



## FAITH VS FINANCE: A COMPARATIVE STUDY OF TAKAFUL AND CONVENTIONAL INSURANCE FIRMS ON FINANCIAL STABILITY METRICS

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### **Abstract**

*The purpose of this paper is to perform a comparative analysis of Takaful (Islamic insurance) and conventional insurance companies, both companies based in Pakistan, using the secondary data, covering the period of 2021 to 2024. The comparison is carried out between two insurance models in terms of financial performance utilizing four types of financial ratios: profitability, liquidity, solvency, and capital adequacy. The results show that conventional insurers perform better than Takaful operators in profitability ratios, reflecting better efficiency in the generation of returns on assets and equity. On the other hand, Takaful firms indicate significant better overall financial performance in term of liquidity, solvency and capital structure which indicates that Takaful firms has better short-term financial stability, less risky in debt management and has robust capital structure. Nonetheless, with respect to overall financial performance (mean value of all the ratios selected), conventional insurance companies have relatively stronger position immediately than their Takaful counterpart. The findings of this study have important policy implications for various parties (policyholders, investors, shareholders employees and regulators) by offering them statistical evidence to make informed decision concerning their investments and strategic involvement in Pakistan's insurance industry.*

**Keywords:** *Profitability, Liquidity, Solvency, Capital adequacy, Conventional Insurance, Takaful (Islamic Insurance), and Ratio Analysis.*

### **1. Introduction**

In this life, each of us by nature lives under a cloud of danger and sudden misfortune, including death, property loss, conflagration and accident. These ambiguities are the facts of life. While Muslims have a strong belief in Qadha-o-Qadr (Allah's will), Islamic teachings also enjoin people to seek ways and means to avoid loss to their life or property. A Muslim has a duty to reduce the financial impact to the best of his/her ability in the light of Shariah. One of the most effective ways to manage these economic hardships is through insurance coverage, which provides a cushion when in need (Akhter, Jamil, & Fam, 2021). Insurance is all about 'risk'. Risk is commonly understood as the potential for loss or damage, and within financial literature, the uncertainty of returns, or volatility, is also attached to the definition (Akhtar, 2018). Insurance in the conventional sense is a contract by which an insurer has agreed to indemnify the insured in the event of a particular loss. While straightforward in its design and implementation, its conformity with the principles of Islamic law is the topic of a great deal of discussion. It is largely due to the close

proximity between old insurance and elements such as Riba (usury), Gharar (ambiguity), and Maysir (gambling), all forbidden in Islam (Hassan & Abbas, 2020).

Takaful (Islamic insurance) is offered as an Islamic alternative to the conventional insurance. It is based on shared cooperation, solidarity, and collective responsibility. Takaful is formulated to avoid the unlawful elements in contracts of conventional insurance. Moreover, Takaful risk profit sharing model contributing members' funds are pooled together and are used to indemnify the contributing members who suffer a loss. It converts the insurance scheme from one of profit to a cooperative voluntary scheme based on moral and religious grounds (Khan & Siddiqui, 2017). Linguistically, the term *Takaful* is derived from the Arabic word *Kafala*, which means to guarantee, safeguard, or protect. As explained the Takaful system is essentially a mutual promise made among a group of individuals to support each other in times of financial adversity. Unlike conventional insurance companies, which invest premiums into interest-bearing instruments, Takaful companies reinvest the pooled contributions into Shariah-compliant ventures. This eliminates the presence of *Riba*, which is defined as any predetermined increase over the principal amount in a financial transaction (Safdar, 2023), thus maintaining compliance with Islamic financial ethics.

