



UNIVERSITI PUTRA MALAYSIA

***DETERMINANTS OF DEMAND, EFFICIENCY AND GROWTH OF THE
GLOBAL TAKAFUL INDUSTRY***

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**DETERMINANTS OF DEMAND, EFFICIENCY AND GROWTH OF THE
GLOBAL TAKAFUL INDUSTRY**

By

IBRAHIM MUYE MUHAMMAD

**Thesis Submitted to the School of Graduate Studies, Universiti Putra Malaysia,
in Fulfillment of the Requirements for the Degree of Doctor of Philosophy**

September 2016

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DEDICATION

“All that I am, or hope to be, I owe to my angel mother” Abraham Lincoln
To Hajiya Umairatu Ajuji Muhammad, the epitome of love and sacrifice.



Abstract of thesis presented to the Senate of Universiti Putra Malaysia in fulfillment of the requirement for the Degree of Doctor of Philosophy

DETERMINANTS OF DEMAND, EFFICIENCY AND GROWTH OF THE GLOBAL TAKAFUL INDUSTRY

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September 2016

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Since its introduction over three decades ago, Takaful has witnessed remarkable growth in key markets such as the ASEAN and GCC. According to estimates, the global Takaful market is expected to grow continuously on a double digit momentum of 14%. The total contribution was estimated to be US\$26 billion as at the end of 2015 and expected to exceed US\$42 billion by the year 2020. Studies have previously investigated the factors that influence industry growth, but what drives Takaful growth across markets largely remains unclear.

Therefore, this research aims at exploring the factors that drives the growth and development of this sector in light of demand, governance, and supply. Using the difference GMM and the data envelopment analysis estimation methods. The empirical findings show that economic factors- such as income, financial sector development and inflation- and demographic factors- such as level of education, life expectancy, and old dependency ratio are the strongest predictors of Takaful demand. Religion and young dependency ratio do not appear to strongly drive Takaful demand. With respect to the efficiency and governance characteristics of the industry, the bias-corrected DEA score shows that at best, Takaful firms are inefficient due to their size while the second stage Tobit regression indicate that non-executive directors, audit committees, and product diversification do not improve technical efficiency while audit committees and regulatory jurisdiction tends to reduce scale efficiency. However, separation of office of chairman and CEO, board size, organizational age, regulatory jurisdiction and firm size have positive effect on technical efficiency, while non-executives, Shari'ah board, product diversification and institutional ownership improves scale efficiency. Further, the relative effect of the board characteristics, for example ratio of non-executives on the technical and scale efficiencies of Takaful firms depends on its interaction with other governance characteristics like board size. Therefore, the outcome of governance mechanism on the efficiency of these firms may involve several other company-specific factors. Finally, for the supply of Takaful products and services, the empirical result from the difference GMM estimation indicates that globalization and institutions are indeed

important for the growth of this sector. Financial openness and institutional quality are found to be positive and significant while trade openness appears to be negatively significant. The negative effect from trade openness may be linked to ineffective trade policies in these countries. Furthermore, in terms of the sequence of openness, the empirical result from the GMM estimation fails to support the simultaneous openness hypothesis of Rajan & Zingales, rather, Mckinnon's sequencing hypothesis seem more appropriate.

The results underscore the significance of economic & demographic factors, and globalization in fulfilling the growth potentials of Takaful or in increasing the growth momentum of Takaful. Given that globalization and institutions are also important to the growth of Takaful, then effective globalization and institutional reform policies can be important for policymakers in attempting to accelerate Takaful growth, financial development and savings. The findings from this study could have important commercial and policy implications to countries that have already adopted Takaful insurance.

Abstrak tesis yang dikemukakan kepada Senat Universiti Putra Malaysia sebagai memenuhi keperluan untuk Ijazah Doktor Falsafah

PENENTU PERMINTAAN, KECEKAPAN DAN PERTUMBUHAN INDUSTRI TAKAFUL GLOBAL

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Sejak diperkenalkan lebih tiga dekad lalu, sektor Takaful telah menyaksikan pertumbuhan yang luar biasa dalam pasaran utama seperti ASEAN dan GCC. Menurut anggaran, pasaran Takaful global dijangka berkembang secara berterusan pada momentum dua kali ganda sebanyak 14% dengan jumlah sumbangan dianggarkan sebanyak US\$26 bilion pada akhir tahun 2015 dan ia dijangka akan meningkat kepada US\$42 bilion menjelang tahun 2020. Hasil dapatan daripada kajian sebelum hanya menekankan kepada faktor yang mempengaruhi pertumbuhan industri sedangkan aspek yang mendorong kepada kadar pertumbuhan Takaful di seluruh pasaran masih sebahagian besarnya tidak jelas.

Oleh itu, kajian ini dijalankan adalah bertujuan untuk mengkaji apakah faktor-faktor yang boleh mendorong kepada pertumbuhan sektor Takaful dengan memandangkan kepada aspek permintaan, tadbir urus, dan penawaran. Kajian ini menggunakan kaedah perbezaan GMM dan analisis data selubungan. Hasil dapatan empirikal bagi kajian ini menunjukkan bahawa faktor-faktor ekonomi seperti pendapatan, pembangunan sektor kewangan dan inflasi serta faktor demografi seperti tahap pendidikan, jangka hayat, dan nisbah tanggungan tua adalah pengaruh utama dalam menentukan permintaan terhadap sektor Takaful. Manakala aspek agama dan nisbah tanggungan muda tidak kelihatan mempunyai pengaruh yang kuat dalam menentukan jumlah permintaan ke atas Takaful. Dengan merujuk kepada faktor-faktor yang boleh mempengaruhi kecekapan dan ciri-ciri tadbir urus dalam industri, kaedah analisis DEA berat sebelah diperbetulkan menunjukkan bahawa syarikat Takaful adalah tidak cekap berdasarkan kepada faktor saiz manakala regresi Tobit di peringkat kedua menunjukkan bahawa pengaruh bukan eksekutif, jawatankuasa audit, dan kepelbagaian produk tidak dapat mempengaruhi kadar kecekapan secara teknikal berbanding jawatankuasa audit dan bidang kuasa peraturan adalah cenderung untuk mengurangkan skala kecekapan. Walau bagaimanapun, ciri-ciri seperti pengasingan jawatan antara Pengerusi dan Ketua Pegawai Eksekutif, saiz lembaga pengarah, jangka hayat organisasi, bidang kuasa kawal selia dan saiz firma menunjukkan kesan yang positif ke atas kecekapan teknikal, manakala Pegawai

