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# Micro-Insurance: A Veritable Product Diversification Option for Micro-Finance Institutions in Nigeria

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**Abstract**

Safe-guarding the poor and low-income people from the financial hardship arising from the occurrence of supposedly insurable risks informs this study. This challenges the widely believed concept of the 'non-insurability' of the poor, owing to their inability to pay huge premiums. This study therefore examines the concept of micro-insurance and its applicability in Nigeria. Micro-finance banks, which presently provide mainly micro-credit and savings products targeted at the low-income group, are considered an appropriate facility for the micro-insurance product. The Integrated Theoretical Review Design (ITRD) with focus on archival review and document analysis is adopted for the study. This review brings to the limelight the fact that micro-insurance is relatively new and only remotely practiced in Nigeria. One of the reasons for this is that Micro-finance Institutions are short of appropriate models on which to present their offer. To this end, this study proposes the Community based/mutual micro-insurance model for Nigeria as an effective way of reaching the rural and semi-urban population who mostly fall under the low-income group. Effective and efficient enlightenment programmes on micro-insurance for the low-income people is also encouraged.

**Keywords:** Micro-finance, Micro-insurance, Micro- entrepreneur

## 1. Introduction

Micro-financing is gaining currency world over in recent times. This is because of the poverty reduction prospect it offers and the reported successes in countries like Bangladesh, Philippines and India. In these places, micro-finance institutions, especially micro-finance banks have grown both in numbers and size. They are known to have increased in scope and outreach, providing funds and other financial services to hitherto un-served poor people in rural and semi-urban areas of these countries. The expansion in scope by these micro-finance institutions in providing services other than the traditional bank services of savings and credit, have made them more attractive to the productive poor they serve and more useful to the businesses of their clients.

In addition to the traditional banking services micro-finance banks, in some of the more micro-finance successful countries, now offer micro-leasing services, e-banking, telephone banking, payment transfer services, micro-insurance, etc. These additional product offerings have made them more or less one-stop shops for a gamut of banking services. The businesses they serve need no longer go to many financial institutions to access the financial products they require.

Of these services, micro-insurance is peculiar as it not only protects the banks from credit risks, but also acts as a buffer for the businesses against losses and business failure. This gives the micro-entrepreneur psychological assurance and necessary motivation to invest without the debilitating fear of losses and business failure.

From 2005 when the guidelines for establishing micro-finance banks were rolled out by the Central Bank of Nigeria (CBN), the number of Micro-finance banks in Nigeria has grown. This growth has been observed to be restricted to size without commensurate increment in product scope. To this end, micro-finance banks in Nigeria still confine themselves to the provision of mainly traditional banking services thereby denying their clients of several benefits accruable from the non-traditional products.

This study picks on micro-insurance, one of the additional financial services which micro-finance banks can offer, and assesses the extent it has been adopted by micro-finance banks in Nigeria. The study further examines the benefits of micro-insurance to both the banks and their clients, highlights the different micro-insurance models in use presently and proposes a model suitable to the Nigerian environment.

To achieve these, the study adopts the Integrated Theoretical Review Design (ITRD). This research approach incorporates the exploratory and desk research methods with focus on secondary data review as the basis of

evaluation and judgment. The ITRD research design opens frontiers of opinion and research findings by other experts is used in making recommendations and drawing valid conclusions on topical issues.
The study is organized in sections starting with these introductory remarks, the next section examines the concepts of micro-financing and micro-insurance. It also brings to bear the benefits of micro-insurance and its applicability. The section after that examines micro-financing and micro-insurance in Nigeria. The fourth section highlights the different micro-insurance models and proposes a micro-insurance model for Nigeria. The final section concludes.

## 2. An Overview of Micro-Finance

In a world where very few poor and near-poor households have access to an appropriate range of high quality financial services, micro-finance has come as a welcome development. It serves as a broad category of services usually considered as a tool for socio-economic development and clearly distinguishable from charity.