In recent years, Takaful companies have witnessed a growing presence in Pakistan's financial sector, indicating increased consumer awareness and demand for Shariah-compliant financial solutions. Despite this growing trend, there remains a scarcity of comprehensive empirical studies that critically compare the financial performance of Takaful and conventional insurance companies within the Pakistani context. This lack of comparative analysis limits policymakers and investors in their decision-making regarding which model offers superior financial efficiency and long-term sustainability (Akhter & Khan, 2017). Therefore, the present study aims to bridge this gap by conducting a comparative analysis of the financial performance of Takaful (Islamic insurance) and conventional insurance companies in Pakistan. The comparison will focus on key financial indicators, namely profitability, liquidity, capital adequacy, and risk and solvency ratios. These metrics are crucial in assessing the operational efficiency, financial health, and risk-bearing capacity of insurance firms. By evaluating these parameters, the study intends to provide empirical evidence on whether Takaful offers not only religious compliance but also competitive financial performance compared to its conventional counterparts (Coskun, Habibniya, & Keceli, 2021).

## **2. Literature Review & Hypothesis**

Competitive performance of Takaful and conventional insurance firms has experienced a lot attention. Research on which approach is more profitable has led to mixed findings. For example, (Hassan 2020) studied insurance companies in Malaysia and noticed that conventional insurers generally generated higher returns on assets (ROA) and ROE than the Takaful ones. Such an underperformance is usually explained by the investment constraints set forth by Shariah rules for Takaful activities. Yet, some academicians posit Takaful firms are closing the gap especially in countries where Islamic financial literacy and demands are on the rise (Iqbal et al., 2015). In addition, liquidity ratio analysis is fundamental to evaluating an insurer's capacity to fulfil short-term commitment. Liquidity ratios are higher for traditional insurers, because they have more investment opportunities and access to conventional financial instruments. On the other hand, Takaful operators are generally considered to have more prudent liquidity cushion requirements driven by Shariah-compliant nature of assets which also exposes them to lower risks. Rizwan (2012)

& Al-Malkawi [et al., 2024]). Some jurisdictions also possess higher current and quick ratios for Takaful firms, which doubtlessly shows prudent financial management sometimes at the cost of high profitability. Such a tradeoff represents the decisions against decision between liquidity and operational performance for Islamic insurance company (Waris et al., 2025).

Furthermore, solvency ratios such as debt-equity and equity are important in assessing the long-term financial soundness of insurance companies. Traditional insurers, with their mature operation structure and a mixture of portfolios traditionally have higher solvency ratios. Takaful firms, however, have proved stubbornly resilient in ‘twin track’ financial systems with both conventional and Islamic finance running side-by-side. Findings in this research revealed that despite the over-conventional businesses with solvency buffer in GCC countries, Share Takaful model ensures more stable situation of required capital during financial crisis 3 (Madi & Ben Jedidia, 2025). Finally, capitalization – generally in terms of a firm's ratio of capital to assets or regulatory-based measures such as these ratios that are used to calculate required reserves (regulatory solvency margins) and/or ‘reserves’ buffers. Globally, regulators are driving both conventional and Takaful operators to have good capital buffers so as to protect the interests of policyholders. A comparative work by (Kepramareni, Apriada, Putra, & Rini (2022)) found that traditional insurers may have a relatively higher capital adequacy ratio than Takaful operators on account of their long-term average static funding sources but the availability of surplus capital is achievable for both groups through collaboration; mergers and regulatory reforms those originated after Islamic financial stability. These moves also indicate the increasing sophistication and aggressiveness of Takaful in world financial markets. Therefore, the following hypothesis have been developed based on previous studies that to support and Critically Test the Financial Performance of Takaful (Islamic Insurance) Companies and Conventional insurance companies: Literature Review: ascertain the financial performance of a Takaful Companies.

- H<sub>1</sub>:** Takaful companies exhibit higher profitability compared to conventional insurance companies.
- H<sub>2</sub>:** Takaful companies maintain higher liquidity levels compared to conventional insurance companies.
- H<sub>3</sub>:** Takaful companies are less risky than conventional insurance companies.
- H<sub>4</sub>:** Takaful companies possess stronger capital adequacy than conventional insurance companies.
- H<sub>5</sub>:** The overall financial performance of Takaful (Islamic insurance) companies is significantly better than that of conventional insurance companies, as measured by aggregated profitability, liquidity, solvency, and capital adequacy ratios.

