



## Advancing Takaful Industry to the Next Level:

### **Strategies to Translate Market Potential to Real Growth**

Takaful growth continues unabated, but the question on our minds is whether growth could be even higher, due to the strong fundamentals of the potential market such as the need for Muslims to have insurance coverage and the continued growth of Islamic banking. This paper discusses strategies to translate market potential to real growth from the perspective of customer strategies, product strategies, distribution strategies and branding strategies.

### **Market potential from a macro point of view:**

From the 2012 EY World Takaful Report the total Takaful market was \$8.3 billion in contributions in 2010, but this includes Saudi Arabia cooperative companies. Since it is difficult to determine which companies have shariah councils, we exclude them (\$4.37 billion). Ranking the countries (excluding Saudi Arabia and Iran) in US\$ million:

1.	Malaysia	1,441
2.	UAE	818
3.	Sudan	363
4.	Indonesia	314
5.	Qatar	260
6.	Bangladesh	166
7.	Brunei	158
8.	Kuwait	133
9.	Bahrain	102
10.	Thailand	38

There is varying levels of potential in these markets, as well as new markets not included here. Muslim countries such as Pakistan, Nigeria and MENA countries will surely grow in terms of Takaful sales. This is especially true of MENA with Arab Spring likely to accelerate interest in following Islam in all aspects of our lives, including Islamic finance. It is also expected that non-Muslim countries such as India, the former Soviet States and China with the large Muslim populations will also develop and grow Takaful. Finally western countries with Muslim populations more knowledgeable in insurance will also drive Takaful, not only Turkey but also countries with current or past Takaful operations such as UK, US, Canada and South Africa. Takaful, like any form of insurance, requires appropriate investments. In this regard Takaful's true potential in a country will be related to the growth in Islamic banking and investments. It is telling that even in Malaysia which is a leader in Islamic finance there is a challenge obtaining appropriate assets.

Within the countries currently selling Takaful there is potential in the types of products being sold. For instance in the Middle East currently sales tend to be in general Takaful, especially commercial products. Over time as governments there are less able to take care of the needs of the population in



areas such as health care retail products will grow in popularity. Indonesia is one country with surging Takaful sales and due to the large numbers of Muslims and economic situation growth is likely to continue strongly. Even within Malaysia with its strong growth in Takaful there are vast differences in insurance / Takaful penetration by state, with areas such as Kuala Lumpur, Selangor, Penang and Johor having much higher penetration rates than traditional Muslim areas such as Kedah, Terengganu and Kelantan.

When looking at market potential the market can be split in various manners. The market can be split into mass market, middle market and affluent market, with different product types generally targeting each market. Mass market products tend to be more affordable such as personal accident and term whereas products tailored for the affluent market tend to have more product features and be service oriented. Generally, Takaful operators will have a strength in a particular area, such multinationals tending to focus on the middle and affluent markets.

Potential can also be split between policyholders only interested in conventional insurance, the floating mass market, and policyholders only interested in Takaful. Whereas there are some policyholders who will only buy conventional insurance, most either look for the best value (floating mass market) or will only purchase Takaful. The marketing push and products would likely be slightly different towards each of these markets. In the floating mass market the products will likely look quite similar and comparable to conventional insurance, whereas for participants only interested in Takaful something which looks unique and clearly acceptable would be the focus. Looking at the very low insurance penetration in the Muslim world, especially for family products, this is likely to be a significant potential for growth in the future from participants who would only purchase Takaful. Related to the issue of whether Takaful is to look quite similar to conventional insurance or uniquely different is whether Takaful will complement / complete the market or alternatively take business away from conventional insurance.

The potential for takaful is also not necessarily only limited to Muslims, in some Takaful operations in Malaysia a majority of the participants are non-Muslim. Thus Takaful potential could also include sales to non-Muslims, possibly being sold as an ethical product.

When analysing ideas and strategies to translate market potential to real growth we can categorize them into four main categories:

- Customer Proposition

Customer proposition refers to determining who we want to get as our participant, our value proposition and our target market.



- Product Positioning

This refers to decisions such as focusing on savings versus protection products, family versus general and covering participants' needs at every life stage.

- Distribution Strategy

In addition to the standard agency force and bancatakaful there are other potential distribution channels which can be tapped.

- Brand Strategy

This is the strategy to create brand awareness.

