

Prospects of Takaful's (Islamic Insurance) Contributions to the Nigerian Economy

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Abstract

Economic development has been the focus of many studies in Islamic economics. This paper seeks to highlight the invaluable contributions that Islamic insurance (Takaful) can make to the goal of economic reforms enunciated by the present Nigerian government

The paper generally argues that there is no inherent conflict between the values prescribed and propagated by Islam and the values required for economic growth and development. After contextualizing the study within Nigeria's post-military economic era, the paper discusses the history and objectives of Islamic insurance as a social-economic measure originating from the pre-Islamic era. The study also showcases the global scorecard recorded by Takaful among teeming Muslim masses since its foray into the world economic arena from the early eighties with further promising prospects in non-Muslim countries of Europe and North America.

The paper presents the operational features and the social-economic contributions that Nigeria can enjoy from the rapidly growing patronage of Takaful while highlighting likely teething problems that the ethical insurance scheme could face. While acknowledging the need for further empirical analysis in a future study, the paper concludes with recommendations that policy makers and private entrepreneurs must adopt pragmatic measures to surmount the challenges that might face Takaful. These include designing of appropriate models to regulate the

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activities of the Shariah boards of existing Takaful offices, training of technical manpower to underwrite Islamic insurance products, addressing problems of limited awareness, dearth of technical partners and limited range of Shariah-compliant investments and products.

Keywords: Takaful, Economy, Nigeria, Shariah, Insurance, Islam

1 Introduction

The importance of economic growth and development cannot be overstated. Income growth is essential for achieving economic, social and even, political development. Countries that grow strongly and for sustained periods of time are able to reduce their poverty levels significantly, strengthen democratic and political stability, improve the quality of their natural environment, and even diminish the incidence of crime and violence (Barro, 1996; Easterly, 1999; Dollar and Kraay, 2002).

At independence in 1960, the economy of Nigeria was mainly dependent on agriculture, of which cocoa, palm oil and kernel, groundnut, rubber and cotton were the major export products (Osoka, 1991). Researchers have often been concerned about the role of insurance in economic development (Brainard, 2008). This accounts for why considerable attention has been devoted to evaluating the relationship between economic growth and financial market deepening. Most of what we have had relates to banking systems and securities markets – with insurance receiving only a passing mention. Yet, while insurance, banking and securities markets are closely related; insurance fulfils somewhat different economic functions than do other financial services, and in turn requires particular conditions to flourish and to make a full economic contribution. The insurance sector worldwide remains the only industry that exists to ensure the continuity of other sectors by restoring individuals and corporate bodies to their former positions each time they suffer losses through claims' settlement (Outreville, 1991; Atkins and Bates, 2007).

For decades, the insurance industry in Nigeria was contributing less than one percent to the country's Gross Domestic Product. But, according to the National Insurance Commission (NAICOM), its contribution to the GDP in 2010 has risen to 1.4 per cent. Statistics from NAICOM further states that between 2007 and 2010, the insurance sector recorded a growth rate of 35 per cent, compared to the 11 per cent growth recorded between 2004 and 2007. While the factors behind these figures are not the focus of the present study, it must, however, be established that these postings are a far cry from what ought to be the situation if insurance business had taken deeper root in the economy (Popoola, 2011).

Fortunately, in the past decades, several interesting lines of research have begun to map the specific contribution of Islamic insurance (*Takaful*) to the

economic growth process as well as to the well-being of the poor (For example, see Billah, 2001; Iqbal and Molyneux, 2005; Abdur Rahman et al, 2008). The evidence suggests that Islamic insurance contributes materially to economic growth by improving the investment climate and promoting a more efficient mix of activities than would be undertaken in the absence of risk management instruments (For example, see Fisher and Taylor, 2000; Brainard, 2008; Redzuan et al, 2009). This contribution is magnified by the complementary development of the Islamic banking and other financial systems. And like the rest of the world market, Nigeria has recently introduced the non-interest banking to engender financial inclusion of the unbanked majority in the polity (Emejo, 2011).

