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The effect of compensation on the insurance surplus and the profitability of Takaful insurance companies
A case study of the Islamic insurance company in Jordan, 2010-2019

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Abstract:

This study aims to investigate the effect of compensation on both the insurance surplus and the profitability of Takaful insurance companies by conducting a standard survey on the Islamic insurance company in Jordan during the period 2010-2019. After underwent the study, we concluded that there is an adverse effect of the compensation paid on the insurance surplus remaining in the Takaful Fund whereas, increasing the compensation value by one degree leads to a decrease in the insurance surplus by (0.053), that is, increasing the compensation value by one degree leads to an increase in profits by (0.174). The study proved that the compensations don’t affect the capital or the profits of the Takaful insurance company because they are paid from subscribers' accounts and the total available premiums.

Keywords: Takaful insurance; compensation; insurance surplus; profit.
Jel Classification Codes : C22, G22, G24

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1. INTRODUCTION

The economic progress of any country is measured in the first degree by the progress of the banking and insurance industries. Insurance services occupy today a large area of businessmen’s interest in commercial, industrial, serviceable, and other activities. Attention towards establishing Takaful insurance companies begin with the new trend towards Islamic financial products that are free from usury, ambiguity, and unfairness. The Takaful insurance aims to achieve solidarity and cooperation between the group of insureds and justice between the shareholders by separating the shareholder's account from the insured's account. This study tries to find out how the extent of the commitment of Takaful companies with the principles preaching them. All that leads us to ask the following question:

What is the effect of compensation on the insurance surplus and the profitability of Takaful insurance companies?

To answer this problem, we assumed the following hypothesis:

-The compensation directly and strongly affects the insurance surplus and the profitability of the Takaful insurance companies.

To test the hypothesis and the answer to the problem, the study was divided into three axes as follows:

1-compensation in Takaful insurance companies;
2-the insurance surplus and the profitability of the Takaful insurance companies;
3-the impact of compensation on the insurance surplus and the profitability of the Islamic insurance company in Jordan.

2. Compensation in Takaful Insurance Companies

2.1. The definition of Takaful insurance

There are different definitions of takaful insurance, but all of them are close in meaning and express the principle of solidarity and cooperation, which this type of insurance aims at. The following definition is considered one of the most prominent of these concepts:

"Takaful insurance is the participation of a group of people who are exposed to a certain risk, provided that each of them pays a certain amount in cooperation with a non-profit fund to compensate for the damages that may befall any of them if the specific risk is realized, following the concluded contracts and the regulatory legislation". (International Islamic Fiqh Academy, 2013, p. 11)

2.2. A Concise History of Islamic Takaful insurance

a) Global Takaful insurance market

The Takaful insurance industry had a remarkable development in the last decades. It started with the first Islamic insurance company in Sudan in 1979, until the number of takaful insurance companies in the world increased to 215 companies and 96 takaful windows in 2014. (finance cambridge institute of islamic, 2016, p. 279)

The largest number of Islamic insurance companies is in the Gulf Cooperation Council countries, with 78 companies, followed by the East Asian countries with 42 companies and Africa with 38 companies. (Deloitte, 2011, p. 11)

The increasing emergence of Takaful insurance companies is a clear indication of the increasing demand for their products, as the growth rate of the Takaful insurance market around the world reached (14%) in 2015 compared to the growth rates of conventional insurance that did not exceed (7%). n 2015, the size of the Takaful insurance market reached 14.9 billion dollars, compared to 13 billion dollars in 2014. The share of the Gulf Cooperation Council countries (Bahrain, Kuwait, Qatar, the United Arab Emirates, Saudi Arabia) reached (77%) of the total global Takaful market.

