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Managing risks (more) effectively: Rethinking insurance for MSMEs

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Introduction

MSMEs form the backbone of many economies globally and give rise to economic growth, employment and innovation. The IFC (International Finance Corporation, 2015), for example, estimates that MSMEs account for 90% of businesses and are a source of more than 50% of employment worldwide. The ongoing global COVID-19 crisis has, once again, highlighted the extreme vulnerability of MSMEs to exogenous shocks and risks. However, the uptake and use of insurance remains extremely low for this group. In Sub-Saharan Africa, for example, it is estimated that less than 2% of all MSMEs have any form of insurance. Ultimately, during what may well be the largest economic risk event to face MSMEs in a lifetime, very few have any form of insurance cover to help shield them. Even those that have insurance are only covered for the personal impacts on their health expenses, while their enterprises remain highly exposed to risks.

Whilst COVID-19 has especially exposed the vulnerable MSMEs to a high level of risk, the pandemic is just one infrequent and specific risk. Across the world there is a lack of adequate MSME insurance. This is particularly pronounced in emerging markets, where few insurers offer specifically designed insurance products for MSMEs. MSMEs are often overlooked by banks and insurers – that usually target large corporate businesses. Even alternative financial institutions, such as MFIs and SACCOs, or microinsurers – which tend to serve micro-businesses, also do not meet all the needs of the MSME market. This gives rise to what is known in the MSME literature as the 'missing middle'.

The implication is that across developing markets insurance market actors, including providers, regulators and development partners need to rethink MSME insurance because current approaches are clearly, with a few exceptions, not working.

A number of key challenges exist, that make serving the MSME target market particularly challenging for insurers. Firstly, the insurance companies are hesitant to enter this MSME market due to their own lack of experience and data on this market, as well as regulatory barriers due to a lack of stable regulatory frameworks. They prefer to provide cover when they have a thorough understanding of the probability of losses. In many developing countries, this data and actuarial capabilities are not plentiful. This can cause insurers to add a high loading to cover the uncertain risk[1].

According to a 2017 report by the Swiss Re Institute, regulatory barriers can also impede insurers entrance into new markets without sound legal and regulatory systems. A reliable and stable regulatory framework is required to carry out efficient and effective supervision. Without these prerequisites, insurers' business can be limited by arbitrary, unclear, ineffective, and unnecessarily costly regulatory interventions, which can cause consumer distrust.

Secondly, it is not only the insurers' lack of knowledge, but also the MSME's lack of experience and knowledge of business principles, risk management, and insurance products which cause challenges for insurers to offer cover to this market.

In this note, we will discuss the following challenges and possible solutions.

- Inadequate risk management strategies
- Rapidly changing risk management needs
- Lack of awareness of insurance
- Insurers' lack of knowledge about MSMEs as potential target market
- High heterogeneity of MSMEs

- MSMEs are difficult to reach for insurers
- Regulatory barriers

In light of these obstacles, three areas of opportunities have emerged for insurance providers:

1. ***Deepen the understanding of MSMEs and their needs.*** A lack of data and understanding is a major challenge in designing fit-for-purpose insurance solutions for MSMEs. As with microinsurance, taking a customer-centric approach to understanding MSMEs is critical and can lead to the design of products that offer enhanced value to MSMEs. Furthermore, the high level of heterogeneity means that understanding MSMEs requires thoughtful segmentation and disaggregation of the group to identify subsets with similar risks that can be targeted.

2. ***Offer risk management and risk transfer solutions.*** The focus of nearly all MSME insurance that does exist is on the development of insurance policies, in other words, the transfer of specific risks from enterprise to insurer. However, the mitigation and management of specific risks that either reduce the likelihood of occurrence or the scale of the risk when it does occur offers a potential win-win. New technologies, such as IOT sensors and apps, make these types of offerings increasingly feasible to incorporate as part of a 'holistic' resilience solution. This offers greater tangibility for MSMEs, responds better to their risk management needs, reduces the risk for insurers (potentially even making uninsurable risks insurable) and supports data collection by insurers.
3. ***Strategic partnerships with aligned incentives are key.*** As MSMEs are too small to individually constitute a sustainable business case for insurance providers, aggregation of subsets of MSMEs with similar risks and needs remains important. As with microinsurance, partnerships with aggregators still remain important even as these aggregators change form. What also remains critical is that the incentives of the partners are well aligned with each other and the end client to ensure the sustainability and value of the insurance solution.

This note is produced by the Microinsurance Network's (MiN) Best Practice Group (BPG) on Insurance for MSMEs. It draws on the joint expertise and experience of group members to articulate the challenges for MSME insurance and identifies key considerations and opportunities to rethink the approach to MSME insurance.

2. Challenges to serve MSMEs with insurance

Insurance markets in most developing and emerging economies are vastly underdeveloped. Only a fraction of the population has access to any kind of insurance coverage. Therefore, it is not surprising that the same is true for MSMEs – only a handful of insurers offer services to this target group. In general, commonly available insurance offerings are not adapted to the needs of MSMEs. While microenterprises may find some value in existing microinsurance products, as businesses grow insurance needs become more sophisticated and heterogeneous, which often leaves small and medium-sized enterprises (SMEs) entirely out in the cold. But why hasn't the insurance industry identified MSMEs yet as a target market worth tapping into? We identified seven main challenges that prevent the development of insurance markets for MSMEs.

