



Global Advanced Research Journal of Engineering, Technology and Innovation (ISSN: 2315-5124) Vol. 4(5) pp. 190-195, May, 2015
Available online <http://garj.org/garjeti/index.htm>
Copyright © 2015 Global Advanced Research Journals

Review

Business Ethics In Takaful Industry: Between Myth And Reality

Abdullah Ali Abdullah Mohammed

Assistant Prof. IIUM
abdo.ali111@yahoo.com

Accepted 23 February 2015

This paper discusses several key ethical issues confronting employees of Takaful industry. A survey was conducted through the use of questionnaire to seek responses from several employees of Takaful companies in different location. The finding shows that several business ethical challenges facing conventional insurance industry is still prevalent in the Takaful industry. A simple descriptive statistical technique was used which is basically weighted average and ranking according to the order of problem it present to the employees. Regulatory measures are advocated to improve the business ethical environment.

Keywords: Business ethics, Takaful, Shariah, Regulation, Employees.

INTRODUCTION

The development of Islamic finance in the last three decades has provided a platform for market players (individual and groups) and economic institutions to tailor their behavior in line with ethical standards and values dictated by Sharia'ah (Islamic laws and principles). Sharia'ah pays attention to the moral values of Muslims and thus seeks to preserve and protect them in achieving the ultimate spiritual and worldly benefits (*mashlah*) for the human life (*al-nafs*), intellect (*al-aql*) and property (*al-mal*). Hence, Islamic religion regarded performing business transaction as religious duty and must be done according to the principle of brotherhood, solidarity and mutual assistance. This could be found in the holy Quran which says "And help one another in goodness and piety and do not help one another in sin and aggressor" (Quran 5:2).

Takaful sector is one of the principal components of Islamic finance. It is based on the Taa'wun principle literally means cooperation and caring for each other. The operation of Takaful is almost similar to mutual insurance but is quite distinguished by the guiding principles dictated by Sharia'ah. The global Takaful industry has witnessed remarkable growth in the last decade with global contribution estimated to reach US\$17 billion at the end of 2012 (Am-Best Takaful report, 2013). Different studies have estimated the size and growth of Takaful industry; these studies have pointed to the industry's strong growth potentials. The promising future economic outlook of the industry has lead to rapid proliferation of operators particularly in area region regarded as the core market centers such as Malaysia, GCC region, North Africa and South Asia. It is believed

that the remarkable performance of Takaful institutions is based on the superior ethics and values which uphold the principle of brotherhood and mutual assistance as a mechanism for risk sharing pooling.

In the last few years the favorable regulatory policies has lead to springing up of new operators in addition to the existing local and foreign conventional insurance companies entering the market. Presently, the total number of operators was estimated at 225 with largest concentration in GCC region (Ernst & Young, 2012). The overall implication is increasing competition and market congestion, particularly, when they are operating side by side with the established conventional insurance corporations. Since most of these new Takaful entrants are in their early years of operation, they tend to rely on aggressive pricing strategies in order to build presence and achieve the target market share. Such strategy is not sustainable because of the socio-ethical implication which may impact negatively on the growth of the industry.

Problem Statement

Although, economic theory suggests that competition can be beneficial, because it promotes market efficiency through evolving of innovation; however, studies have shown that its impact on business ethical behaviors is not always favorable especially in insurance business where customers are vulnerable to information asymmetrical behaviors of the insurance operator. This can affect the right of /and obligation to other stakeholders such as customers, employees, and the general public which the Sharia'ah principles seek to protect.

The potential for competition to impact negatively on business ethical environment was evident in some mature insurance markets such as in Europe and United States during the first half of the last decade (Pitchelis, 2010). This paper will focus on business ethics in the Islamic insurance industry, given several ethical issues confronting the Takaful industry in their competitive behaviors to secure the targeted market share and pose appreciable market share for their shareholders.

