

Chapter One

Introduction

1.1 Introduction

Mankind has to face the consequences of misfortune. Misfortune can arise in many forms, all of them leading to some form of loss. For example, the sole breadwinner of a family may meet with an accident and die. The dependents face two immediately obvious forms of loss that is emotional and financial. The natural question to ask then is: 'What arrangements can be made to overcome or at least reduce the effects of misfortune that may befall any one person?'

Not all forms of loss can be made good. What can be done is to devise a compensatory system which will at least seek to reduce the impact of financial loss that is consequent to an unfortunate event. This concept has advanced and developed from the simple protective measure of ancient times to the scientific and beneficial industry of the present, which we know as life insurance business.

Records indicated that the first life insurance policy was written in the 16th century in England. The insurance industry in Malaysia first started in the 18th century. The insurance industry then was based on the British system because it was introduced and managed by the British trading companies and agencies, among which were Harrison & Crossfield, Boustead and Sime Darby. There were few local companies involved due to lack of expertise.

The insurance industry really took off only in the 1950s. British and American firms then controlled the market. At the same time, locally incorporated companies had also started selling insurance. After independence in 1957, nationalistic policies gave much encouragement to domestic companies to improve their market share. However, this boom burst when many companies, without proper underwriting practices, went out of business leaving their policy owners holding worthless policies.

This feature culminated in the Government's intervention through the enactment of the Insurance Act, 1963 to regulate the insurance industry. This Act is the principal document governing the conduct of insurance business in Malaysia.

The office of the Director General of Insurance (DGI) was given the task of regulating the insurance industry. Today, the Governor of Bank Negara is also the DGI.

1.2 Definition of Insurance

Insurance has been defined in many different ways. Willett, for example, has defined it as "that social device for making accumulations to meet uncertain losses of capital which is carried out through the transfer of the risks of many individuals to one person or to a group of persons."¹ Kulp states "insurance is a formal social device for the substitution of certainty for uncertainty through the pooling of hazards."² In the same vein, Riegel and Miller say that from a functional standpoint, "insurance is a social device whereby the uncertain risks of individuals may be combined in a group and thus

¹ Allan H. Willett, *The Economic Theory of Risk and Insurance*, University of Pennsylvania Press, 1951, p.72.

made more certain, small periodic contributions by the individuals providing a fund out of which those who suffer loss may be reimbursed.”³ Finally, Pfeffer, in his search for a generic definition, concludes that “ Insurance is a device for the reduction of the uncertainty of one party, called the insurer, who offers a restoration, at least in part, of economic losses suffered by the insured.”⁴

Insurance organizations seek to provide protection against financial loss caused by fortuitous events. Insurance is based on the principle of mutuality, formed for the purpose of establishing a common fund, the need for which arise from chance occurrences of nature, whose probability can be fairly estimated.⁵

1.3 Objectives of the Study

The purpose of this study is to trace the history of the life insurance industry and the life insurance legislation in Malaysia. This study also focuses on concepts or main features that are common to many aspects of the life insurance mechanism. Specifically, the objectives of this study are: -

- a) To look at the profile of insurance industry in Malaysia.
- b) To examine the performance of Great Eastern Life Assurance (M) Berhad.

² C.A. Kulp, *Casualty Insurance*, New York, Ronald Press Co., 1956, p.9.

³ Robert Riegel and Jerome S. Miller, *Insurance Principles and Practices*, New York, Prentice-Hall, Inc, 1947, p.19.

⁴ Irving Pfefer, *Insurance and Economic Theory*, Homewood, Ill., Richard D. Irwin, Inc., 1956, p.53.

⁵ The Malaysian Insurance Institute, *The Pre Contract Examination for Insurance Agents*, p.4.

- c) To analyze the total demand of insurance and its relationship with the Gross National Product (GNP), population, and savings for the years 1980-1999.
- d) To analyze total profit and its relationship with the demand of insurance, annual premium, net investment income, expenditure, and terminations for the years 1980-1999.
- e) To recommend improvements on the life insurance industry in Malaysia.

1.4 Methodology

The research mainly utilized secondary data that are published. The sources of data include the library of Great Eastern Life Assurance (Malaysia) Berhad, Annual Reports of the Director General of Insurance, Malaysian Insurance Institute (MII), Life Insurance Association of Malaysia (LIAM) resource center, National Association of Malaysian Life Insurance Agents (NAMLIA), public announcements in newspapers and magazines, and local universities.

Primary data on the performance of Great Eastern were obtained through interviews with the management team, company executives and insurance agents. Basic statistical tools like the mean, average and percentage were used to analyze these data. Data and findings will be presented in the regression model by using the Econometric Views (E-views).

1.5 Limitations

This study only focuses on four main objectives as spelled out earlier. In addition, in profitability and demand of Great Eastern, analysis must be careful to include appropriate variables over a period of years in order to avoid misleading data.

1.6 Scope and Significance of the Study

This study is of significant value to the Malaysian Life Insurance industry. In particular, it will enable the companies to have a better understanding of the performance to the Great Eastern in developing their strategy to tap the potential and in their future planning and the capture of the opportunities offered in the market. Besides that, the development and main features of life insurance industry in Malaysia will be discussed. Several factors that affect total demand of insurance and total profit for the Great Eastern will also be discussed. Great Eastern Life will hopefully be able to take corrective actions to address weaknesses with the aim of increasing sales.

Only ordinary life businesses will be examined in this study as they form the bulk of life insurance business in Malaysia. Group life insurance and home services are excluded because the organizations purchasing such policies are likely to have greater expertise and bargaining power than the average consumer. Annuities and investment linked products are also outside the scope of this study.

The life insurance industry utilizes a number of specialized terms regarding its business and products. Some of the most significant terms and their definitions are shown in the “A Glossary of Life Insurance Terms” at the end of this study.

1.7 Organization of the Study

This report consists of six chapters. The first chapter is the introduction of the study. The objectives, methodology, limitation, scope and significance are also be discussed.

Chapter II gives a review of literature on insurance industry with emphasis on the factors of the total demand and total profit in the insurance market.

Chapter III describes the development and the main features of the life insurance industry in Malaysia such as the background of life insurance industry, insurance legislation, and the role of life insurance industry in the economy. It also presents a statistical overview of the importance of the life insurance industry. This chapter also discusses the issues related to the concept of the life insurance, and choice of customer toward purchasing the life insurance. The various types of policies are described, including term insurance, whole life insurance, and endowment insurance as well as the distinctive features of life insurance contracts.

The background, developments and performance of the Great Eastern are described in Chapter IV. Outlook and prospects of Great Eastern are also reviewed here.

Chapter V provides the results of the study using E-views. This chapter also examine several factors that affect total demand of insurance and total profit in Great Eastern between the years 1980 to 1999. This analysis includes hypothesis of the study, the model, results of the study, and findings and discussions.

Chapter VI concludes the study through suggestions and recommendations towards the improvement of the industry.