Inadequate risk management strategies: MSMEs face many risks; however, they lack adequate risk management strategies. MSMEs are more vulnerable to financial volatility compared to larger enterprises. They are vulnerable to the personal risks of their owners and their family members, compounded with the personal risks of their employees. The personal risks affect the business, in addition to the various business-related risks the enterprise faces. The situation is aggravated by the fact that MSMEs face a higher exposure to threats and disasters, while operating with limited funds for emergencies. It is also very common for them to pay more attention to perceived rather than actual risks. This may result in underestimating or even disregarding certain critical risks, e.g., by settling in disaster-prone areas or failing to comply with safety standards.

Rapidly changing risk management needs: Risk perceptions and, thus risk management needs, can change rapidly. This is usually the case when a hazard materialises that was previously disregarded entirely or assessed as negligible. The current Covid-19 crisis provides a textbook example for that. Millions of MSMEs around the world have experienced business interruptions (BI) due to Covid-19. However, the few BI policies available in developing countries pay out on interruptions caused by the loss or destruction of physical assets, thereby excluding business interruption caused by a pandemic. Even before the Covid-19 pandemic, many MSMEs have perceived business interruption as a major risk. However, Covid-19 has put business interruption exposure on centre stage and has shown that existing covers do not address this risk adequately. Moreover, in increasingly digitalised economies physical assets may no longer be the greatest cause of business interruption for enterprises across the developing world.

Lack of awareness of insurance: MSMEs often suffer from a lack of knowledge on how best to use financial services, how insurance works, or what risks they should seek insurance coverage for. Particularly for micro entrepreneurs, this is often exacerbated by a lack of formal and financial education, also increasing the risk of mis-selling. This also partially contributes to a general lack of trust towards insurance, prevalent in many markets, which often reinforces the perception that insurance is of little value to manage personal and business risks.

Insurers' lack of knowledge about MSMEs as potential target market: On the other hand, insurers have little experience in catering to the insurance needs of MSMEs. MSMEs are a largely untapped market for insurers, which poses a significant business opportunity. Nevertheless, MSME insurance penetration remains low, with supply generally limited to only a few product types. One of the major reasons is a severe lack of data and information on MSMEs as an insurance target market:

- how many there are,
- what their needs are,
- how risks differ between the different segments in MSMEs,
- and whether insurance is the appropriate tool in the face of certain shocks.

The IAIS Issues Paper on Microinsurance (2007), captures the challenge well: “When insurers cannot distinguish between good and bad risks, they tend to avoid this market. Even when insurance is available, the fear of adverse selection and moral hazard, and the costs of mitigating it, results in rationing. Information asymmetry may be an even more severe problem for microinsurance, especially for a mainstream insurer with little experience or understanding of the low-income market.” This dynamic is equally true for the MSME segment now. The high level of informality among enterprises also limits the ease and availability for insurers to access reliable information and data on the MSME segment. This results in a lack of understanding on both sides, as MSMEs often do not understand insurance and insurers do not understand the business realities and, thus, the insurance needs of this group.

High heterogeneity: Classical microinsurance is based on the assumption that basic insurance needs of underserved individuals are relatively homogeneous, and at least can be served with standardised products. Based on that prerequisite microinsurance products are highly standardised to keep complexity and costs down. This basic approach does not effectively serve this market. MSMEs differ vastly based on size, age, sector and a multiplicity of other factors. Disaggregation is crucial to understand the risks faced, needs and contextual realities of different MSMEs. It is challenging but essential to strike the right balance between standardised and tailor-made insurance products. While very standardised offerings will not do justice to the diverse needs of different MSMEs, it is generally not cost-effective to tailor solutions to every individual MSME.

Difficult to reach: A high proportion of MSMEs are unbanked or inaccessible, which makes it difficult to reach this target market to sell policies, provide post-sale service, collect premiums and pay out claims. Although some microenterprises can take advantage of existing microinsurance products, these products are usually too standardised to be of value for more heterogeneous MSMEs. On the other hand, MSMEs are often still too small to warrant being served individually by insurers. Hence, there is a need to aggregate them to make a viable business case for the insurers. However, the aggregators and distribution partners that work for microinsurance do not necessarily work toward reaching different segments of MSMEs. Generally, there are few natural aggregators due to the heterogeneity of the businesses. Insurers and brokers, therefore, must find new ways of aggregating MSMEs, such as wholesalers or sector-specific value chain aggregators.

Regulatory barriers: An enabling regulatory environment is important to foster the development of insurance markets for MSMEs. Common regulatory restrictions that can hold back insurers to tap into the MSME market are manifold. Among others, this may include restrictions on distribution channels and on bundling coverages or product types. In Ghana, for example, only personal policies are permitted to be distributed through bancassurance. This example illustrates the fact that MSMEs may slip through the gaps between micro and standard regulation, often meaning that MSME insurance cannot access the advantages around lower requirements and distribution opportunities available for microinsurance. Additionally, not all insurance regulators facilitate or even allow a test-and-learn environment which can impede the insurance industry to explore new markets such as different segments of MSMEs.

3. Emerging opportunities to develop and deliver effective insurance solutions

3.1. What can and what can't we learn from microinsurance

The term "microinsurance" was first published around 1999 and the definition has been the[2] subject of much debate and discussion within the development environment. "Microinsurance" first appeared as a new financial service within microfinance and, like microfinance, was used to describe insurance products designed for the largely unserved, lower income populations, particularly within the developing world. The concept of and language around microinsurance has evolved substantively in the intervening twenty years. This is a result of both insurance providers and development partners having learnt some hard lessons about what doesn't work when selling insurance to low income populations. One particularly important lesson has been the example of taking standard retail insurance policies, targeted at high net worth individuals, and simply reducing the premium and claims pay-out to make them 'affordable' doesn't work. It doesn't work for consumers that face vastly different financial realities and contexts and it doesn't work for providers that aren't able to shrink their operational costs in proportion to the reductions in premiums and margins. Fortunately, it was quickly recognised that to really be successful in the provision of microinsurance it required a fundamental re-thinking of the traditional approach to designing, distributing and administering insurance to both meet clients' needs and to enable sustainable business models.