The share of Southeast Asian countries (Malaysia, Indonesia, Brunei) was 15%, while the share of African countries (Sudan, Egypt, Kenya, Gambia, Tunisia) amounted to (5%), or $ 0.7 billion, while the share of the rest of the countries (Bangladesh, Pakistan) Turkey, Sri Lanka, Syria, Yemen, Jordan "(3%), or 0.5 billion dollars. (Milliman Research Report, 2017, p. 07)

Despite the increasing growth shown by the global Takaful insurance market, where total Takaful subscriptions amounted to $ 18.6 billion for the year 2016 (finance cambridge institute of islamic, 2016, p. 280), observers expect that it will reach $ 40 billion by 2023 (PR Newswire, 2018). However, regulations and legislations in this sector remain under development and face many challenges on top of which are conflicting legislations.

b) The historical stages of the Takaful insurance industry

The following table summarizes the stages of the Takaful insurance industry:

Table 1. Development of the Takaful Insurance Industry

Year	Development of the Takaful Insurance Industry
1964	A meeting of the Islamic Fiqh Academy was held in Damascus, in which the issue of insurance was discussed, as most of the scholars agreed on the prohibition of commercial insurance and approved cooperative insurance as an alternative to it.
1979	Faisal Islamic Bank in Sudan established the first Takaful insurance company under the name of the Sudanese Islamic Insurance Company, and at the end of the same year, Dubai Islamic Bank in the United Arab Emirates established the Arab Islamic Insurance Company in the Emirate of Dubai.
1983	Establishing Islamic Takaful Company in Bahrain and Luxembourg
1984	Establishing a Takaful Insurance Company and activating the Islamic Insurance Law in Malaysia
1985	The first Islamic insurance company was established in the Kingdom of Saudi Arabia under the name of the National Company for Cooperative Insurance, which is a fully governmental company. In the same year, the Islamic Insurance and Reinsurance Company was established in Bahrain.
1992	The global Islamic insurance company in Bahrain, established with the support of Bahrain Islamic Bank
1994	The Indonesian Takaful Company
1995	The Singaporean Takaful Company and the Islamic Cooperation Company of Qatar
1996	The Islamic Insurance Company in Jordan, established with the support of the Jordan Islamic Bank.
2003	Al-Ikhlas Takaful Company.
2004	Al-Ikhlas Takaful Company is established in Malaysia
2005	Mae Pan Takaful Company is established in Malaysia
2009	The number of Islamic Takaful companies reached 173 companies, most of which were direct insurance companies and some were re-insurance companies.
2013	The number of Takaful insurance companies in the world has increased to 206
2015	The size of the Takaful insurance market reached 14.9 billion dollars, compared to 13 billion dollars in 2014
2016	Total Takaful contributions amounted to $ 18.6 billion
2019	Total Takaful subscriptions amounted to $ 23.7 billion

Source: Prepared by the two researchers based on the following sources:

- Ahmad Salem Melhem, Islamic Insurance, Dar Al Thaqafa for Publishing and Distribution, Amman-Jordan, Edition 1, 2012, p. 23.
- Deloitte, The global Takaful insurance market, p11, Access date 29/01/2015, from http://www2.deloitte.com/content/dam/Deloitte/lu/Documents/finance/1947_global-takaful-insurance-market_AAM.pdf
- Global Islamic Finance Report 2016, The Dynamics of Takaful Market: Growth Beyond 2016, p279, Access date 27/11/2017, from http://www.gifr.net/gifr2016/ch_09.pdf
- IMARC, Takaful Market: Global Industry Trends, Share, Size, Growth, Opportunity and Forecast 2020-2025, Access date 06/06/2020, from https://www.imarcgroup.com/takaful-market

2.4. The differences between takaful and conventional insurance

There are many differences between takaful and conventional insurance due to the nature of each of them and the relationship that arises with others (Beltagy, 2008, p. 41). The following table shows the most important of these differences:

