BRIEFING PAPER
Managing risks (more) effectively: Rethinking insurance for MSMEs

In cooperation with:
Micro, small and medium enterprises (MSMEs) account for 90% of businesses and are a source of more than 50% of employment worldwide. Should they suffer risks, the implications for livelihoods and economic activity are severe. Yet only 2% of MSMEs in Sub-Saharan Africa have insurance and most of that is personal rather than business insurance. Many MSMEs are overlooked by banks and insurers that target large corporate businesses, as well as by alternative financial institutions (like MFIs and SACCOs) or microinsurers, which tend to serve micro-businesses, such as smallholder farmers, often in their personal rather than business capacity. This gives rise to what is known in the MSME literature as the ‘missing middle’.

WHY THE BIG GAP?

There are a number of challenges to providing business insurance to MSMEs. As Figure 1 indicates, the heterogeneous nature and risk profile of MSMEs make it difficult to provide tailored options to them, while their often informal and unnetworked nature make them difficult to reach from a distribution point of view. MSMEs’ own awareness and behaviour, as well as regulatory barriers can also undermine the development of a viable MSME insurance market.

Figure 1: Challenges to providing insurance to MSMEs

- **Inadequate risk management strategies**: MSMEs are vulnerable to personal and business-related risks but lack adequate risk management strategies.
- **Rapidly changing risk management needs**: Risk perceptions and, thus risk management needs, can change rapidly, e.g. when a hazard materialises that was previously disregarded.
- **Lack of awareness of insurance**: MSMEs often suffer from a lack of knowledge on how insurance works and what risks they should seek insurance coverage for.
- **High heterogeneity**: MSMEs have little experience in catering to the needs of MSMEs.
- **Difficult to reach**: It is challenging to strike the right balance between standardised and tailor-made products.
- **Regulatory barriers**: Insurers must find new ways of aggregating MSMEs.

OPPORTUNITIES TO BRIDGE THE GAP

For policymakers and regulators wishing to develop their markets and serve broader economic development and welfare objectives, it is a clear imperative to bridge the gap. There are also several reasons why it makes business sense to do so. In fact, a number of innovative market players are already working to increase the resilience of MSMEs by filling the missing middle.

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There are three key opportunities for building the MSME insurance market:

- By forming a deeper understanding of MSME needs through informed segmentation
- By providing risk management solutions in addition to risk transfer solutions
- By utilising strategic partnerships to reach MSMEs

UNDERSTANDING MSME NEEDS THROUGH SEGMENTATION

Understanding customer needs should always be the first step in product development. This aligns with customer-centric thinking, which places the customer at the centre of decisions. Simply shrinking existing polices meant for larger organisations does not work. Market segmentation provides an opportunity to develop tailored, but scalable solutions. A well-defined segment has similar needs, allowing for a solution that is scalable while being sufficiently tailored to the segment’s specific needs.

In the literature, MSMEs are most often segmented by number of employees. However, that approach groups very heterogeneous MSMEs together - a sole proprietor technical expert would be in the same category as an informal vendor. A more useful segmentation for financial services purposes is to consider why MSMEs are in business and which economic sector they operate in:

- **Reason for operating.** Traditionally, MSMEs have mostly been segmented on size, measured according to the number of employees an MSME has. However, doing so groups vastly different MSMEs together. Differentiating on why MSMEs are in business allows a differentiation between **survivalist enterprises** and **aspirational enterprises**, each with their own needs:

  » **Survivalist enterprises** are in business due to a lack of alternatives and do not distinguish between their personal and business finances or needs. This suggests insurance needs very similar to that of individuals. They also usually account for the vast majority (80-90%) of MSMEs across developing countries.

  » **Aspirational enterprises** are usually larger and see their business not just as a means of survival but as having the ability to grow. From the insurer’s perspective, these enterprises are more likely to distinguish between their personal and business risks and needs. These enterprises are thus more likely to require enterprise insurance solutions in addition to personal insurance. Even if insurers are only considering aspirational enterprises, this still includes a large variety of MSMEs.
• Sector. An effective segmentation would also consider the economic sector that MSMEs operate in. 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. In fact, insurance solutions for MSMEs work most effectively when targeted towards players in a specific value chain. Working through established value chain structures offers an existing point of aggregation. Moreover, 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.

FROM INSURER TO RISK MANAGEMENT PARTNER

Well-placed for risk management. After identifying the needs by segment, the next step is to consider how best to fulfil those needs. Traditionally, this is done through the sale of insurance products as a form of risk transfer. However, the insurance industry’s understanding of risks makes them well-placed to provide a broader offering to MSMEs, where insurance is just one of the options to manage customers’ risks.

Value chain lens. Apart from being an important tool in market segmentation, the value chain perspective also helps to identify specific risks and opportunities for a variety of risk management solutions. This is illustrated in Figure 2, which shows the dearth of risk management offerings along a simple view of the logistics value chain in Ghana.

Figure 2: Insurance’s role in the road transport and logistics value chain in Ghana

Source: Cenfri, The Role Of Insurance in Inclusive Growth: Ghana Diagnostic
The Ghana study identified the driver as the primary source of risk along the value chain. While no insurers were providing proactive solutions to manage this risk, some MSMEs were in fact implementing a range of risk management solutions:

- By installing tracking devices in trucks to monitor driver behaviour, including speed, distance travelled and stops.
- By educating drivers on road safety through a short course on safe driving.
- By limiting distance travelled for new drivers, thereby ‘testing’ their reliability.
- Through on-site inspections of the condition of trucks by engineers before drivers begin an 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.