It is worth reflecting on these learnings from microinsurance in the past when considering how to effectively reach MSME target markets. Some comparisons are quite clear:

- **Reaching a new target market:** Microinsurance focused on reaching down market to serve a new, previously uninsured, customer group with insurance. MSMEs are similarly unserved. For example, only 2% of MSMEs across Sub-Saharan Africa report having any kind of insurance cover, and therefore, similarly require providers to target a new, largely uninsured target market.
- **Shrinking existing policies doesn't work:** In the same way that the first attempts to develop microinsurance focused on shrinking traditional retail insurance policies, the bulk of MSME-targeted insurance policies currently available are effectively standard corporate policies that have simply reduced the size of the premium and pay-out[3]. As with microinsurance, this approach does not take into account the specific and unique needs of different MSMEs, nor the contextual realities within which they operate, and it has clearly been unsuccessful to date.

However, an approach that simply applies the principles learnt from microinsurance to MSME insurance is also unlikely to work. As discussed in section 2, MSMEs differ vastly based on a number of factors, meaning that disaggregation is crucial to understand the risks faced, needs and contextual realities of different MSMEs and to tailor products or solutions accordingly.

The lack of meaningful success in designing valuable and fit-for-purpose MSME insurance solutions underlines the need for a fundamental paradigm shift in how MSME insurance is approached, similar to what has occurred in microinsurance. Invariably, the starting point for insurance providers when targeting MSMEs tends to be "what insurance product can we design for MSMEs" instead of starting from understanding the major risks faced by a specific set of MSMEs and then considering how to develop solutions that address those risks and build resilience. This is an important paradigm shift, that we will build on further in the sections below.

3.2. Understanding MSMEs and their risk management needs

The opportunity to improve the provision of insurance to MSMEs starts with a need to understand the consumers. This is consistent with the need to apply customer-centric thinking to any insurance target market, and indeed beyond insurance too. However, understanding the needs, risks and contextual realities of MSMEs arguably constitute a greater challenge than other target markets and therefore requires a more nuanced approach. As discussed, MSMEs differ vastly and disaggregation is required in order to effectively understand the needs of potential consumers, and thereby design solutions accordingly.

The challenges of disaggregating by size. MSMEs are defined in a wide variety of ways across different countries and different sectors. The most common parameter used is the number of employees. The number of people employed by a given enterprise can be a useful proxy for the size of the enterprise. However, the traditional categorisations are not particularly useful for identifying target groups of enterprises with similar risks and insurance needs. For example, a business with seven employees might not have insurance needs that are significantly different from the needs of a business with fourteen employees. However, a business with just one employee (the owner) most likely has needs that are quite different. Yet under the common employee-led definitions the enterprise with seven employees and the enterprise with just one employee would both be classified as micro enterprises, whilst the business with fourteen employees would fall into a different category – as a small enterprise.

Distinguishing between 'survivalist' and 'aspirational' enterprises. A more useful segmentation, somewhat linked to size, to consider is to differentiate between survivalist and aspirational enterprises:

- Survivalist enterprises' primary objective is to earn income to maintain their livelihoods. They run businesses because they typically have no alternatives. The line between proprietor and business is likely to be blurred, resulting in survivalist enterprises often having insurance needs similar to individuals. As a result, survivalist enterprises can be considered as a sub-group of micro enterprises and across most developing countries account for the vast majority of total MSMEs within an economy. (Usually 80-90% of total enterprises would be considered as survivalist).

- Aspirational enterprises, on the other hand, are usually slightly larger and most critically see their business as more than just a means of survival, but rather as having the ability to grow. From an insurer's perspective, these enterprises, therefore, distinguish between personal and business expenses and risks and, unlike survivalists, would have the need for enterprise-specific insurance solutions as well as for personal risk cover.

The diagram below is an example of a more nuanced approach to disaggregating enterprises by size and level of development and illustrates that the traditional employee-based measures can be quite limiting for insurers to design targeted solutions.

Figure 1: Disaggregated Enterprises

Large companies

Large multinational

- High number of employees, valuable assets and high turnover
- Large business insurance needs, including employee benefits, through playing in international value chains
- Insurance premium capital available

Mid-size or large national

- High number of employees and larger risk
- Business insurance needs including employee benefits
- Insurance premium capital available

SMEs

Mid-size export

- Participates in international value chains
- Mainly business insurance needs (compulsory and voluntary), including employee benefits
- Insurance premium capital available

Historic established

- Has grown to mid-size or bigger slowly over time; often a family business
- Can have small or larger numbers of employees
- Both personal and business insurance needs including employee benefits
- Insurance premium capital available

Sustainable startup

- Small number of employees
- Aim is to grow the business
- Mainly business insurance needs (key man insurance) but insurance premium capital trade-off with other expenses

Micro-enterprises

Skilled self-employed

- Formal freelancers: e.g. Uber drivers, plumbers and IT specialists
- Not necessarily aspiration to grow
- Mix of personal and business insurance needs with capital available to cover premiums

Aspirational self-starter

- Desire to grow informal business to formal business
- Mix of personal and business insurance needs but limited insurance premium capital available
- Limited access to finance
- Uses personal network for risk management

Survivalist

- Informal business out of necessity
- Lack of formal job opportunities/access to markets
- Personal insurance needs but no capital available to cover these
- Uses personal network for risk management

Source: Cenfri

Disaggregating by economic activity. Although insurance companies may decide to focus only on aspirational enterprises, there remains substantial heterogeneity between different enterprises. The nature of business operations and sector within which different MSMEs operate will result in markedly different contextual realities and risks faced. MSMEs operating in the logistics sector, for example, would face fundamentally different risks to MSMEs operating in the technology sector and would need different kinds of insurance solutions. Insurance solutions seem to work most effectively for MSMEs when they are targeted towards players within a specific value chain. Working through existing value chain structures often offers an existing point of aggregation and, critically, all the MSMEs conducting similar functions in the same value chain are likely to face similar risks and have a similar set of insurance needs.