Table 2. The most important differences between takaful and conventional insurance

comparison aspects	conventional insurance	takaful insurance
Parties of the relationship	company and policyholders	Total participants in the Takaful Fund and the administrative body
The nature of the contract	A netting contract between the policyholders and the company	Donation contract/cooperation
objective	Achieving the largest possible profit for the shareholders at the expense of the insured	Cooperation to mitigate harm between participants
The managing company	owns the premiums and has profits	It manages the insurance, in terms of managing coverage, insurance business, and investing the fund's money for a pay
legitimacy	Quasi-consensus among contemporary scholars on the inadmissibility of conventional insurance	Islamic insurance permissible
Sharia control	Not subject to Sharia supervision	Subject to Sharia supervision
Financial structure	There is no difference between insurance contributions funds and shareholder funds	Divided into the shareholder's account and the subscribers account to avoid money mixing
Policyholders Fund	There is no such box	Its assets consist of the total contributions of policyholders, investment profits, and approved reserves
Insurance surplus	Installments become the property of the company by contract and receipt, as it is considered revenue and profit	It is a surplus property of subscribers, the regulations of the fund decide how to behave
Insurance disability	Responsibility of the shareholders alone	To be paid by the group of subscribers (policyholders)

Source: Prepared by the authors.

2.5. The account of the shareholders and subscribers and what each of them bears

The Takaful insurance company consists of two independent bodies: the Shareholders 'Authority and the Participants' Authority. The following is specified what each of them will bear:

a) **shareholders ’account consists of:** The following table shows the resources of the shareholders' fund and their corresponding uses:

Table 3. Resources and Uses of the Shareholders' Fund in the Takaful Insurance Company

Resources	Uses
Shareholders' Fund Capital	An interest-free loan to the subscribers' fund
Return on investments for shareholders	Administrative and operating expenses
Interest-free loan repayment	Investing shareholders' money
The Mudarabah profit share as a Mudaraba factor	Reserves
Insurance Department wages and allowances	----

Source: Muhammad Ali Al-Qari Bin Eid, The Insurance Surplus, Its Calculation Criteria, and Provisions, Conference: Cooperative Insurance: Its Dimensions, Prospects, and Islamic Sharia’s Attitude Toward It, Jordan, April 11-13 2010, p. 04.

b) What the subscribers account consists of:

The Takaful Fund resources and expenses include the following:

Table 4. Resources and uses of the subscribers' fund in the Takaful insurance company

Resources	Uses
Subscriptions	Actual risk compensation for subscribers
Investment returns for subscribers	Administrative and operating expenses
Refunds	Commissions for insurance brokers
commissions and returns of reinsurance	Reinsurance premiums
Other income	Investing subscribers' funds
---	Precautions
---	Distributions of insurance surplus

Source: Muhammad Ali Al-Qari Bin Eid, The Insurance Surplus, Its Calculation Criteria, and Provisions, Conference: Cooperative Insurance: Its Dimensions, Prospects, and Islamic Sharia's Attitude Toward It, Jordan, April 11-13 2010, p. 04.

2.6. Compensation in Takaful insurance companies

a) Definition of compensation

Compensation is a contractual obligation whereby one of the parties undertakes to compensate the other party for a specific loss suffered by it, in other words, compensation is considered an acknowledgment and commitment by one of the parties to cover the obligations that another party is likely to face.

One of the main advantages of compensation is that the resulting obligation can extend beyond what is imposed on one of the parties in one way or another under common law. (Adorante, 2007, p. 15)

Compensation is primarily aimed at returning the aggrieved party to their first position again, he becomes as if he did not suffer any loss whatsoever, even if the party who agreed to compensation was not obligated to do so.

b) Definition of compensation process in Takaful insurance companies:

It is the process related to the payment of the sum of the insurance or the compensation due to the insured based on cooperation. The contract is based on solidarity in distributing risks and restoring their effects (Melhem, 2005, p. 47). Compensation in the takaful insurance is paid out of the total available premiums. The compensation in the takaful insurance is disbursed from the total available premiums, and if the installments are not sufficient to meet the compensations, members are asked to increase their contributions to compensate for the difference, or from the reserves made from profits by law or through a free from interest loan (Eid Ahmed Abu Bakr, 2009, p. 316).