bukan eksekutif, lembaga Shari'ah, kepelbagaian produk dan pemilikan ke atas institusi telah meningkatkan skala kecekapan. Di samping itu, kesan relatif seperti ciri-ciri lembaga pengarah sebagai contoh nisbah pegarah bukan eksekutif terhadap kecekapan teknikal dan skala syarikat Takaful bergantung kepada cara interaksinya dengan ciri-ciri tadbir urus lain seperti saiz lembaga pengarah. Oleh itu, hasil daripada mekanisma tadbir urus kepada kecekapan syarikat ini juga melibatkan beberapa faktor lain khusus syarikat. Akhir sekali, hasil kajian empirikal daripada perbezaan GMM menunjukkan bahawa globalisasi dan institusi amat penting dalam menentukan kadar pertumbuhan terhadap jumlah penawaran produk dan perkhidmatan Takaful. Amalan terhadap konsep keterbukaan kewangan dan kualiti institusi menunjukkan kesan positif yang ketara berbanding konsep keterbukaan perdagangan telah menunjukkan kesan negatif yang begitu ketara. Kesan negatif daripada amalan keterbukaan dagangan juga boleh dikaitkan dengan ketidak keberkesanan ke atas dasar-dasar perdagangan negara. Tambahan pula, dari segi urutan keterbukaan, hasil empirikal dari anggaran GMM gagal untuk menunjukkan keterbukaan hipotesis secara serentak Rajan & Zingales, sebaliknya penjujukan hipotesis secara McKinnon ini adalah kelihatan lebih sesuai.

Hasil daripada dapatan kajian ini menunjukkan faktor ekonomi dan demografi, dan globalisasi adalah penting dalam memenuhi potensi pertumbuhan Takaful atau meningkatkan momentum terhadap pertumbuhan Takaful. Bahawasanya globalisasi dan institusi adalah penting dalam menentukan kadar pertumbuhan sektor Takaful di mana globalisasi yang berkesan dan dasar pembaharuan dalam institusi boleh menjadi faktor yang penting dalam usaha menggubal dasar-dasar untuk mempercepatkan pertumbuhan sektor Takaful, pembangunan kewangan dan simpanan. Penemuan daripada kajian ini adalah penting dalam mengkaji keberkesanan terhadap sektor perdagangan dan implikasi terhadap penggubalan dasar kepada negara-negara yang telah pun menerima pakai insurans Takaful.

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Finally, I am delighted to acknowledge all that I owe to my parents, especially my mother whom I owe so much. The best I can say to them is “My Lord! Bestow on them Your mercy as they did bring me up when I was small” (Q17:24).

I certify that a Thesis Examination Committee has met on 22 September 2016 to conduct the final examination of Ibrahim Muye Muhammad on his thesis entitled "Determinants of Demand, Efficiency and Growth of the Global Takaful Industry" in accordance with the Universities and University Colleges Act 1971 and the Constitution of the Universiti Putra Malaysia [P.U.(A) 106] 15 March 1998. The Committee recommends that the student be awarded the Doctor of Philosophy.

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LIST OF ABBREVIATIONS

ASEAN	Association of Southeast Asian Nation
BODs	Board of Directors
CG	Corporate governance
DEA	Data Envelopment Analysis
FDI	Foreign Direct Investment
FP	Financial Performance
GCC	Gulf Cooperation Council
GDP	Gross Domestic Product
GMM	Generalized Method of Moments
IFI	Islamic Financial Institutions
PBUH	Peace be upon him
SB	<i>Shari'ah</i> Board
SC	<i>Shari'ah</i> compliant

CHAPTER 1

INTRODUCTION

1.1 Overview

The Islamic insurance industry is growing to be a significant part of the Islamic financial system (IFS), taking a leading role in countries such as Sudan, Iran, Indonesia, Malaysia and the Gulf region (Swiss Re, 2013). It has been experiencing healthy growth since its inception in the 1970s. This research effort addresses three key issues relating to the performance, growth and development of the Islamic insurance industry (henceforth, Takaful). The first issue covers the demand for, or consumption of Takaful products and services. Previous research highlights that the degree of insurance demand and consumption within a country can be affected by variables such as social, economic, political, and legal factors (Ward & Zurbrugg, 2002; Beck & Web, 2002; Browne et al. 2000; Kim & Browne, 1993). However, researchers such as Li et al (2007) observe that some countries experience an increase in insurance demand with the level of education and number of dependents, and the demand becomes less with an increase in social security spending and life expectancy.

Furthermore, a few studies have appeared over the last few years to suggest that religion could be a deciding factor in the decision to purchase insurance; this is particularly the case in Muslim dominated markets with insurance demand, especially life insurance being at a very minimal rate (see Beck & Web, 2003). This is because, aside the investment policies of the insurance companies, Islam does not permit the conventional life insurance policy. In contrast, Takaful investment policies are purely Shariah-compliant (SC) and therefore it does not offer life insurance policies (although the family Takaful is similar to the life policy).

Many studies have alluded to the key drivers for insurance demand, especially life insurance demand (see Li et al. 2007; Kjosevski, 2012; Hwang & Gao, 2003; Lewis, 1989) but few have investigated factors driving Takaful purchase (for example Sherif & Shaairi, 2013; Gustina & Abdullahi, 2012; Shukri et al., 2012), and again, the limited research in this area are mostly related to only a segment of Takaful (i.e., family Takaful). Hence, it is important to study the driving forces influencing the demand for, or consumption of Takaful insurance across different markets.