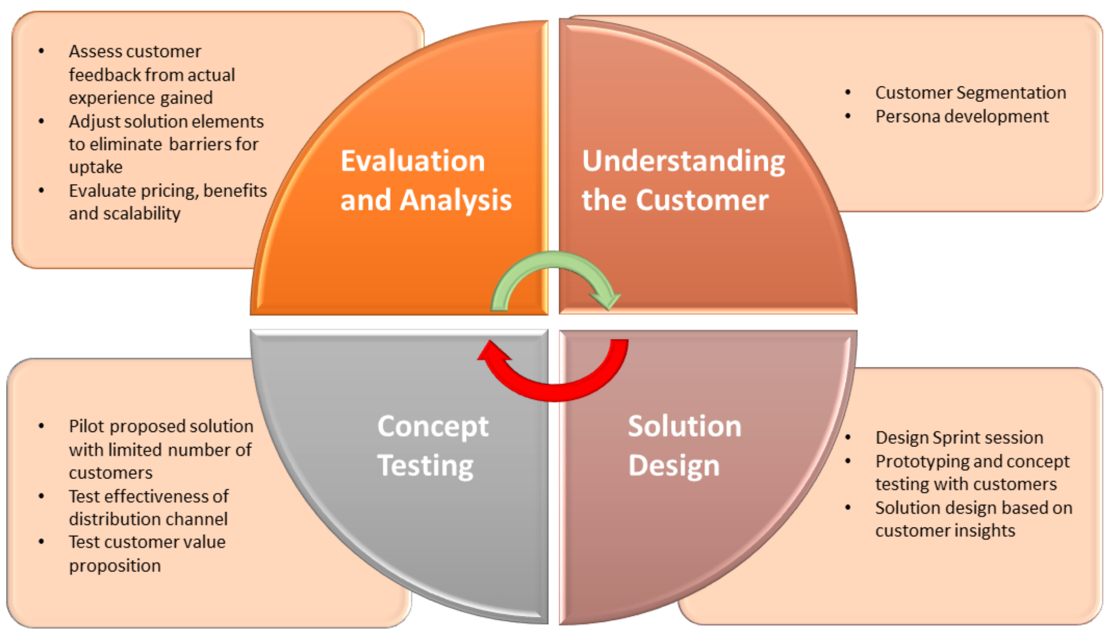
Hollard Zambia offers an example of the extent of in-depth research required to understand and tailor insurance solutions to specific MSME target markets. Their experience, discussed in Box 1 below, is also an illustration of how insurance providers can go about this.

Box 1: Case Study: The approach taken by Hollard Zambia to understand potential MSME consumers

Before designing a product for microenterprises, Hollard conducted extensive market research with the target consumers to get insights into the financial challenges they face on a daily basis. Through a design sprint process using a human-centred design approach, Hollard tested product concepts with potential customers to understand if the planned benefits would address their main risks. They asked the customers the following:

- how much they would like to pay for the product,
- how they would like to pay for it,
- how would they like to submit their claims,
- and in what time-frame would they like to receive the pay-out.

Hollard aimed to build MSME resilience through customer-centric solutions that enable their MSME clients to adopt better risk management principles; reduce dependency on costly informal coping strategies, and that will promote faster recovery after shocks. Hollard approached this customer segment, through the Fin-client Centric Cycle (F3C) Process in partnership with Financial Sector Deepening Zambia. The adopted framework for understanding financial risks faced by MSMEs, including value chain challenges was a four-tiered approach:



