

# CHAPTER 1

## INTRODUCTION

### A. Background

Human life in this world is surrounded by various dangers that cause fear and anxiety in humans. Death, accidents, sickness, natural disasters, fire, and other risks are examples of conditions that make people worry because these conditions cause harm to humans. Risk always comes at any time, and we cannot predict how significant the risk is. Allah SWT has explained the risks in Surah Al-Luqman verse 34.

إِنَّ اللَّهَ عِنْدَهُ عِلْمُ السَّاعَةِ وَيُنزِلُ الْغَيْثَ وَيَعْلَمُ مَا فِي الْأَرْحَامِ وَمَا تَدْرِي نَفْسٌ مَّاذَا تَكْسِبُ غَدًا وَمَا تَدْرِي نَفْسٌ بِأَيِّ أَرْضٍ تَمُوتُ إِنَّ اللَّهَ عَلِيمٌ خَبِيرٌ

*“Indeed, Allah (alone) has knowledge of the Hour and sends down the rain and knows what is in the wombs. And no soul perceives what it will earn tomorrow, and no soul perceives what land it will die. Indeed, Allah is Knowing and Acquainted.”(Q.S Al-Luqman: 34)*

One of the financial institutions that specifically deal with risks is Sharia Insurance. Sharia Insurance's role is to protect and help each other based on *ukhuwah Islamiyah* among sharia Insurance participants in facing calamities. The principle of protecting and helping each other in Sharia Insurance is the embodiment of Allah SWT's command in Surah At-Taubah verse 71.

وَالْمُؤْمِنُونَ وَالْمُؤْمِنَاتُ بَعْضُهُمْ أَوْلِيَاءُ بَعْضٍ يَأْمُرُونَ بِالْمَعْرُوفِ

وَ يَنْهَوْنَ عَنِ الْمُنْكَرِ وَ يُقِيمُونَ الصَّلَاةَ وَ يُؤْتُونَ الزَّكَاةَ وَ يُطِيعُونَ اللَّهَ وَ

رَسُولَهُ ؕ أُولَئِكَ سَيَرْحَمُهُمُ اللَّهُ إِنَّ اللَّهَ عَزِيزٌ حَكِيمٌ

*“And the believing men and the believing women, they are friends of each other. They enjoin Al-Ma’rûf and forbid from Al-Munkar and keep up the prayer and give alms (the Zakât) and obey Allah and His Messenger. These, Allah will show mercy to them. Surely Allah is All-Mighty, All-Wise.”(At-Taubah: 71)*

The verse above shows that Allah SWT will have mercy on His servants who protect each other. This verse is in line with one of the main principles of Sharia Insurance, which is to protect each other based on *ukhuwah Islamiyah* in facing calamities.

Based on the Islamic Financial Service Board Report in 2019, the world Sharia Insurance industry experienced a growth of 1.5% with an estimated USD 4.892 billion. In the report, Indonesia's Sharia Insurance industry was ranked 15th after Pakistan as the country with the world's highest gross premiums. Meanwhile, in Southeast Asia, Indonesia was in the 3rd position after Brunei Darussalam and Malaysia. These conditions were unfortunate, considering that Indonesia is a country with the largest Muslim population in the world.

The sizeable Muslim population in Indonesia should be able create a favourable market climate for the Sharia Insurance industry's growth, so that the Sharia Insurance industry can have a tremendous opportunity to develop its products in the market. However, the facts on the ground said that Sharia

Insurance in Indonesia only had a market share of 4.8% in 2018 (Financial Services Authority, 2018).

Furthermore, insurance data published by the Financial Services Authority in Indonesian Insurance Statistics 2020 have shown that from 2015 to 2019, the Sharia Life Insurance industry business has experienced a slowdown in growth, as shown in Table 1.1 below.

**Table 1.1.**

The Growth of Sharia Life Insurance Business 2015-2019 (In Trillion Rupiah)

Description	Year				
	2015	2016	2017	2018	2019
Assets	18,08	21,73	33,19	34,28	37,89
Investments	19,6	24,32	30,4	31,87	34,40
Claim	2,58	3,06	3,5	7,19	9,24
Gross Premium	8,27	9,44	11,09	12,66	13,96

Source: 2019 Indonesian Insurance Statistics by the Financial Service Authority

The graph above shows that the Sharia Life Insurance industry has experienced a slowdown in growth from 2017 to 2019. Assets in 2018 only grew by 3,2% compared to 2017, after the highest increase of 52,7% in 2017, compared to 2016. The investment growth was in line with asset growth. In 2018, the investment growth in Sharia Life Insurance companies only shifted by 4,8% compared to the previous year, whereas in 2017, the investment growth reached 25% compared to 2016.

The Sharia General Insurance industry has also experienced a slowdown in business growth in line with the Sharia Life Insurance industry as recorded

in the Financial Services Authority's insurance statistics from 2015 to 2019 below.