### **3. Methodology**

The objective of this study is to assess and contrast the financial performance between Islamic insurance companies (Takaful) with conventional Insurance Companies in Pakistan. The study is quantitative in nature and it employs secondary data from selected insurance companies audited annual financial statement. The data set consists of both

Islamic and conventional insurers intentionally chosen to represent companies that have produced annual reports at all times during 2021-2024. The data were downloaded from the official websites of each insurance company in order to maintain truth and trustworthiness, similar with previous comparative study on health services (Indah et al., 2024). In this research, the financial performance is assessed through four critical indicators: profit ability, liquid it; solvency and capital adequacy. These ratios are derived using typical financial calculations used on income statements and balance sheets, which enables a formal, consistent comparison to be made. ROA and ROE are employed to measure profitability, while CR) \_CAR) and NETAR are used to assessed liquidity. Solvency is measured using the ratios of DER and DTAR, while capital adequacy by ELR. The ratio-based comparison technique is commonly applied in insurance performance analysis and has been supported by similar comparative research that conducted within Malaysia, the GCC area also South Asia (Mittal & Singh 2023). This method allows identifying structural opportunities and weaknesses under these insurance models in a Pakistani context.

**Table-I: - Financial Ratio Framework Used in the Study**

Ratio Category	Ratio	Formula
Profitability Ratios	ROA	Earnings after tax/ Avg. Assets
		Avg. Assets = opening assets + closing assets/2
	ROE	Earnings after tax/ Avg. Equity
		Avg. Equity = opening equity + closing equity/2
Liquidity Ratios	CR	Cash & Bank/ Total Deposit
	CAR	Current Assets/ Total Assets
	NETAR	Net equity/ Total Assets
Solvency Ratios	DER	Total Debt/ Net Equity
	DTAR	Total Debt/ Total Assets
Capital Adequacy Ratio	ELR	Average equity/ Average Liabilities
		Avg. Equity = opening equity + closing equity/2
		Avg. Liabilities = opening liabilities+ closing liabilities/2

**4. Data Analysis and Interpretation**

Analysis of individual financial ratio categories profitability ratios, liquidity ratios solvency indicators as well capital adequacy percentage is giving in the table II on category-wise average figures. This table disaggregates the performances of each ratio group for all companies in our study. In addition, Table III provides the mean ratios of all (repeated for clarity) areas over a 4-year time period (=2021–2024); to give some insight into financial trend performance strategies in data analysis. Finally, the summary view of all firm performance at a glance is presented in Table IV by average combined values for four groups defined ratios and reported firms gives up holistic look on how analyzed companies perform.

**4.1. Analysis of Financial Performance Using Mean Ratio Comparison**

The comparative analysis revealed the following. First, it is worth noting that two profitability indicators, Return on Assets and Return on Equity, for conventional insurance are significantly higher than for Takaful, which means it performs better in terms of

profitability. Second, as for liquidity assessment, three critical ratios, CR, CAR, and NETAR, were also calculated. The findings demonstrated that for CR, Takaful performs better in the short run, while, CAR and NETAR performed much better for companies specializing in conventional insurance, which means they have a stronger capital and efficient asset use. As for solvency, the assessment of DER and DTAR is higher in Takaful, which implies a better reliance on debt funding rather than total funding as well as compared to equity. Finally, in terms of capital adequacy, DLR is more beneficial for those specializing in Takaful, which means they operate well in the long run.