### **Customer Proposition:**

In a nutshell we want to get everyone as our customer! To be more precise we want to target the segments of business discussed above under a macro view. We need to be careful however in trying to be a jack of all trades not to be seen as an expert in nothing. We must also ensure the market segments we target are profitable. Whereas there are Takaful operators that focus on all markets, most have a specialty within certain subsets. We need to determine where exactly we are adding value versus conventional insurance. Is it transparency, fairness, equity, surplus sharing, or something else? Whatever it is we need to understand this and focus on it. We also need to target our product strategy to cater for each target market we are interested in. This is discussed below.

### **Product Positioning:**

In Malaysia unit linked products are currently extremely popular. This is good in that it is directly comparable to conventional insurance products. This ignores the potential value of non-linked Takaful plans which can be compared to conventional participating products. For conventional insurance products occupy a certain market segment, distinct from unit linked, for people who do not want the daily fluctuation of unit linked. Such Takaful products can occupy the same sphere.

Annuity is a particular market segment where sales in the developed world make up a significant portion of total sales, but is virtually non-existent in Takaful. Here there are model issues which must be solved for this plan to move forward. This has the potential to be a significant growth area for Takaful, along with other plans for needs during the retirement years, such as long term care and other medical plans.

Universal life is one product type which might work very well in Takaful. A participant could increase or decrease contributions and / or benefits as their life stages change, such as a participant getting additional coverage when they get married or have children.



There are some participants who prefer to have guarantees in their products. The challenge in Takaful now is in deciding if this is acceptable and under what model. Takaful is not a finished product. It is quite likely that new models and methods of operations will continue to be introduced over the next 5 to 10 years as Takaful matures. One question which we need answers to is how to design products which incorporate guarantees: use a wadiah model? Some sort of Qard model? Something we haven't heard of yet?

In general Takaful motor Takaful is one product type where operators generally lose money due to the levels of the tariffs, to the extent that in Malaysia many operators are avoiding this class of business completely. Motor is one class of business where it is vital to achieve critical size. With critical size there is more leverage to control claims and thus ensure the business is profitable. In Takaful fairness is a key aspect so in this regards charging tariff rates rather than basing rates on expected claims amounts hurts the entire Takaful process. When Takaful rates are based on expected losses segregated pools can be developed for each major product type, whereby surplus received back from each pool can be used to encourage more participants and for participants to see the beauty of Takaful and gain faith in the system.

Takaful is better suited for personal risks rather than commercial risks. Takaful is based on the idea of mutual help and assistance, which implies the use of the law of large numbers. For large and specialized risks in general Takaful the law of large numbers does not generally exist. Thus the use of retakaful is needed. Unfortunately in many cases the retakaful operator can only retain a small portion of this risk, passing the rest of the risk to conventional reinsurers. Thus significant amounts of contributions are "leaked" into the conventional sphere. Perhaps for these risks a Lloyd's type "MENA pool" for example can be developed whereby the risks are pooled amongst a larger group of operators. This allows operators to gain diversification of its risks as well as ensure more contributions are kept in the Takaful system. Such pools can have their own actuary or other technical experts and fair rates charged to each operator for the particular risk. In this way undercutting is minimized, which is a concern in much of the Takaful world.

### **Distribution Strategy:**

A conventional insurer starting sales of Takaful will need to determine if only new agents can sell Takaful or whether existing conventional agents will be allowed to sell Takaful. Allowing this opens the insurer up to cannibalism if the agent can only sell a certain volume of business, but if the agent regularly ran into potential participants interested in Takaful (but had to turn down in the past) then allowing these agents to sell Takaful represents an area for growth.

Bancatakaful represents a particular challenge for Takaful. Bancatakaful products generally need to have a different look and feel than equivalent agency products. This is due to the reality of the banking staff having relatively less time to close a case, thus needing to focus on simple products. This is also due to the need to differentiate from agency products to not take from agency sales. If the same product is available at a bank for a much cheaper price due to lower commissions (this is a requirement in Malaysia though there are ways around it) then it might be very difficult for an agent to



sell. In some cases this challenge is solved by charging the same for both agency and banca distributions, but this is not always possible. In Takaful products are extremely transparent and generally lack guarantees, thus making differentiation from agency products a challenge.