**Table 1.2.**

The Growth of Sharia General Insurance Business 2015-2019 (In Trillion Rupiah)

Description	Year				
	2015	2016	2017	2018	2019
Assets	4,96	6,22	7,34	7,32	7,91
Investments	3,5	4,24	5,04	5,1	5,49
Claim	0,91	1,23	1,44	1,47	1,44
Gross Premium	1,96	2,87	2,65	2,75	2,79

Source: 2020 Indonesian Insurance Statistics by the Financial Service Authority

The graph above shows that assets, investments, claims, and gross premiums have all experienced a slowdown from 2017 to 2019. In 2017, the gross premiums of Sharia General Insurance even decreased to 7,6% compared to 2016. Then in 2019, claims on Sharia General Insurance also reduced by 2,08% from the previous year. The same thing also happened on the asset side. Whereas in 2018, the assets of the Sharia General Insurance industry decreased by 0,27%.

The Financial Services Authority assessed that the slowdown in Sharia Insurance performance growth was also due to the stagnant number of Sharia insurance players in Indonesia. In 2017, there were 62 Sharia insurance companies and sharia reinsurance companies, consisting of 12 sharia insurance companies (full-fledge), one sharia reinsurance company, 47 Sharia insurance companies with sharia units, and two sharia reinsurance companies with sharia

units. These figures did not change until the end of December 2019, as shown in Table 1.3 below.

**Table 1.3.**

Growth in the number of Sharia Insurance Companies in Indonesia

<b>Description</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>
Sharia Life Insurance	7	7	7
Sharia General Insurance	5	5	5
Sharia Reinsurance	1	1	1
Sharia Life Insurance Unit	22	23	23
Sharia General Insurance Unit	25	24	24
Sharia Reinsurance Unit	2	2	2

Source: The Financial Service Authority

The slowdown in the insurance industry's growth will undoubtedly impact the value and health level of insurance companies. Therefore, it is necessary to improve company performance, especially to maintain profit stability and company solvency, because profit is the primary goal of establishing a sensitive company to interested parties such as company owners, managers, investors, creditors, government, employees, and the general public (Amrin 2011).

Supervision and assessment of the insurance companies' performance need attention. According to Robert (2007), the importance of performance monitoring in the insurance sector is because the insurance industry requires public trust regarding Indonesia's financial institutions' condition. Samad and Hassan's (2006) research supported this statement, which stated that Sharia Insurance performance appraisal's importance to determine the company's

health level achievement and the company's ability to benefit from the Sharia Insurance profit-sharing system.

The financial performance can be seen from its financial statements because, in the financial statements, there are estimates such as assets, liabilities, capital, and profits. According to Horne and JR (2009), the tools used to assess a company's financial condition and performance are financial ratios obtained from the company's financial statements, which describe profitability, solvency, and management efficiency. Financial ratio analysis for insurance companies prepared by The National Association of Insurance Commissioner (NAIC), which is the regulatory body for insurance companies in the United States under the Organization for Economic Co-Operation and Development (OECD) (NAIC 2016; Pitselis 2009).

NAIC raises several types of insurance performance measurements, namely 1) Early Warning System (EWS), which includes elements of financial ratios, productivity, profitability, and growth in its calculations, 2) Insurance Regulatory Information System (IRIS) to assess company financial distress using a national computerized database, 3) Risk-Based Capital (RBC) to take into account the risk of failure in wealth management, an imbalance between asset and liability values, and 4) Financial Analysis and Surveillance Tracking (FAST) conducted by the state to monitor financial performance conditions and prevent inability to pay by insurance companies (Pitselis 2009).

In a study conducted by Shu-Hua Hsiao (2000), it was found that to review the financial landscape and monitor an insurance company, it is necessary to carry out an Early Warning System (EWS) to assess its performance comparison between domestic insurance companies and overseas branches. Furthermore, Eduardo T. Tornoa and Tomas S. Tiub (2014) examined the factors that affected the survival and failure of non-life insurance companies in the Philippines and classified companies' viability into strong, medium, weak, and bankrupt. The research was conducted overseas with company-specific variables including company size, profitability, premium growth, cost ratio, combined ratio, leverage, equity growth, type of claim ownership, investment performance and operating costs for premium growth, and the level of diversification.

Anggika Fitri (2016) conducted tests using the Early Warning System (EWS) method and the Risk-Based Capital (RBC) method to analyze the financial performance of Sharia Life Insurance companies in Indonesia. Meanwhile, Aulia Repati Indah (2014) used the EWS and RBC methods to compare the financial performance of Conventional Life Insurance and Sharia Life Insurance registered with the Indonesian Life Insurance Association.

From the various studies stated above, we know that insurance performance using the EWS and RBC analysis methods are the most studied in analyzing insurance performance. EWS is a benchmark for calculating financial performance and assessing insurance companies' health levels in Indonesia (Orros and Smith 2012). Meanwhile, RBC is a measurement model

for the minimum amount of capital appropriate for reporting entities to support overall business operations by considering the size and risk profile.