De Aghion, Beatriz and Jonathan (2005) define micro-finance as the provision of financial services to micro-entrepreneurs and small businesses, which lack access to banking and related services due to the high transaction costs. Thus, it serves as a way of promoting economic development, employment and growth through the support of micro-entrepreneurs and small businesses. As a financial service, micro-finance incorporates a wide range of services such as: savings, micro-credit, insurance and fund transfers.

The history of micro-financing can be traced to the middle of the 1800s. At this time, the theorist Lysander Spooner identified small credits to entrepreneur and farmers as a way of getting the people out of poverty. However, Friedrick Wilhelm Raiffeisen founded the first cooperative lending bank to support farmers in rural Germany in 1884. The modern use of the expression "micro-financing" has roots in the 1970s, when organizations such as Grameen Bank of Bangladesh with the micro-finance pioneer Muhammad Yunus, started and shaped the modern industry of micro-financing. He was closely followed by Akhtar Hameed Khan (Khandker, 1999).

In 2004, the Consultative Group to Assist the Poor (CGAP) promulgated several principles summarizing the essence of micro-finance. These principles which were later endorsed by the Group of Eight leaders at the G8 Summit on June 10, 2004 are as follows:

(i) Poor people need not just loans, but also savings, insurance and money transfer services.
(ii) Micro-finance must be useful to poor households, helping them raise income, build up assets and/or cushion themselves against external shocks.
(iii) Micro-finance can pay for itself. This is owing to the fact that subsidies from donors and government are scarce and uncertain; to reach large numbers of poor people, micro-finance must pay for itself.
(iv) Micro-finance means building permanent local institutions.
(v) It also means integrating the financial needs of poor people into a country's mainstream financial system.
(vi) The job of a government is to enable financial services, not to provide them.
(vii) Donor funds should complement private capital, not compete with it.
(viii) The key bottleneck is the shortage of strong institutions and mangers. Hence donors should focus on capacity building.
(ix) Interest rate ceilings hurt poor people by preventing micro-finance institutions from covering their costs, which chokes off the supply of credit.
(x) Micro-finance institutions should measure and disclose their performance – both financially and socially (Mas, Ignacio and Kumar, 2008).

While much progress has been made in developing a viable, commercial micro-finance sector in the last few decades, several issues remain that need to be addressed before the industry will be able to satisfy massive worldwide demand. The obstacles or challenges to building a sound commercial micro-finance industry include:

- Inappropriate donor subsidies
- Poor regulation and supervision of deposit-taking Micro Finance Industries (MFIs)
- Few MFIs that meet the needs for savings, remittances or insurance
- Limited management capacity in MFIs
- Institutional inefficiencies
- Need for more dissemination and adoption of rural, agricultural and micro-finance methodologies (Adrian and Richard, 2006).

From the above excerpt, it can be inferred that insurance (or micro-insurance as is more applicable in this context) is basically one of the challenges faced by micro-finance institutions. It is therefore treated in detail below.

### *2.1 Micro-Insurance: Concept and Products*

Micro-insurance is the protection of low-income people against specific perils in exchange for regular premium payment proportionate to the likelihood and cost of the risks involved. Its clearly prescribed target market–the low income people–typically consists of persons ignored by mainstream commercial and social insurance schemes and persons who have not had access to appropriate insurance product (Dercon, 2005).

Churchill (2006) describes micro-insurance as "a financial arrangement to protect low-income people against specific perils in exchange for regular premium payments proportionate to the likelihood and cost of the risk involved". He adds that micro-insurance does not refer to: the size of the risk carrier (could be informal households to large companies); the scope of the risk (as the risks are not 'micro' to the households experiencing them), nor the delivery channel (which could be small community-based schemes, credit unions or other micro finance institutions).

On a similar note, Alexander, Carrin, Dror, Jakab, William and Arhin-Tenkorang (2002) view micro-insurance as synonymous to community-based financing arrangements including community health funds, mutual health organizations, rural health insurance and revolving drug funds. Most community financing schemes have evolved in the context of severe economic constraints, political instability and lack of good governance. The common feature within all is the active involvement of the community in revenue collection, pooling, resource allocation and frequently, service provision. Still, Dror (1999) describes micro-insurance as the use of an economic instrument at the "micro" (smaller than national) level of society. Here, decisions are made within the unit, rather than far away at the level of government, companies, and NGOs etc. that offer support in operations.

