

IEBMC 2017
**8th International Economics and Business Management
Conference**

**FACTORS AFFECTING FINANCIAL PERFORMANCE OF
TAKAFUL OPERATORS IN MALAYSIA**

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Abstract

This study identifies the factors that affecting the financial performance of Takaful operators in Malaysia. Data were gathered using secondary data collection method from annual report for each of Takaful operators and Bank Negara Malaysia from year 2007 until 2016. The data consist of profitability, leverage, liquidity and firm size for 5 registered Takaful operators in Malaysia namely; Syarikat Takaful Malaysia Berhad, Takaful Ikhlas Sdn Bhd, Prudential BSN Malaysia Berhad, Sun Life Malaysia Takaful Berhad (CIMB Aviva Takaful Berhad) and Hong Leong MSIG Takaful Berhad. Data were analysed using multiple regression analysis. From the analysis, firm size was found significantly positive effect towards financial performance. In contrast, leverage and liquidity were found significantly negative effect related to the financial performance. Thus, this study is very important and beneficial to regulators, investors and customers. As recommendation, Takaful operators should improve their sales in order to enhance the consistency of profit growth. Besides that, Takaful operators need to disclose the financial report from the beginning because it could make an easier for researcher in collecting data. Moreover, as the Islamic insurance that applies *Shariah* compliance, Takaful operators should sustain the customer trust in order to achieve well in financial performance.

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Keywords: Takaful operators, financial performance, leverage, liquidity, firm size.



1. Introduction

Takaful or Islamic insurance is coined from the Islamic word kafalah, which means ‘guaranteeing each other’ or ‘joint guarantee’. This concept which is grounded in Islamic Muamalat, observing the rules and regulation of Islamic law that involves participants and operators. Participants will contribute a certain amount to a fund as his or her obligation and managed by a third party which is called Takaful operators as a protection and profit sharing venture. Takaful operators will disburse the funds accordingly to its participants when the event of loss or damage suffered. In Malaysia, there are 11 registered Takaful operators which included 2 foreign and 9 local Takaful operators. According to statistics by Bank Negara Malaysia (BNM), Takaful operators have been showing rising from the year 2010 until 2015. It is supported by Fitch Ratings report, where Malaysian Takaful sector saw strong growth in 2015. Besides that, BNM also reported Malaysia dominates two-third market share of Takaful in ASEAN.

1.1. Financial Performance

Financial performance is an essential to management as the act of performing the financial activity. It can be used to compare with similar companies across the same sectors to measure overall financial health at a certain period. Hidayat and Firmansyah (2017) stated that assessing the financial performance of companies can be measured by Return on Assets (ROA) which focuses the company’s ability to earn profit from its assets. Based on the study done by Siminica *et al.* (2012), the study relies on the assumptions that financial balance influences most of the indicators towards company’s performance. Hardwick and Adams (1999) and Malik (2011) also suggested that although there are different ways to measure profitability, ROA is the best measurement to measure the financial performance.

1.2. Leverage

Chen and Wong (2004) claims that leverage beyond the optimum level could result in higher risk and low value of the firm. According to Almajali *et al.* (2012), companies that are unable to make payments on their debt or highly leverage, they might be at risk of bankruptcy and difficult to find new lenders in the future. Empirical evidence found that leverage has a significant statistical impact of insurance companies on financial performance by increasing return on investment for shareholders and tax advantage associated with borrowing. It was supported by Mohammad Ali (2014) in his findings shows a positive relationship between ROA and debt to equity. However, Hidayat and Firmansyah (2017), Sambasivam and Ayele (2013) and Malik (2011) indicates that there is a negative relationship between ROA and leverage.

1.3. Liquidity

A company can use liquid asset to finance its activities and investment if inaccessibility from external financing. According to Shiu (2004), a company will perform better and less expose to liquidity risk if the company’s asset is more liquid. It is because they are able to realize cash at any time to meet its obligations. On the other hand, study done by Arshad *et al.* (2016) and Almajali *et al.* (2012) were found that liquidity is statistically significant impact on financial performance of insurance companies. However, Sambasivam and Ayele (2013) illustrated that there is a negatively and significantly affect between ROA and liquidity.

