

COMPATIBILITY BETWEEN ISLAMIC INSURANCE THEORY AND ITS CURRENT MODELS OF OPERATION

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ABSTRACT

Aspiring organization or profession must have a holistic unification of theory, philosophy and practice. This line of idea applies to the Islamic financial industry, specifically the Islamic insurance industry. Therefore, this study evaluates how articulated is the system of Islamic insurance in terms of its theory and business models. This is essential for the industry to combat external threats and challenges. Qualitative methods of induction and deduction were adopted to explore existing literature on Islamic insurance's theory and business models. The comparative and dedicated analysis was employed to vindicate whether Islamic insurance's system is unified or fragmented. The results showed that Islamic insurance's system is totally in fragmentation as there was no compatibility between Islamic insurance's theory and business models. To eradicate factors mitigating the industry's progress, there should be further investigation on ways of homogenizing and harmonizing all branches and core system of the industry.

Keywords: Islamic, Insurance, Operation, Model, Theory.

JEL: G22, G23

INTRODUCTION

Islamic insurance is one of the ancillary aids to Islamic commercial activities such as the role of conventional insurance to trade. The conventional insurance has been practised and standardized over centuries compared to Islamic insurance which is less than a century in practice. It is expected that Islamic insurance is influenced by the conventional insurance orientation (Cohen, 2005). This expectation is obvious and manifested in the objectives and aims of Islamic insurance industry. These include reduction or elimination of hazards, protection of properties, caring for aftermath (loss or damages) of perils and other general risk management issues (Al-Shubayli, 2009; Al-Suwaylim, 2009). It is furthermore assumed that the formation and development of Islamic insurance follow most (if not all) of the hurdles conventional insurance had passed throughout its standardization processes (Abidin, Bakar & Haseeb, 2014 & 2015; Abidin & Haseeb, 2015).

Insurance business began as a profession without theoretical justification during the Europeans' exploration periods which entail the discovery of Africa and other Asian nations. In addition, there were limited means of transportation and amount of life entails in the sea voyage. The common way was to navigate the oceans, lakes, seas, etc. in order to facilitate the exchange of goods and services and as well as to fulfil the explorers' taste for new discoveries (Schultz & Bradwell, 1960). For example, the first slaves and gold to be exported from Africa was in 1445 by the Portuguese from the gold coast (Ghana) (Black Presence, 2013). Without standardization, early insurance business was dominated by gambling activities. This allowed anyone to affect

insurance policy on anything without financial stakes and for the purpose of financial gains (UK Government, 1774). However, in 1668, the standardization surfaced through the official status of Lloyd's underwriters. This was followed by the establishment of life expectancy table which makes premium calculations at least reasonable (Schultz & Bradwell, 1960). This was because life assurance is one of the earliest forms of insurance contracts. The British Government enacted life assurance gambling act of 1774 prohibiting and declared criminal offence all forms of life assurance policy without insurable interest (UK Government, 1774).

For the sake of brevity, the above scenarios over the time were conceptualized as a theory. There has been a solidifying system which linked every aspect of insurance to one another. For example, there have been connections between the antecedent of insurance, its regulations, products and its justifications as shown above. It serves as guidance for further development of insurance professionals and its related areas such as actuary, etc. Since Islamic insurance is mirrored or portrayed as insurance and aims to provide similar services as conventional insurance, then its features must be shaped by the insurance industry's history albeit with differences in concepts. Therefore, the justification of relevancy of Islamic insurance must be theorized in line with traits of insurance (Abidin, Haseeb, Azam & Islam, 2015; Abidin, Haseeb & Islam, 2016; Abidina, Haseeb & Jantan, 2016). This is in terms of traits and substances. This includes the theory, models of operations, etc.