The second issue that this research aims to investigate relates to the institutional policies that influence the supply of Takaful products and services through globalization, which includes liberalization of the trade and financial sectors of the economy. The substantial increase in the amount of capital flows globally and the increased cross-border movements of goods and services, evidenced by the amount of international foreign direct investment (FDI) could play a key role in the supply of risk management services by practitioners. In addition, the continuous diffusion of

different economies through globalization could prompt the provision of some kind of hedging mechanism. Researchers have explored the impact of liberalization on financial sector development and growth (see Beck, 2002; Klein & Olivei, 2008; Baltagi et al. 2009), yet many others have studied empirically the effect of FDI on financial sector development (for example Otchere, Soumare, & Yourougou, 2015; Soumare & Tchana Tchana, 2015; Agbloyor, Abor, Adjasi, & Yawson, 2013; Malik & Amjad, 2013; Adam & Tweneboah, 2009).

However, a major concern with such studies is that they are somewhat generalized and ambiguous¹. Recent studies show that liberalization improves the banking sector and equity markets (see Henry, 2000), others have attempted to demonstrate the relationship between globalization and the insurance market (see Lee & Chen, 2012; Chen et al. 2013; Zhang, 2008). However, the literature is yet to empirically show how liberalization and the globalization process influence the supply of Takaful services, leading to its growth and development. This, therefore, stimulates further enquiry. As a result, it is important to not only understand the role of policymakers in facilitating the provision of Takaful insurance but also to ascertain which of the liberalization policies contribute to increasing the growth of this key sector.

A further issue that has failed to receive the necessary attention from researchers relates to the governance mechanism adopted in the Takaful industry. After all, Boards of Directors (BODs) are responsible for the alignment of the interests of shareholders and managers, thus minimizing information asymmetry and agency costs. It is well accepted that a weak corporate governance (CG) mechanism leads to poor performance by a firm in the market (Bauer, Frijns, Otten, & Tourani-Rad, 2008; Bhagat & Bolton, 2008; Bauer, Guenster, & Otten, 2004; Klapper & Love, 2004; Mitton, 2002; S. Johnson, Boone, Breach, & Friedman, 2000; Core, Holthausen, & Larcker, 1999). Given that the duty of the board, is to monitor the affairs of the management team, and that the performance of the firm, ultimately, depends on the board fulfilling its responsibilities. Although, these duties are numerous, but the three most significant responsibilities according to Johnson, Daily, and Ellstrand (1996) include service, control and resource dependence. The importance of boards and their composition has been a subject of intense debate since the corporate scandals in the American market (see Cheng, 2008; Coles, Daniel, & Naveen, 2008)

Moreover, a strand of the literature argues that a larger number of non-executives on the board is key to its effectiveness (see Gales & Kesner, 1994; Pathan & Faff, 2013). Other researchers highlight that size matters when it comes to its performance and effectiveness (see Coles et al. 2008; Gales & Kesner, 1994; Pathan & Faff, 2013) whilst others believe the frequency of meetings matter and yet there is a section of researchers that do not believe in the postulation of the aforementioned groups (see Cheng, 2008). In general, the arguments postulated in the literature are ambiguous but it cannot be denied that BODs play a crucial role in the performance

¹ They are based on the banking sector and stock market, the limited studies that focus on the insurance sector are scarce.

of any company. In the context of this study, Takaful companies are required to have a Shariah board (SB) in place, however, the size, composition or structure of these boards is not determined and is company dependent². Even with the impressive performance of the sector, to date, researchers have not yet studied the governance mechanisms of the companies that operate in this unique and distinct industry. Therefore, a detailed study on these important organs, i.e. BODs and SB may provide an interesting insight into the mechanisms that may propel Takaful growth.

This research will, therefore, examine these three issues discussed above. Section 1.1 provides a brief background to the study; subsection 1.2 highlights the research problems and issues. Subsection 1.3 lists the research objectives while subsection 1.4 deals with the significance of the study and lastly, the organization of the study is given in subsection 1.5.

1.2 Background to the Study

During the past five decades, a remarkable growth has been witnessed in the insurance sector of the global economy. From the 1950s to the end of the 1980s, the insurance industry around the world had experienced an annual growth rate exceeding 10 percent (Browne & Kim, 1993) while having been seriously affected by the financial crisis that destabilized the Asian region in the mid-1990s, and later the world financial setback of 2007/2008, the global gross insurance premiums (the non-life insurance and life premiums), recorded a compound annual growth rate (CAGR) above 5 percent from 1994 to 2011 (Swiss Reinsurance Company (Swiss Re., 1996; 2012). The sector has now become an important segment in the service sector.

The sector, especially the life insurance market have, over the years, grown to become a vital source of capital for investment and consumers have derived a wide range of financial services from it (Beck & Web, 2003). For thirteen countries, the gross assets of life insurers constituted 11 percent of their gross domestic product (GDP) between the period 1980 to 1985, while this percentage more than doubled to 28 percent for the same set of countries for the period 1995 to 1997 (Beck & Web, 2003) and in nineteen (19) countries the amount of penetration recorded from the period 1961 to 1965 was 1.2 percent which grew to 4.2 percent between the period 1996 to 2000 for the same countries (Chen, Cheng, Pan, & Wu, 2013). Entering the millennium, the gross premium of the world insurance market amounted to above US\$2 trillion, of which life insurance recorded US\$1.5 trillion (about 62.3%) and non-life was US\$922.4 billion (about 37.7%) (Swiss Re, 2001).

