the *takaful* operator's investment which benefited the *takaful* operator as well as the policyholders. Abduh & Isma (2016) inform that *takaful* operator's investment instruments consists of bonds, *sukuk* and fixed deposit which rely on the profit rate determined for the instruments, and influence the stakeholders' decisions either to supply more funds or otherwise; instead of increasing the solvency of the companies (Mwangi & Murigu, 2015).

iii. Equity return: One of the factors that influence the profitability performance of *takaful* operation. Equity returns result for the dividend income to the company (Ismail, 2013). Based on findings from Abduh & Isma (2016) indicated that equity return is one of the critical factors that influence profitability of the insurance and *takaful* companies. The lower the equity index will cause the asset liability mismatch.

iv. Size: includes the number of employees, branches and the total asset which pointed by Reshid (2015) to be either positive or negative relationship concerning the profitability. The larger the firm; it will have more resources, better risk diversification, complex information systems and a better expenses management (Burca & Batrinca, 2014).

v. Stability of Underwriting Procedure: Ismail (2013) findings informed that by increasing the premium; it will give better financial performance of the *takaful* companies. Any unfavourable changes to the chain process of underwriting, it can cause lower profitability due to the financial difficulties. A sound process is needed because *takaful* operator has the fiduciary duty to ensure the business is managed prudently, even though the *takaful* operator is only acting as agent. The fiduciary duty of the *takaful* operator requires the shareholders to top up if there is deficit in the risk fund (Muhamat, Mainal, Alwi & Jaafar, 2018).

vi. Liquidity: Mazviona, Dube & Sakahuhwa (2017) suggest that companies with more liquid assets are less possible to fail because they can liquidate their cash when there is need for it especially in a dire situation. Abduh & Isma (2016) conclude that liquidity is one of the variables that represent *takaful* operator capability to pay the liability such as claim and expenses to the policyholders.

vii. Re*takaful* or Reinsurance: Shiu (2004) clarifies that reinsurance or re*takaful* increases operational stability, greater dependence on reinsurance will reduce the company's preservation level which can decrease the potential profitability for the insurer. Ismail (2013) suggests that coefficient for re*takaful* dependence is positively related to investment yield.

Method

The data were obtained based on the financial statements and additional notes of the companies of composite *takaful* operators from 2007-2018 from the Central Bank of Malaysia.
Model Specification:

$$ROI = \beta 0 + \beta 1\ PR + \beta 2\ Eq + \beta 3\ LOGSi + \beta 4\ ReT + \beta 5\ Li + \beta 6\ Und + \varepsilon\ it$$

Table 1: Proxies for Composite Takaful Operators' Financial Performance

Variables	**Measurement**	**Notation**
Return on Investment	**Method:** Gain of Investment – Cost of Investment Cost of Investment	ROI
Profit or interest rate level	**Method:** 5 year Malaysian Government Securities (MGS) 5 year Government Investment Issue (GII)	PR
Equity return	**Method:** Total equity Total asset	Eq
Company size	**Method:** Log of total asset (Total contribution earned – *Retakaful* ceded)	Si
Underwriting procedure	**Method:** Benefits paid Net contribution	Und
Liquidity	**Method:** Current Assets Current Liabilities	Li
Retakaful Dependence	**Method:** Amount of *Retakaful* Total Assets	ReT

Findings

Descriptive results

Table 2 show the descriptive statistics of the dependent and independent variables for eight composite *takaful* operators for ten years from 2007-2016. The tables illustrate the results of the mean, standard deviation, skewness, kurtosis and Jarque-Bera. The result shows that the average return from investment of composite *takaful* operators was 1.43% with a dispersion of 1.53%. This indicates that the variations of composite *takaful* operators in Malaysia will not increase above 2.96%. Furthermore, the mean value of company size was 8.25. There is significant variation across the sample *takaful* operators for the reason of the standard deviation is 0.88. Hence, the presence of significant different in term of *takaful* operators' size produce significant impact on the profitability of *takaful* operators.

Table 2: Descriptive results

Variables	ROI	Profit Rate	Equity	Liquidity	Size	Underwriting	ReTakaful
Mean	1.429333	4.196	0.172793	1.271249	8.248357	0.619121	0.054052
Median	1.3	3.43	0.108488	1.141641	8.46737	0.545868	0.031008
Std. Dev.	1.527744	4.940751	0.188769	0.699411	0.88485	0.60241	0.05531
Skewness	1.399157	3.176488	3.83513	6.159659	-1.43758	3.905333	1.519235
Kurtosis	6.710182	16.4586	17.16637	40.23818	4.247877	20.75926	4.400188
Jarque-Bera	40.49252	415.3014	486.598	2884.589	18.41951	705.7459	20.98654

The findings show that R-squared is 0.558 and it means that on average 55.8% of the variation in return on investment (ROI) can be explained by the independent variables under the model above. T-test shows that liquidity is significant with the p-value equal to 0.0495 respectively.

Table 3: Random Effect Model

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-20.7449	12.78319	-1.62283	0.1148
Profit rate	0.006384	0.038673	0.165069	0.87
Equity	0.343568	2.221646	0.154646	0.8781
Liquidity	0.581536	0.284452	2.04441	0.0495
Size	2.558765	1.511831	1.692494	0.1006
Underwriting	0.426642	0.411739	1.036195	0.3081
ReTakaful	-0.387	7.068593	-0.05475	0.9567
R-squared	0.557912			
Adjusted R-squared	0.372521			
F-statistic	3.009371			
Prob(F-statistic)	0.005865			

Correlation Test ROI has a positive relationship with equity return, liquidity, company size and underwriting procedure for composite *takaful* businesses. There were no variables detected to have correlation coefficients more than 0.8 or less than -0.8 which inferred that each variable is independent from one and another. The results show that the correlation coefficients between pairs of independent variables are less than 0.8, means that there are no serious correlations among the variables. The coefficient estimate of correlation is -0.135 for re*takaful* and the result suggest that re*takaful* has negative relationship to return on investment (ROI). Thus, the less funds channeled to re*takaful*; the better profitability it will be. In addition, profit rate signifies negative relationship to ROI. This is contradicted with most of the previous studies. One possible explanation is that during the study period; there was financial crises from 2007-2008.

Table 4. Model of Determinants of composite *takaful* operators' financial performance

Independent Variable	Composite Takaful Operators
	Random Effect Model
C	-0.982114
	0.3323
PRL	-0.440308
	0.6622
SI	1.721838
	0.0932*
TLLA	1.040067
	0.0304**
LOGTA	1.436621
	0.0159**
CGCW	0.064205
	0.9491
RTCTA	-1.006819
	0.3204
R-squared	0.162316
Adjusted R-squared	0.03005
F-statistic	1.22719
Prob(F-statistic)	0.314111
Durbin-Watson stat	0.537139

Notes:
1. *Figure in parentheses are t-statistics.*
2. ****, **, * denote significant at 1%, 5% and 10% significant level respectively.*

Conclusion

Takaful operators need to consider factors that influence the financial performance of the companies because it will affect the company's image as well as the growth of the companies in the future. The challenges faced by the composite *takaful* operators are different from the specialized type of *takaful* operators. Nevertheless, starting 2018, the composite *takaful* operators will be separated into specific business according to their line of business either family or general *takaful*. Limitation of this study is that the data should be separated into the line of businesses either family or general *takaful* business. Accordingly, the limitation can be future area of research that can be executed in order to understand and perhaps produce a model that will be unique for *takaful* operators.

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