**Table-II: Comparative Financial Ratio Analysis: Takaful vs. Conventional Insurers**

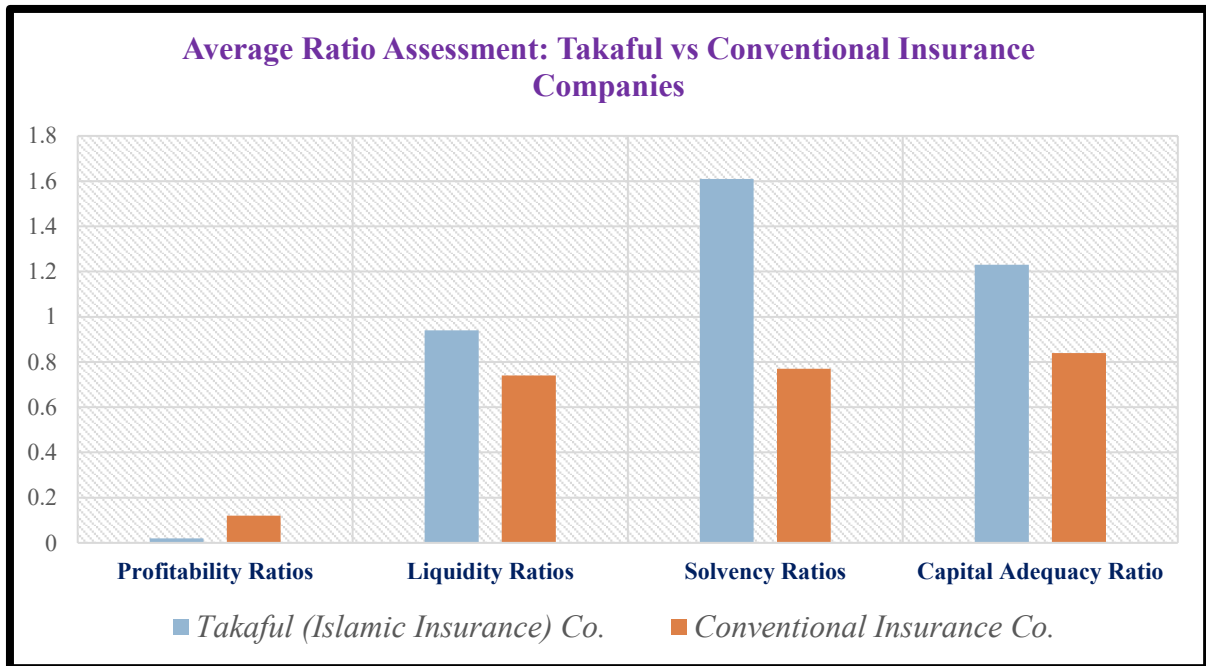
Categories of Ratios	Name of Ratio Used	Takaful (Islamic Insurance) Co.	Conventional Insurance Co.
Profitability Ratios	ROA	0.01	0.11
	ROE	0.03	0.12
Liquidity Ratios	CR	2.15	1.40
	CAR	0.28	0.43
	NETAR	0.38	0.40
Solvency Ratios	DER	2.66	1.80
	DTAR	0.56	0.51
Capital Adequacy Ratio	ELR	1.23	0.84

#### 4.2. Analysis of Financial Performance Using Mean Ratio Comparison

Table III shows the financial comparison between Takaful (Islamic insurance) and conventional insurers as an average of ratio performance. Results of the ratio analysis show that in profitability ratios conventional insurance companies do better than Takaful operators because they have higher return on assets and equity. On the other hand, Takaful firms are found to have better liquidity coverage ratio (LCR), solvency and capital adequacy ratios which indicate a higher degree of short-term financial safety, more conservative equity structure and stronger long term financial position than that of their conventional peers.