² Except for Malaysia, where the regulation requires a minimum of three members. For more details, see Bank Negara Malaysia (2012)

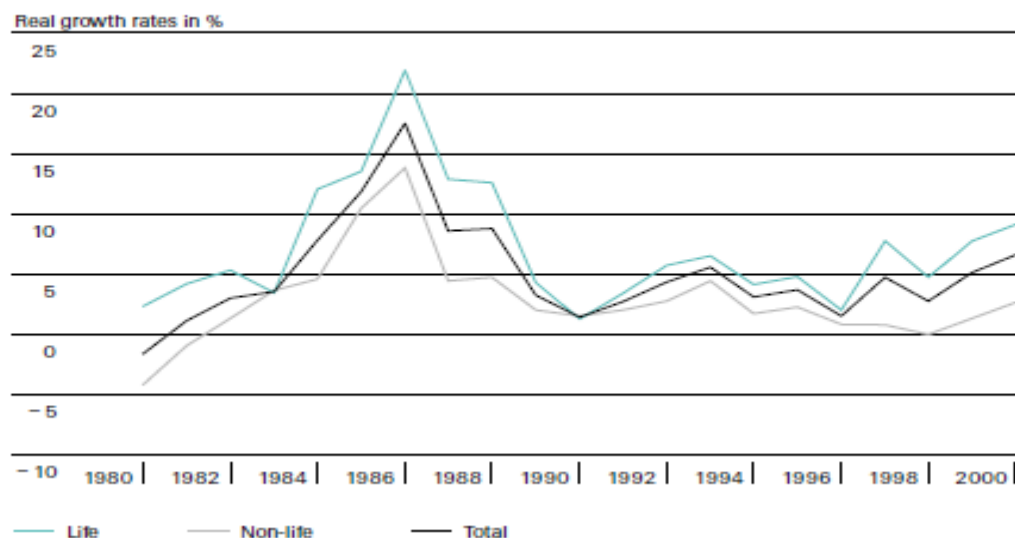


Figure 1.1 : Global Premium Vol. 1980-2000
(Source: Swiss Re, Sigma No. 6/20)

Regionally, during the same period, most of the regions recorded or equaled their forecasted growth averages on the long-term excluding the Oceania which recorded a growth in the life insurance and the Middle East in the non-life insurance significantly lower than their 10-year average, while the emerging markets fared well during the said period (Swiss Re, 2001).

There were diverse growth levels in the life insurance business, recording growth in the range of 30 percent for both the emerging economies and the developed world, with most of the countries witnessing a growth rate exceeding that of their respective economies, scoring twice as the GDP. The non-life insurance premiums, on the other hand, grew at a slower pace than the life business. On average, the emerging markets recorded a 16 percent growth entering the millennium while the industrialized markets grew an average of 22 percent. This growth had been in line with the economic growth in the industrialized markets but slightly higher in the emerging markets. The insurance market, in other words, increased greatly around the world (Swiss Re, 2001). The growth in the non-life business was influenced, however, by the long-term economic development only; while, in the short term, only the price cycle was affected (Chen et al. 2013).

Although this growth was negatively affected during the decade (especially during the global financial meltdown), the market returned to growth in 2012, with significant difference across the various markets. According to the report by Swiss Re (2013), the total life insurance premiums grew around the world by 2.3 percent in 2012 to increase to above US\$2 trillion, with the bulk of this mainly witnessed in the emerging markets, although this growth level is still below the pre-financial crisis average.

In the market divide, aided to a great extent by the performance in the United States and advanced Asian nations, insurance grew by 1.8 percent. The US premiums increased by 2.3 percent while advanced Asia recorded 8.8 percent. On the other hand, life premiums in the emerging markets increased by 4.9 percent, with the entire key markets recording improved performance (Swiss Re, 2013). The non-life premiums also grew globally, increasing by 2.6 percent with the emerging markets being the chief drivers. Premiums improved by 1.5 percent in the advanced economies supported in some countries by price increases. Growth level was 5.8 percent in the advanced Asian countries, with the emerging markets also experiencing a strong growth of 8.6 percent (Swiss Re, 2013). In all, the past five decades have been robust for the general insurance market. Market penetration has seen an increase from 1962 to 2012 in all the major economies around the world, although a decline was witnessed during the financial meltdown that affected the world economy (Swiss Re, 2013).

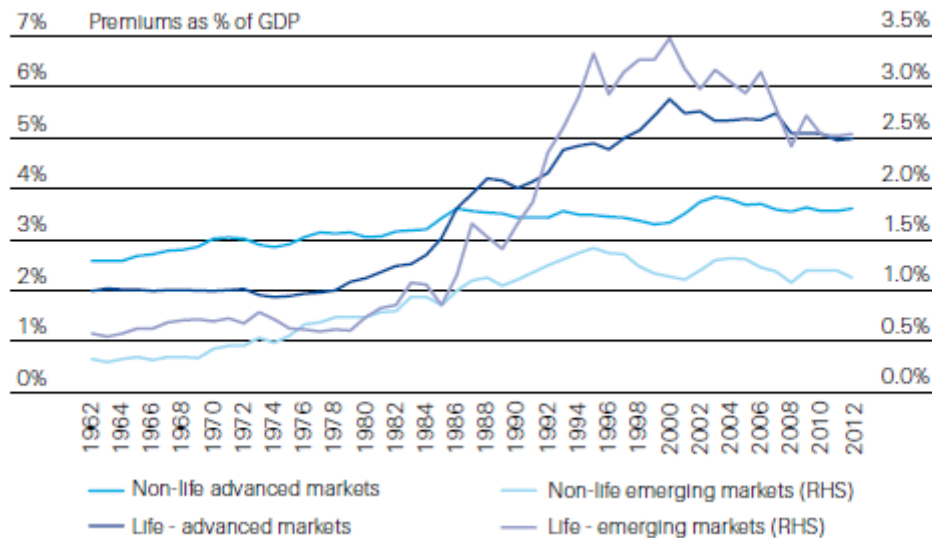


Figure 1.2 : Life and non-life insurance growth 1962-2012
(Source: Swiss Re Economic Research & Consulting)

For a very long time, the insurance industry is known to be the provider of risk management for the financial sector, making vital contributions to the banking sector growth and development through the various activities of insurance firms, especially in the area of secured lending. The sector helps facilitates cross-country commerce and international trade, thereby generating revenue. Insurance activities could also cause a boom in the local economy by investing in the bond and stock markets, with the system of long-term premium. In some environments, insurance activities spur globalization, which leads to economic growth (Chen et al. 2013).

The concept of insurance is built on a risk-transfer mechanism and a lack of investment restriction aside those imposed for reasons of prudence, which totally

goes against business ethics in Islam. This has led to the introduction of the concept of Takaful which has also been witnessing equal or superior growth to the conventional insurance since its inception. Since its commencement in the late 1970s, Takaful has been experiencing persistent, unbroken growth which has been double-digits. The global gross Takaful contributions are estimated to be in the region of US\$19.87 billion (KFH, 2013), with a 15% year-on-year growth as at the end of 2013 (MIFC, 2014) and according to Ernst & Young (2014), the global Takaful market is estimated to continue its double-digits growth momentum of about 14% in 2014, and by 2017, the global Takaful industry may reach over US\$20 billion.