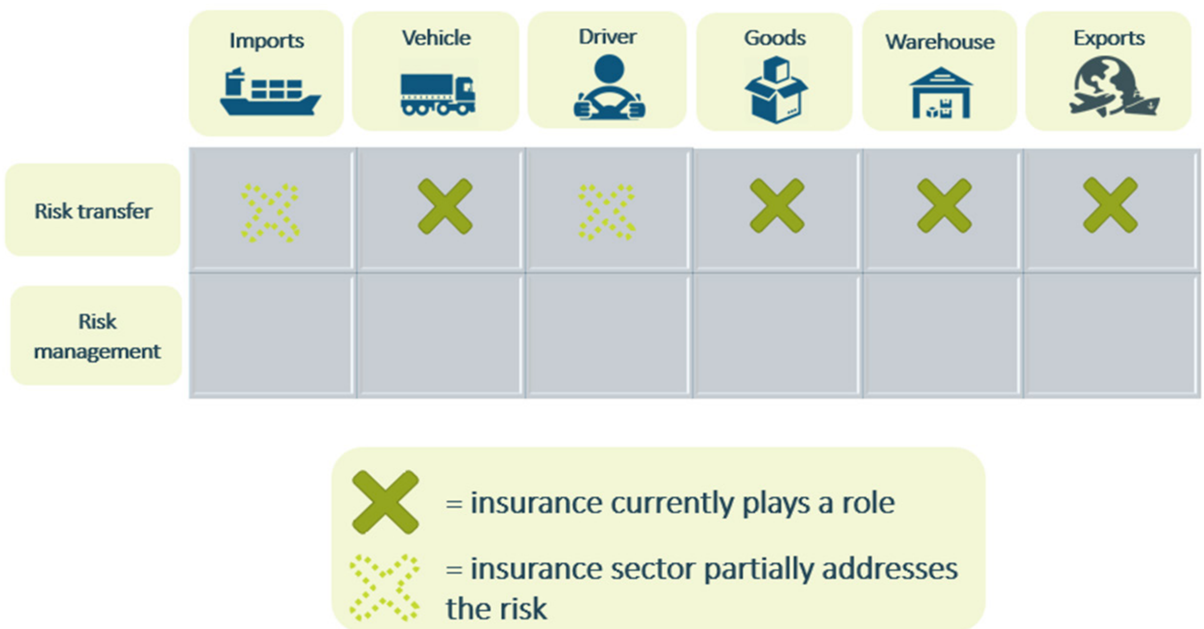
Source: Hollard Zambia

3.3. Being a risk management partner – rather than an insurance provider

The previous section considers how to disaggregate MSMEs in order to better understand their specific needs and risks. Insurance providers should then consider what are the most appropriate solutions to meet these needs and build MSME resilience, rather than diving straight into what insurance products can be designed for them. Whilst insurance can be an enormously valuable mechanism to build enterprise resilience, it can never fully address the full range of risks faced by MSMEs. The lack of trust in insurance and low uptake by MSMEs across the developing world further emphasises that insurance products, as they are currently designed, are perceived to be ineffective tools to deal with the most immediate risks faced by MSMEs.

Considering risk holistically. Insurance providers can make a fundamental shift by developing risk solutions for MSMEs more broadly than simply insurance products. Insurance players have far greater and more sophisticated understanding of risks, and how to model and mitigate them than most MSMEs. Working with enterprises to assess their risk and supporting the implementation of risk prevention and management mechanisms, rather than only focusing on the transfer of risk through traditional insurance policies, can be mutually beneficial and add far greater tangibility to MSME insurance offerings. Thom et al., (2018), for example, highlight the example of the road transport and logistics value chain in Ghana. As discussed in section 3.2, focusing on a specific value chain helps to identify the specific risks of the MSMEs operating within that value chain and in turn identify the specific gaps and opportunities. Figure 2 below provides a simplified illustration of this value chain in Ghana and highlights the role that the insurance sector plays at each stage. It is particularly interesting to note that based on the qualitative interviews conducted with MSMEs within the sector, the primary risk identified was also the one most poorly addressed by existing insurance solutions – namely the driver. Driver risk is a term which is intended to capture anything that can go wrong because vehicles are driven by human beings. Accidents or delays may occur because of basic human error, tiredness and/or alcohol consumption. Human error was consistently identified as the most significant risk that these players face. Delays in lead-time due to a lack of reliability on the driver's part, overloading of trucks as well as damage to vehicles and/or to the goods being transported, caused by speeding and accidents, are among the most pertinent manifestations of driver risk outcomes.

Figure 2: Insurance Role in the Road Transport and Logistics Value Chain in Ghana



Source: Cenfri, *The Role of Insurance in Inclusive Growth: Ghana Diagnostic*

This highlights the usefulness of understanding MSMEs from a value chain perspective, but also highlights the weakness of considering insurance solutions as limited purely to the provision of insurance products. The study found no proactive risk management solutions available to road transport and logistics MSMEs in the Ghanaian market, despite the fact that such solutions would likely be better able to address what these MSMEs identified as their greatest risk. Some of these MSMEs have already implemented some risk management mechanisms to mitigate their driver risk, such as:

- Inserting tracking devices in each of their trucks, which allows management to track speed, distance travelled, stops etc. of every truck and driver.
- Educating their drivers on road safety by sending them to short courses on safety driving.
- 'Testing' the reliability of new drivers by only sending them on short distance deliveries during their initial period at the company.
- Having trucks inspected on-site by the engineers that they employ, who are tasked with checking the condition of the trucks before drivers begin any new assignment.

If insurance providers would offer some of these services, or similar risk management solutions within their portfolio of insurance services, they would then more directly address these MSMEs' primary risk need, add tangibility to their insurance offering and mitigate against their own risk of claims.

This specific example illustrates the broader need for insurance providers to assess risks and opportunities through a value chain lens. It also highlights the important need to consider risk prevention and management services as core parts of their value offering, rather than focusing purely on traditional risk transfer insurance products. New and emerging technologies offer increasingly viable options to incorporate these solutions more proactively into insurance providers' value propositions.

Box 2: Applying technology solutions to risk management

Parsyl. Parsyl offers insurance cover, backed by Lloyds, for perishable cargo and vaccines with quality monitoring technology embedded into the product. This is done through a tracking device located within the cargo that records the location of the cargo as well as the temperature, light and humidity that the cargo is exposed to. If breaches of these requirements are recorded, the customer is notified of the event and Parsyl can identify where the breach occurred in the supply chain and responsible party. This technology offers customers immediate value because it helps monitor cargo and reduce spoilage. It is also linked to goods-in-transit cover, thus mitigating the claims risk from an underwriting perspective. In addition, it provides information to process claims payments rapidly, based on the sensor data. Parsyl is currently licensed to offer insurance solutions in the UK and US. Furthermore, this technology solution has been bundled with an AXA insurance solution for the cocoa value chain in Cote d'Ivoire and will operate across the developing world as part of Global Health Facility and Syndicate 1796 to cover vaccine distribution from 1 October 2020 in partnership with Ascot and AXA.[4]

Lumkani. Lumkani is a distributor of inclusive insurance products in South Africa that offers funeral and fire insurance, underwritten by Hollard. In order to mitigate the risks of fires, Lumkani provides customers with early warning fire sensors. The sensor is a heat detector and not an ill-suited smoke detector. In case of fire, the device will ring alerting the family inside enabling them to be proactive before the fire becomes unmanageable. After 20 seconds, the device transmits a signal to all devices in neighbouring homes up to 60 metres away, creating a community-wide response to the fire. This device offers significant value to consumers and the underwriter, including market based MSMEs, in helping to mitigate the risk of a fire.