Meanwhile, many scholars have criticized the Takaful operators for failing to adhere to the Sharia'ah rules and principles in their business model by avoiding practices that may brought about uncertainty (gharar), gambling (mysir) and other prohibited practices. The concept of Takaful contribution (Tabarru), separation of policyholders fund from shareholders fund, surplus distribution are features that distinguished Takaful business model from conventional insurance practices. Takaful operators' needs to realized that compliance to the Sharia'ah rules in achieving highest ethical standard may have positive influence of their value proposition.

A mix of Islamic and conventional ethical parameters is adopted for measuring business ethics in Takaful industry. The essence is to build reputation for Takaful industry to achieve and uphold high standard of business ethics beyond that of conventional insurance in order to attract Muslim and non Muslims alike who placed higher premium on moral value and social conscience.

For Takaful value chain to be Sharia'ah complaints, they should avoid major elements such as *riba* (interest/usury), *gharar* (uncertainty), ambiguity (gambling) and other prohibits elements in their operation. Creating fiat money through interest (*riba*) has negative socio-economic consequences on the individual and group in the society by perpetuating disparities and injustice. *Gharar* (uncertainty) as mentioned earlier is described as unjustifiable risk of loss to a contracting party as a result of uncertainty. This problem is particular relevant to insurance where the customer are subjected to information asymmetric behavior of the operators. Takaful must be based on a valid and legitimate contract. *Mysir* (gambling) is a zero- sum game of chance through which the gain of one party can only occurs form others loss. This is best explaining when investing in derivatives instrument in the quest for maximizing return.

Furthermore, other important factors that allow unethical behaviors to thrive in insurance market are considered in the survey conducted aimed at identifying key ethical issues confronting the employees in the Islamic insurance industry. The survey outcome are discussed and compared with similar findings from recent studies in the matured conventional market such as the United States insurance industry. In addition, the effect of regulatory measures in reducing these behaviors is also highlighted with consideration for the protection of customers and safeguarding them against unnecessary risk taken. Finally, the willingness of top management of Takaful companies to entrenched positive corporate culture in the organizational strategic management are examine in term of the potential impact on insurance ethical business environment.

Sources of unethical behaviors

The relevant factors that influence business ethical behaviors are adopted from Dorfmann & Ennsfellner (2001) ethical model developed in their studies of business ethics in Central and Eastern Europe insurance industry. These factors in addition to basic Islamic ethics made up of five parameters considered and these include *Sharia'ah* reputation, supervision and regulation, Accounting practices, distribution and marketing conduct, and management expert.

First, *Sharia'ah* complaints reputation is fundamental to the existence of Takaful, the business operation must be

Table 1. shows the description of sources of unethical behaviors in Takaful industry discussed above

S/N	SOURCES OF UNETHICAL BEHAVIORS
1	Sharia'ah reputation
2	Supervision and Regulation
3	Accounting and disclosure of relevant and material information
4	Distribution and marketing conduct
5	Management expertise

based on a valid contract which includes the contributions of the participants, investment of money received, and the payment of claims to those who are entitled to them. Takaful cannot adopt the concept of exchange (i.e. exchanging protection for a premium), and free from uncertainties of counter value as the case with conventional insurance. Based on the fact that uncertainty cannot be completely eliminated from the real world, the type of contract that can tolerate the presence of this uncertainties based on fiqh maxim (Fiqh maxim "uncertainties are tolerable in the gratuitous contract") is the concept of Tabarru which is adopted for Takaful. Failure of Takaful undertakings to comply could serve as a major source of unethical behavior and social responsibility.

Next , an unregulated market provides opportunities for the operators to engage in unethical behaviors. The ideological dimension of Takaful creates additional regulation than do exist in conventional insurance. This is because the risk-reward and control structure is heavily tilted against the Takaful participants (as ultimate risk bearer and owners of Takaful fund). Therefore, market regulation finds it justification in protecting the policyholders and to infuse market discipline an essential ingredient to ensure the confidence of market participants and ultimately stability of the financial system.

