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IMPACT INSURANCE

International Labour Organization

Insurance for small businesses

Briefing Note

Small businesses are vital to economic development. However, they are exposed to a wide range of risks, ranging from theft of assets to illness of a key worker or a natural disaster. Furthermore, they struggle more than larger businesses to cope with these risks. Insurance represents an important tool to help them better manage such risks.

Insurance can provide small businesses with financial protection for many (though certainly not all) risks, while also helping to boost productivity and increase access to finance. Yet, small businesses worldwide are generally underinsured or have no insurance at all. This problem is particularly acute in developing countries, where a very small percentage of small businesses have ever bought any insurance policy.

Insurance for small businesses represents a promising market for insurers. Nonetheless, it poses three significant challenges. The first is product design – many insurers do not sufficiently understand small businesses and their risks, and do not offer them suitable and valuable products. Secondly, once a product is designed, insurers face challenges in finding an appropriate distribution strategy to get it into the hands of their clients. Since small businesses are heterogeneous and only loosely grouped, it is difficult to find aggregators. Finally, insurers face limited demand and poor understanding and trust of insurance among small businesses.

In order to overcome these challenges, it is useful to look at the emerging good practices of those providers already making headway in this market:

PRODUCT DESIGN – In general, it is vital that insurers understand the context, business activities, needs, preferences and current risk management practices of their market. To offer products that can compete with existing mechanisms to manage risks, insurers must learn from the strengths of such mechanisms, particularly their versatility, as well as pain points and gaps which insurance can fill.

The vast majority of providers interviewed said that a product covering multiple risks was far more attractive to small businesses than single covers. This need not necessarily mean a very expensive cover offering high benefits across a number of risks. Even limited cover for certain risk types can be attractive and useful to small businesses owners, who usually prefer limited protection across a range of risks that they can easily imagine occurring, than a high cover on a single risk that may never occur. It is particularly relevant to include some simple health benefits, as health is a very significant and important risk for small business owners.

Customization of benefit packages should be limited. Few insurers can afford sales forces with the time and expertise to explain complex products and options to small businesses owners, who may in turn easily be put off by complexity and too many options. For most insurers, it is therefore wise to adapt products to suit a distribution channel or large segments of clients, rather than individual customization and options at the client level.

This brief is authored by Alice Merry, of the ILO's Impact Insurance Facility. It is excerpted from Paper no. 43, available at http://www.ilo.org/impactinsurance

DISTRIBUTION – Financial institutions are a common way for insurers to reach entrepreneurs running small businesses, as they frequently already have partnerships with them and such institutions are often willing to bundle insurance with their loans or savings products. Business associations are another possible distribution channel. Such associations aggregate many small businesses within an industry and may be willing to help market and sell a product to their members.

Another effective way to aggregate small businesses is to look to other businesses or institutions in the same value chain, with which they regularly come into contact. For small shops this could be the larger shops or wholesalers from which they buy their inventory. For many retailers of all kinds, this could be the distribution networks that provide them with fast moving consumer goods ready for sale. For small factories, it could be the companies they sell to.

Success depends on the insurer finding ways in which insurance can boost the core business of the channel. This could include using insurance to boost loyalty, to protect a company's image, to help clients to keep using services during shocks, or even to help governments achieve public policy objectives.

Finally, technology provides opportunities to overcome traditional barriers to distributing insurance to small businesses in a cost effective way. Technology can be used across all processes, from digital payments for premiums and claims, to financial education.

INSURANCE CULTURE AND DEMAND – Many insurers have observed that small businesses owners generally have a better understanding of the risks they face than other individuals, suggesting that significant potential exists to develop a stronger insurance culture among small businesses in many markets.

Many possible pathways exist to develop a small business market, but all must happen over a long time frame and can require significant investment. One pathway to enter the small business market is to start by offering compulsory embedded products. This provides an opportunity to demonstrate the value of insurance and build trust, which can later be leveraged to introduce further voluntary products to the same client base. Another possible pathway is to grow alongside existing microinsurance clients of partner microfinance institutions (MFIs) as their activities grow into small businesses. One more option may be to start with salaried workers, who frequently also own small businesses in many countries and generally have greater experience and understanding of financial services.

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Finally, segmentation is important. Some segments, with greater education, income, experience with financial services and aspirations for their business, may represent a significant market opportunity and be more willing to embrace insurance.

Given their economic importance, support for small businesses is clearly vital. Insurance is certainly not a complete solution. However, when well integrated with other interventions to boost the capacity of small businesses, improve the environment in which they operate, and reduce the risks they face, better insurance provision could provide a significant boost for small businesses.

Housed at the International Labour Organization, the Impact Insurance Facility enables the insurance industry, governments, and their partners to realise the potential of insurance for social and economic development. The Facility was launched in 2008 with generous support from the Bill & Melinda Gates Foundation, and has received subsequent funding from several donors, including the Z Zurich Foundation, Munich Re Foundation, the World Bank Group, USAID, AFD, FSDA, Africa Re and AusAID. See more at: http://ilo.org/impactinsurance