1.4. Firm Size

Sambasivam and Ayele (2013) found that firm size was statistically significant and positive relationship towards financial performance. Firm size is used to release the fact that larger insurance companies are better positioned than smaller once in harnessing economies of scale in transactions and adore a higher level of profits. Based on the empirical result, size of the company is statistically significant towards the performance of the general Takaful in Malaysia. Hidayat and Firmansyah (2017), Almajali *et al.* (2012) and Malik (2011) also identified that the firm size as an effective factor or positive statistically significant effect on the company's financial performance.

2. Problem Statement

Financial performance is a primary concern in all types of industry including with Takaful industry. Financial performance is an indicator for organization's well-being and ultimately its subsistence. The good financial performance reflects the management effectiveness and competence in using the company resources. Takaful Ikhlas annual report has recorded progressive growth during the period of 2009 until 2016 as shown in Figure 01. The interesting facts are between 2009 and 2014, the growth rate of net contributions from the Takaful sectors were between 12% and 13%. According to Fitch Ratings (Worldwide), (2016) stated that Takaful industry with general and family Takaful recording 8.3% and 9.7% growth faster than conventional insurance at end of June 2015, with conventional general and life insurance growth of 6.6% and -0.4% respectively in Malaysia.



Source: Statistic Bank Negara Malaysia

Figure 01. Graph of Takaful operators profit from 2009 until 2016

A study done by Almajali *et al.* (2012), they were found that leverage, liquidity, size and management competence index have a positive statistical effect on the financial performance in Jordanian insurance companies. Moreover, Ismail (2013) used profit or interest rate levels, equity returns, size of company, reTakaful or reinsurance dependence, solvency margin, liquidity, and contribution or premium growth to investigate the determinants of financial performance in general Islamic and conventional insurance companies in Malaysia. The study was identified for Islamic insurance; only 3 variables (size of company, reTakaful dependence and solvency margin) are statistically significant towards investment performance. While for conventional insurance, all factors are statistically significant except for equity returns. Besides that, Siminica *et al.* (2012) studied the statistical correlation between Return on Assets

(ROA) and some measures of financial balance. The research concluded that the financial balance influences most of the indicators in the company's performance.

In addition to that, there are a lot of researches focused on determinants factors that affecting the financial performance of banks rather than insurance companies especially in Malaysia. Thus, this study is very important and beneficial to regulators, investors and customers. By understanding determinants contributing to the financial performance, the regulators could play a vital role in helping Takaful operators to increase their market share. For investors, they can choose their investment places while customers will select the best Takaful operators for their Islamic insurance protection. Hence, this study used ROA to measure financial performance as dependent variable, whereas leverage, liquidity and firm size as the independent variables, in identifying the factors that affecting the financial performance of Takaful operators in Malaysia.

3. Research Questions

Is there any significant effect of leverage, liquidity and firm size towards financial performance of Takaful operators in Malaysia?

4. Purpose of the Study

To identify the factors that affecting the financial performance of Takaful operators in Malaysia.

5. Research Methods

Data for this study were obtained using secondary data collection method. The data consist of profitability, leverage, liquidity and firm size for 5 registered Takaful operators in Malaysia namely; Syarikat Takaful Malaysia Berhad, Takaful Ikhlas Sdn Bhd, Prudential BSN Malaysia Berhad, Sun Life Malaysia Takaful Berhad (CIMB Aviva Takaful Berhad) and Hong Leong MSIG Takaful Berhad. A total of 11 registered Takaful operators but only 5 Takaful operators were selected because the limitation of data. The data were collected from annual report for each of Takaful operators and Bank Negara Malaysia from year 2007 until 2016.

