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Expanding the Concept of Microinsurance to Reduce Uncertainty and Aid Development in the Balkans

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Abstract

Serbia and the surrounding Balkan states hold the enviable position of having the ability to proactively create and mold some portions of their economies (and the corresponding economic regulations), before those particular markets are fully developed. The concept of microinsurance has now been used for approximately two decades in Third World countries, and has the potential to be successfully utilized by low-income individuals and micro, small, and medium-sized enterprises (MSMEs) located in more developed, Western economies. While Serbia and other Balkan states work to increase economic growth and development in their economies, in anticipation of joining the European Union, they may find that the fostering of a healthy market for microinsurance not only reduces uncertainty for local MSMEs and nurtures their ability to expand their income potential, but it also moves the state closer to the larger, European goals of economic inclusion and sustainable development.

Key Words: microinsurance, insurance, microcredit, sustainable development, inclusive economy, Balkans, Serbia, small enterprises, medium enterprises, micro enterprises

1. INTRODUCTION

Microinsurance is a relatively new form of insurance, with origins in the early 2000s. Initially, microinsurance was developed to aid those in Third World countries who live below the poverty line. The vast majority of microinsurance is currently offered in the Third World for health insurance and death/burial benefits. However, microinsurance need not be limited to these regions, and can be expanded to provide coverage for additional categories of risks. Specifically, coverage can be offered for overlooked risks in developing economies such as those in the Balkan states.

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1.1. Microinsurance

The International Association of Insurance Supervisors broadly defines microinsurance as "insurance for low-income populations" (IAIS 2012, 31). The International Labor Organization (ILO) defines it as "a mechanism to protect poor people against risk… in exchange for payments tailored to their needs, income, and level of risk. It is aimed primarily at the developing world's low-income workers, especially those in the informal economy who tend to be underserved by mainstream commercial and social insurance schemes" (ILO, 2023). There are approximately 600 million microinsurance policies in effect, mostly for life, health/accident, and death/burial benefits (Sahier, Pfister, 2019, 1). However, the ILO estimates that there are 4 billion individuals, globally, without insurance coverage, and 2 billion of these are classified as low-income.

Insurers are interested in offering microinsurance, not only because of the large market of 2 billion potential consumers, but also because the offering of microinsurance supports an inclusive economy and sustainable development – which is a credit toward corporate responsibility. Additionally, in the eyes of an insurance company, any new policyholder is a potential long-term customer. Today's microinsurance customer might become tomorrow's customer of traditional, more expensive insurance products (Bernauw, 2018, 30).

The microinsurance market is still in its infancy. Despite the large, attractive potential pool of policyholders, financial institutions offering microinsurance have encountered difficulty with sales, due in part to the barriers to accurately estimate risks (and set premium rates), and in part due to the lack of awareness of the product and its utility. Private insurance companies are wary of offering microinsurance to low-income individuals or small, unestablished businesses with little or no collateral. Additionally, in order to create a product inexpensive enough to attract these policyholders, insurers are risking low profitability – or worse, an actuarial loss. Nonetheless, as we will discuss, there are several non-traditional approaches being applied successfully.

1.2. Microcredit

Microcredit is defined as the provision of loans to low-income borrowers who typically are unable to obtain loans from financial institutions. Microinsurance and microcredit are naturally complementary products. When a small business owner or entrepreneur applies for a microcredit loan from a financial institution, it is only natural that this individual may wish to insure their new endeavor against risk. However, this has not been possible for the vast majority of low-income borrowers.

While microcredit was introduced in the 1970's and has become a broadly accepted product since, microinsurance has trailed far behind. In Serbia, microcredit has been available since just before the turn of the century. Microcredit lenders were initially required to partner with a licensed bank, which led to a reliable product, and added stability in the financial market (Gies, 2010, 4). The introduction of microcredit to the Serbian market is considered a proven success. Regulators may wish to consider a similar introductory method for microinsurance products.

Interestingly, research by the European Bank for Reconstruction and Development shows that microcredit does *not* lead to a substantial increase in household income, but it *does* help households better cope with risk. The EBRD studied seven countries around the world, including the Balkan state Bosnia and Herzegovina, and concluded that microcredit is a useful financial tool, but not effective against anti-poverty (EBRD, 2015). If microcredit is not leading to increased income, but is instead insulating entrepreneurs and owners of small businesses against risk, this lends to the conclusion that what is needed by low-income business owners is micro*insurance*, not microcredit.