Economic development has been the focus of many studies in Islamic economics. For instance see Ahmed, 1981; Ali, 1991; Iqbal, 1997; Ariff, 2005; Badawi, 2005; Chapra, 2002, 2005; Haron, 2004). This paper is intended to highlight the invaluable contributions that Islamic insurance (*Takaful*) can make to the goal of economic reforms enunciated by the present Nigerian government since there is no inherent conflict between the values prescribed and propagated by Islam and the values required for economic growth and development. The reasons for the dismal performance of some Muslim countries in the field of economic development must be sought elsewhere and particularly in poor management of development activity. Instead of advocating an Islamic strategy of development, integration of Islamic institutions into a development strategy is pleaded. (Ahmad 2004).

For Nigeria, the motive to study how Islamic insurance (*Takaful*) can contribute to the goal of economic growth and development of Nigeria is borne out of several factors; some of which are 1) the pervasive poverty trend abound in the Nigerian populace; 2) stack lack of awareness of the workings of insurance among most of the elite class; 3) image deficit of most conventional insurers; 4) growing awareness of Islamic alternative among the Muslim populace who constitute the majority in the country; and 5) the ethical contents of the Islamic alternative. The above stated factors, no doubt, can attract substantial funds hitherto, left dormant in the informal sector; thereby stimulating economic activities.

Hence, the main objective of this study is to theoretically explore the contributive potentials of Islamic insurance to the Nigerian economy through financial inclusion and risk management of the most vulnerable elements of the population. This objective is accomplished through review of the existing literature and secondary data.

From the above background, the rationale for exploring the potentials of Islamic insurance (*Takaful*) to the Nigerian economy is underscored. To critically address these issues, the remaining sections of the paper are structured as follows: The next sections 2 and 3 present an overview of the Nigerian economy and the insurance sector. Section 4 chronicles the history and objectives of Islamic insurance (*Takaful*) while the global scorecard is highlighted in section 5. Section 6 presents the operational features of the relatively new paradigm in poverty

alleviation. The performance of Takaful, so far, in the Nigerian economy is discussed in section 7 while section 8 dwells on the contributive potentials to the economy while section 9 concludes with recommendations.

2 Nigerian economy overview

Oil-rich Nigeria, long hobbled by political instability, corruption, inadequate infrastructure, and poor macroeconomic management, has undertaken several reforms over the past decade. Nigeria's former military rulers failed to diversify the economy away from its overdependence on the capital-intensive oil sector, which provides 95% of foreign exchange earnings and about 80% of budgetary revenues. Following the signing of an IMF stand-by agreement in August 2000, Nigeria received a debt-restructuring deal from the Paris Club and a \$1 billion credit from the IMF, both contingents on economic reforms. Nigeria pulled out of its IMF program in April 2002, after failing to meet spending and exchange rate targets, making it ineligible for additional debt forgiveness from the Paris Club. Since 2008 the government has begun showing the political will to implement the market-oriented reforms urged by the IMF, such as to modernize the banking system, to curb inflation by blocking excessive wage demands, and to resolve regional disputes over the distribution of earnings from the oil industry.

In 2003, the government began deregulating fuel prices, announced the privatization of the country's four oil refineries, and instituted the National Economic Empowerment Development Strategy (NEEDS), a domestically designed and run program modeled on the IMF's Poverty Reduction and Growth Facility for fiscal and monetary management. In November 2005, Abuja won Paris Club approval for a debt-relief deal that eliminated \$18 billion of debt in exchange for \$12 billion in payments - a total package worth \$30 billion of Nigeria's total \$37 billion external debt. The deal requires Nigeria to be subject to stringent IMF reviews. Based largely on increased oil exports and high global crude prices, GDP rose strongly in 2007 and 2008, and less strongly in 2009. The current regime has pledged to continue the economic reforms of its predecessor with emphasis on infrastructure improvements. Infrastructure is the main impediment to growth. The government is working toward developing stronger public-private partnerships for electricity and roads (Okonjo-Iweala and Osafo-Kwaako, 2007). The Nigerian insurance sector benefitted from this set of reforms which significantly transformed its capacity to assume leading role in the services sector.

3 Brief overview of the Nigerian insurance market

The Nigerian insurance market consists of the buyers of insurance and the

sellers together with the intermediaries (agents) who bring the two together. In addition there are also the regulators, representative bodies or organizations, consultants and technical advisers which are part and parcel of the market (NIA, 2009). The focus of the following structural analysis of the Nigerian insurance market is to identify the underlying characteristics that shape the competitive arena allowing the Nigerian insurers to tap from the boundless potentials which *Takaful* promises to deliver to the Nigerian Muslim masses and hence grow and develop the economic into top twenty economies of the world by the year 2020.