Insurance functions on the concept of risk pooling and so does micro-insurance, regardless of its small unit size and its activities at the level of single communities. Micro-insurance also links multiple small units into larger structures, creating networks that enhance both insurance functions (through broader risk pools) and support structures for improved governance like training, data banks, research facilities and access to reinsurance. This mechanism is conceived as an autonomous enterprise, independent of permanent external financial lifelines. Its main objective is to pool both risks and resources of whole groups for the purpose of providing financial protection to all members against the financial consequences of mutually determined risks.

From the above definitions, it can be deduced that micro-insurance entails the following features

(i) transactions at low-cost and reflecting members willingness to pay;
(ii) clients who are essentially low net-worth, but not necessarily uniformly poor;
(iii) community involvement in the important phases of the process such as package design and rationing of benefits; and
(iv) its essential role of networking micro-insurance units to enhance risk management of the members of the entire pool over and above what each can do when operating as a stand-alone entity (Churchill, 2006; Alexander, Carrin, Dror, Jakab, William and Arhin-Tenkorang, 2002; Dror, 1999).

Like regular insurance, micro-insurance covers a wide variety of risks. The most frequently patronized micro-insurance products are:

- life micro-insurance involving retirement savings plans
- health micro-insurance covering hospitalization, primary health care and maternity.
- disability micro-insurance
- property micro-insurance covering assets, livestock and housing against damage or loss

(v) crop micro-insurance covering crop products and livestock (Churchill, 2006; Dror, 1999).

### *2.3 Micro-Insurance Development, Practice and Effects*

As already noted, few poor households have access to formal insurance against risks such as the death of a breadwinner, severe or chronic illness or loss of assets such as livestock and housing. These shocks are particularly damaging for poor households that are more vulnerable and less able to absorb the financial consequences of such events. When farmers are insured against a bad harvest (usually resulting from drought), they are in a better position to grow crops which gives high yields in good years and bad yields in years of drought. Without the insurance however, they will be inclined to do the opposite; since they have to safeguard a minimal level of income for themselves and their families. Crops would be grown which are more drought-resistant, but which have a much lower yield in good weather conditions (Dercon, 2005).

Micro-insurance is practically a new field and still in its experimental stage although its life products are becoming increasingly available. As MFIs expand credit to a broader array of financial products, there is increasing interest to offer their clients access to micro-insurance products in partnership with insurance companies. While commercial insurers provide the majority of the world's products, mutual, cooperative and other community-based or community-led insurance organizations are emerging as providers of micro-insurance. Its greatest challenge however, is that of providing real value for poor house-holds; thus finding the right balance between adequate protection and affordability (Dror, 1999). This inevitably brings us to the issue of sourcing an appropriate insurance scheme.

A micro-insurance scheme is a scheme that uses, among others an insurance mechanism whose beneficiaries are (at least in part) people excluded from formal social protection schemes, particularly in informal economies, where it includes workers and their families. The scheme differs from others created to provide legal and social protection to formal economy workers. Membership is not compulsory and members pay in part or whole the necessary contributions to cover benefits. A micro-insurance scheme could also be used to refer to the institution that provides insurance (e.g., a health mutual benefit association) or the set of institutions (in the case of linkages) that provide insurance or the insurance service itself provided by an institution that also handles other activities (e.g., a micro-finance institution).