The global Takaful grew between the period 2004 and 2007, from a contribution of US\$2.1 billion to US\$3.4 billion, equivalent to a CAGR of about 30%, with the largest markets being Saudi Arabia and Malaysia (Ernst & Young, 2008).

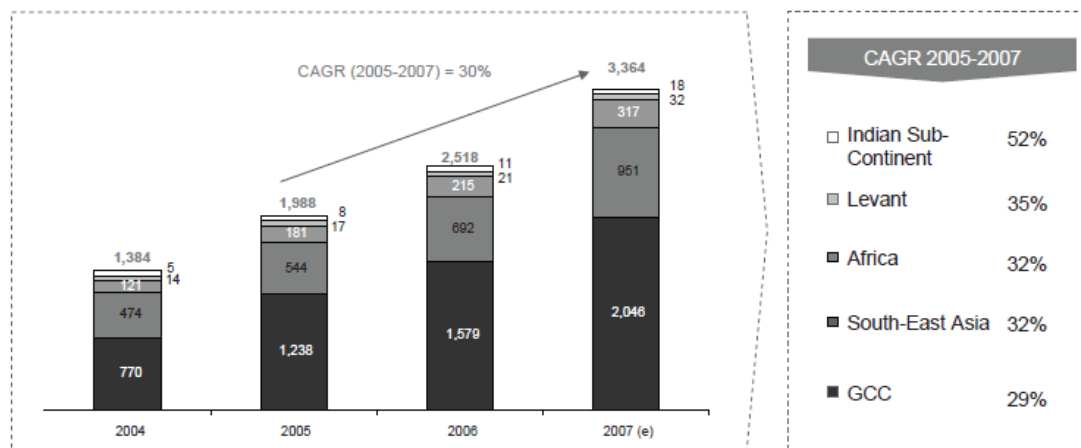


Figure 1.3 : Global gross Takaful contributions by year (US\$m)
(Source: Ernst & Young analysis WTR08)

In terms of regional growth, the GCC³ had the highest growth rate of 45% (CAGR) with Saudi Arabia contributing US\$2.9 billion to the gross premium, while the fastest growing was the U.A.E, while the South East Asian market grew 28%, with Malaysia being the biggest market for the period 2005-2008 (Ernst & Young, 2010).

³ Gulf Cooperation Council

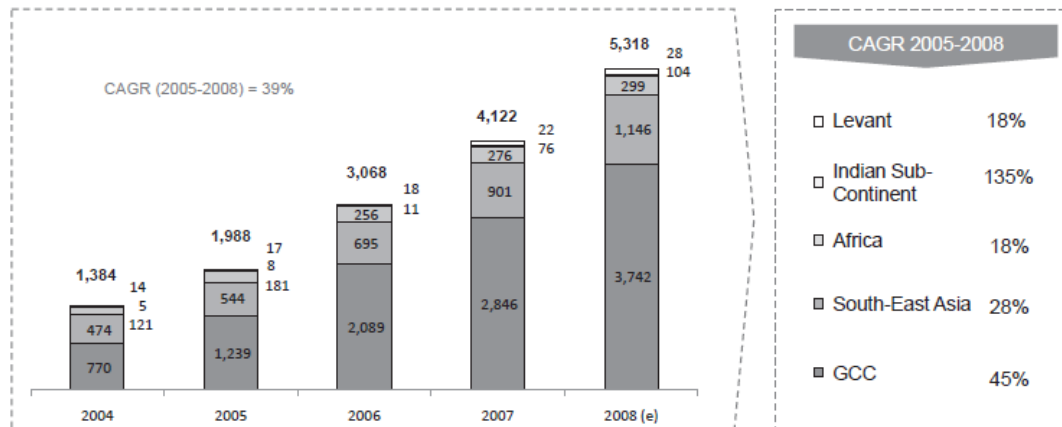


Figure 1.4 : Global gross contribution 2005-2008
(Source: Ernst & Young analysis 2010)

Within the same period, other markets also experienced growth of 28%, with Sudan being the most important player. Growth continued in the sector unabated, adjusted for global inflation, the growth rate of the sector was 28% annually between 2007 and 2010, surpassing the conventional insurance, which grew by 5% in the respective Muslim countries and 8.1% in the emerging economies during the period. Malaysia averaged 20% annually, Indonesia 33% while in the Gulf Cooperation, both Saudi Arabia and the UAE increased at above 30% (Ernst & Young, 2011).

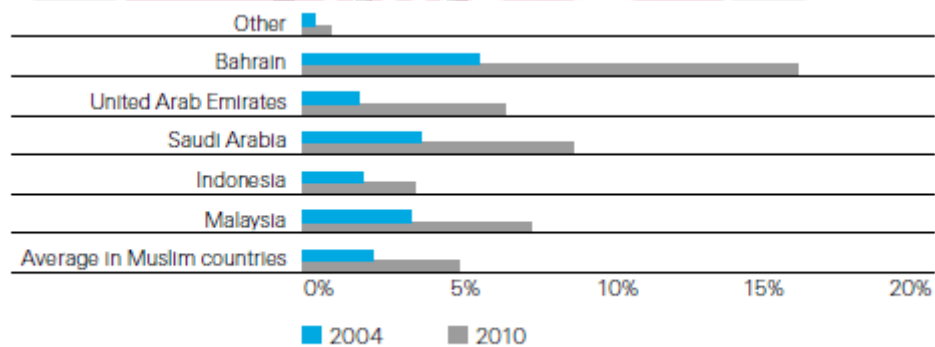


Figure 1.5 : Takaful penetration in Muslim Countries
(Source: Economic Research and Consulting, Swiss Re 2011)

Overall, total world Takaful contributions have been increasing and forecasted to exceed US\$14 billion in the year 2014, from an estimated sum of US\$12.3 billion in the year 2013. Although the growth rate has slumped from 22% CAGR between 2007 and 2011, the sector is still growing at an enviable, healthy level of 14%-15% between the period 2012 and 2014.