The Nigerian insurance industry is today ranked 65th globally in terms of size and 6th out of the 8 largest markets in Africa. The sector has contributed less than two percent to the Gross Domestic Product GDP due to systemic failures of regulation and supervision. The industry also grows at an average rate of 23.0 and 20.7 for Life and Non-life businesses respectively.

Though, the insurance industry in Nigeria has over the years recorded some measure of growth, with gross premium increasing from N55.9 billion in 2003 to N164.5 billion in 2008, this represents an insurance penetration of only 0.6 per cent in the country. According to *Sigma Re* report of 2008 on the Nigerian market, life business posts USD193 million while non-life accounts for the balance of USD 1.044 billion. With a population of 151.5 million, insurance density records USD 8.2 for both life and non-life businesses. This abysmal score card reflects a market suffering slow growth syndrome. In a slow growth industry, such as the Nigerian insurance underwriting industry, it is difficult to achieve significant improvements without taking market share from competitors.

The last time a significant expansion in the market occurred was during the privatization boom of the late 1980s and early 1990s. Also, changing attitudes towards insurance by some customers is reducing the overall market for insurance. Many large companies have reappraised their strategy towards risk and are using their own internal funds to cover a risk that might once have been covered by insurance. As a whole, only few have considered an alternative ethical approach to risk management that *Takaful* promises due largely to lack of awareness of its objectives and economic benefits.

4 The history and objectives of Islamic insurance (*Takaful*)

Islamic insurance or *Takaful* in Arabic, means joint guarantee. In practice, however, it can be visualized as a pact among a group of members or participants who agree to jointly guarantee one another against loss or damage that may be inflicted upon them. Each member of the group pools effort to support the aggrieved member. This is similar to some customs or traditions practiced in Arab society during the *Jahiliyyah* (*before the advent of Prophet Muhammad*) period, where mutual help was extended within the society upon the death of its members. They contributed together in terms of energy to help settle the funeral affairs of the deceased member. Some were more sympathetic, and went further to offer

material or financial assistance to the deceased family.

During the era of the Prophet Mohammed (S.A.W), some of the practices of the *Jahiliyyah* were continued. This specifically involved the payment of compensation to the relatives of the deceased in one tribe when killed by a person from another tribe. The practice was thought to be able to reduce the tension between the tribes, as the Arabs during that era, were more prone towards revenge. This practice of paying compensation is called *diyat* or blood money and must be paid by the killer's relative's (*aqilah*) to the heirs of the deceased. This was later extended to include that if a tribe killed someone from another tribe, all the people from the same tribe must be held responsible to compensate the deceased relatives under the doctrine of *Aqilah* enshrined under Article 3 of the Madinah Constitution (Fisher and Taylor, 2000).

5 Takaful's global scorecard

According to *The Banker* (2001), the Islamic insurance sector or *takaful* has expanded in many major markets and in Muslim dominated countries around the world. Among the Top 25 companies in the world, ranked by *The Banker*, Brunei's Takaful IBB Bd is first followed by SCA's of Iran Insurance Company and Malaysia's Syarikat Takaful Malaysia Berhad with *Shariah* compliant assets worth US\$31.5 billion, US\$1.5 billion and US\$824.8 million respectively, while the Gulf Cooperation Council (GCC) companies, is led by Saudi Arabia's Company for Cooperative Insurance. The impact of Islamization has not only been felt where Islam is practiced, but also in countries where the Muslim population has increased tremendously and this is particularly true in the Western world, Europe and North America (Fisher and Taylor, 2000).

The world-wide *takaful* industry is estimated by Moody's Investors Service of the US, to be worth around US\$2-3 billion and set to grow to US\$7.4 billion by the year 2015 (Islamic Financial Service Sector Report, 2007; The Nikkei Weekly, 2007). There are around 80 *takaful* operators around the globe with an additional 200 '*takaful* windows' – the *Shariah* compliant operations of conventional financial institutions. The growth rates of the global *takaful* market for the past few years have been recorded at around 20 percent (Deputy Governor of Bank Negara Malaysia, 2007 cited in Abdul Rahman 2009).