One important regulatory function is the existence of standards that allow for the disclosure of material and relevant information for market participants to make informed judgments. Strict adherences to this regulation will foster market discipline and accountability, and promote market integrity among the industry employees. The existing and potential Takaful participants should be able to evaluate their financial position and risk exposure. Undertakings are required to act prudently in managing their risks and also to meet certain financial standards such as minimum capital and surplus standard. Disclosure of solvency information has recently assumed important regulatory importance and such information should describe overview of risk management framework for identifying, measuring, monitoring and controlling relevant risk in monitoring the solvency control levels.

Thirdly, accounting practices, in the absence of timely, accurate and relevant financial information reporting assembled according the specified accounting standard, the discovery of unethical behaviors (such as the excessive risk taking) might be difficult to detect at the

early stage. If the operator is fully aware of that such problem exists, it may encourage unwholesome practices as a result of delay in detection.

The fourth potential source of unwholesome behavior is the conduct in distribution and marketing of Takaful product. This is important because agent and brokers are widely used in selling insurance product. An appropriate standard needs to evolve to regulate the operation and marketing conduct for selling insurance product. This is necessary to avoid unwholesome practices and other forms of fraudulent activities. This practice is not uncommon even in developed markets such as Europe and United States, but there is appropriate mechanism to detect such abuse for immediate remedial action.

Finally, from ethical standpoints, management expertise is critical because the top managers take the lead in setting standard of behavioral conduct that will percolates down and obviously form the ethical environment through which business operates (Fulip, Hisrich and Szegedi, 2000). This involves leadership and innovation. It is the responsibility of top management to establish corporate code of conduct, ethics training and an office to monitor unethical behavior. An effective corporate culture should be the one that encourages and reward ethical behaviors. Employees need guided on myriad of their day to day operation, hence they should not be left unguided when faced with ethical issues that is beyond their comprehension. Several studies have shown the importance of corporate guidance of employees on job particularly the professionals because they rely entirely on business environment for assistance in dealing with ethical issues encountered on the job (Cooper & Frank, 2002).

RESEARCH METHODOLOGY

A survey was conducted to investigate the key ethical issues confronting employees in the Takaful industry by using questionnaire to find information from the various stakeholders who are knowledgeable about the ethical environment of the industry. The questionnaire contained the list of 22 ethical issues as shown in the table II. The respondent are required to rate each issue on a 5-point Likert scale, where the highest number 5 indicates that the issue present major problem for employee working in the industry and lowest number 1 represents non

ETHICAL ISSUES IN TAKFUL INDUSTRY

S/N	ISSUES	Weighted average
1	Failure to pay claims promptly and fairly.	4.8
2	Failure to provide honest response to customer demand.	4.2
3	Failure to design product and services that does not mimic the conventional form (which contain elements of gharar and	4.5
4	mysir).	
5	Failure to avoid financial transaction that involved element of riba/usury.	2.2
6	Abuse of sensitive information.	3.8
7	Creation a disparaging comments about competitors.	3.6
8	Inappropriate process of capturing competitors' information.	3.2
9	False and misleading representation of product or resources and advertising or sales efforts.	4.8
10	Conflict between opportunities for personal financial gain (other benefits) and proper performance of our responsibilities.	4.7
11	Conflict of interest involving the marketing of product and services competing with those of employee's own companies.	3.6
12	Conflict of interest that involved working for competitors,	2.1
13	Customers, suppliers without approval.	3.9
14	Misuse of company assets/property.	4.2
15	Receiving excess gift/entertainment.	
16	Offering or soliciting payment or contribution for the purpose of influencing legislation or regulator's decisions.	4.1
17	Inaccuracy of books records and accounts.	4.5
18	Antitrust issues.	3.6
19	Employee theft and dishonesty.	2.1
20	Lack of Knowledge and skill to perform his/her duty.	4.7
21	Failure to identify customer needs and received the services that meet their needs.	4.4
22	Failure to be objective with others in business dealings.	4.5
23	Misrepresentation or concealing limitation of employee's ability to provide services.	3.6

significant problem. Moreover, additional space was provided to permit the respondent to make additional comment not provided for in the questionnaire.