3. The insurance surplus and the profitability of the Takaful insurance companies

The difference between what was collected from the premiums and what was paid in terms of compensation in the Islamic Takaful insurance system is called an insurance surplus. It is called a profit In the commercial insurance system. We will define the concept of the insurance surplus accurately through the following elements:

3.1. Definition of insurance surplus

There is a set of definitions that highlight the concept of insurance surplus, the most prominent of which is the following definition: The insurance surplus is: "the financial balance remaining from the subscribers' premiums and their investments, after paying compensation and deducting the balance of technical reserves and covering all expenses and expenditures, and it is the absolute property of policyholders that they share as determined by the insurance system approved by policyholders, the shareholders of the Islamic insurance company have no right to the insurance surplus " (Al-Khoweildy, 2012, p. 08).

3.2. The components of the insurance surplus

The insurance surplus consists of:

a) All insurance premiums were written by the company (Al-Homsi, 2008, p. 32), Excess amounts after paying insurance sums to those on whom the insured risks have fallen, payment of insurance management wages, Other expenses related to the Takaful insurance fund (Al-Aifah Abdel-Haq, 2012, p. 11);

b) Policyholders' share of premiums investment profits (Sabbagh A. M., 2012, p. 09);

c) Returns from reinsurance operations (Al-Saad, 2011, p. 21).

3.3.The difference between the Takaful insurance surplus and the commercial insurance profit

The insurance surplus is one of the essential differences that distinguish Islamic insurance companies from conventional insurance companies. The following table highlights the most important differences between the surplus in Takaful insurance companies and the profit in conventional insurance companies:

Table 5. The difference between the Takaful insurance surplus and the conventional insurance profit

	Islamic insurance surplus	**Profit of Conventional insurance**
the meaning	The surplus of contributions and their profits after paying compensation and expenses, paying reinsurance amounts, and setting aside reserves and allowances	The increase in the capital after it is circulated in trade and investment
its nature	it is unintended from the act of insurance, as the Takaful insurance is based on a binding organized donation contract	Originally intended and included in the calculation of the premium elements, because the traditional insurance is based on the netting contract on ambiguity
its target	Cooperate in breaking down the risk and bearing the damage by initially donating the premiums	Netting and the interest of shareholders in the insurance company only
Property	It is the right of policyholders alone and owned by the subscriber's body	It is the right of the shareholders alone and is owned by the insurance company
distribution	Following the provisions of the company's statute and the board of directors, as required by the interest of policyholders and the nature of the takaful insurance system	As required by law and the interest of the insurance company shareholders

Source: Al-Aifah Abdel-Haq, Mohamed Ibrahim Madi, insurance surplus and its distribution in Islamic insurance companies, the seventh international conference on "the insurance industry, practical reality, and development prospects - the experience of some countries- Hassiba Ben Bouali University, Chlef, 03-04 December 2012, p. 08.

4. The effect of compensation on the insurance surplus and the profitability of the Islamic insurance company in Jordan

4.1. Introducing the Islamic insurance company

The Islamic insurance company is a financial company whose activity is based on managing its funds by the provisions of Islamic law, away from unfairness, deception, usury, and consuming people's money unlawfully, and it practices insurance operations based on solidarity approved by Islamic law and based on the agency with a determined wage or the investment in policyholders money:

a) **The establishment:** The Islamic Insurance Company was established on 01/10/1996 corresponding to 1416 AH and registered under No. (306), it started working on 05/02/1996, with a capital of fifteen million Jordanian dinars, fully paid. (The Islamic Insurance Company, 2019, p. 10)

b) **The main activities of the company:** property insurance and social insurance for medical treatment expenses following the provisions of Islamic Sharia and under the instructions of the Insurance Authority in Jordan.