Micro-insurance has made a significant difference in countries like Mali and Bangladesh, although institutional and financial challenges are still being experienced in its practice. Perhaps a more exemplary case would be that of Ghana where credit health insurance is being launched for the benefit of micro-finance clients. According to MicroFinance Africa, the Ghanaian Branch of MicroEnsure, a UK based subsidiary of nonprofit Opportunity International that serves as a micro-insurance intermediary, has announced plans to offer credit health insurance to micro-finance clients in Ghana. The product will enable MicroEnsure to cover weekly micro-credit payments in the event that the borrower is admitted to the hospital during the loan term. To effect this, clients would need to present proof of admission and discharge from a recognized inpatient hospital in order to file a claim. The cost of the coverage would start at 0.25USD per month and will cover loan payments for any health condition for any amount of time. According to Eugene Adogla, director of MicroEnsure operations in Ghana, MicroEnsure expects to pay hundreds of claims that range between 30USD and 60USD per month. It is hoped that soon coverage would be extended to client's families. Presently, two Micro-Finance Institutions (MFIs) partnering with MicroEnsure Ghana have signed up for the new product, and more organizations have also expressed interest. MicroEnsure serves approximately 3.5 million poor clients in Ghana, India, Bangladesh, Mozambique, Malawi, the Philippines, Tanzania and Kenya (microcapital.org).

A recent 100-country study demonstrates a market demand for micro-insurance exceeding one billion people. In emerging markets, there appears to be the same inherent desire to protect one's possessions and safeguard one's family against devastating financial losses such as death of a breadwinner or crop failure. The diagram below shows the current supply of micro-insurance in 100 poor countries.

Insert Figure

Figure 1 indicates that the micro-insurance market is significantly underpenetrated, thus presenting a huge opportunity. There exists the need to capitalize on this massive and growing demand; and in recognition of this immense opportunity, a number of commercial insurers have entered the space globally forming partnerships with large distributors to meet the strong demand. For instance Zurich Financial Services has micro-insurance operations in South Africa and China; CNP Assurance, France's leading personal insurance company partners with China Post. AIG runs micro-insurance operations not only in India but in South Africa and Uganda, while a number of regional insurers manage their own micro-insurance businesses. The trend signifies the obvious interest of commercial insurers in micro-insurance products. In the words of Kuper (2008);

> *The involvement of commercial insurers is driven by a number of imperatives. Firstly, insurance markets in developed countries are relatively saturated. Secondly, within fast emerging markets, today's low income policy holder is tomorrow's middle class, a budding market of hundreds of millions of upwardly mobile people. Thirdly, regulators who are often wary of foreign insurers take*

 

> *well the idea of coverage being extended to the poor in their countries. Finally, and most importantly, done right, micro-insurance is a rapidly expanding and highly profitable business.*

From the citation above, Kuper (2008) provides a basic clue to the seemingly influx of commercial insurers into the micro-insurance business. But how does this product fare with micro-finance banks in Nigeria. The subsequent sections would lead us into this.

### 3.0 Micro-Insurance and Micro-Financing in Nigeria

The Microfinance Information Exchange provides the following cross market analysis of the MFIs in Nigeria:

| | | |
|---|---|---|
| MFIs | - | 35 |
| Funders | - | 7 |
| Networks | - | 4 |
| Service Providers | - | 7 |
| Loans | - | 132.1 million USD |
| Active Borrowers | - | 647, 479 |
| Deposits | - | 73.8 million USD |
| Depositors | - | 686, 950 |

Source: Micro-Finance Information Exchange (2011)

One of the key management issues that could enhance the growth of microfinance institutions in Nigeria is their ability to mitigate risks, especially for the low income earners. Micro-insurance products have therefore been tailored to help low income earners mitigate risks and give them hope. Abayomi (2010) observes that the emergence of micro-insurance is an important development within the field of micro-finance and challenges the widely held belief of the 'non-insurability' of the poor. MFIs are better suited to provide its service as micro-insurance is a combination of micro-savings, micro-finance and micro-credit. It thus serves the dual purpose of a risk management and loss protection machinery.

A quantitative and qualitative survey carried out by Center for Microenterprise Development (CMD) on 604 urban households in Lagos State and 405 rural households in Kano state indicated 2.0% extremely poor people, 44.4% poor people, 52.4% vulnerable poor people and 1.2% vulnerable non-poor people in Kano state. On the other hand, Lagos state had 13.4% poor people, 66.6% vulnerable poor people and 20% vulnerable non-poor people. On the concept of micro-insurance product to buy, 73.2% of Lagos respondents preferred health product, 25.8% preferred property, 29.1% preferred life and 22.5% preferred funeral products. In Kano state, 69.6% preferred health product, 31.4% preferred property, 14.6% preferred life product while 7.2% preferred funeral product (Center for Microenterprise Development, 2010).