Further, common sense dictates that reducing financial risk leads to an increase in lending to small businesses. Many different insurance coverages can reduce the risks a small business is likely to face, such as coverages against natural disasters and health/disability coverage for the owner and/or primary workers. When a potential lender sees a reduction in risk, they are more likely to issue the microcredit. In some countries, this is accomplished through the bundling of insurance with the microcredit loans (Merry, 2016, 16–17).

2. USING MICROINSURANCE TO PROMOTE AN INCLUSIVE ECONOMY

Historically, European financial institutions have neglected the need of lower-income Europeans to access financial services, even in countries which are considered highly developed. In 2006, the European Union directly called upon Member States to support the financing of small and medium enterprises (SME's), asking member states to issue legislation to facilitate the provision of microcredit loans, because they encourage entrepreneurship and social inclusion (Gies, 2010, 6). In 2010, leaders at a meeting of the G20 in Toronto endorsed "The G20 Principles for Financial Inclusion," adopted as an effort to encourage and enable policies to close the financial services access gap for more than two billion excluded low-income people. In 2012, the IAIS applied those principles to microinsurance (IAIS, 2012, 33–34). An increasing number of policies are now in place which aim to reach marginal populations in Europe. Further, in 2015 the United Nations set detailed sustainable development goals to, amongst other objectives, eradicate poverty and promote economic growth. These were adopted by all Member States (United Nations, 2015).

We can see that microcredit has made significant strides in the European Union, so this begs the question – Why not microinsurance? All large businesses are aware of the need for insurance to mitigate the risks which are inherent in their business endeavors. In fact, as mentioned above, the EBRD study showed that recipients of microcredit were actually using the loans to insulate themselves from risk, not expand their businesses in any meaningful way. Some common insurance coverages for small businesses include – insurance to cover the loss or damage of products and inventory during transit, insurance to cover for the loss or damage of real property (buildings, real estate, machinery, products, and raw materials on-site), insurance to cover periods of non-productivity, such as the mandatory shut-downs during Covid-19 (business interruption insurance or payroll insurance), coverage for the life and health of the business owner, coverage for the life and health of the employees, coverage for vehicles or crops, liability coverage, etc. (Sahier, Pfister, 2019, 3).

Small and medium businesses (SMEs), as well as "micro-enterprises," are subject to these same risks, and therefore should have correlating insurance coverages available to them. An entrepreneur who received microcredit can find his or herself out of business very quickly if they encounter a loss they were not insured for. When this occurs, that person is once again excluded from the economy. Microinsurance can be used as a tool for inclusion, but also as a tool to *keep* individuals included – meaning, they retain their economic success and do not slide back into poverty due to an insurable misfortune. A more sustainable inclusion leads to better sustainable development.

2.1. SME Access to Finance in the Balkans

Not much research has been performed on the subject of microinsurance, much less the more specific topic of an SME's access to microinsurance (Bernauw 2018, 27–28). However, because microcredit has been available to SME's for many more decades, a closer look on the status of an SME's access to finance is instructive.

Small and medium-sized Balkan enterprises report that access to finance is one of their main obstacles. This is particularly prevalent in the Western Balkan states which are official European Union candidates, or, potential candidates. In most cases, high interest rates hinder the availability and feasibility of credit, but SMEs also report barriers such as complex loan application procedures and requirements to post a large amount of collateral. However, most of these same Western Balkan states acknowledge the issue, and are implementing concrete measures toward resolution (Moder and Bonifai, 2017, 2–3).

In 2018, Western Balkan EU candidate states declared their dedication to the European Pillar of Social Rights, which sets out 20 key principles, including equal opportunities and access to labor markets, fair working conditions, and social protection and inclusion (European Parliament, 2017). Progress toward the EU's initiative for improved economic opportunities and social rights will certainly bolster the ability of SMEs to obtain finance.

2.2. SME Access to Finance in Serbia

The Serbian SME experience is in line with the remainder of the Western Balkans – access to finance is the main challenge. Although improvements are underway, Serbia still has higher-than-average poverty and unemployment rates, and the lack of access to credit products has stymied entrepreneurship and self-employment, particularly in rural areas (Gies, 2010, 8).

As reported to the EU Commission in Serbia's yearly Economic Reform Programme (ERP) report, a number of measures are underway with the goal of improving SME access to credit. Additional loan agreements have been signed with the European Investment Bank (as of 2017), and Serbia experienced only a mild economic contraction in 2020, partly due to the effective, transparent, and non-discriminatory support that Serbian regulators offered to businesses affected by the Covid-19 pandemic (European Commission, 2021, 3–4).