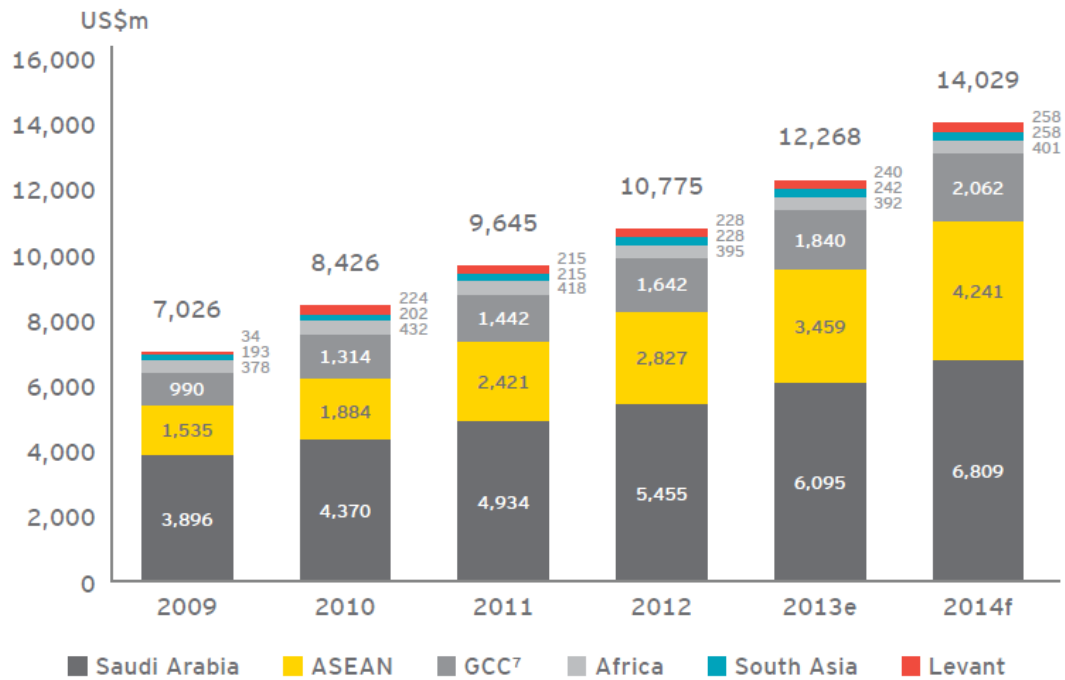


Figure 1.6 : Global gross Takaful contributions by region, 2009-2014f
(Source: Ernst & Young 2014)

Despite the surprising double-digit growth rate the sector has been witnessing, the industry is still a small segment of the IF market. While the global Takaful market, especially in the GCC and ASEAN⁴, has increased rapidly and the internationalization of the Takaful business is becoming more prevalent, the area has not been greatly studied. Thus, empirical research is required to determine the variables that drive this growth and performance; however, it is a surprise that to some extent, there are few or no studies about the growth of the Takaful sector for a better understanding of the industry. Rationally, for a product and service industry growth, the basic ingredients are; the demand for its products and services, the policies that aid the smooth supply of those products and services, and lastly the governance and daily management of the firms operating in such industry.

Previous studies have examined several factors when investigating the demand for insurance (for example Hussels, Ward, & Zurbruegg, 2005; Ben-Arab, Briys, & Schlesinger, 1996; Meyer & Meyer, 1998), while some have studied the factors that determine demand for family Takaful, focusing mainly on Malaysia (see Sherif & Shaa'iri, 2013; Arifin, Yazid, & Sulong, 2013), there are few or no researchers that have studied the determinants of Takaful demand across different markets.

The issue of financial performance (FP) or firm growth has long been under the microscope of researchers and policy makers alike. Previous studies have tested the

⁴ Association of Southeast Asian Nations

impact of CG characteristics on company performance (see Cheng, 2008; Brown & Caylor, 2006; Filatotchev, 2005; Brenes et al. 2011; Core et al. 1999). Examining the relationship between CG and FP, Guo and KGA (2012) showed evidence that board size and ratio of non-executive directors are negatively related with company performance while Jackling and Johl (2009) on the other hand gave support of a positive linkage between proportion of external directors, board size, and FP of firms. A lot of other analyses (such as Adams & Mehran, 2012; Basu et al. 2007; Bennedsen et al. 2008; Bhagat & Bolton, 2008; Pathan & Faff, 2013; Arosa et al. 2010; Brenes et al. 2011; Cheng, 2008; Core et al. 1999; Judge et al. 2003) have also explored the relationship or influence of CG on organizational performance. However, none of the previous studies have examined this relationship or the effect of CG mechanisms on FP in the Takaful industry despite the fact that the Takaful industry has a different governance system due to the presence of the Shariah Board.

Researchers have argued that globalization and financial liberalization strictly determine economic growth (e.g. Cheng et al. 2013; Berggren & Jordahl, 2003) while economic growth leads to financial development (see Bekaert et al. 2005; Levine, 1997). In recent years, we have been witnessing impressive growth in the Takaful market, especially in the GCC and some parts of ASEAN. Given the procedure of financial liberalization and integration, questions are raised on whether globalization and capital account openness affects the Takaful market activities. Some scholars (e.g. Chen et al. 2013; Lee & Cheng, 2012) report that globalization spur insurance market development. The Takaful industry plays a significant role in the Muslim world where there is an aversion to the risk-transfer and “unethical” business model of the conventional insurance, to facilitate some economic transactions by way of risk-sharing and ethical investment but the studies above are based on the conventional market and surprisingly, there is no study that analyzed such relationship in the Takaful sector.

