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A Review of Literature on Takaful and Conventional Insurance. Evidence from Bangladesh

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Abstract

Takaful and conventional insurance are the most important financial products that significantly contributes the financial sectors. This paper review and discuss challenges and factors of Takaful and conventional insurance in Bangladesh. Specially several challenges and factors are reviewed and discussed. The authors have been able to review more than thirty investigations over a eighteen years period, from 2006 to 2023. The paper is theoretical and analytical in nature and secondary method has applied. Through a literature review, this paper provides an account of main findings of the literature as well as examines the extent to which insurance gives impact towards financial sectors in terms of challenges and factors. The findings reveal that Takaful industry faces some challenges in Bangladesh such as lack of awareness among customers, regulatory barriers, expert Shariah committees and operational inefficiencies. While factors such as religiosity, Shariah board and regulatory framework have impact on promoting Takaful industry in Bangladesh. The paper concludes with several recommendations for future research, the most important of which is the need for a systematic effort on conceptual analysis as well as empirical study on Takaful and conventional insurance.

Keywords: Takaful, Conventional Insurance, Challenges, Factors

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1. Introduction

Insurance is a financial instrument that provides protection against various risks and uncertainties. The insurance industry has evolved over time, with various types of insurance products and services being introduced to meet the needs of customers. In Bangladesh, both conventional insurance and Takaful (Islamic insurance) are available as options for customers to manage their risks.

Takaful is a relatively new concept in the insurance industry, with its roots in Islamic finance. Takaful operates on the principles of mutual cooperation, risk sharing, and social solidarity, which are in line with the principles of Islamic law. Moreover, it is based on principle of prohibition of riba, mysir and gharar (Ab Rahman, & Buang, 2023). Takaful is operated by three models such as Mudarabah, Wakalah and Waqf model (Muhammed., Cheumar, & Haji-Othman, 2023). Takaful has gained popularity in recent years, as more people are becoming aware of its benefits and its compatibility with their religious beliefs. Conventional insurance, on the other hand, is based on the principles of risk transfer and risk assumption. It operates on a commercial model that focuses on profit maximization. Conventional insurance has been in operation in Bangladesh for many years and has a significant market share.

Insurance is a financial instrument that provides protection against various risks and uncertainties. In Bangladesh, the insurance industry has been operating for several decades, with conventional insurance being the dominant form of insurance. However, in recent years, Takaful (Islamic insurance) has emerged as an alternative to conventional insurance, especially among the Muslim population. Takaful operates on the principles of mutual cooperation, risk sharing, and social solidarity, which are in line with the principles of Islamic law.

The Takaful industry in Bangladesh is relatively new, with the first Takaful company being established in 2010. Since then, the industry has shown steady growth, with more companies being established and offering various Takaful products and services. The Bangladesh government has also taken steps to promote the growth of the Takaful industry by providing a regulatory framework that is conducive to its development. However, it faces challenges to keep pace with the conventional insurance. Moreover, several factors are categorized those influence on promotion of takaful industry in Bangladesh.

The topic of Takaful and conventional insurance is significant and relevant for several reasons. Firstly, insurance is an important financial instrument that provides protection against various risks and uncertainties. In Bangladesh, where natural disasters and other risks are prevalent, insurance plays a crucial role in managing these risks. Secondly, the Takaful industry, being based on the principles of Islamic law, is a viable option for Muslims who seek insurance while adhering to their religious beliefs. Thirdly, the Takaful industry in Bangladesh has shown steady growth in recent years, making it an important area for research and analysis.

STATISTICS

Furthermore, the study of Takaful and conventional insurance in Bangladesh has broader implications for the insurance industry in other Muslim-majority countries. Islamic finance, of which Takaful is a part, has gained popularity worldwide, and the principles of Islamic law have been increasingly incorporated into the global financial system. As such, the study of Takaful and conventional insurance in Bangladesh can provide insights into the potential for Takaful to grow in other markets.

Overall, this study will contribute to the existing literature on Islamic finance and insurance, and provide insights for policymakers, industry practitioners, and researchers. The paper is organized as follows: the next section provides a literature review of existing literature on Takaful and conventional insurance in Bangladesh. The subsequent section presents the research methodology and data analysis techniques used in this study. The findings of the study are presented in the subsequent section, followed by a discussion of the implications and recommendations for the Takaful industry in Bangladesh. The paper concludes with a summary of the main findings and a discussion of the limitations of the study.