Source: Parsyl and Lumkani

The case for bundling. MSMEs typically have a range of different risks and needs. These include risks to the enterprises and their employees. Examples of these risks are loss or destruction of productive assets, loss of IP, and liability. Bundled products that address the range of specific risks faced by individual MSMEs may therefore offer them greater value and convenience than standalone insurance products. However, beyond the bundling of different insurance policies, there is also potential benefit in bundling different types of mutually supportive insurance and non-insurance products, such as credit or non-financial services.

Box 3: The business case for product bundling: The example of SA Taxi

SA Taxi is a South African based taxi association that started out offering financial services by providing vehicle finance to its members. Taxi drivers in South Africa are notorious for their dangerous driving. This risk combined with the frequency of travel meant that established insurers were either unwilling to insure the vehicles or would only do so at very high premiums, often unaffordable for the taxi owners. SA Taxi began offering their own insurance under a cell captive arrangement underwritten by Guardrisk. SA Taxi also inserted telematics devices into the vehicles to better understand and model driver behaviour and the accompanying risks. Additionally, SA Taxi began offering in-house panel beating services. These three services offered together are mutually supportive and result in far better value for consumers that need all three. Insurance premiums, interest rates on loans and the panel beating costs are all lower for consumers. As a result, this partnership is providing this MSME segment of approximately 40,000 taxi owners with appropriate and affordable resilience tools.

Source: SA Taxi

3.4. The importance of aggregators and partners with aligned incentives

As we learned in section 3.2, disaggregation is crucial to understand the risk management needs of different MSMEs. Additionally, we learned that it is important to aggregate MSMEs in order to make the business case for insurers viable. So, how do we handle this market – aggregation or disaggregation? Simply, the trick is to strike the right balance. It is crucial to segment MSMEs which is more than just according to size measured in number of employees, turnover and value of assets. These operating numbers provide only a vague indication of the MSMEs' insurance and risk management needs. On the other hand, insurers will not be able to build a viable business case by offering tailor-made insurance solutions to individual MSMEs. Thus, it is important to aggregate MSMEs according to a combination of characteristics that translate into similar insurance needs.

In order to reach MSMEs with similar insurance needs effectively, it is important to partner with organisations that aggregate the targeted MSMEs and have frequent touch points with them. However, there are few natural aggregators due to the heterogeneity of the businesses. Therefore, insurers must break new ground to form such distribution partnerships. Table 1 below illustrates which types of distribution channels can generally be used to aggregate MSMEs and distribute insurance to them.

Table 1: Distribution Channels*

Channel	Opportunities	Challenges	Examples
Financial institutions (FIs)	• Process regular financial transactions that can be leveraged for premium and claims payments • Can bundle insurance with other financial products such as savings and loans • Meso-level schemes to insure entire loan portfolios might be an option	• In many countries MSMEs are also not well served by FIs • Insurance often seen as secondary product rather than a tool to mitigate risks for FI and customer	• Banks that also serve at least medium-sized companies • MFIs
Suppliers	• Regular financial transactions • May be able to pre-finance premiums	• Low familiarity with financial products which increases risk of mis-selling	• Wholesalers • Fast-moving consumer goods companies
Buyers	• Regular financial transactions • Interest in their loyalty and continued ability to provide stock	• Low familiarity with financial products which increases risk of mis-selling	• Export companies that buy finished goods • Buyer in contract farming
Agent networks	• Network constitutes an aggregated group of MSMEs • Both the small businesses that make up the network and their customers can be considered as potential insurance clients	• Network itself and customer base usually limited to micro-enterprises • Shop owners/staff not familiar with financial products which increases risk of mis-selling	• Neighbourhood shops acting as agents for mobile networks, banks and insurers
Business associations	• Aggregate many MSMEs within an industry • To make additional services available for members • Can provide platform for awareness raising	• Varying degree of organisation • Usually no regular financial transactions with members	• Industry specific associations e.g. food processing or market traders

Cooperatives	• Regular financial transactions with member businesses • Generally aggregate businesses with very similar characteristics	• Only exist in some countries and industries • Insurance usually seen as a secondary product with increased risk of mis-selling	• Cooperatives with specific agricultural crops (e.g. cocoa, coffee) • Cooperatives- transportation services, e.g., taxis, mini-buses
Government	• Leverage government interest in incentivising certain behaviours (e.g. tax payments) and improving productivity • May be able to facilitate insurance transactions through existing (social security) schemes	• May be able to reach microenterprises but possibly not SMEs • Level of aggregation may not be adequate	• Existing government programs, e.g. social security or health schemes • Existing government-led insurance schemes
Digital platforms	• Already an aggregator of MSMEs for existing value chain functions • Already has built-in payments mechanisms • Platforms typically incentivised to offer value added services to users to build their network of platform participants	• High rate of attrition amongst platforms • Once platforms get bigger than a critical mass of suppliers, their primary focus may shift towards attracting consumers, rather than providers (MSMEs)	• E-hailing platforms offering motor vehicle insurance to drivers

* In addition to the listed distribution channels there might be sector or country specific channels that can be used to aggregate MSMEs; e.g., in the Philippines various FIs and insurers partner with pawn-shop chains to distribute financial products and insurance.