Truly, Islamic insurance has strived over the time to justify its existence through theory and as well as its models of operations that distinguish it from conventional insurance (Billah, 2003; Al-Qurradaghi, 2009; Al-Sanad, 2009). However, it is expected that there are greater and solid connections between the theory and models if the industry would survive competition against the insurance industry. Thus, this paper aims to evaluate the compatibility between the theory and models of operation of the Islamic insurance industry. The paper is arranged as follows: The next section states the role of theory in conceptual development, theory of Islamic insurance, business operational model, Islamic insurance models, methods and analysis of results which is an evaluation of fitness between Islamic insurance theory and models and conclusions.

ROLE OF THEORY IN CONCEPTUAL DEVELOPMENT

Idea generation is the initial phase of knowledge. These ideas, albeit, can be regarded as raw material or information. It is an unorganized concept floating on the cognizance of the researcher. However, its truth or falsehood is yet to be ascertained (Percy, 1982; Onwuegbuzie et al., 2009). This procedure in view of the empiricists-rationalists such as Campbell (1974) is what is known as evolutionary epistemology. Evolutionary epistemology tries to address knowledge questions from natural or epistemology viewpoint. It posited that the beginning is to generate natural or cognitive knowledge. The ideas generated can further be empirically tested (Gardner, 2006; Lea & Street, 2006; Bradie & Harms, 2012). These initial ideas were recorded for further deliberations, re-examination and investigation of concepts. The researchers' norm of keeping detailed records of earlier ideas and findings marked the development of theories. Thus, theories are justifications of claims of existential of knowledge or benefits in a specific field or profession.

It suffices that Islamic insurance concept has passed through the right procedure as demanded by educational norms. At this junction, it is important to state that the early proponents of Islamic insurance's idea have led to the development of Islamic insurance concept. This concept has positively developed into theory and practices. Whether the theory generated

from their natural assumptions is correct, is one of what prompted this study. The next section, therefore states precisely the theoretical justification of Islamic insurance profession.

THEORETICAL JUSTIFICATION OF ISLAMIC INSURANCE

Muslim scholars, secularists and other stakeholders have provided justification for the Islamic insurance concept. They have substantiated the claims of Islamic insurance's resemblance to conventional insurance. All these have repeatedly alluded to a form of pre-Islamic Arabs' system of fatal dispute settlement known as Aqilah (mutual prudence). Notably among these scholars are Yusof (2000), Billah (2003), Al-Qurradaghi (2004 & 2009), Hussain & Pasha (2011). Similarly, prominent regulatory institutions such as Islamic Finance Services Board (IFSB, 2012) and INCEIF (2012) proclaimed this concept.

The operation of Aqilah (mutual prudence), as stated above, is to prevent further bloodshed among the tribes in the Ijaz before the birth of Islamic civilization (Yusof, 2000; Billah, 2003; Al-Qurradaghi, 2004). It was usually invoked when a man from a tribe kills another man from any of the other tribes. Normally, the Arabs' norm was to kill the murderer in return and the dispute is settled or resulted in full-fledged civil war among the tribes at stake. In order to prevent further loss of lives and properties, the killer/murderer's family would step into his shoes and avail themselves for remedy. The remedy, usually, was financial compensation to the equivalent emotional value of the victim. Once the mutual agreement has been reached between the two conflicting tribes and as well a settlement is made, further bloodshed is prevented (Yusof, 2000; Billah, 2003).

The above idea was the assertion that Aqilah resembles conventional insurance because it prevented loss of lives and property that are main motives of conventional insurance. Based on this conclusion, it suffices to state that Islamic insurance operational models must be designed to reflect such assumed similitude. The business operational model must be inconsonant with its aims, objectives, theory and practices. In other words, there must be a holistic relationship among these variables before organizational success can aspire.

BUSINESS OPERATIONAL MODEL

Every organization must have its business model. This is because every organization takes some decisions in approaching its internal and external environmental issues. The internal issues are those within the organization such as governance structure and content (Casadesus-Masanell & Ricart, 2010). External issues however are those that the organization must provide such as adequate strategies in order to be able to withstand aggressive competitors in a similar industry. Thus, Amit and Zoh (2001) posited that business model depicts the content, structure and governance of transactions designed to create value through exploitation of business opportunities. Likewise, Baden-Fuller, MacMillan, Demil & Lecocq (2010) defined it as "the logic of the firm, the way it operates and how it creates value for its stakeholders".