4.2. The basis for determining the insurance surplus in the company

The insurance surplus is what is left of the total collected contributions, the returns on its investments, and any other revenues, after deducting the compensation paid to the subscribers, technical allocations and reserves, and the share of property rights holders in exchange for managing each of the takaful insurance business and investment activities and all other expenses of the policyholder fund. The company also calculates the insurance surplus based on considering all different types of Takaful insurance as one unit. (The Islamic Insurance Company, 2019, p. 12)

4.3. The development of compensation, surplus, and profits in the Islamic Insurance Company of Jordan for the period 2010-2019

By reading the data contained in Table No. (06), it is noted that the average compensation paid amounted to 8633491 Jordanian dinars during the period 2010-2019, and the compensation value during the study period ranged between (6156912) and (11733026) Jordanian dinars, and the rate of increase in compensation was estimated at (5.99%) during the study period, i.e. doubled by about (90.57%), thus witnessing a steady increase from year to year, at an annual rate of increase estimated at 578080 Jordanian dinars.

It is noticed that the average surplus of policyholders amounted to 366304.8 Jordanian dinars during the period 2010-2019, and the value of the surplus during the study period ranged between (15484) and (599633) Jordanian dinars, and the percentage of increase in the surplus was estimated at (53.8%) during the period The study doubled by about (3772.6%).

While the average profits of the company amounted to 1165515.8 Jordanian dinars during the period 2010-2019, and the value of profits during the study period ranged between (334199) and (2002246) Jordanian dinars, The rate of increase in profits was estimated at (20.2%) during the study period, i.e. doubled by about (499.12%), which means a regular increase from year to year at an annual rate of increase estimated at 128,312

Jordanian dinars.

Table 6. Development of compensation, surplus, and profits in the Islamic Insurance Company in Jordan from 2010 to 2019.

Year	Compensation	Growth	Surplus	Growth	Earnings	Growth
2010	7327077	-	336563	-	334199	-
2011	6930634	-5,41	537367	59,7	558309	67,1
2012	6156912	-11,16	209206	-61,1	725000	29,9
2013	7204394	17,01	556440	166,0	1008184	39,1
2014	7941213	10,23	599633	7,8	1080947	7,2
2015	7887501	-0,68	502099	-16,3	1787628	65,4
2016	9907369	25,61	451001	-10,2	1863302	4,2
2017	10877033	9,79	369830	-18,0	2002246	7,5
2018	10369750	-4,66	15484	-95,8	1114427	-44,3
2019	11733026	13,15	85425	451,7	1180916	6,0

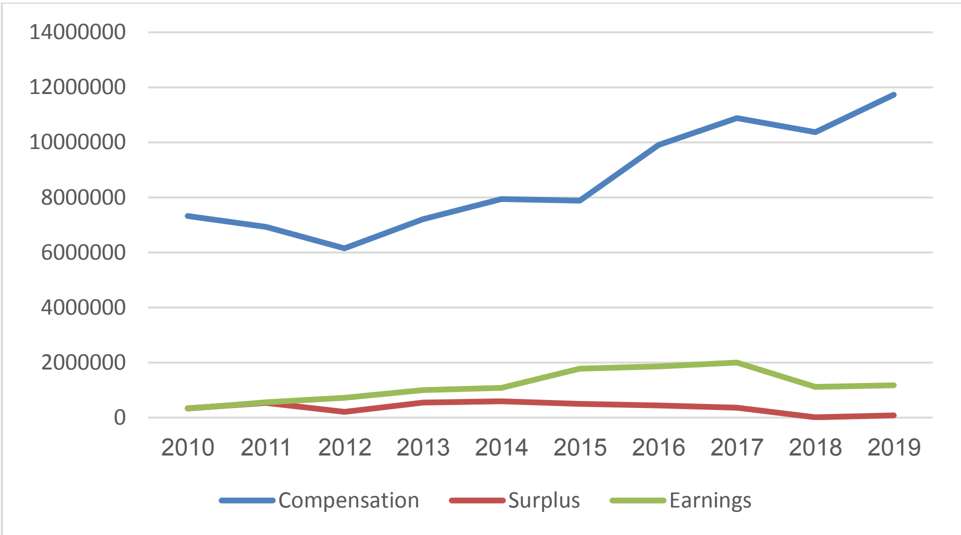
Source: The Islamic Insurance Company, Annual Reports, Access date 20/06/2020, from http://www.islamicinsurance.jo/page/annual-reports