Source: Table created by Microinsurance Network's Best Practice Group on Insurance for MSMEs based on ILO Impact Insurance Facility and GIZ information

Each type of distribution partner provides specific opportunities but also comes with certain challenges and limitations. For example, suppliers, buyers and cooperatives often have frequent financial transactions with MSMEs. These financial transactions could also be used to facilitate premium and claims payments, which makes it easier to financially interact with MSMEs and reduce operating costs. On the other hand, these types of organisations are often not very familiar with any type of financial products, including insurance. Awareness raising and training should be part of these partnerships in order to manage expectations and mis-selling.

Box 4: Pioneer's Negosure product to insure neighbourhood stores

Filipino insurer Pioneer has developed a retail product designed to protect "sari-sari stores" or mom and pop stores from property damage caused by fire. Additionally, it provides storeowners with personal accident (PA) cover called Negosure, short for "negosyo" (business) insurance. Pioneer conducted field research of store owners that identified fire property damage and personal accident as the top two concerns.

Pioneer developed the Negosure product to be simple and easy to remember. The two types of coverages are similar and differ only in insured amounts. Plan 1200 costs Php 1,200 (US$24) in premium and provides Php100,000 (US$2,000) reconstruction and PhP200,000 (US$4,000) PA protection. Plan 480 with a premium of Php480 (US$9.60) offers PhP40,000 (US$800) reconstruction and PhP80,000 (US$1,600) in PA coverage. Cover is activated by answering a handful of questions in a form followed by premium payment.

Negosure is marketed two ways, namely, personal delivery by the store suppliers' salespeople or as an incentive programme offered by manufacturing companies or wholesalers for store owners. The latter is a more successful programme. Despite efforts to simplify the product and the process, salespeople continually admit that it takes more time to sell insurance than FMCG products. The limited understanding of insurance in the market contributes to the challenge. Pioneer partners with the distributors, who offer the insurance products as an incentive to its customers. The suppliers are motivated to supply the storeowners with the insurance products because they have higher sales from the storeowners than their retail clients. It is in their best interest to support the survival and growth of these businesses and the insurance coverage protects these storeowners from financial volatility. This programme enables store owners to purchase insurance for the very first time.

Source: Pioneer

Partnering with MFIs or other financial institutions is probably the most wide-spread partnership model in the insurance industry.[5] Unsurprisingly, partnering with FIs is also at the top of the list when targeting MSMEs. This is understandable since FIs are known to have a thorough understanding of their customers' financial needs and risk profiles. In addition, FIs are also the ideal partner to facilitate insurance related payments. On the downside, FIs segment MSMEs relatively broadly. From an insurance perspective, this might be sufficient to offer relatively simple coverages such as credit-life insurance for business owners. However, when looking at more comprehensive insurance solutions for MSMEs, additional segmentation may be necessary. Moreover, the perception that FIs naturally understand insurance, is often wrong. After all, selling insurance is a very different business than extending loans and collecting savings. Making sure that the FI and its staff understand insurance well is important. Otherwise, there is the risk that insurance is perceived as a secondary by-product to loans bringing little additional value to the MSME.

Generally, partnerships between insurers and distribution channels work best if they function as true partnerships. Insurers that have recently set-up or are in the process of developing insurance schemes for MSMEs, often report that finding the right distribution partner has been among the hardest challenges. Incentives for both the insurer and the distribution partner must be well aligned. Earning additional income through commissions is usually not enough incentive for a successful partnership. Examples in the field of microinsurance and agricultural insurance show that partnerships work best when they add value to both the core business of the insurer and the distribution partner.

Box 5: Case Study: MiCRO offers index-based insurance to cover MSMEs against natural disasters. Business built on key distribution partnerships

MiCRO partnered with BanRural in Guatemala, Banco de Fomento Agropecuario in El Salvador, Bancamia in Colombia, and with another ten aggregators and insurance companies to provide an index-based insurance to protect MSMEs against natural disasters. Thus, MiCRO has learnt several lessons to improve their distribution strategy:

In order to strengthen the resilience of the underserved population against natural disasters, these insurance products must be both appealing and affordable, but the value proposition also needs to be aligned with strategic objectives of the distribution channels. In that regard, it is imperative to have a good understanding of the distributors' needs, expectations, or concerns of selling insurance products. Moreover, the insurance products must be designed to adequately address their needs. Assisting them in improving the risk profile of their client portfolio, differentiating themselves from competitors, diversifying their service offering, contributing to sustainable development goals, are good examples of supporting their business and motivating them to increase sales.

In other words, it is critical that the insurance programme becomes a priority for the distribution channel and that they are offered an appealing value proposition. They should be incentivised to sell high value products which offer an additional source of revenues significant enough to achieve the scale necessary to reach sustainability, but at the same time keeping the product affordable and valuable for the end clients.

4. Conclusion

MSMEs constitute major drivers of economic activity across developing countries and support the livelihoods of millions of individuals. They are arguably the engines of growth to developing economies and support the livelihoods of the communities they serve. They are also highly vulnerable to a range of shocks and yet they remain almost entirely unserved by insurance solutions. Not only are resilience tools critical from an economic and social perspective, but these enterprises also constitute a target market of significant potential growth opportunity for insurance providers. In conclusion, we have identified some practical actions that key insurance market stakeholders can and should prioritise in order to better serve MSMEs.

4.1. Insurance providers

Build a deeper understanding of MSME markets and their needs. As discussed throughout this paper, few insurance providers have an explicit focus on MSMEs and most still consider MSMEs a single target market. The lack of data and information on MSMEs across markets remains a major challenge. It is imperative for insurance providers, who are looking to serve these markets, to research and understand MSMEs from a more granular and disaggregated viewpoint, so that solutions that meet their actual needs can be developed. Partnerships with development partners and local entities, like NGOs, with experience working with MSMEs can offer valuable insights and opportunities to begin this process.