1.3 Problem Statement

Over the last few decades, there has been a rapid growth of the Islamic financial services sector, which has continued to gain wider acceptance even beyond the boundaries of Muslim-dominated economies. It is now offered in over 60 countries, moving as a niche commodity serving a specialized segment of the market to the whole market (Sherif & Shaairi, 2013). Due to its increasing integration with the world financial system, the internationalization of IF has gained considerable importance and has emerged in an increasingly challenging global financial market, which is characterized by uncertain and volatile conditions, to be a formidable and competitive form of financial intermediation.

With this expansion and growth of the Islamic financial system (IFS), the Takaful industry, a subsector of the IFS has also been experiencing significant growth and development, pointing to the relative importance of Islamic insurance as a means of protection against unforeseen occurrences without breaching the Shariah law. Since its introduction in Sudan in 1979, it has made remarkable progress into other regions and economies as seen in the ever-increasing amount in contributions as well as the

increasing number of operators globally. The total global Takaful premiums are estimated at US\$19.87 billion at the end of 2013 (MIFC, 2014) and expected to exceed US\$20 billion by the year 2017 (Ernst & Young, 2014), the industry has emerged as one of the most significant constituents of the IFS contributing to economic development of several countries and despite the turbulent global financial market condition, it has turned out to be viable and resilient (Beck & Web, 2003).

Previously, researchers have examined a number of variables when investigating the demand for insurance services (see Hussels, Ward, & Zurbruegg, 2005; Akotey et al. 2011; Meyer & Meyer, 1998; Ben-Arab, Briys, & Schlesinger, 1996; Cummins & Mahul, 2004) and others on the demand for life insurance (see Ward & Zurbruegg, 2002; Brown & Kim, 1993; Beck & Web, 2003; Hwang & Gao, 2003) while some researchers have studied the determinants of demand for Takaful, mainly focusing on family Takaful in Malaysia (for example Sherif & Shaairi, 2013; Arifin, Yazid, & Sulong, 2013; Gustina & Abdullah, 2012). It is worthy to note that despite the relative growth and importance of the Takaful industry to the global economy in general and Muslims in particular, there are a few or no studies at all that focus on the factors that influence its demand. Knowledge of factors affecting individual purchases of Takaful is essential for evaluating the soundness and growth of Takaful sector. This research will attempt to identify the variables or factors that determine the demand for or consumption of Takaful across different boundaries.

Previous empirical studies into factors that influence firm performance have primarily focused on corporate social responsibility and CG mechanisms in the banking sector, including the Islamic banking sector (see Clarke et al. 2005; Kang & Shivdasani, 1995; Ghayad, 2008). CG is generally concerned with the protection of the stakeholders against the excesses of management, it is centered on the principles of accountability, transparency and responsibility in managing the firm. It basically deals with the ownership structure, board of directors composition, such as the size, proportion of non-executives, skills and so forth (Ehikioya, 2009). It also deals with board independence and separation of authority of CEO and chair. A defined and functioning governance system is believed to help companies lure investors, raise funds and strengthen the foundation for firm performance and growth because it protects the firm from exposure to financial distress (Ehikioya, 2009). Studies have shown that strong CG mechanisms positively affect firm performance (e.g. Ammann, Oesch, & Schmid, 2011; Renders, Gaeremynck, & Sercu, 2010; Cremers & Ferrel, 2010; Bebchuk, Cohen, & Ferrell, 2009; Johnson, Moorman, & Sorescu, 2009; Bhagat & Bolton, 2008; Brown & Caylor, 2006) which is consistent with results from the banking sector (e.g. Cornett, McNutt, & Tehranian, 2009; Jiraporn & Chintrakarn, 2009; Laeven & Levine, 2009; Cooper, 2009; Andres & Vallelado, 2008; Caprio, Laeven, & Levine, 2007) while other scholars found a negative relationship (see Beltratti & Stulz, 2012; Fahlenbrach & Stulz, 2011; Guo & Kumara, 2012; and Demsetz & Lehn, 1985). Most of these studies are based on the banking and non-financial sectors. Even with the consistent growth and positive performance in the Takaful sector, there is no study that examines such a relationship.

Researchers have argued that globalization and financial liberalization strictly determine economic growth (e.g. Cheng et al. 2013; Berggren & Jordahl, 2005) while economic growth leads to financial development (see Levine, 1997; Bekaert et al. 2005). In recent years, we have been witnessing impressive growth in the Takaful market, especially in the GCC and some parts of ASEAN. Given the process of financial liberalization and integration, questions are raised on whether globalization and capital account openness affects the Takaful market activities. Some scholars (e.g. Chen et al. 2013) report that globalization spur insurance market development and financial liberalization leads to financial sector development (Ang & McKibbin, 2007; Baltagi, et al. 2009). The Takaful industry plays an important role in the Muslim world where there is an aversion to the risk-transfer and “unethical” business model of the conventional insurance, to facilitate some economic transactions by way of risk-sharing and ethical investment but the studies above are based on the conventional market and surprisingly, there is no study that analyzed such relationship in the Takaful sector.

In response to these, this research intends to examine the growth of the Takaful market. The study plans to investigate the following: the determinants of Takaful demand, the link between the governance structure and the performance efficiency of Takaful firms, and the relationship between globalization (measured in terms of trade and financial liberalization) and the growth of Takaful.

An understanding of the patterns of growth of an industry is important in order for policymakers to establish sustainable growth strategies.

1.4 Objectives

The main objective of the research is to analyze the determinants of the growth and performance efficiency of the Takaful industry.

The specific objectives are:

1. To determine the driving forces influencing the demand for Takaful across different markets
2. To examine the link between corporate governance mechanisms and the performance efficiency of Takaful firms.
3. To examine the relationship between globalization and Takaful growth.

1.5 Research Questions

On the backdrop of the above objectives, the study intends to answer the following questions:

1. Which demographic and socio-economic factors are related to Takaful demand?

2. What are the governance mechanisms that propel efficient performance of the Takaful sector?
3. Which of the globalization policy of governments assists entrepreneurs and practitioners to supply this service?

1.6 Significance of the Study

This study will measure the growth and performance efficiency of the Takaful industry, through exploring the demand, the linkage between corporate governance mechanisms, trade and financial liberalization and the industry growth.