The survey received appreciable response from the several people who are in position to give useful and concise information with regard to issue raised in the questionnaire. This includes industry leaders, researcher with extensive industry knowledge, and employees of finance services regulatory authority and some individual employee of Takaful industry. Simple statistical descriptive technique is employed in analyzing the

degree of responses. The response provides good insight on the focus of the study.

Below are the information provided by the respondents. The confidentiality of the respondent as well preserved. Table II shows the ranks and weighted average of the ethical issues considered. The top 10 ranking of ethical issue that present problem to employees are highlighted below.

Issue 20: inadequate knowledge and skill to perform duty (1st)

Issue 1: failure to settle claims quickly and fairly (2nd)

Issue 21: failure to identify the customers' needs and recommended product and services (3rd)

Issue 23: misrepresenting or concealing in one's ability to provides services (3rd)

Issue 22: failure to be objective with others in one's business dealings (5th)

Issue 2: failure to provide prompt and quick response to customers' complains and request (6th)

Issue 7: misleading representation of product and services marketing and advertising or sales efforts (7th)

Issue 8: conflict between opportunity for personal financial gain or benefit and proper performance of one's responsibilities (7th)

Issue 15: receiving excessive gift or entertainment (8th)

Issue 4:

First, the top 10 issues in the ranking worth discussing in that they have greater effect on the ethical business environment. The first sixth of these ten issues in the ranking emphasizes the ethical problem of concerns to the employees and business in general. The top ranked five points to the importance of professionalism and innovation in the design of Takaful product and services; marketing, and final delivery to the customers according to their needs. Based on the regional ratings respondent from Malaysia ranks the following issues lower than other region, the issues includes; issue 20, 21 22 and 23 indicating that these ethical issue posed little no challenge to the industry compared to other areas such as GCC region, North Africa and South Asia.

Next, the respondents identified strict adherence to contractual agreement as critical business ethical issue as categorized in issue 1: failure to pay claims promptly and fairly. It is not unexpected why it ranks highest. Apparently, claims is paid when the Takaful companies has enough cash flow to fulfill their obligation. Whereas, during shortfall they tends to delay or out rightly cancelled the claim payment. The regulatory authority should be strengthened to enforce the Takaful institutions to respect their contractual agreement and prevent them from excessive risk taking.

Third, the top ranked five on ethical issue confronting employees' of Takaful industry in the discharge of their business and social responsibilities to the policyholders and general public has the weighted average of 6.5 thus explained the importance of ethical decision making by the managers as a test of social responsibility while operating within the framework of ethics and standard. This finding is in line with Fulop, Hisrich and Szegedi (2001) study that examine the managers' views on 19 different aspects of business ethical and social responsibilities toward policyholders, employees, public and entrepreneur including product selection, fair advertising and ethical decision making. Moreover, the ranking of issues involving customers' relations, correct advertising and product selection similar to Csurgo (1994) that classifies deception of customers and

misleading advertisement as one of the major unethical behaviors in the industry. This helps to explain why issues 2 (failure to provide, honest response to customer's request), issue 7 (false and misleading representation of product or services in marketing and advertising) & issue 21 (failure to identify customers' need and recommend appropriate product and services that met their needs) ranked relatively higher.

In addition, Issue 3 best explains the failure of Takaful industry to achieve the goal of providing quality product and services. Many industry analysts complained of "cut and paste syndrome" the practice in which the employees of Takaful industry carries the conventional insurance mindset to Takaful product and services design. Takaful industry requires innovation in product and services design and high performance, this expectation drives customers toward subscribe to Takaful products as against conventional products. A proper performance of employee's responsibilities as depicts by issue 8 (conflicts between opportunities for personal financial gain in the discharging of one's duty) is a typical phenomenon of agency problem. Furthermore, issue 15 (offering or soliciting payment or contribution for the purpose of influencing regulatory policies) has unhealthy implication to the industry.

