

Insurance for Micro, Small and Medium Enterprise Development

The Inclusive Insurance Factsheet Series, developed by the GIZ Sector Programme "Global Initiative for Access to Insurance", highlights how insurance as a tool contributes towards meeting the needs of vulnerable individuals, households and micro, small and medium-sized enterprises (MSMEs) in developing countries and emerging economies. It furthermore accentuates insurance's role in helping achieve goals of the following development agendas: sustainable development and poverty alleviation, gender and women's empowerment, agricultural development and food security, MSME development, and climate change mitigation and adaptation.

This factsheet highlights the vital role inclusive insurance plays in the development of micro, small and medium-sized enterprises (MSMEs).¹ It emphasizes how insurance can improve risk management and increase the resilience of MSMEs, as well as spur investments. It also presents examples of emerging offerings and, finally, recommendations for support approaches of development cooperation agencies.

1. Role of insurance for MSME development

MSMEs are key contributors to economic growth and employment, yet have limited access to financial services including insurance. Formal small and medium-sized enterprises (SMEs) contribute approximately 60% of total employment and 40% of national production (GDP) in emerging economies, figures which increase significantly when adding informal enterprises.

Approximately 65 million formal MSMEs are reported to be credit constrained, whereas the total unmet demand for credit by formal MSMEs in developing economies is estimated to be \$5.2 trillion. Financially unserved or underserved MSMEs also lack insurance coverage.²

Commonly available insurance offerings are not adapted to the needs of MSMEs. The microinsurance offerings that have emerged in the past two decades mostly provide coverage for life and accident risks, making up the bulk of the approximate 600 million microinsurance policies globally.³ Microinsurance is often the first and only type of insurance policy MSMEs have access to. In fact, there is a large gap in insurance provision for microenterprises (MEs) and SMEs.

MSMEs face many risks; however, they lack adequate risk management strategies. MSMEs are more vulnerable 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. In addition, 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. 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 underestimate or disregard certain critical risks, e.g. by settling in disaster-prone areas or failing to comply with safety standards.

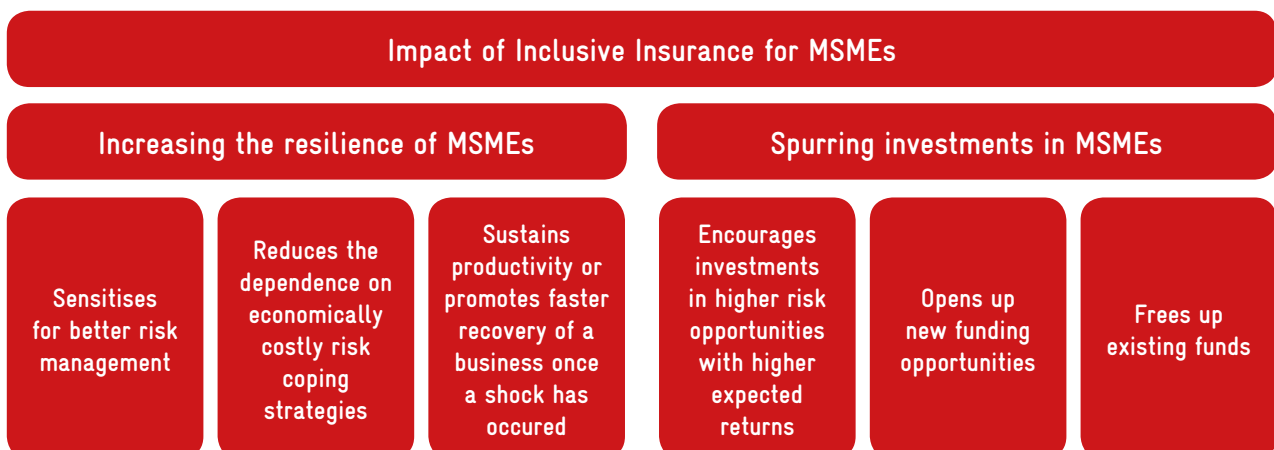


Enterprises that grow require insurance. As enterprises grow, the financial losses from an adverse event are likely to exceed what they can cover with informal risk mitigation mechanisms or reserves. Formal insurance products are a crucial tool to increase the resilience of MSMEs, spur business investments and, thereby, contribute to the growth of the enterprises (see Figure 1).