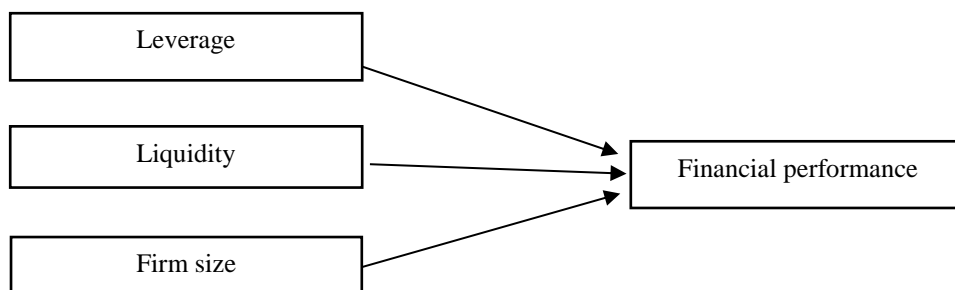


Figure 01. Conceptual framework of the study

Table 01. Proxies and formulas of the study

| Variables | Proxies | Formulas |
|-----------------------|---------------------------------------|--------------------------------------|
| Financial performance | Return on assets | Net income ÷ Total assets |
| Leverage | Debt to equity ratio | Total liabilities ÷ Total equity |
| Liquidity | Current assets to current liabilities | Current assets ÷ Current liabilities |
| Firm size | Total assets | Log total assets |

5.1. Regression model

This study used multiple regression analysis to test the effects of leverage, liquidity and firm size on financial performance of Takaful operators in Malaysia. The regression models used in this study are as the following:

$$FP = \alpha_0 + \beta_1(LV) + \beta_2(LQ) + \beta_3(FS) + \varepsilon$$

Where:

FP = financial performance; α = constant value; β = regression coefficient; LV = leverage; LQ = liquidity; FS = firm size; and ε = residual term

Based on the preceding discussion, five hypotheses are developed:

H₁: There is a significant effect of leverage towards financial performance of Takaful operators in Malaysia.

H₂: There is a significant effect of liquidity towards financial performance of Takaful operators in Malaysia.

H₃: There is a significant of firm size towards financial performance of Takaful operators in Malaysia.

6. Findings

Table 02 presents the multiple regression analysis, in which to identify the effect of leverage, liquidity and firm size towards financial performance of Takaful operators in Malaysia. Based on the table 01, firm size (p -value = 0.000, t = 7.381) was found to be positively and significantly related to financial performance. This result is consistent with the assertion by Hidayat and Firmansyah (2017), Sambasivam and Ayele (2013), Almajali *et al.* (2012) and Malik (2011). It shows that the larger the size of Takaful operators, the well position they will get in compassionate their organisation. For instance, the company will make a better risk management practice, upgrade their information system, and improve the level of management and technical expertise in the company. According to Ismail (2013), this major factor also will prevent a development and competitive position of Takaful and insurance companies in Malaysia.

On the other hand, leverage (p -value = 0.000, t = -3.931) and liquidity (p -value = 0.035, t = -2.177) were found to be negatively and significantly related to the financial performance. For leverage, the result was consistent with the claimed by Hidayat and Firmansyah (2017), Sambasivam and Ayele (2013) and Malik (2011). The finding suggested that high leverage will lead to the high risk of company's bankruptcy if they are unable to pay their debt obligations. Furthermore, the result for liquidity was supported by Sambasivam and Ayele (2013). The higher liquidity the more proficiencies of Takaful operators in managing their asset. But too high liquidity will lead poor performance because it allows a company to deal

with unexpected contingencies and to cope with its obligations during the period of low earning (Liargovas and Skandalis, 2010).

In addition, *R*-squared value for financial performance is 0.586 indicating that 58.6% of the variation of determinants factors that affecting the financial performance of Takaful operators in Malaysia, could be explained by the 3 independent variables. The remaining of 41.4% variance in the financial performance is an unexplained variation which due to the unpredictability or exclusion of some important independent variables in the model. After adjusting for the degrees of independence, the value of the coefficient of determination has declined to 55.9%. There is a possibility that one of the variables in this model does not have a strong relationship with the financial performance. Besides, *p*-value for *F*-statistic is 0.000 which is below than 5% significance level and thus, accept the hypothesis and the model have a good fit. Hence, the regression model demonstrates leverage, liquidity and firm size significantly influence financial performance at 95% confidence interval.