Some of the major challenges hindering the growth of micro-insurance design and delivery in Nigeria as cited by Abayomi (2010) include

(i) Insufficient micro-insurance models capable of fitting into the micro-finance clientele models.
(ii) The lack of adequate trust existing between the micro-insurer and client. This is because unlike the case of credit, where the micro-entrepreneur borrows the money and takes up responsibility for repayment, insurance is the reverse.
(iii) Absence of highly specialized product to serve the needs of different groups and communities facing diverse risks.

In essence, since insurance is fairly popular among the middle and low-income earners, much is yet to be done to entice the 'poor' to embrace the idea of micro-insurance.

### 4. Basic Micro-Insurance Models and Their Applicability in Nigerian

One of the greatest challenges for micro-insurance is the actual delivery of the service to clients. Methods and models for doing so vary depending on the organization, institution, and provider involved. As Dror (1999) states, one must be thorough and careful when making policies, otherwise micro-insurance could do more harm than good. Generally, there are four main methods for offering micro-insurance, which are: the partner – agent model, the provider – driven model, the full – service model and the community – based model. These are treated in detail below.

(i) Partner – Agent Model: A partnership is formed between the micro-insurance provider and an agent such as an insurance company, micro-finance institution, donor etc. In some cases a third-party healthcare provider may be involved. The micro-insurance provider is responsible for the delivery and marketing of products to the clients, while the agent retains all responsibility for design and development. In this model, the provider benefits from limited risk as the burden of risk is shared; though this could also be disadvantageous to them as the premium is also shared.

(ii) Full – Service Model: In this model, the micro-insurance provider is in charge of everything; both the design and delivery of products to the clients. He may work with external healthcare providers to provide the services. Although this model has the advantage of offering the service provider full control, it also has the disadvantage of incurring higher risks.

(iii) Provider – Driven Model: Here, the healthcare provider is the micro-insurance provider. He is responsible for all operations, delivery, design and service. The amount of control retained once again acts as an advantage; while the disadvantage is that of limitations on products and services.

(iv) Community – Based/Mutual Model: With this model, the policyholders or clients are in charge, managing and owning the operations and working with external healthcare providers to offer services. It is advantageous for its ability to design and market products more easily and effectively. Its basic disadvantage is that of the small size and scope of operations it usually entails.

(Chuchill, 2006; Décor, 2005; Dror, 1999)

This research has shown that micro-insurance is not a very popular financial service in many developing countries; as many fail to appreciate the importance of transferring risk. While the upper and middle class would venture only so far as to sign up for car insurance, the idea of a steady cash outflow to recover from something that may or may not occur, simply evades the poor, who are already hard up on cash. Chang (2010) observes that although insurance has a low penetration rate of 6% in Nigeria, statistics indicate that in comparison to the 35 countries considered to be 'low in human development, Nigeria actually has a more developed insurance market. As such, Nigeria provides an appropriate environment for micro-insurance, which can be regarded as a new with an enormous market waiting to be explored. There have been several failed attempts to go into micro-insurance by insurance providers. A research carried out by Obuvie (2010) proves that the few insurance providers that may have incorporated the product, produced products that were thrift in nature, hence did not survive the test of time. He propounds a need for a thorough research on micro-insurance products as a step towards a deeper insurance penetration in Nigeria. It is in line with this statement that this study advocates for the adoption of the community-based/mutual micro-insurance model in Nigeria.

The community – based/mutual micro-insurance model provides an avenue for the micro-insurance provider to develop products which serve the peculiar needs of each individual community. There is also the added advantage of community participation, which aside from involving the 'clients' or 'policy holders' in the management and operations of the product, also serves as a medium of intimating the rural dwellers on the necessity and functions of insurance. Efficiently managed, this model may be an effective way of reaching out to the rural dwellers, who invariably represent a proportionate number of low-income people, with micro-finance products.