Insurance increases the resilience of MSMEs. Insurance can sensitise business owners and employees about risks and inform them on the price of insuring specific risks. By putting a price tag on insurable risks, insurance can promote better risk management. As such, insurance protects MSMEs from financial losses due to risks related to the business, owner and employees. Without insurance entrepreneurs resort to economically costly risk coping strategies, including selling productive assets, depleting savings, taking out additional loans, reducing or stopping investments in the business, or reducing household expenditure for food and schooling.⁴ These strategies are often more costly, generally cover only part of the loss, can threaten the family and the business and tend to contribute to inter-generational transmission of poverty. Insurance can reduce the dependence on these deficient strategies, sustain the productivity of a business and promote a faster recovery once a shock has occurred.

Insurance spurs investments in MSMEs. Insurance can influence the entrepreneurs' investment behaviour by encouraging them to invest in higher risk activities with higher expected returns. For example, an entrepreneur may buy a machine to scale up production processes if at least some risks associated with this investment are covered by insurance. Further, insurance can increase the credit worthiness of MSMEs, enabling them to access formal credit as they can prove that the owner and the assets are protected. As such, insurance can increase financial institutions' willingness to lend to MSMEs, or even lower collateral requirements. Moreover, insurance frees MSMEs' funds for productive investment. By allowing MSMEs to pay for risk protection in small instalments in the form of regular premiums, insurance enables MSMEs to re-allocate funds they would have otherwise needed to reserve for potential shocks towards investment in better technologies, product innovation, and ultimately income generating activities. All in all, insurance has the potential to increase the entrepreneurs' confidence in investing, as well as their ability to secure the necessary finance.⁵

FIGURE 1: Impact of Inclusive Insurance for MSMEs



2. Differentiating between the insurance needs of microenterprises (MEs) and small and medium enterprises (SMEs)

A distinction between microenterprises (MEs) and small and medium enterprises (SMEs) helps to identify the insurance needs of both customer groups. In both groups the business owner is key and needs personal insurance. However, ME's set-up, use of finance (for instance ME owners rarely differentiate their business and family finances), the socio-economic profile of the entrepreneur and his/her purchasing power are different to SMEs. SMEs usually have a larger asset base, more sophisticated business systems and more employees. As such, MEs and SMEs constitute two distinct customer segments and their specific insurance needs should be considered separately (see table 1).

A more in-depth segmentation to understand the insurance needs of MEs on the one hand, and SMEs on the other is required. Generally, the insurance needs of MEs may centre more on personal risks. SMEs, on the other hand, have a more diverse need for a range of insurance products and have more resources to afford cover for these diverse insurance needs. However, a more in-depth segmentation of both, MEs and SMEs, will help to understand their distinct demand for asset-based or personal coverages, and the respective elements these coverages should entail, such as group policies for employees, bundled policies for various asset-related risks of the business, or liability insurance for certain types of SMEs.

TABLE 1: Distinction between insurance needs of microenterprises and small and medium enterprises

	Microenterprises (MEs)	Small and medium enterprises (SMEs)
Characteristics of the enterprise	<p>MEs depend very much on the owner and his/her family members</p> <p>Often, MEs don't distinguish between household and business finances and assets</p> <p>Affordability limited</p>	<p>The owner is also key</p> <p>SMEs have a larger number of employees that can be aggregated as a group</p> <p>Significant business assets</p> <p>Book keeping systems and financial planning more sophisticated</p>
Possible insurance demands	<p>Life, accident and health of owner and family members</p> <p>Multi-risk coverage in one policy for business assets: vehicles, stock, premises, crops</p>	<p>Life, accident and health of owner</p> <p>Life, accident, health and pension for the employees as group insurance</p> <p>Coverages for vehicles, stock, premises, crops</p> <p>May need liability insurance</p> <p>May be able to afford business interruption insurance</p>