The European Commission's 2021 ERP for Serbia included an analysis of the main challenges to inclusive growth in Serbia's economy. Serbia was found to need improvement in creating a more favorable business environment for investment, and in increasing employment and social protection against poverty. The Commission recognized that the Serbian government had recently made notable progress in reducing regulatory and administrative burden on businesses. Specifically, setting up a new business had been significantly simplified, and the cost was reduced. This improves an SME's initial access to the market (European Commission, 2021, 15, 19).

Additionally, the Commission reported that Serbia had committed itself to the European Pillar of Social Rights, including providing better social protections and improved rates of social inclusion. The Commission noted that Serbia increased the gross minimum wage, in an effort to move closer to an adequate minimum income for Serbian citizens, and that trends in employment have been improving. However, Serbia's at-risk-of-poverty-or-social-exclusion rate was 31.7% in 2019, much higher than the EU-27 average of 20.9% (European Commission, 2021, 18–19, 27). If the country is able to improve an SME's access to finance, the owner and employees of that SME will gain the opportunity to improve their financial situations, and move further away from the at-risk-of-poverty category. Access to microinsurance products which protect entrepreneurs and SME's from risk is also a critical element in an SME's recipe for success.

2.3. Product Oversight for Inclusive Insurance (Microinsurance)

Although generally scholarship on the subject of microinsurance is light, the IAIS has issued numerous papers on the subject, most importantly the Application Paper on Product Oversight in Inclusive Insurance, which guides insurance supervisors in how to apply current EU insurance regulations to new microinsurance products. The IAIS asserts that microinsurance products must be strictly supervised and monitored, because the typical microinsurance customer is vulnerable due to low income, a lack of education, and either no experience with insurance, or a negative perception (IAIS, 2017, 51). Because Serbia is a candidate to join the European Union, Serbian regulators would be wise to consult with the IAIS recommended standards to the greatest extent possible.

However, the IAIS also recognizes that inclusive insurance products are unique, and that under the proportionality principle, regulations "should be tailored to the specific conditions and characteristics of the jurisdiction allowing solutions that are adequate to achieve [desired] outcomes without becoming excessive." The IAIS does not wish for unnecessary barriers to hinder market development and block access to inclusive insurance products for consumers (IAIS, 2017, 51).

A detailed and instructive analysis by insurance law scholar and professor Kristiaan Bernauw concludes that if microinsurance is to be utilized efficiently and effectively for low-income residents of the European Union, some changes will be necessary in the applicable public and private law. The IAIS has also recognized the fundamental differences inherent in microinsurance, and acknowledged that the product may require a separate legal regime. Bernauw aptly highlights that the challenge for regulators lies in reaching the ideal balance of regulation – enough to protect the less-sophisticated low-income consumer, but not so much that the coverage becomes too complicated, too expensive, and difficult to access (Bernauw, 2018).

The first microinsurance regulation was written in India in 2005. Since then, there are dozens of regulations across the world. The Access to Insurance Initiative (A2ii) provides a list of regulations, as well as some detail on how regulators have approached the balance between consumer protection and sufficient access to coverage. In collaboration with the IAIS, A2ii has also addressed how regulators can draft laws which support sustainable development goals (Access to Insurance Initiative, 2023).

3. USING MICROINSURANCE TO PROMOTE SUSTAINABLE DEVELOPMENT

The IAIS, in conjunction with A2ii, asserted that access to inclusive insurance coverages supports progress in the attainment of nine of the seventeen sustainable development goals set by the United Nations. Specifically, No Poverty (SDG 1), Zero Hunger (SDG 2), Good Health and Well-Being (SDG 3), Gender Inequality (SDG 5), Decent Work and Economic Growth (SDG 8), Industry Innovation and Infrastructure (SDG 9), Reduced Inequalities (SDG 10), Climate Change (SDG 13), and Partnerships for Goals (SDG 17) (IAIS, 2021).

While addressing each SDG individually is beyond the scope of this paper, SDG 8 is the only goal which directly mentions insurance, and SDG 9 is closely intertwined with SDG 8. In order to progress toward the development goals of Decent Work and Economic Growth, and Industry Innovation and Infrastructure, the A2ii encourages supervisors to consider the importance for micro, small, and medium-sized enterprises (MSMEs) to have access to simple, affordable, broad-coverage insurance products. A2ii highlights that SMEs are key economic drivers, which is supported by the fact that SMEs contribute approximately 60% of total employment and 40% of national production in emerging economies (Access to Insurance Initiative, 2023; Sahler, 2018, 1).