Clearly, effective regulatory monitoring and human resources development will assist in creating standard accounting book, record and reporting will assists in streamlining the unwholesome behaviors as indicated in issue 16.

The finding of this survey is consistent with the similar studies conducted in the United States insurance industry. Some of the items merit highlighted. First, issue 1 presents no problem because of the strong solvency regulation, thus excluded in the U.S. survey. Issue (20-23) is of relevance to the professionals and ranked among the top-5 in the Islamic insurance survey, also in U.S. studies it ranks among the top-10 ethical issue of note. However, they have their mean greater than that of the U.S. Moreover, issue 2, 7 & 8 too ranked among the top-10 ethical issues in the U.S. studies. As matured as the U.S. insurance market is, market conduct related ethical challenges are also prominent (i.e. misrepresentation of product and services; failure to identify the customers' needs and recommend product and services that meet their needs; conflicts between opportunities for personal gain and proper performance of employee's responsibilities).

These findings give the impression that numbers of key ethical issues confronting Islamic insurance market also occurs in the conventional market such as in United States insurance market. This made us to suggest that human nature is core to the promotion of positive business ethics irrespective of the market, sector and the geography. Hence, the consequence of these unethical practices if unchecked has the potentials of causing

market disruption. Regulation and standard is therefore required to streamline the behavior of market participants.

Noteworthy, is the claim of Ennsfellner & Dorfman (2011) that though market liberalization could promote competition and encourage innovation, they points that it may at the same time leads to decline in market transparency and poor quality of product and services. As a result, individual customer may not be able to make efficient choice because of the existence of market conduct related ethical problem.

Regulatory role

Regulation has the potential of tailoring the behavior of market participants toward best practices and reduces unethical practices. Thus appropriate measure should be taken to improve ethical environment in insurance market and in financial services environment in general. Obviously, the top management of Takaful companies have significant role to play toward influencing positive ethical business environment. As market competition increases, the ability to control significant market shares will to a greater extent influenced by corporate culture and the history of services quality.

Jaffer (2007) suggests that Takaful undertakings that take long-run sight based on stakeholder management, an approach that is aligned with corporate sustainability and social responsibility is less probable to engage in unethical activities. The sustainable growth of Takaful industry lies heavily on the governance and leadership quality in implementing high standard of ethics and values set by Sharia'ah which will attract customers (Muslim and non- Muslim) because it addresses the ethical concerns so identified in the conventional insurance industry.

REFERENCES

- Am-Best World Takaful Report, 2012
- Bohata M (1996). "Current issues in Business ethics in Czech Republic", *Business Ethics: A European Review* 5 (2).
- Cooper RW, and G.L. Frank GL (2002). 'Ethical Challenges in the Two Main Segments of Insurance Industry: Key Consideration in the Evolving Financial Services Marketplace. *Journal of Business Ethics*, 36 (1and2), 5-20.
- Csurgo O (1994). 'Business Ethics Mirrored in the Opinion of Hungary managers
- Dorfman MS, and K.S. Ennsfellner KS (2011). 'The Taxonomy of Transition from Communism to Market-Based Insurance Transaction, A Case Study of Poland, The Czech Republic and Hungary: Proceeding of the 37th Annual Seminar of the International Insurance Industry Society (International Insurance Society, New York)
- Ernst and Young (2012). 'World Takaful Report
- Fulop G, Hisrich RD, and Szegedi K (2000). 'Business Ethics and Social Responsibility in Transition Economies, *Journal of Management Development*
- Jaffer Sohail, (2007). *Islamic Insurance-Trends, Opportunities and Future of Takaful* (London: Euromoney)
- Pitselis G (2008). 'An Overview of Solvency Supervision, regulation and Prediction of Insolvency, *Belgian Actuarial Bulletin*