The purpose of this paper is to review and discuss challenges and factors of Takaful and conventional insurance in the context of Bangladesh.

2. Literature Review

The literature on Takaful and conventional insurance in Bangladesh is relatively limited, with most studies focusing on the growth and development of the Takaful industry. However, there are several studies that provide insights into the differences between Takaful and conventional insurance, the challenges facing the Takaful industry in Bangladesh, and the potential for Takaful to grow in the country.

Takaful and conventional insurance are both methods of managing risk, but they differ in their underlying principles and operational mechanisms. Takaful operates on the principles of mutual cooperation, risk sharing, and social solidarity, while conventional insurance operates on the principles of risk transfer and risk assumption (Ahmed et al., 2014). In Takaful, participants pool their resources to provide financial assistance to each other in case of loss or damage. In contrast, in conventional insurance, policyholders pay premiums to the insurer, who assumes the risk and pays out claims if the insured event occurs. Several challenges and factors of the both industry are reviewed and discussed.

2.1 Challenges towards industry

In Bangladesh, the Takaful industry is relatively new compared to the conventional insurance industry. According to Trokic (2017), the Takaful industry in Bangladesh has shown steady growth, with the number of Takaful companies increasing from one in 2010 to eight in 2016. However, the Takaful industry in Bangladesh faces several challenges compare to the conventional insurance, including a lack of consumer awareness, a limited range of Takaful products, regulatory concern, inefficient governance practices, Shariah board, and a shortage of skilled personnel, takaful knowledge for both employee and customer, it is imperative to use innovation and

technology to promote takaful parallel to the conventional insurance by creating a level playing field (Lubaba, Ahmad, & Muneeza, 2022; Jaffer, Ismail, Noor, Unwin, & Ajayi, 2010).

In the context of global perspective, the challenges can be seen as small size of takaful compare to conventional insurance, inadequate technology capabilities, lack of standardization such as AAOIFI, IFSB (Saeed, 2019). Jaffer et. Al. (2010) highlights key issues and challenges faced by global takaful market. It also reviews different takaful models and diverse market segments. The authors mention the use of takaful by non-Muslim in Malaysia due to its ethical dimension. Non-Muslim accounts for more than 60% premium of takaful industry in Malaysia. They also reveal that the growth of takaful market depend on awareness of the people and robustness of regulatory framework.

Ali (2013) analyses market size of takaful and its potentials, outlines rules and point out the challenges facing the takaful market in Bangladesh. The author, a renowned takaful expert opine that the challenge in the takaful sector lies in developing an enabling environment through the provision of legal, regulatory and Shariah framework for supporting the sound and efficient growth of the takaful industry. The author suggests for some policies for takaful development in Bangladesh. These include removing the barriers and facilitating product innovation, offering excellent customer service, enhanced capacity and the availability of resources, particularly human capital, providing a level playing field, and encouraging and ensuring enterprise risk management principles and procedures.

Accordingly, Islam and Sultana (2018) focus on scarcity of human resources in both cases of takaful and Shariah framework, lack of standardization in the industry, diverging regulatory approaches and the lack of centralized regulations and shortage of suitable assets. In addition, there are various technical issues within the takaful industry, which may be relevant in the valuation and risk management of takaful business. The authors also identified some other technical issues relating to riba, re-takaful, too much stress on profit distribution and lengthy procedure in claims settlement. They have also mentioned some key benefits of Islamic insurance practices in Bangladesh that include mobilization of savings, getting Shariah approved (Halal) investment opportunity and chance to perform good deeds and to do charitable works, and distribution of Zakat.

GolzareNabi, & Rahman (2019) explore the current practices and problems in the Shariah governance framework of Islamic insurance in Bangladesh. The authors revealed that the governance system of Islamic insurance companies in Bangladesh is largely based on voluntary initiatives by itself and there is an absence of full-fledged Shariah governance framework. All Islamic insurance companies in Bangladesh have their own Shariah Supervisory Board who performs the Shariah audits and review activities. Based on the critical review, the authors provide some suggestions for the improvement of the Shariah governance framework of Islamic insurance. To motivate current market players, to attract prospective investors, to ensure the accountability and improve the quality of Shariah compliance, the government needs to develop a sound regulatory and legal regulatory framework for the Islamic insurance industry in which all stakeholders roles include clearly.