Last but not least, Variance Inflation Factor (VIF) test is to avoid bias decision making process that will affect a part of independent variables on the dependent variable. Based on the table 01, VIF test shows that the degree of multicollinearity is not severe. According to Gujarati (2003), the values of VIF for all independent variables should be less than 5 and it indicates that the data has no multicollinearity problem.

Table 02. Regression results

| Variables | β | <i>t</i> -value | <i>p</i> -value | VIF |
|-----------------------------|---------|-----------------|-----------------|-------|
| Leverage | -0.142 | -3.931 | 0.000 | 1.269 |
| Liquidity | -0.014 | -2.177 | 0.035 | 1.266 |
| Firm size | 0.222 | 7.381 | 0.000 | 1.010 |
| <i>R</i> -squared | 0.586 | | | |
| Adjusted <i>R</i> -squared | 0.559 | | | |
| <i>F</i> -statistic | 21.725 | | | |
| Prob (<i>F</i> -statistic) | 0.000 | | | |

7. Conclusion

The main purpose of this study has been answered where all the independent variables, leverage, liquidity and firm size are affected to the Takaful operator's financial performance. From the findings, firm size has significantly positive effect related to financial performance. The positive effect between financial performance and firm size are consistent with prior studies by Hidayat and Firmansyah (2017), Sambasivam and Ayele (2013), Almajali *et al.* (2012) and Malik (2011). It shows that the larger the size of Takaful operators, the well position they will get in supportive their company. Thus, firm size is an effective factor towards the financial performance of Takaful operators in Malaysia.

However, leverage and liquidity have significantly negative effect towards financial performance of Takaful operators in Malaysia. For leverage, the result was consistent with the study done by Hidayat and Firmansyah (2017), Sambasivam and Ayele (2013) and Malik (2011). The finding suggested that high leverage will lead to the high risk of company's bankruptcy if they are unable to pay their debt obligations. Reducing debt of the company shows the more effective the company managing their debt. On the other

hand, the result for liquidity was supported by Sambasivam and Ayele (2013). Higher liquidity of the Takaful operators will lead them managing their asset very well. Liquidity is one of the instruments that measure how quickly the company convert their assets into cash. As conclusion, the finding of this study can be used to contribute towards a better understanding about the financial performance of Takaful operators in Malaysia.

As recommendation, Takaful operators should improve their sales in order to enhance the consistency of profit growth. Nowadays, the developments of Malaysia Takaful operators become the world attention. Therefore, the improvement of sales is very important. Besides that, Takaful operators need to disclose the financial report from the beginning because it could make an easier for researcher in collecting data. Moreover, as the Islamic insurance that applies *Shariah* compliance, Takaful operators should sustain the customer trust in order to achieve well in financial performance.

Table 03. Summary of findings

| Hypothesis | t-value | p-value | Remark | Result |
|----------------|---------|---------|--------|-----------|
| H ₁ | -3.931 | 0.000 | Accept | Supported |
| H ₂ | -2.177 | 0.035 | Accept | Supported |
| H ₃ | 7.381 | 0.000 | Accept | Supported |

7.1. Limitations and future research

There is obvious limitation while conducting this study in terms of data collection. In Malaysia, we have 11 registered Takaful operators, however, this study only used 5 Takaful operators due to limited accessibility in collecting the data. In addition, these 5 Takaful operators were among the earliest local operators that registered in Bank Negara Malaysia. Thus, this study would be an indicator to the other Takaful operators in sustaining their performance.

Acknowledgments

The authors would like to thank the anonymous reviewers who will give their extensive and thorough comments which had enormously helped us improved the quality of our paper. The perspectives and the positioning of our paper has certainly benefited from their valuable feedback and comments.

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