Another indicator for Takaful vibrant growth in the future is the size of the Muslim market. Experts' estimate on the number of Muslims in 1999 was 1.2 billion representing between 19.2 to 22 percent of the world's population and growing at 2.9 percent per year, (2.3 percent growth rate for total world population), provided by the Council on American-Islamic Relations in 1999 (See Table 1 below). According to another estimate, Muslims have grown by more than 235 percent in the last 50 years and now stands at 1.6 billion. Population size and demographic consideration is certainly of vital concern for an enterprise before embarking on a new venture, because the larger the population, the larger is the

potential market size while social structure also plays an important role in dictating demand. Also past and various studies have shown a positive and significant relationship between insurance market growth and economic development (Abdul Rahman, 2009). Therefore, education and income level are factors that would support the initial projection for takaful growth, which is predicted by HSBC bank to reach US2 billion up to 2010 and by 2015 it would be worth US7 billion. Industry experts forecasted a large proportion of this increase will be in the Western world, particularly in the European market. Therefore, the assumption here is, the potential market for Islamic insurance (*Takaful*) is indeed extensive in the untapped market of Europe and North America.

Curiously enough, while the modern Islamic insurance first started in Africa (Sudan), in 1984, (Redzuan et al, 2009) the potential contributions of *Takaful* to the developing economies of the Sub-Saharan Africa are yet to attract much debate. Nigeria, with its population size of 160 million and as the most populous black nation on earth is yet to fully join the *Takaful* fray; not to talk of other Muslim nations of the Maghreb (North Africa). Since these countries are noted to be taking economic cues from the West, it is expected that the response will be rapid; judging from the ethical contents of the *Takaful* operational features.

Table 1: Percentage growth of Muslims in the World Population

1900	12.4%
1980	16.5%
2000	19.2%
2025 (Projected)	30%

Source: http://www.factbook.net/Muslim_pop.php

6 Operational Features of *Takaful* Business

It was the historical evidence that led Muslim jurists to acknowledge that the basis of shared responsibility in the system of *aqilah*, laid the foundation of mutual insurance, and in general conclude that insurance in Islam must be based on the principles of mutuality and cooperation. Muslim jurists' acceptance of insurance is outlined as follows:

- **Ne'aa** or utmost sincerity of Intention for knowingly following the guidance and adhering to the rule and purposes of Takaful - cooperative risk sharing and mutual assistance.
- Integration of **Shariah conditions**, namely risk sharing under Ta'awuni (cooperative) principles, coincidence of ownership, participation in

management by policyholders, avoidance of Riba and prohibited investments, and inclusion of al Mudharaba and/or al Wakalah principles for management practices.

- **Presence of Moral Value** and Ethics whereby business is conducted openly in accordance with utmost good faith, honesty, full disclosure, truthfulness and fairness in all dealings.
- **No Unlawful Element**, that contravenes *Shariah* and strict adherence to Islamic rules for commercial contract, namely:
 - o Parties have legal capacity and are mentally fit
 - o Insurable interest
 - o Principle of indemnity prevails
 - o Payment of premium is consideration (offer and acceptance)
 - o Mutual consent which includes voluntary purification
 - o Specific time period of policy and underlying agreement
- Appointment of ***Shariah* Advisory Council** or Committee to oversee the development and Islamic auditing of the takaful operation (Fisher and Taylor, 2000).

In light of the above explanations, one should take note that in a family *takaful* contract, once it is signed, the participant shall agree to relinquish as a donation, a certain portion of his contribution enabling him to fulfil his obligation of mutual help and joint guarantee, called *tabarru'*. The incorporation of *tabarru'* (*voluntary donation*) is to eliminate both the element of *gharar* (*deceit*) and *maysir* (*gambling*). Besides enabling the participants to perform their divine duty of helping the unfortunate few in hardship, there is another aspect of the contract called *mudarabah*, which comprises of the profit-sharing element between the participants and the *takaful* operator to enable both parties to reap some worldly benefits. This is allowable in Islam. Therefore, the *takaful* contract affords the protection element as mentioned above as well as the savings or investment element. If the participant dies before maturity, the *takaful* operator will compensate the heirs of the deceased; however, if the participant lived until maturity, the benefits will be paid to him. Either way, the social obligation of helping the unfortunate few, as well as preparing for retirement days when one is physically helpless, will be met by this scheme. (El-Sawy, 2003; Fisher and Taylor, 2003; Redzuan et al, 2009).