A2ii specifically advises regulators to do the following: (1) create a segment of regulation which is clearly applicable to MSMEs and addresses their needs, and promote coverage for MSMEs in the insurance industry, (2) keep restrictive regulations proportionate to the "nature, scale, and complexity of the business," with special attention to the distribution channels and innovation, (3) provide strong consumer protection for MSMEs because they often do not have financial education or the ability to fully appreciate their risks and the technicalities of insurance policies, (4) encourage the provision of broad, affordable, and streamlined products which are marketed in innovative methods. (Access to Insurance Initiative, 2023). Attention to these guidelines will not only contribute to reaching the sustainable development goals of economic growth, and strong and innovative infrastructure, but will also reinforce an inclusive economy.

4. POSSIBLE METHODS

While access to financial tools such as microcredit and microinsurance is the first step toward reducing uncertainty and aiding in economic development in the Balkan states, and appropriately tailored regulation is necessary – of equal importance to the success of a microinsurance program is how the product will actually be designed, sold, and distributed.

4.1. Product Design

ILO research revealed that SMEs prefer an insurance product which covers multiple risks, rather than individual policies dedicated to single coverages. However, the coverage for the multiple risks need not be exhaustive – limited protection for a range of risks which are more likely to occur is the preferred coverage. SMEs also reported that health or disability coverage is of primary importance, because often the owner of the business is the key driver of production – without the owner, the business cannot function (Merry, 2016, 19–24).

The ILO also warns against providing too much customization of the microinsurance product. SME owners may be intimidated by complexity, or by a distributor who asks too many questions. Also, customization is time-consuming, and adds to the premium cost (Merry, 2016, 22).

A study on behalf of the German Federal Ministry for Economic Cooperation and Development stressed the importance of differentiating between the insurance needs of micro enterprises and small and medium enterprises (SMEs) when designing an insurance product. The study concluded that while the owner of any one of these businesses is critical, and will need health/accident/disability coverage, a larger enterprise may require additional coverages which a micro enterprise has no need for. The micro enterprise will likely prefer a multi-risk policy covering business assets (and so will the SME), but only an SME will consider additions such as employee group insurance for health, life, and pension; business interruption coverage; and liability insurance (Sahier, Pfister, 2019, 3).

4.2. Distribution

Because SMEs have not traditionally been consumers of insurance products, a distribution channel tailored to reach SMEs does not naturally exist. The most obvious channel of distribution is through the same financial institutions which offer microcredit and financing. SMEs which seek financing can simultaneously learn about microinsurance products. In some countries, insurance is bundled with loans or savings products. However, caution is needed when bundling products, due to the EU prohibition on certain "tie-in" financial products (Bernauw, 2018, 43).

In some cases, distribution channels have been established relative to supply chains. For example, the company or factory which supplies goods to retail stores can be utilized as an information source about microinsurance coverages, and even encourage the coverages or provide an incentive for the retailer to purchase a policy (Merry, 2016, 24–26).

In many countries, new or innovative uses of technology have resulted in large increases of microinsurance sales. One example is the use of mobile phone networks to both promote microinsurance products and also provide support for the product once it has been purchased (i.e. use an app to check benefits, pay premiums, make a claim). The major drawback of using mobile phones for policyholder interaction, however, is that there is little to no personal interface (Merry, Prashad, Hoffarth, 2014, 14; Prashad, 2013).

4.3. Financial Literacy and Insurance Education

The sale and distribution of (non-bundled) microinsurance will not be possible without first taking the time to educate the potential consumer about why they should consider purchasing microinsurance in the first place. Most SME owners do not fully understand insurance because they have not encountered it previously, and most particularly not in the context of their business. Also, many SME owners are skeptical of the credibility of an insurance provider, either because they are not familiar with that provider, or because they have learned of what has generally become a world-wide negative reputation for unfair claims handling by insurers (Merry, 2016, 28–29; Bernauw, 2018, 35).

However, dialogue with SME owners is critical, as they are the true experts on which types of risks they are likely to face in the course of their business. Once an owner has identified a risk and is aware that microinsurance coverage is available to protect them from that risk, they will be more open to the benefits of purchasing coverage. In the EU, financial literacy programs already exist which can be utilized as a model for a new, regionally specific education program (Bernauw, 2018, 35).

5. CONCLUSION

While microinsurance is still in the early stages of development, there are already many active models upon which to base new applications of the microinsurance principles. For the most part, microinsurance has been sold to low-income individuals and small business owners in Third World nations. However, the concept of microinsurance, which was designed to increase economic inclusion and promote sustainable development, can also be applied to low-income SMEs in Western, developing states. As the Serbian economy continues to expand and improve, insurance regulators have the opportunity to encourage and foster insurance products which are tailored to the unique experience of the Serbian SME. "As more nuanced approaches to the microinsurance market have emerged, greater successes have been experienced as well" (Biener, 2013, 28).

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