3. Examples of emerging insurance services for MSMEs

Innovative insurance offerings tailored to the needs of MSMEs are slowly emerging. MSMEs rarely have insurance because insurers have barely targeted the MSME sector as clients; hence only standard insurance products are usually offered.⁶ Existing products and distribution strategies are often not tailored to the particularities and specific needs of different MSME segments. However, slowly, supply is growing and some innovative products and distribution models are emerging. Some are provided or facilitated by MFIs or FinTech ventures that cooperate with commercial insurers or with MSME aggregation platforms of large retailers (see box).



EXAMPLES OF INSURANCE PRODUCTS FOR MES AND SMES

Pacifico, Peru – multi-risk cover: Pacifico is a popular insurer in Peru. Pacifico partners with MFIs and offers a variety of credit-linked products to small businesses including a multi-risk business insurance, which protects against fire, earthquake, civil unrest, natural disaster, robbery, cash in premises and transit, electronic and mobile devices, and breakdown of machinery. To market this product to small businesses, Pacifico provides a variety of value-added services, such as free 24-hour hotlines for medical and legal advice, free transport to hospitals, as well as free annual medical check-ups for the owner.⁷

Pioneer, Philippines – bundled insurance products: Pioneer is a Filipino insurer that introduced MSME insurance in 2014. The company offers two MSME insurance products, which account for around 1% of its total portfolio. The first product, “Negosure”, is a bundled product with coverage for personal accident and fire assistance on the physical structure (excludes inventory) of the Sari-Sari stores (convenience-type stores). The second, “Sagip Negosyo”, is a bundled product with coverage for personal accident, fire assistance on the physical structure (excluding inventory) of the Sari-Sari stores, and for typhoons and floods. It partners with distributors, for example supermarkets, who purchase the products and provide the insurance as part of their customer rewards programme.⁸

CIC Insurance Company, Kenya – MSME insurance coupled with loans: CIC focuses on protecting small businesses from risks such as burglary, fire and other natural disasters through their “Baishara Salama” product. It is an all-inclusive package that is loan-based and sold through MFIs and other financial institutions. Its benefits include comprehensive credit life cover, e.g. for death and permanent disability, and funeral expense cover for the policyholder’s spouse and children. There is also cover for stocks and business tools in case of fire and lightning, burglary, riot, strike and civil commotion.⁹

Pakistan EFU Life and Planet N Supply Chain Insurance:¹⁰ Six different packages of hospital cash and term-life insurance are marketed to SME retailers, with coverage ranging from 1000 to 5000 USD. Two tech partners support its distribution. Order Call (OC) is in charge of enrolment and sales, whilst Tez Financial Services provides loans transferred to mobile accounts and collects the insurance payments from OC. Sales started in July 2017 and 3,000 retailers have already enrolled out of a target of 25,000 retailers nationwide as of September 2017.

4. Advice for development cooperation agencies

Development cooperation agencies should support insurance solutions for MSMEs under various development agendas. Fostering the provision of MSME insurance requires a holistic approach in financial systems development. There is the potential to make greater use of MSME insurance to deliver on a variety of development agendas, e.g. private sector development and employment, agricultural development, women's economic empowerment, climate change adaptation or green investments. Insurance should be integrated into a broader range of risk management strategies that MSMEs are generally using. It should be applied at the beginning, when planning any MSME development or other development project. Development agencies have a range of **entry points** as presented below:

Assessing the current supply and demand, as well as enabling environment in the form of a micro-enterprise and/or SME insurance diagnostic, may include the following aspects:

- » **Enabling Environment:** How can the legal and regulatory framework enable inclusive insurance approaches for MSMEs? Are regulations restricting innovative approaches, and also protecting consumers? What are the relevant national policies, and how can insurance for MSMEs be integrated into the national development agenda?
- » **Service Providers:** What technical infrastructure exists? Are associations and service providers (e.g. training institutes, actuaries, and technology providers) prepared for supporting insurance for MSMEs?
- » **Insurers and Distributors:** Are current offerings (products, distribution avenues) suitable for the different segments of MSMEs? What capacity development measures are required to develop products and business models for MSMEs?
- » **Consumers/MSMEs:** What formal and informal risk reduction measures are used/existing to support business owners and continuity in case of shocks? What insurance literacy measures are required for business owners and employees to enable up-take and consumer protection?