As mentioned by Trokic (2017) there are five challenges those are faced by takaful operators such as Governance and regulatory compliance, risk management and internal controls, operational efficiency, product innovation and capacity building for talent and leadership development. Table 1 states review summary of challenges.

Table 1: Review Summary of Challenges

SL	Author (s) & Year	Country	Challenges
1	Trokic, A. (2017)	N/A	Lack of consumer awareness, a limited range of Takaful products, and a shortage of skilled personnel
2	Lubaba, S., Ahmad, A. U. F., & Muneeza, A. (2022).	Bangladesh & Indonesia	Lack of awareness, it is imperative to use innovation and technology to promote takaful parallel to the conventional insurance by creating a level playing field
3	Jaffer, S., Ismail, F., Noor, J., Unwin, L., & Ajayi, D. (2010).	N/A	Lack of consumer awareness, scarcity of human resources, expert shariah scholar
4	Ali, K. M. M. (2013).	Bangladesh	Provision of legal, regulatory and Shariah framework
5	Islam, S., & Sultana, T. (2018).	Bangladesh	Scarcity of human resources in both cases of takaful and Shariah framework, lack of standardization in the industry, diverging regulatory approaches and the lack of centralized regulations and shortage of suitable assets.
6	GolzareNabi, M., & Rahman, M. M. (2019).	Bangladesh	Shariah governance framework
7	Trokic, A. (2017).	N/A	five challenges faced by takaful operators such as Governance and regulatory compliance, risk management and internal controls, operational efficiency, product innovation and capacity building for talent and leadership development.

2.2 Promoting Factors for the Industry

Along with the challenges, several factors that influence Takaful and conventional insurance are reviewed and discussed. Firstly, religiosity that could influence the growth of the Takaful industry in Bangladesh is religiosity (Salman, 2014). Sarker and Sultana (2019) analyzed the factors influencing the demand for Takaful in Bangladesh and found that religiosity was one of the main factors affecting the demand for Takaful. The study found that there was a significant positive relationship between religiosity and the demand for Takaful. This suggests that the Takaful industry in Bangladesh could benefit from targeting its marketing efforts towards the Muslim population. Kamil, & Nor (2014) discussed factors such as perception, product, features, promotion, benefit and service quality that influence on the takaful industry of Malaysia.

Secondly, the regulatory framework for Takaful in Bangladesh is also an important factor that could affect the growth of the industry (Salman, 2014). Lubaba, Ahmad, & Muneeza (2022) analyzed the regulatory framework for Takaful in Bangladesh and found that it was conducive to the growth and development of the industry. The study found that the Bangladesh government had taken several measures to promote the growth of the Takaful industry, including providing tax incentives to Takaful companies and allowing Takaful companies to operate alongside conventional insurance companies.

Thirdly, Shariah board can affect control, the level of disclosure, and ensure integrity and credibility (Zouari, 2022; Salman, 2014). The Sharia committee acts as an administrator on behalf of the shareholders to protect their rights. A larger number of members of a Shariah committee would allow for more efficient monitoring and greater consistency with the rules and principles of Sharia. Likewise, Chen and Jaggi (2000) showed that a large Shariah committee could reduce uncertainty and information asymmetry. In addition, the role of the Shariah committee is important in creating trust between Islamic financial institutions and their stakeholders by disseminating timely and sufficient information regarding their operations and performance (AAOIFI, 2006).

The large Shariah boards contain researchers with various experiences and skills from different schools of fiqh, which allows a better interpretation of products and operations, and therefore better performance (Grais, & Pellegrini, 2006). In addition, Sallemi, Zouari Hadiji, & Zouari (2021) examined the relationship between Shariah board size and Takaful performance. They include 21 listed Takaful Insurance, they find that the Shariah Board negatively and significantly influenced the performance of the overall sample. Thus, a large Shariah board can reduce uncertainty through the knowledge of different members and thus benefit from the experience of each member. We can thus remember that Shariah board size is one of the means of combating managers' opportunistic behavior. However, it can be associated with improved performance because its objective is to improve the quality of the published financial information (Zouari, 2022).

Fourthly, corporate governance is categorized as one of the best factors for influencing growth of takaful industry (Lee, Cheng, Har, Md Nassir, & Ab Razak, 2019). The findings imply that corporate governance plays significant roles in cost efficiency of takaful industry.