Bundle in risk management services. Few MSMEs across the developing world see value in existing insurance products. Limited understanding of the needs and poorly designed products are major contributors to this perception. MSMEs are not so much interested in insurance as in mitigating or limiting their risk. Creatively designed solutions that bundle risk mitigation mechanisms with traditional risk transfer mechanisms will add tangibility to the insurance offering. This type of bundled insurance product provides greater value to the MSMEs and helps to reduce the insurers' own risks.

Partner with value chain aggregators with well-aligned incentives. Another critical but common challenge for potential providers looking to serve MSMEs is in how to reach them. The insurance business model relies on scale and this is difficult to attain when developing targeted solutions for such a heterogeneous group. Identifying sub-groups of MSMEs with similar sets of risks and needs that can be reached through a small number of aggregation points, is a key success factor for insurance providers. Partnering with value chain aggregators, such as associations, cooperatives or digital platforms, may offer the best opportunity. However, a well-aligned incentive programme for partners is a crucial success factor. Distribution partners need to have the proper incentives to sell products that will build MSME resilience. Value chain aggregators are probably the best opportunity to distribute insurance. Since most of them are reliant upon the delivery of goods and services, distributing insurance would not only give them another source of revenue but also strengthen the resilience of their suppliers. This in turn would support their own sustainability. Collecting and analysing relevant data on an ongoing basis can demonstrate the value of insurance solutions to these partners. A reduction in the number of supplier failures is also crucial to show value, beyond the revenue stream.

Buy-in at the executive and board level. Despite the immense opportunities for growth, most insurance providers see the MSME market as too challenging to enter, especially since it could require a prohibitively high initial investment. Executives that are required to show annual shareholder return are unlikely to invest in a new target market that may only show a return over a longer period. Here are two recommendations that could shift this paradigm:

- Present clear projections on the length of the investment period and the size of the opportunity based on market data and analyses;
- Develop partnerships with those organisations that are able and willing to share the risk with providers during the initial investment period.

4.2. Regulators

Assess and reduce hurdles in current regulation for MSME insurance. From a regulatory perspective, MSME insurance is not fundamentally different from any other form of insurance except that unlike individual retail, the policyholder can be an institution. Therefore, regulatory restrictions on distribution and innovation will similarly apply when targeting MSMEs. However, specific regulatory barriers to insuring MSMEs may arise in certain instances. Regulators can then assess the current landscape and remove unnecessary barriers to serving this target market.

Foster test-and-learn environment. In order to innovate, it is vital for insurance providers to be able to test new products in a controlled environment. As a result, providers can receive direct feedback from perspective customers and constantly assess and adapt product features. This is only possible if regulators foster or at least allow for such a test-and-learn environment.

Measure usage of insurance by MSMEs across different value chains. Measuring usage of insurance by MSMEs can support the consideration of MSMEs as a relevant target market, nudging insurance providers towards targeting MSMEs. Furthermore, it can identify the specific market opportunities, particularly if collected by the sector or value chain.

Engage in multi-stakeholder platforms to actively support market building. Many insurance regulators are explicitly or implicitly mandated to support the development of their national insurance markets. By actively engaging with multi-stakeholder platforms that develop insurance markets for MSMEs, regulators can share their expertise with market participants and gain first-hand knowledge from insurance providers, MSMEs and other relevant actors. This way regulators can demonstrate the importance of developing insurance markets for MSMEs to the insurance industry and other stakeholders.

4.3. Development partners

Provide targeted capacity building. As we have learnt, only a small fraction of MSMEs have any kind of insurance coverage. They generally lack the knowledge required to identify risks they face and assess the severity and frequency. Moreover, they are not familiar with how to manage these risks effectively and the role that insurance could play in managing these risks. Usually, insurance providers are also lacking in experience with serving the MSME market. They do not sufficiently understand business models, risk profiles and insurance needs of different segments of MSMEs. In summary, there is a lack of knowledge on both the supply and the demand side that prevents the development of insurance markets for MSMEs. Development partners can provide a multitude of capacity building measures to tackle these challenges, such as:

- design and support campaigns to raise awareness about insurance and improve insurance literacy of MSMEs;
- provide training to actors on the supply (insurance providers) and demand (MSMEs) side as well as to actors that set framework conditions (policy makers and regulators);
- facilitate matchmaking between insurance providers and MSMEs, e.g., through business associations and existing exchange platforms or those in development.

Support piloting of innovative models. Insurance providers that develop innovative models to target different segments of MSMEs face steep up-front investment costs. Development partners may be willing to both provide technical assistance to support the development and implementation of the new insurance product, as well as share in investment costs.

Advise regulators and policy makers. Development actors can advise regulators and policy makers to help create and enable a regulatory framework that allows for innovative insurance solutions for MSMEs. Furthermore, development actors can support regulators in assessing existing regulation to identify barriers preventing insurance solutions for MSMEs from being developed.

Conduct research and disseminate knowledge. Insurance for MSMEs is a relatively recent addition on the agendas of development actors and researchers. Consequently, there is presently a considerable research gap in assessing success factors of insurance solutions for MSMEs and measuring the impact of insurance for this group on national policy and development goals. Development partners need to invest in providing better guidance and support for the development of insurance markets that work effectively for MSMEs.

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About the Microinsurance Network

A not-for-profit membership-based association, the Microinsurance Network is driven by its vision of a world where people of all income levels are more resilient and less vulnerable to daily and catastrophic risks through improved access to effective risk management tools. Low-income consumers lie at the heart of our mission. We work with a broad range of stakeholders around the world to prioritise the needs, interests and well-being of our ultimate beneficiaries.

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