**Table-III: Category-Wise Financial Ratio Analysis**

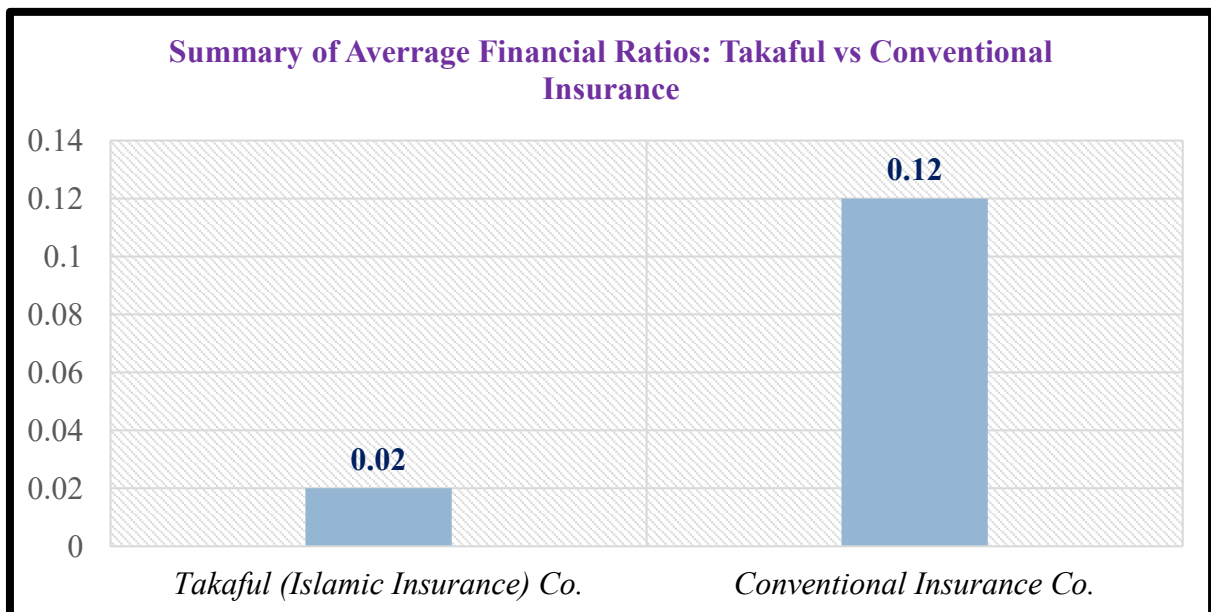
Categories of Ratios	Takaful (Islamic Insurance) Co.	Conventional Insurance Co.
Profitability Ratios	0.02	0.12
Liquidity Ratios	0.94	0.74
Solvency Ratios	1.61	0.77
Capital Adequacy Ratio	1.23	0.84



**4.3. Aggregate Comparative Financial Ratio Analysis:**

The overall analysis of the financial performance between Takaful and non-Takaful insurance companies is summarized in Table IV, including an average figure for each ratio calculated across all four dimensions: profitability, solvency; liquidity demand on assets as well as capital adequacy. The comparative analysis shows that conventional insurance generates better overall performance as compared to Takaful based companies when considering the composite financial measures, indicating more efficient and stable capital position in the traditional sector of Pakistan.

**Table-IV: Summary Regarding Financial Ratio Analysis**



Indicator	Takaful (Islamic Insurance) Co.	Conventional Insurance Co.
Average Ratio Assessment	0.02	0.12

**5. Conclusion:**

The purpose of this research is to assess and compare the financial performance of Islamic insurance (Takaful) versus conventional insurance companies in Pakistan during 2021-24. Sample selection and period We have nine insurance companies (four Takaful firms and five conventional ones) in our sample, which is chosen as a function of availability and completeness of financial data over the years. All necessary financial data were extracted from the audited annual reports and statement of accounts among companies, thus maintaining uniformity and reliability in input variables. To evaluate and compare performance in these two insurance models, the ratio analysis was used applying selected financial indicators under four major categories: profitability, liquidity, solvency, and capital adequacy. We chose these values since they are already popular and very pertinent for the valuation of financial performance. The comparison reveals the relative economic soundness and operational effectiveness of these systems. Different performance of Takaful and conventional insurance companies was also statistically proven by hypothesis testing. A comprehensive review of results, which is derived from hypothesis testing can be found in the later sections proving empirically significant insights to contribute over all discussion about survive and competition of Islamic insurance within financial market of Pakistan.

Sr. #	Hypothesis	Decision
H <sub>1</sub> :	Takaful companies exhibit higher profitability compared to conventional insurance companies.	Rejected
H <sub>2</sub> :	Takaful companies maintain higher liquidity levels compared to conventional insurance companies.	Accepted
H <sub>3</sub> :	Takaful companies are less risky than conventional insurance companies.	Accepted
H <sub>4</sub> :	Takaful companies possess stronger capital adequacy than conventional insurance companies.	Accepted
H <sub>5</sub>	The overall financial performance of Takaful (Islamic insurance) companies is significantly better than that of conventional insurance companies, as measured by aggregated profitability, liquidity, solvency, and capital adequacy ratios.	Rejected

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