**Role of technology.** As seen above, technology is already being deployed as a risk management solution via the use of tracking devices. Parsyl and Lumkani offer two further examples of the innovative application of technology to manage risk:

- **Parsyl** provides goods-in-transit insurance for perishable cargo such as vaccines. Its insurance offering is bundled with quality-monitoring technology. The sensors monitor the cargo’s temperature, humidity, location and exposure to light. Doing so provides significant and immediate customer value by reducing spoilage.

- **Lumkani**, a provider of fire insurance in South Africa, provides customers with early warning heat detector sensors to mitigate the risk of fire. These sensors alert customers to fire outbreaks. If after 20 seconds the sensor still senses a fire it signals all the devices within 60 metres that a fire is breaking out to encourage a community response.

**The case for bundling.** MSMEs typically have a range of different risks and needs. These include risks to the enterprises and their employees, such as loss or destruction of productive assets, loss of intellectual property (IP) and liability. Bundled products that address the range of risks faced by individual MSMEs may offer them greater value and convenience than standalone insurance products. 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.
PARTNERING WITH AGGREGATORS FOR BETTER REACH

Reaching scale through aggregation. Segmentation and disaggregation of MSMEs is important to ensure that products speak to customer needs. However, the cost of tailoring and the typically small ticket size of MSME premiums mean that insures are unlikely to be able to feasibly tailor every insurance contract to an individual MSME’s needs. Insurers need to balance understanding customers well enough with having enough customers in a segment to be able to serve them effectively. This is best done by teaming up with aggregators operating in the MSME market as distribution partners.

The ideal MSME aggregator would be one that has frequent touch points with a particular segment of MSMEs and has an existing financial relationship with them. It would therefore understand the target MSMEs, be trusted by them and be able to highlight to MSMEs how they can benefit from insurance, in addition to serving as a conduit for premium collection and payouts. It will also understand the insurance product being offered to avoid mis-selling of insurance policies.

As MSMEs vary significantly, there is a wide range of aggregators that insurers could partner with to reach customers:

Table 1: Examples of distribution channels to reach MSMEs

<table>
<thead>
<tr>
<th>Distribution Channel</th>
<th>Examples</th>
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<tbody>
<tr>
<td>Financial institutions (FIs)</td>
<td>• Banks that also serve at least medium-sized companies</td>
</tr>
<tr>
<td></td>
<td>• Microfinance Institutions (MFIs)</td>
</tr>
<tr>
<td>Suppliers</td>
<td>• Wholesalers</td>
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<tr>
<td></td>
<td>• Fast-moving consumer goods companies</td>
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<tr>
<td>Buyers</td>
<td>• Export companies that buy finished goods</td>
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<tr>
<td></td>
<td>• Buyer in contract farming</td>
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<tr>
<td>Agent networks</td>
<td>• Neighbourhood shops acting as agents for mobile networks, banks and insurers</td>
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<tr>
<td>Business associations</td>
<td>• Industry-specific associations e.g. food processing or market traders</td>
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<tr>
<td>Cooperatives</td>
<td>• Cooperatives with specific agricultural crops (e.g. cocoa, coffee)</td>
</tr>
<tr>
<td></td>
<td>• Cooperatives - transportation services, e.g., taxis, mini buses</td>
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<tr>
<td>Government</td>
<td>• Existing government programmes, e.g. social security or health schemes</td>
</tr>
<tr>
<td></td>
<td>• Existing government- led insurance schemes</td>
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</tbody>
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| Digital platforms           | • E-hailing platforms offering motor vehicle insurance to drivers
Opportunities and challenges. 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, but may not be familiar with financial products, including insurance. Financial institutions, in turn, have a better understanding of their customers’ financial needs and risk profiles than most distribution partners, but often still segment customers too broadly to effectively tailor insurance products and offer insurance simply as a by-product, with limited value to customers.

Aligned incentives. Finding the right partner is often expressed as the biggest challenge by insurers branching into the MSME market. A successful partnership requires incentives for the insurer and the distribution partner to be well-aligned – earning additional income through commissions is usually not enough, it also needs to add value to the core business of the distribution partner.

HOW TO CAPITALISE ON THE OPPORTUNITIES?

What would it take in practice to unlock these opportunities? Insurers, regulators and development partners all have a role to play:

- To understand customer needs through segmentation, insurers need to conduct market research and analyse the results by segment to identify opportunities; regulators need to measure insurance penetration across value chains to signal opportunities to the market; while development partners could fill research gaps and facilitate dialogue on issues such as success factors for MSME insurance or measuring the impact of MSME insurance.

- To shift the focus to risk management, insurers need to consider which risk transfer services would provide value to MSMEs, while reducing the risks they themselves are exposed to. They could also bundle services to increase their value proposition to MSMEs. Regulators need to assess the regulatory hurdles for MSME insurance and consider their role in advocating for better risk management in the market. Development partners have a role in sharing the risk with insurers to develop new risk management approaches, thereby creating a stronger incentive for insurers to invest.

- To build innovative distribution to reach MSMEs at scale, insurers need the patience to build partnerships with value chain aggregators in a way that aligns incentives for both parties. Regulators in pursuit of a market development mandate need to engage multiple stakeholders to support market building and apply a test-and-learn approach to test new partnerships in a controlled environment. Development partners, likewise, can play an engagement and market-building role. They can also broker partnerships directly and provide financial and technical support for pilots of innovative distribution models.

Combined, these actions hold much promise to generate growth opportunities for insurers. But even more importantly, by supporting the livelihoods of millions of individuals, rethinking insurance for MSMEs to manage their risks more effectively can be a key driver of economic activity across developing countries.
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