At this juncture, it might be worthwhile to briefly analyse where Islamic insurance differs from the conventional counterpart.

In brief, the contract of Takaful provides solidarity in respect of any tragedy in human life and loss to the business or property. The policyholders (Takaful partners) pay subscription to assist and indemnify each other and share the profits earned from business conducted by the Company with the subscribed funds.

Table 2: Comparison between the conventional insurance and Takaful

Conventional	Takaful
It is a risk transfer mechanism whereby risk is transferred from the policyholder (the insured) to the insurance company (the insurer) in consideration of 'premium' paid by the insured.	It is based on mutuality; hence the risk is not transferred but shared by the participants who form a common pool. The Company acts only as the manager of the pool (Takaful Operator)
It contains the element of uncertainty, i.e. "gharar" which is forbidden in Islam. There is an uncertainty in as to when any loss would occur and how much compensation would be payable.	The element of 'uncertainty' i. e. 'gharar' is brought down to acceptable levels under Shariah by making contributions as "Conditional Contributions" (tabarru') for a good cause, i. e. to mitigate the loss suffered by one of the participants.
It contains an element of gambling (maisir) in that the insured pays an amount in (premium) in the expectation of gain (compensation/payment against claims). If the anticipated loss (claim) does not occur, the insured loses the amount paid as premium. If the loss does occur, the insurer loses a far larger amount than collected as premium and the insured gains by the same.	The participant pays the contribution (tabarru') in the spirit of ne'ea (purity) and brotherhood. Hence, it obviates the element of maisir (gambling) while at the same time without losing the benefit of Takaful in the same way as conventional insurance.
Funds are mostly invested in fixed interest bearing instruments like bonds, TFC, securities, etc. Hence, this contains the element of riba (interest) forbidden in Islam.	Funds are only invested in non-interest bearing ,i. e., riba-free instruments.
Surplus or profits belong to the shareholders. The insured is covered during the policy period but is not entitled to any return at any of the period.	Surplus belongs to the participants and is accordingly returned to them (in proportion to their respective shares of contribution) at the end of their accounting period.

Takaful companies normally divide the contributions into two parts, i.e. donations for meeting mortality liability or losses of the fellow policyholders and the other part for investment. How much of the contribution is meant for mortality

liability and how much for investment account is based on a sound technical *Takaful* operator's basis or mortality tables and other actuarial requirements. Both the accounts are invested and returns thereof distributed on *Mudarabah* (profit and loss) principle between the participants and the operators (Khan undated).

7 Preliminary performance of *Takaful* Business in Nigeria

In Nigeria, African Alliance Insurance Company Limited, being the oldest and strongest specialist life assurance and pension office, blazed the trail in introducing Islamic Insurance (*Takaful*) into the market in 2003. Since then other two conventional insurance companies have joined the fray. These are Niger Insurance Plc and Cornerstone Insurance plc. As a composite Insurance Company, Niger Insurance Plc transacts all classes of insurance business and offers a wide range of innovative products and customer-oriented services to its growing clientele. In addition, they support their products with one of the most efficient and constantly improving claims settlement procedures in the insurance market. Cornerstone is an ethical, dynamic and innovative custom products for the large Muslim population in Nigeria and decided to establish *Halal Takaful Nigeria* for the purpose.

Of all the three existing *Takaful* underwriting companies, only Cornerstone offers a separate Takaful office; being run by one of its subsidiaries –*Halal Takaful Nigeria* -- where assets of Takaful are not merged with the conventional insurance funds.

8 Potentials of Islamic insurance to the Nigerian economy

The importance of the insurance-growth nexus is growing due to the increasing share of the insurance sector in the aggregate financial sector in almost every developing and developed country (Haiss and Sumegi, 1999). Insurance companies, together with mutual and pension funds, are one of the biggest institutional investors into stock, bond and real estate markets and their possible impact on the economic development will rather grow than decline due to issues such as ageing societies, widening income disparity and globalisation. This trend is likely to be accelerated with the new foray of Islamic insurance (*Takaful*) into the economic space by essentially targeting a sizeable mass of low-income earners. The growing links between the insurance and other financial sectors also emphasise the possible role of insurance companies in economic growth (Rule, 2001).