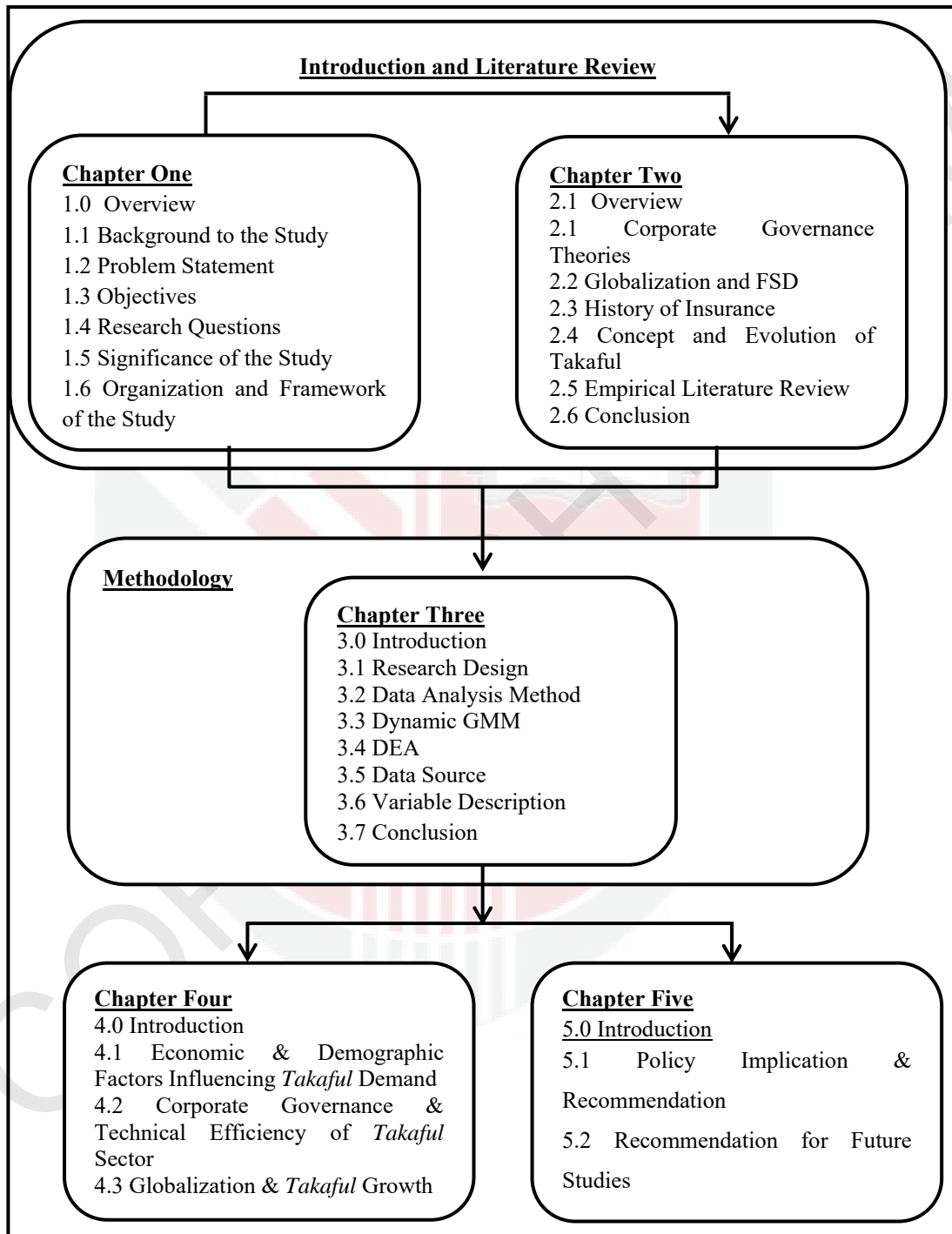
To the best of my knowledge, there is no such research in the existing body of research, although similar studies exist in the conventional insurance market, there is a different business orientation and governance mechanism between them (such as the existence of a SB). The study will serve as a reference for future researchers in the area of Takaful, CG, and globalization.

This research is significant in several ways; firstly, it will lend to the growing amount of research that focus on CG and performance, being that it will be among the small number of studies on corporate governance in the Takaful sector. Secondly, the thesis examines change over time in the extent of liberalization across various groups of countries and try to link those changes to Takaful growth. Understanding the effect of liberalization on the development and growth of Takaful market is quite beneficial. From the position of policymakers, globalization is linked with openness or liberalization related to political, economic, and socio-cultural facets within the economy. If globalization affects Takaful growth, then the attitude of policymakers towards globalization may affect the market indirectly. For the industry, if globalization promotes its growth and development, then practitioners can focus on untapped markets because it indicates that there exist opportunities if globalization can promote the growth of Takaful market. Thirdly, the study provides a careful assessment of corporate governance mechanisms drawn from various studies on the performance of firms. Theoretically, a lot of these studies are similar, but subtle differences exist which affects the results. Hence, the extensive appraisal of performance efficiency based on corporate governance characteristics provides a benchmark result that should be useful for further empirical and theoretical undertaking in this field. It is obvious that there are little or no studies that investigate the demand for Takaful, and the available ones focus on family Takaful demand in Malaysia. With regards to this, this study will contribute in filling the void in the literature in terms of coverage and scope. While it is expected that this study will provide more awareness and better understanding on the notion of Takaful and factors that affects its consumption, it is hoped that the study will help researchers and policymakers to have a better grasp of this emerging sector of IF.

1.7 Organization of the Study

Chapter one has provided the background to the study, enumerated the objectives, problem statement, questions the research seek to answer, and the significance of the study. The second chapter provides the review of various works (both theoretical and empirical) on the demand for insurance products and services, firm performance in relation to corporate governance and financial market development on the backdrop of globalization. The chapter focused on four theories used in the research as the theoretical framework for corporate governance study together with the theory of globalization and financial sector development. Chapter three covers the methodology, model specification and the research design. Variable description and hypothesis development are outlined in this chapter. The fourth chapter presents and discusses the results and finally, the last chapter will summarize the findings, conclude the study and give some policy recommendations.

A graphical framework for this thesis is presented in the figure below:



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