From the above definitions, it is crystal-clear that the first definition highlights that organization's transaction contents such as goods or services, resources and capabilities are cogent aspects of business model. Similarly, transaction structures which include the parties, the link and the way they choose to operate make a reasonable degree of the system. Transaction governance, that is, the way flows of information, resources and goods are controlled by relevant parties, the legal form of organization and the incentives to the participants. Furthermore, Baden-Fuller et al. (2010) theorized that business model comprises of two different sets of elements: 1.

The concrete choices such as policies, governance structure and assets choices made by the management on how the organization operate. 2. The consequences of the choices (Casadesus-Masanell & Ricart, 2010).

From the above two paragraphs, it is appropriate to assume that Islamic insurance has been designed on solid business model. That its business models take care of all aspects of the industry and that it has positive impacts on the industry. At organizational levels, it is assumed that Islamic insurance organization' consents to the current business models that they are right choices as regards to business contents, governance, structures of transactions, assets' choices, etc. thus, the next section explores the operating models of Islamic insurance.

ISLAMIC INSURANCE MODELS OF OPERATION

Islamic insurance, like its counterpart insurance, provides soft product "services" of protections and preventions to its clientele. Its concept, as defined, is far different from the conventional insurance but the end results are certainly the same as the conventional insurance. While conventional insurance directly sells its products of protections and preventions to the insuring public in return for a guarantee of compensation in the events of losses or damages; Islamic insurance, however, encourages some sorts of mutual cooperation amongst its clientele. This transformation necessitates the change in business models and arrangement. In addition to the change in models, other important aspects of business such as regulations and governance, investments and innovations etc. were transformed to comply with the renovation. Hence, the famous, as stated in earlier literatures such as Billah (2003 & 2007), Maysamia and Williams (2006), Khan et al. (2011), Islamic insurance models of operations are wakalah (agency), mudharabah (investment), wakalah-mudharabah (agency-investment) and waqaf (pledge), just to name few were reiterated by INCEIF (2012). For the sake of brevity, these models are briefly but concisely narrated as follows:

Wakalah Model

Wakalah model "agency model" as defined dictate that the relationship between the Islamic insurance operators and the insuring public (technically known as Islamic insurance participants and henceforth refer as "participants") is based on agent and principal relationship. It defines the participants as the principals because they provided the Islamic insurance funds through their financial contributions to the pools. The operator, therefore, is their agent who manages the funds on behalf of the contributors. The amount to be contributed by each of the participants is based on the extent of their exposure to a specific and stated risk or perils. The Islamic insurance operators are the ones who determine the amount to be contributed. They are the ones who set criteria for participation and as well determine who and who qualify to join any of the available pools of funds. In the event of loss or damage which attracts compensation, the operator determines whether the claim is to be paid or not. In fact, in the event of deficient in the pools' funds, the operators were empowered by the Accounting and Auditing Organization for Islamic Financial Institutions' (AAOIFI) standard to call for additional contributions. Furthermore, the AAOIFI standard empowered the operators to institute a legal action against any participant who refuses to provide an additional contribution. Nonetheless, the operators are entitled to agency fees for their services provided. This model is a most celebrated model among the operators around the world (Khan & Hassan, 2007; AAOIFI, 2010).

Mudharabah “investment” Model

This model as defined dictates that the relationship between the Islamic insurance operators and the participants is a partnership relationship. The operators provide expertise and act as entrepreneurs and managers and the participants' funds serve as the capital provided for the investment. Therefore, the operators are playing professional funds' management roles. They manage the total funds and at the same time act as co-investors in the capital, based on their intellectual know-how of the investment. Like the agency model, the operators determine the type of investment, the allocation of funds and the sole knower of the revenue realized on both policy and investment returns of the funds. The sharing of profits among the investors and amounts are according to the predetermined ratio/percentage agreed between the partners. The participants however have no representative in the investment procedures or management. Likewise, the operators determine who and who entitled to join the pools of funds. They also determine the eligibility of a claim to be paid. In a null shell, the participants only provide the pools' funds which serve as the capital contributed to the investment model. In the event of loss arising from the investment, the capital providers “contributors” bear the total liability provided this arise without the negligence act of the operators. If the loss arises out of the operators' negligence, the operators are liable for all liabilities arising thereof (INCEIF, 2012).