There are other distribution strategies for Takaful to target differing market segments. Strategies such as web sales and credit card sales can target the middle market effectively, as this market segment tends to be computer savvy and actively uses credit cards. The products under such distributions would need to be relatively simple which would likely not be ideal for the affluent market. Worksite marketing can be used to target the mass market. In worksite marketing the Takaful operator sets up a booth or tables at a company worksite to market its products with the endorsement of management. Management of the company is sold the need and usefulness of Takaful coverage for the company's employees (paid for by the employees themselves) and how this can be seen as completing the company's other employee benefits. Due to the potential for discounted rates this marketing might be considered an employee benefit. Since management provides an endorsement this effectively jump starts brand awareness for Takaful at the company. The salary deduction services by the employer also help in expense and persistency management. Call centres as well can be very effective in targeting the mass market depending on the type of name list being rented / purchased. Similarly due to the overwhelming use of mobile phones, sales of Takaful via mobile phones can effectively tap into the mass market.

Another distribution strategy for the mass market is microtakaful. Operators in several countries are targeting this channel, such as in Indonesia and Bangladesh, but there is much more which can be done. For instance sales can be channelled through the imam (leaders) of the mosques, firstly through the national mosque, then down to the state mosque and further to individual mosques. In many countries the religious leader holds significant sway over the behaviour of the people in his area. Thus if this leader can be effectively shown that Takaful is acceptable religiously, he can be used for selling to his constituency. Surplus and part of the commissions for such sales can be used to help the area it came from, further increasing awareness and sales. This will help show Takaful as a means of gaining religious benefit and instil the spirit of helping one another. The use of the mosque structure will help to contain costs, which is a key consideration for microtakaful. Microtakaful as well is a complement to microfinance efforts in a market.

**Brand Strategy:**

A 2011 Swiss Re APAC survey of risk appetite and insurance showed that around 40% of Indonesians and 20% of Malaysians were not aware of Takaful. Extending this to people with only limited knowledge of Takaful, 95% of Indonesians and 70% of Malaysians have limited or no knowledge of Takaful. This lack of brand recognition points to a glaring need to promote Takaful as a brand. With greater awareness of Takaful sales will surely increase. One way to do this is through industry products, products developed for sales by the entire industry rather than a particular operator. In Malaysia it is common for such industry plans to be sold by conventional insurers through the life and general insurance associations. These plans tend to have reasonable profits as insurers are working



together to sell such plans rather than competing on price. Marketing can also be more focused and efficient.

### **The role of regulators:**

Any discussion of market potential is incomplete without discussing the role of the regulators. An excellent example of regulators who have actively attempted to realize market potential is Bank Negara Malaysia (BNM). BNM has released a number of guidelines to help with market conduct and corporate governance. These include guidance as to the role of the actuary (key person in ensuring fairness and equity in Takaful which plays a large role in helping to gain faith in the Takaful concept), surplus sharing, the role of the shariah council, investment management and related party transactions. Perhaps Takaful needs to go further, and implement a participants' advocate who will sit in on shariah council meetings and board meetings to ensure the voice of the participant is being heard. To the extent regulations assist or hinder the development of differing products, models or distributions regulators assist or hinder the realization of potential growth. A robust regulatory environment in which the unique features of Takaful are accounted for goes a long way in this regard.

Regulators also determine the amount of solvency capital the Takaful operator needs to hold. The larger the capital held the higher (absolute) returns are needed to service this capital. Higher returns for the operator implies lower returns for participants as at least initially, most of the required solvency capital is provided by the Takaful operator, so the regulator must ensure the level of capital held is fair for the risks being taken on as well as fair versus conventional insurance. How this solvency capital translates to the pricing of individual products and product types will determine the extent potential growth from such products can be realized. Risk Based Capital is coming worldwide and Takaful will be no exception to following this. Regulators thus play a key role in translating market potential to growth.

In jurisdictions where Takaful is not formally allowed Takaful operators will need to operate under conventional insurance rules, either continuing to follow Takaful models and methodology or as a cooperative insurer. In each case the focus should be on how to best translate potential to actual growth (substance over form). This is seen in Takaful in countries such as Saudi Arabia, who follow Takaful models and methodology but also fit into a cooperative framework.

### **Conclusion:**

Translating potential to growth involves careful analysis of the customer proposition, product positioning, distribution strategy, and brand strategy. As an industry we need to work to expand our product range to equal that of conventional insurance, continue to expand the distribution strategy to capture the mass market, and develop industry products to increase brand awareness. There is also an important role for the regulators and the Islamic capital markets as without the two complementing the industry's push for takaful, opportunities for takaful would be severely limited.