## 5. Conclusion and Recommendations

This study identifies micro-insurance as a risk management tool and loss protection mechanism made accessible to the low-income population, provided by a variety of different entities, but run in accordance with generally accepted insurance practices. Micro-Finance Institutions (MFI's) are one of such entities providing micro-insurance product. MFIs provide this service in its course of providing various financial services such as microcredit, savings, insurance and fund transfers to micro-entrepreneurs and small businesses, who would have otherwise lacked access to these services as a result of high transaction costs associated with them. In line with the literature review and theoretical studies performed, the study concludes that micro-insurance is fairly applicable in Nigeria, though if properly managed stands a better chance in the near future.

To this end, this study recommends the following:

(i) The introduction of highly personalized micro-insurance products targeted at meeting the needs of each individual, group or community.
(ii) More models capable of fitting into the micro-finance clientele model should be developed.
(iii) MFIs should be encouraged and sponsored to venture into micro-insurance as a means of mitigating poverty among the low-income class.
(iv) Micro-insurance providers should imbibe utmost good faith in the course of their operations to engender trust between the service provider and the micro-entrepreneur. This will promote confidence in the low-income earner who is prudent in the use of his income.
(v) More enlightenment and educational programs are encouraged especially for the low-income earners in order to intimate them on the micro-insurance offer and products.

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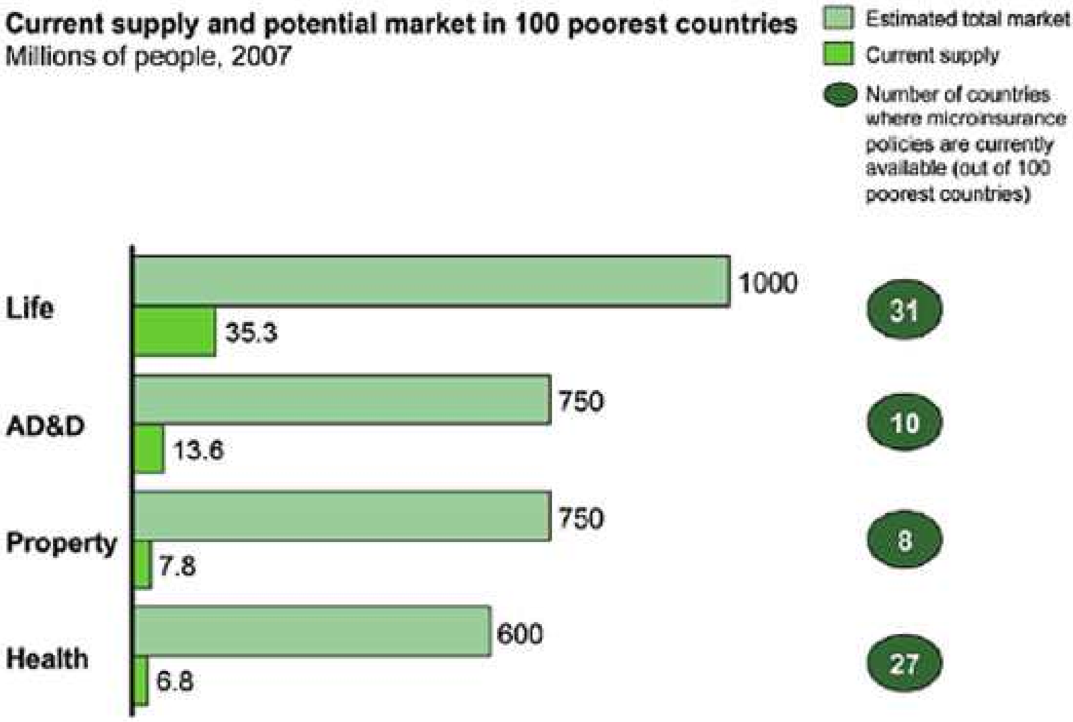


Figure 1. The Supply of Micro-insurance in 100 countries

Source: International Finance Institute and World Research Institute, 2007