4.4. The impact of compensation on insurance surplus and profit

Through the figure below, we notice the existence of an inverse relationship between the compensation value and each of the insurance surplus and the company's profits, that is, the higher the compensation value, the lower the surplus and the profits. However, it is noticed that the value of the decrease in the surplus is greater than the value of the decrease in profits. We also find in some years a direct relationship between the compensation and the profits of the company, meaning that the increase in the compensation value did not negatively affect the profits of the company.

As a result, it can be said that the compensation value hurts the insurance surplus while not affecting the company's profits.

Fig.1. Development of compensation, surplus, and profits in the Islamic Insurance Company in Jordan for the period 2010-2019



Source: Prepared by the researchers according to Table No. 06

To confirm the findings, we conducted a standard study to find out the effect of compensation on the insurance surplus, by adopting a simple linear regression of the compensation value on the surplus. The results of the linear estimate are shown in the following:

From the table below, the regression model can be written as follows:

$$Y^{*}= a + b\ x \pm Syx$$

Y = (Surplus) ،x = Indemnisation

Surplus = 825901,578- (0.053) Indemnisation

The slope parameter indicates that increasing the compensation value by one degree leads to a decrease in the insurance surplus by (0.053).

Table 7. Results of the written assessment of the effect of compensation on the surplus

Coefficients						
Model		Unstandardized coefficients		Standardized coefficients	t	Sig.
		A	Standard error	Bêta		
1	(Constant)	825901,578	286526,910		2,882	,020
	Compensation	-,053	,032	-,501	-1,639	,140
a. Dependent variable: Surplus						

Models summary				
Model	R	R-two	R-two adjusted	Standard Error of Estimate
1	,501[a]	,251	,158	186823,849
a. Predicted values: (constant), Compensation				

Source: Prepared by the two researchers, based on IBM SPSS Statistics 20

We will use the "t" test to test the hypothesis of the slope parameter "b" according to the following hypotheses:

H0: b = 0 H1: b ≠ 0

The decision on these hypotheses is to reject the null hypothesis at a significance level of 5% if (p <0.05).

The p-value of the slope parameter "b" is equal to (0.14) and it is greater than 0.05. This reflects the insignificance of the variable in the model i.e. acceptance of the null hypothesis, which means that there is a weak effect of compensations on the surplus. Therefore, we find that there is a weak inverse relationship between compensation and insurance surplus, which is confirmed by the coefficient of determination, whose value is weak and is estimated at 25 percent, and the explanation for this is that 25% of the data or total deviations in the values of the adopted variable (insurance surplus) are explained by the linear relationship, i.e. The regression model and that 75% of the deviations are due to other factors represented by the following elements (Sabbagh A. M., 2012, p. 227):

a) Contributions volume (insurance premiums) and the Takaful Fund (number of participants);

b) Experience and activity of marketing departments in Takaful insurance companies;

c) Sums collected through contributions assigned to investment;

d) The company's management experience in legitimate investments and was well-chosen from among those investments;

e) Reinsurance: With the good management of the company for the global reinsurance process and taking into account the return rate, the return price will be large;

f) The amount of remuneration known to the agency on which the company manages insurance operations;
g) Expenses incurred by the Takaful Insurance Fund;
h) Composition and volume of technical reserves;
i) The behavior of policyholders and the extent of their liability.