In Nigeria, the Muslims constitute 75% of the population (CIA Fact book, 2010). This is expected to rise as Muslims are noted to be sceptical about the use of contraceptives to plan their families. Muslims are also noted to marry early and

even more, permitted to marry up to four wives at a time. These and other demographic characteristics account for the growing population of the Muslims. Currently, Nigerian conventional underwriters and intermediaries would admit the difficulty in penetrating the Northern Muslim-dominated market. Of all the 49 registered underwriters, only 3 have their headquarters located in Northern Nigeria; 62 of 510 registered brokers and none of the 37 registered loss adjusters are located up North (Nigeria Insurance Digest 2007). These figures are instructive to illustrate the skewed distribution of insurance patronage among the geopolitical zones in the country. The main reason for this could be traced to religious and cultural factors which forbid Muslims to patronise corporate entities which deal in uncertainty, interest, and gambling – elements seriously forbidden in Islam. Arguably, Northern Nigerian states have been adjudged to be more impoverished than their southern counterparts. This accounts for why a poverty-reducing mechanism such as the *Takaful* would attract a wide clientele in the north than in the south; more so for the religious concern.

For economic development, investments are necessary. Investments are made out of savings. A *Takaful* operating company is a major instrument for the mobilization of savings of people, particularly from the middle and lower income groups. These savings are channeled into investments for economic growth. The Insurance Act of 2003 has strict provisions to ensure that insurance funds are invested in safe avenues like government bonds, companies with records and so on. Even at that, *Takaful* operators have several avenues of non-interest yielding portfolios to invest its huge funds, accumulated through the payments of small amounts of premium of individuals. These funds are invested in ways that contribute substantially to the economic development of the countries in which they do business. But even their investments in the various sectors and contributing directly and indirectly to the country's economic development would be of similar proportions; more so since the contribution of insurance to poverty alleviation and the welfare of the poor is also potentially of considerable importance.

Insurances are similar to banks and capital markets as they serve the needs of business units and private households in financial intermediation (Haiss and Sumegi, 1999). The availability of Islamic insurance (*Takaful*) services is essential for the stability of the economy and can make the business participants accept aggravated risks. By accepting claims, Islamic insurance (*Takaful*) also have to pool contributions (premiums in conventional insurance) and form reserve funds. *Takaful* can, thus, make vital contribution to the growth of the economy by enhancing cash flow for the contributors and creating large amount of assets placed on the capital market.

Job creation is yet another growth contribution to the Nigerian economy through the *Takaful* mechanism. More Muslim conventional insurance personnel might be attracted into switching their employment to the *Takaful* alternative which might trigger the establishment of Islamic financial institutions in the country. With the expected Muslim masses patronage, backed, of course, by

effective and efficient marketing strategies, new jobs are inadvertently created for Nigerians which ultimately translates into economic growth and development.

9 Conclusions and Recommendations

In conclusion, Islamic Finance and Islamic Takaful are ethical financing and cooperative risk protection methods that are superior alternatives precisely because they reinvigorate human capital, emphasize personal dignity, community self-help, and economic self-development, generating manifold benefits for all participants. Islam is an integrated way of life. Thus, interest-free financing and Takaful are mutually reinforcing systems that promote at once economic efficiency, communal risk-sharing and individual rewards through self-purification. In as much as the Takaful system revolves around active participation by members of the community, it is imperative that public awareness be enhanced. As Muslims and non-Muslims alike come to understand the real benefits of Takaful and cooperative risk sharing, the evolution of the Takaful industry will accelerate making the projections described herein overly conservative.

In addition, policy makers and private entrepreneurs must adopt pragmatic measures to surmount the hurdles facing Takaful's entry into the Nigerian economy. Some of these might include designing of appropriate models to regulate the activities of the Shariah boards of existing Takaful offices, training of technical manpower to underwrite Islamic insurance products, address the problems of limited awareness, dearth of technical partners and limited range of Shariah-compliant investments and products.

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