Wakalah-Mudharabah Model

By definition, this model combines both agency and investment models together. Simply, a two-in-one model of operation. In this model, wakalah is instrumental for the underwriting procedure and mudharabah is instrumental in investment procedure. The operators' role is limited to the provision of expertise in the investment of the Islamic insurance funds. This is, wherein, the operators manage these funds on behalf of the participants and are entitled to performance fees. The fees are estimated as a percentage of each amount contributed “tabarr” (donation) by individual participants. The revenue realized after the deduction of performance fees and others liabilities are divided among the participants or as defined by the authorities (INCEIF, 2012).

Waqaf Model

In this model the participants' contributions of tabarru' (donation) i.e., the Islamic insurance funds are linked to a waqaf. Therefore, as the participants are making their contributions, they have agreed to relinquish a certain amount of money which is regarded as the waqaf funds. The waqaf can be established by the Islamic insurance operator by ceding a certain amount for compensating the participants or their beneficiaries. The ceded amount of the waqaf will be invested. Similarly, the Islamic insurance's funds will be invested. All investments are in accordance with Islamic law. Whoever signs up to an insurance contract would automatically participate in the waqaf program. The waqaf belongs to the contributors and stands as a legal entity as per its terms for investment, compensations and dealing with surpluses if any. The Islamic operator serves two roles. It acts as the manager and as the trustee (Abdul Wahab, Lewis & Hassan, 2007; Al-Shubayli, 2009).

METHODOLOGY

The researcher adopts a qualitative method to measure the rate of compatibility between Islamic insurance and its operational models. Particularly, induction and deduction methods followed by dedicated analysis would be employed to vindicate whether there are justifications for the relevancy of the current state of affairs in Islamic insurance. This is based on standard criteria such as market efficiency, operational efficiency and reliability, innovation, governance and regulatory insight and interconnection policy, etc. set for measuring alternative business models since Islamic insurance serves as an alternative model to the conventional insurance.

Worldwide and generally accepted concepts on the issues were provided. This was followed by previous articles on various areas justifying the relevance of Islamic insurance theory, models and its alternativeness to the conventional insurance. This would be followed by a tabulation of the relevant and salient elements deduced and extracted from existing literature for ease comparison with dedicated analysis. Precisely, the researcher chooses four famous and popular models (Akhter, 2010; Razimi, Romle & Ahmad, 2017) of Islamic insurance operation i.e., wakalah (agency), mudharabah (investment), wakalah-mudharabah (agency-investment) and waqaf (pledge) models to be discussed and evaluated consecutively.

ANALYSIS OF RESULTS

Measuring of Fitness between Islamic Insurance Theory and Models

No.	Salient Features of “Islamic Insurance” Theory	Salient features of Wakalah Model
1	Instituted after the crime “murder” has occurred	Instituted before the loss occurred
2	The contract is between two families	The contract is among people who have perhaps never met before and will never do so.
3	The amount of compensation is largely based on emotional attachment to the victim	The amount of compensation is strictly based on the actual value of the lost property or life.
4	There must be blood relation for a person to be a stakeholder in this contract.	Blood relation does not constitute an insurable interest in Islamic insurance
5	This contract is not binding on either party. They might accept or decline it.	Once the contract is signed it is binding on all parties. He who violates the terms and conditions of the contract would be liable for breach of contract.