In the same way, we conduct a standard study to find out the effect of compensation on the profit of the company, as we conduct a simple linear regression of the value of compensation on profits, and the results of the linear estimate are shown as follow:

$$Y^* = a + b\,x \pm S_{yx}$$

Y = (Profit) ،x = (Indemnisation)

Profit = -335870.625+ (0,174) Indemnisation

The slope parameter indicates that increasing the compensation value by one degree leads to an increase in profits by (0.174).

Table 8. Results of the linear assessment of the impact of compensation on profits

Coefficients						
Model		Non-standardized coefficients		Standardized coefficients	t	Sig.
		A	Standard error	Beta		
1	(Constant)	-335870.625	739858,850		-,454	,662
	Compensation	,174	,084	,591	2,074	,072
a. Dependent variable: Profit						

Models summary				
Model	R	R-two	R-two adjusted	The standard error of estimate
1	,591[a]	,350	,268	482409,413
a. Predicted values: (constant), Compensation				

Source: Prepared by the two researchers, based on IBM SPSS Statistics 20

We will use the "t" test to test the hypothesis of the slope parameter "b" according to the following hypotheses:

$H0: b = 0$ $H1: b \neq 0$

The decision on these hypotheses is to reject the null hypothesis at a significance level of 5% if ($p < 0.05$).

The p-value of the slope parameter "b" is equal to (0.072) and it is greater than 0.05. This reflects the insignificance of the variable in the model i.e. acceptance of the null hypothesis, which means that there is a weak effect of compensation on profits.

Consequently, we find that there is a weak direct relationship between compensation and profits, which is confirmed by the coefficient of determination, whose value is weak and is estimated at 35 percent, and the explanation for this is that 35% of the data or total deviations in the values of the dependent variable (profits) are explained by the linear relationship, i.e. the regression model And that 65% of the deviations are due to other factors, including returns on investments to shareholders, the share of speculative profit, wages and allocations of the insurance management.

5. CONCLUSION

Through this research, we made sure that the goal of takaful insurance is limited to providing insurance services to its members in the best way and at the lowest possible cost. In other words, this type of organization does not seek to achieve any profit from carrying out insurance operations, as profitability in takaful insurance is a secondary matter and not a primary objective. This is what was explained to us by the result of the standard study, which is the existence of an inverse relationship between the compensation value and the insurance surplus remaining in the takaful fund, and a weak positive relationship between the compensation value and the company's profits, that is, the more compensation, the higher the profits by a small percentage, and vice versa. This proves for us that the compensation does not diminish the profits of the company, but rather it is spent from the total available installments. The study highlighted the most important characteristics of Takaful insurance, which is the separation of the shareholders' account from the account of the insured participants (policyholders).

5.1. Results:

The most important results of the research are the following:

a) The compensation in takaful insurance is disbursed from the total available premiums, unlike the compensation in the conventional insurance, when the profit of one of the parties means the loss of the other;

b) The contract between the participants in the Takaful insurance company is a donation and takaful contract that is not intended to be profitable in the first place;

c) The financial structure of a Takaful insurance company is based on two different parts of the accounts, which are the shareholders' account which systematically represents the capital of the company, and the insured subscriber's account (policyholders), which systemically represents the Takaful insurance fund

d) The existence of an inverse relationship between compensation and insurance surplus (negation of the research hypothesis);

e) There is a positive relationship between the compensation and the company's profits (confirmation of the research hypothesis).

5.2. Recommendations:

Based on the research results, the study recommends the following:

a) Developing insurance companies by introducing the artificial intelligence feature in claim settlement to be faster and more accurate, as well as saving time and effort and avoiding mistakes, which increases the profitability of these companies;

b) Work on enacting laws and legislations that encourage and facilitate the work of Takaful insurance companies.

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