Implementation support for more and more valuable MSME insurance:

- » **Insurers** should be encouraged to address MSMEs as consumer segments, e.g. by implementing demand research, developing adequate products, innovating with new distribution avenues and contributing to financial education campaigns with a focus on MSMEs.
- » **Powerful distributors, such as banks and FinTechs** should be encouraged to enter into partnerships with insurers and consider targeting the segment of micro-enterprises and SMEs to provide tailored insurance services.
- » **Governments** of partner countries should be encouraged to promote MSME insurance as part of financial sector development, and within other policies, and foster publically available risk data as well as relevant financial literacy. Policy and regulatory frameworks should be analysed and adjusted where necessary.
- » **Development cooperation** should support partner governments in their efforts to promote MSME insurance. This can, for example, be implemented by providing support for public goods such as market research, risk data collection, or by promoting global, regional and national level dialogues on the topic, by supporting capacity building for the various stakeholders, by supporting product development and by providing capital for insurance companies.



Endnotes

- 1 The definition of MSMEs varies by country: Most countries use sales turnover and the number of employees, some coupled with total assets, as criteria. This note does not distinguish between formal and informal MSMEs, as between 70 and 80 % of MSMEs are informal and non-employer firms. This note will classify MSMEs into two groups: microenterprises (MEs), and small and medium enterprises (SMEs), regardless of their state of formalisation. The note will generally use the term MSMEs and only distinguish between the two groups when necessary.
- 2 IFC (2017) MSME Finance Gap: Assessment of the shortfalls and opportunities in financing micro, small and medium enterprises in emerging markets.
- 3 Institute of International Finance and Center for Financial Inclusion (2018) Inclusive Insurance: Closing the Protection Gap for Emerging Customers.
- 4 Munich Re Foundation, ILO and Microinsurance Network (2012) Protecting the poor: A microinsurance compendium, Vol. II. http://www.ilo.org/wcmsp5/groups/public/---dgreports/---dcomm/---publ/documents/publication/wcms_175786.pdf.
- 5 KfW Development Bank (March 2017) Materials on Development Financing. https://www.kfw-entwicklungsbank.de/PDF/Download-Center/Materialien/2017_Nr.6_Mikroversicherung_Final.pdf and Swiss Re Institute sigma (2017) Insurance: adding value to development in emerging markets. http://media.swissre.com/documents/sigma4_2017_en.pdf.
- 6 Asian Development Bank (April 2017) ADB Briefs N° 78, Insurance for MSMEs, A. Chatterjee and R. Wehrhahn.
- 7 Alice Merry (March 2016) Insurance for small businesses. ILO. <http://www.impactinsurance.org/publications/mp43>.
- 8 Ibid.
- 9 Ibid.
- 10 MEFIN Network (2017) Factsheet Microinsurance business model, Pakistan: Making Life and Health Insurance Accessible for Middle to Low-End Retailers (SME Segment): http://www.mefin.org/files/businessmodels/EFU_Life_Factsheet_OrderCall_13Sep2017.pdf.

Published by:
Deutsche Gesellschaft für
Internationale Zusammenarbeit (GIZ) GmbH

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Bonn and Eschborn

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Design/layout etc.:
Jeanette Geppert, pixelundpunkt kommunikation, Frankfurt am Main

Photo credits/sources:

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On behalf of
German Federal Ministry for Economic Cooperation and Development (BMZ)
Division 110, Cooperation with the private sector; sustainable economic policy
Bonn

GIZ is responsible for the content of this publication.

Eschborn, January 2019

On behalf of



Federal Ministry
for Economic Cooperation
and Development