Companies can apply EWS and RBC analysis as supervisors of the company's internal financial performance. Both methods analyze financial ratios that represent and describe financial performance in more detail and specific to each company in the insurance industry. Meanwhile, IRIS and FAST are used nationally by insurance regulators to determine the company's financial performance based on the computerized database of a country's insurance industry.

Based on the theory and phenomena above, the researcher feels it is essential to analyze the financial performance of Sharia Insurance, especially Sharia Life Insurance and Sharia General Insurance in Indonesia, by using two methods of analysis, namely EWS and RBC methods.

In addition to conducting analysis, the researcher also wants to compare the financial performance of Sharia Life Insurance companies and Sharia General Insurance companies in Indonesia. This calculation is also explicitly applied only to Sharia Insurance companies without including Sharia Insurance units. This calculation is the author's attempt to make a fair comparison between companies.

Based on the description above, the authors conducted research entitled "Analysis of Financial Performance on Sharia Life Insurance Companies and



Sharia General Insurance Companies in Indonesia using the EWS and RBC Methods for the Period 2017-2019".

## **B. Identification of Problems**

Based on the background described above, several problems that can identify include the following:

1. Sharia Insurance has enormous market potential in Indonesia. However, the Sharia Insurance industry has not maximized its opportunities in this country with the largest Muslim population. It is evidenced by the market share of Sharia Insurance in Indonesia of only around 4.8% (Financial Services Authority, 2018). Indonesia's Sharia Insurance industry's position was still in 15th position in the world and third position in Southeast Asia (Islamic Financial Service Board, 2019).
2. The Financial Services Authority statistics noted a slowdown in growth in Sharia Life Insurance and Sharia General Insurance, both in terms of asset, investment, claim, and premium from 2015 to 2019.
3. The Financial Services Authority also noted that the number of Sharia Insurance companies in Indonesia has stagnated from 2017 to 2019.
4. There are very few studies comparing the financial performance of Sharia Life Insurance companies and Sharia General Insurance companies.

### **C. Problem Limitation**

The problem limitations imposed by the researcher are as follows:

1. The author only includes Sharia Insurance companies with full-fledges without involving the Sharia Insurance unit.
2. This research was conducted regarding the company's annual financial statements from 2017 to 2019.

### **D. Problem Formulation**

1. How is Sharia Life Insurance companies' financial performance based on the EWS and RBC methods for the period 2017-2019?
2. How is Sharia General Insurance companies' financial performance based on the EWS and RBC methods for the period 2017-2019?
3. Which Sharia Insurance has a better financial performance between Sharia Life Insurance and Sharia General Insurance based on the EWS and RBC methods?
4. Is there a significant difference in the financial performance of Sharia Life Insurance companies when compared to Sharia General Insurance companies measured using the EWS and RBC methods for the period 2017-2019?

## **E. Research Objective**

1. To know Sharia Life Insurance companies' financial performance based on the EWS and RBC methods for the period 2017-2019.
2. To know Sharia General Insurance companies' financial performance based on the EWS and RBC methods for the period 2017-2019.
3. To know which Sharia Insurance has a better financial performance between Sharia Life Insurance and Sharia General Insurance based on the EWS and RBC methods.
4. To know is there a significant difference in the financial performance of pure Sharia Life Insurance companies when compared to pure Sharia General Insurance companies measured using the EWS and RBC methods for the period 2017-2019.

## **F. Research Benefit**

Concerning research problems, the benefits expected from this study's results can be broadly divided into two areas, namely theoretical and practical.

### **1. Theoretical Benefits**

This study's results are expected to be a further study in science related to Sharia Insurance's performance. This research is also expected to contribute ideas about the science of company financial performance management using the Early Warning System (EWS) and Risk-Based

Capital (RBC) analysis methods, as well as adding intellectual treasures for the development of Sharia Insurance industry, especially the financial performance and health level of Sharia Insurance companies.

## 2. Practical Benefits

### a. For Writers

As a means of adding insight and knowledge and understanding about the analysis of Sharia Insurance companies' financial performance. This study used the Early Warning System (EWS) and Risk-Based Capital (RBC) in Sharia Life Insurance companies and Sharia General Insurance companies.

### b. For Companies

Providing information and advice for Sharia Insurance companies in general, and especially Sharia Life Insurance companies (full-fledges) and Sharia General Insurance companies (full-fledges) regarding the analysis of the company's financial performance based on the Early Warning System (EWS) and Risk-Based Capital (RBC) analysis.

### c. For Academics

This research is expected to provide information, knowledge, and references for further researchers, especially regarding the financial performance of Sharia Insurance.

d. For the Community

As a positive contribution in providing information about the condition of Sharia Insurance companies' financial performance, especially information about the health level of Sharia Life Insurance companies and Sharia General Insurance companies in Indonesia.