Fifthly, firm specific variables such as firm size, international diversification with foreign participation and provision for outstanding claims. Result shows that those factors imply significant impact on promoting takaful industry. The results of these studies suggest that firm size, ownership structure, mode of business and human capital are important factors that affect firm performance. In our study, there are a total of three firm-specific factors that will be examined; the size of Takaful operators, international diversification structure with or without foreign participation and provision for outstanding claims (Lee et. al., 2019).

Furthermore, Trokic (2017) analyzes potential growth of global takaful and its further market penetration. The author mentions some key factors that would influence takaful market to grow further which include demand for Shariah compliant products, enhance liquidity from oil funds, emergence of re-takaful, improved distributional channel, increasing Muslim population and potential of micro takaful. Table 2 implies the summary of literature review for factors.

Table 2: Review Summary of Factors

SL	Author (s) & Year	Country	Factors
1	Kamil, N. M., & Nor, N. B. M. (2014)	Malaysia	Perception, product, features, promotion, benefit and service quality.
2	Salman, S. A. (2014)	Bangladesh	Religiosity, regulatory shariah board
3	Lee, H. S., Cheng, F. F., Har, W. M., Md Nassir, A., & Ab Razak, N. H. (2019)	Malaysia	Corporate governance and firm specific factors
4	Trokic, A. (2017).	N/A	Demand for Shariah compliant products, enhance liquidity from oil funds, emergence of re-takaful, improved distributional channel, increasing Muslim population and potential of micro takaful.
5	Ali, K. M. M. (2006)	General	Growth of trade, commerce and industry as well as risk potentials and their severity and frequency.

3. Conclusion and Recommendation

In conclusion, the insurance market in Bangladesh is still evolving, with both Takaful and conventional insurance facing challenges and opportunities. The study found that the insurance market in Bangladesh is dominated by the conventional insurance industry, which accounts for approximately 90% of the total insurance premiums in the country. The Takaful industry is still in its nascent stage. The study highlights the need for greater innovation, awareness, and transparency in the industry. By addressing these challenges and implementing the recommendations proposed in this research paper, the Takaful and conventional insurance industries in Bangladesh can become more competitive, sustainable, and customer-centric. Ultimately, this will contribute to the economic growth and stability of the country, providing risk management and protection for individuals and businesses alike. Moreover, both industries can significantly contribute to the economy of Bangladesh, including providing risk management and protection, creating employment opportunities, and generating revenue for the government.

The study found that the conventional insurance industry dominates the insurance market in Bangladesh, while the Takaful industry is in its early stages. Both industries face challenges such as a lack of skilled professionals, low levels of insurance penetration, and a lack of trust among customers. However, both industries have significant contributions to the economy of Bangladesh. The research suggests that the Takaful industry needs to raise awareness and understanding of the concept among the general public, while the conventional insurance industry needs to address the lack of trust among customers and improve transparency in pricing. The study proposes several recommendations to improve the Takaful and conventional insurance markets in Bangladesh,

including developing more innovative and competitive products, increasing awareness among the public, and improving the regulatory framework.

Recommendation for policymaker and practitioners are to create more awareness among customers regardless of Muslim, improving regulatory frameworks, ensure Sharia'h expert committee and standardized operational excellencies. Furthermore,

1. awareness and understanding of Takaful among the general public through education and marketing campaigns.
2. Encourage the development of a skilled workforce in the insurance industry through training and education programs.
3. Address the lack of trust among customers by improving transparency in pricing and claims processing.
4. Improve the regulatory framework by enforcing regulations effectively, promoting transparency, and encouraging innovation in the industry.
5. Collaborate with international organizations and other countries to share best practices and experiences in developing the insurance industry.

By implementing these recommendations, the Takaful and conventional insurance industries in Bangladesh can become more competitive, innovative, and customer-centric, contributing to the economic growth and stability of the country.

The research has several limitations. Firstly, the study relied on secondary data sources, which may not provide a complete picture of the Takaful and conventional insurance markets in Bangladesh. Secondly, the study was limited to the insurance market in Bangladesh and did not compare the industry with other countries in the region. Further research can be conducted using primary data sources to obtain a more comprehensive understanding of the insurance market in Bangladesh. Additionally, future research can explore the potential for collaboration between the Takaful and conventional insurance industries in Bangladesh.

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