Islamic insurance has one celebrated theory which is “Aqilah”. Nevertheless, numerous models were fabricated from this theory. For the purpose of this study, the researcher has chosen four famous and popular models among operators nationally and internationally. These models would be juxtaposed with the theory and elements of similarities and dissimilarities would be exposed. The evaluation would be in the order of earlier discussions of these models with the exclusion of wakalah-mudharabah model. This is because the comparison of wakalah-mudharabah model would amount to tautology since wakalah and mudharabah have been stated separately. Therefore, Table 1 below highlights and juxtaposes the salient features of Islamic insurance and its wakalah model of operation.

From Table 1 above incompatibilities abound in all selected elements. These discrepancies show that Islamic insurance theory and its wakalah business model are parallel lines that would never be united. Obviously, it indicates that the Islamic insurance business model failed to fulfil or meet up with the standard expected of a successful business model. Current results are in line with Salman (2014), Dikko (2014), Abdul Aziz, Abdul Ghani & Shaari (2016), Fauzi et al. (2016), Noordin & Fares (2016) findings on complex problems hindering the development and performance of Islamic insurance market around the globe. It is sufficient to say that the operational efficiency and reliability have not been incorporated into Islamic insurance. Since the theory is far apart from the operational model, the regulatory and governance oversight is to be seriously called to question. This, in turn, would make innovation as well as an investment much difficult due to irregularity in the regulatory and governance system. Further, it also points to the fact that there is no interconnection of policy which is vital to the success of the organizations. In addition, lack of efficiency in the financial market would mar the image and products of the organization. Furthermore, Table 2 compares between Islamic insurance's theory and mudharabah operational model.

No.	Salient Features of "Islamic Insurance" Theory	Salient features of Mudharabah Model
1	Instituted after the crime "murder" has occurred	The contract is instituted before the loss and a party "operator" only contributes its knowledge as capital. The participants, however, provided the cash capital
2	The contract is between two families	The contract involves many stakeholders. Every one of these stakeholders plays different roles. But not a negotiation of compensation.
3	The amount of compensation is largely based on emotional attachment to the victim	The funds are generated through investment and underwriting returns (if any). The benefits are determined according to the value of the risk in question.
4	There must be blood relation for a person to be a stakeholder in this contract.	There is no blood relation among the participants and the operators have no relationship with any individual other than contractual relationship
5	This contract is not binding on either party. They might accept or decline it.	The contract is binding on all signatories to its terms and conditions.

Table 2 above indicates that Islamic insurance operation and its justification are not in favour of needed growth and development of the industry. The contract of Aqilah failed to support Islamic insurance rather dented the better image of the industry. It failed to transmit the needed encouragements to buster the insuring public accepting the notion of Islamic finance which termed to failing market efficiency. The political aspect of using blood relations among the insuring public is not appealing to consumers particularly in the larger US-European markets. Investment opportunities are meagre and finding compliance with regulatory aspects is a bone of contention. Furthermore, operational efficiency is not really expected since the distance between the foundation "theory" and the building "mudharabah model" is a mile away. There is no way to adopt regulations from different concept to manage mudharabah model. In addition, Table 3 investigates compatibility between Islamic insurance's waqaf model and its theoretical justification.

No.	Salient Features of “Islamic Insurance” Theory	Salient features of Waqaf Model
1	Instituted after the crime “murder” has occurred	Like other models, it is usually instituted before the loss.
2	The contract is between two families	The contract involves hundreds or thousands of people.
3	The amount of compensation is largely based on emotional attachment to the victim	Part of the funds of the contract is held in waqaf and invested in a tangible asset which would generate additional incomes. The beneficiaries are the clients and compensation is based on law of equity.
4	There must be blood relation for a person to be a stakeholder in this contract.	Blood relation is in contradiction to the tenet of this contract. In fact, it constitutes a rejection of participation.
5	This contract is not binding on either party. They might accept or decline it.	The contract is binding on the parties according to the terms and conditions of the contract.

Table 3 above showed the extent of non-equivalency between Islamic insurance theory and its operational model. Business model demands that organizations make decision and are responsible for the consequences of such a decision. Islamic insurance operators are responsible for the current state of affairs in the industry. With waqaf model, the industry seems yet to understand how complex their choices are and the consequences on the intending professionals of Islamic insurance. Governance and regulatory oversight of both insurance and waqaf programs demand more personnel at extra cost. In fact, regulations of insurance aspect most stand apart from the waqaf funds. In the long run, who owns the waqaf property is a question yet to be answered. This finding is indeed corroborated by Abdullah & Yacoob (2012) that Wakalah-Waqf Model is problematic in operation.

The discussion above showed that the Islamic insurance industry is far from building it unique business models. The fact that current models failed to stand in line with the industry’s foundation “theory” means the industry’s business models’ contributions are insignificant. This problem has been proven by previous literature. A lack of expertise was the concern of many researchers such as Khan and Joseph (2008) Bhatti (2010), Olorogun and Mohd. Noor (2014) and rating agencies such as Alpen Capital (2010), Standard & Poor (2011) and AM Best (2013). Similarly, Annuar & Abu Bakar (2010) uncovered a lack of standard accounting policies among Malaysian Islamic insurance operators. Disparities across boarders’ regulations and governance make the industry a national or regional affair, not a global affair. Lack of unified logo/trademark of the industry (Olorogun, 2014) and inappropriate diffusion of wakalah (agency) contract into the industry business model was revealed by Olorogun (2013b). Similarly, Olorogun (2013a) found that theory of Aqilah does not justify the operations of Islamic insurance. In fact, it has an inverse relationship with the system of conventional insurance. The current findings further strengthen Olorogun’s (2013a) findings that contract of Aqilah is an erroneous concept as justification for Islamic insurance concept.

Our concern in this research has become a trend among contemporary Islamic and conventional finance scholars. Thus, our findings and conclusion are supported by a new perspective by Asutay (2017) who made a clear distinction between real and purpose of Islamic financial institutions and the current practices across the industry. According to Asutay (2017),

there should be no separation between finance and real economic system as it were in the current dominated world economic order “Financialisation”. Asutay opined that financialisation is when profit motive becomes focus and main goal of an economic system. However, Islamic finance industry has been diverting towards financialisation. Current Islamic financial industry is distancing itself from its unique and praiseworthy combination of finance and real economic system which is against its orientation, aims and objectives. Above all, financialisation is against Islamic worldview. Similarly, Razimi, Romle & Ahmad (2017) findings further strengthen our results on problematic business models of Islamic insurance industry as one of the major hindrances to its success.

CONCLUSION

Fragmented states of affairs in the Islamic insurance ethos have definitely negative consequences on the industry as indicates in our findings and other recent literature such as Fauzi et al. (2016), Noordin & Fares (2016) and Razimi, Romle & Ahmad (2017) just to name few. Regardless of global macroeconomic challenges that are hampering the industry performance, the industry’s systems are broken as indicated in the findings above. Putting one’s house in order is first order of safety measure. Articulation of one’s industrial position is the genesis for combating external negative forces that are mitigating the progress of the industry. Without clear, holistic and solid business models, Islamic insurance might not be able to penetrate into US-European markets. This in turn would limit the industry’s role in the global financial market (Nabilah Annuar’s report, 2015). Currently, chunks of Islamic insurance organizations are located in the Muslims countries. Most of the major players are based in Asian countries (Malaysia, Saudi Arabia, etc. all are Asia). With insignificant players operating in African continent such as Nigeria where it’s battling acceptance and rejection based on religious bias.

It is recommended that the Islamic insurance industry stakeholders should accept that the industry needs renovation. Thus, they should move ahead by formulating business models that are intellectually and economically convincing without quotation from the Qur’an and Sunnah. The appealing of these models should be through solid and holistic unification of all parts of its system. This would create market efficiency which has been a long time target of the industry. The new models must be operational efficient and reliable to intellect and application. The policy must be connected to the operation in such a way that would lead to the realization of aims and objectives. None fragmented models would create a chance for unified governance and regulatory oversight at global level. All these would make the Islamic insurance politics appealing to people beyond the faith and continent.

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