Developing Insurance for SMEs

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In Focus: MSMEs in Pakistan

SME Activity by Sector

- Retail Trade, Wholesale, Hotels/Restaurants: 53%
- Industrial Establishments: 20%
- Service Provision: 22%
- Others: 5%

Ownership Structure

- Individual: 97%
- Partnership: 2%
- Others: 1%

Contributions of SMEs in Pakistan

- 3.2 million SMEs
- Contribution to GDP: 40%
- Contribution to Exports: 25%
- Contribution to Non-agri Employment: 73%

Source: SME Observer, Vol. 9, Issue 2, SMEDA
Challenges Faced by MSMEs

1. Inadequate Collateral
   SMEs have to demonstrate that they have sufficient equity to contribute to their businesses.

2. Informational Asymmetries
   Difficult for banks to ascertain if SMEs have the capacity or willingness to pay.

3. Poor Management Skills
   Lack of quality human capital means limited marketing and financial planning and poor business records.

4. Lack of Professionalism
   Corruption, disrespecting contracts and manipulation of organizational structure is common.

5. Competition
   SMEs are unable to serve global markets or establish business linkages with larger firms.

6. Inadequate Financing
   SMEs tend to rely on informal sources of funds such as family, friends and customer advances.
The Role of Insurers

Addressing Uninsurable Risks
Develop a special fund to provide financial support for commercially uninsurable risks such as terrorism, floods, pandemics and strikes.

Preserving the Image of Insurance
Create a special fund to allow settlement of claims for policyholders who have misunderstood the coverage or whose claims fall on the borderline of exclusion.

Developing Tailor-made Products
A thorough understanding of the value chain of different MSMEs and innovative thinking is necessary to develop appropriate products.

Lowering Distribution Costs
Leverage the different SME clusters operating under Insurtech, to ensure that the products offered add value and are affordable to targeted consumers.

Develop better Insurance Markets for MSMEs
The Right Business Model

Successful business models that address MSME sector needs have the following features.

Product Development
Product characteristics take into consideration:
- Accessible and trusted distribution channels
  - Flexible premium payment patterns
  - Competent complaints handling
  - Efficient claims settlement
  - Simple renewals
- Religious and cultural preferences

Coverage for Catastrophic Events
The design of insurance products that address MSME needs after a catastrophe should be encouraged. Products that help maintain income, such as business interruption, re-educational benefits, and access to loans in case of catastrophic events, should be stimulated.

Value Chain Processes
Detailed analysis of the targeted MSMEs is required to identify:
- risks that the insurance product intends to protect
- risks that would be covered by other schemes
- uncovered risks

Affordability
Traditional MSME protection products, such as business interruption, partner insurance, and key man insurance with riders covering re-education expenses, business transition costs, and entrepreneurial advice should be available at affordable prices.
**Impact of Climate Disasters in Pakistan**

Impacts of disasters on the agricultural sector also have implications for MSMEs, which are heavily dependent on agricultural production.

<table>
<thead>
<tr>
<th>Disaster</th>
<th>Crop Area Damage</th>
<th>Crop Losses</th>
<th>Livestock Losses</th>
<th>Total Agricultural Losses</th>
<th>% of GDP (Actual reduction)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005 earthquake</td>
<td>Not quantified</td>
<td>$0.08 billion</td>
<td>$0.25 billion</td>
<td>$0.33 billion</td>
<td>0.2%</td>
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<tr>
<td>2010 floods</td>
<td>2,093,000 hectares</td>
<td>$5.04 billion</td>
<td>$0.57 billion</td>
<td>$5.61 billion</td>
<td>2.2%</td>
</tr>
<tr>
<td>2014 floods</td>
<td>Not quantified</td>
<td>$0.30 billion</td>
<td>$0.05 billion</td>
<td>$0.35 billion</td>
<td>0.15%</td>
</tr>
</tbody>
</table>

*Source: Durrani et al. (2005); Dorosh, Malik and Krausova (2010); Government of Pakistan (2015)*
Low Insurance Penetration in Agriculture Sector

**REASONS**

**Limited knowledge about agricultural insurance**

**Agricultural insurance business is not profitable due to:**

✓ Lack of insurers’ control over underwriting outcome
✓ Relatively low share (1/3rd) of formal agricultural credit in total agricultural credit
✓ Low insurance cover relative to the value of agricultural outputs

**Insurers participating in SBP’s CLIS only, no product innovation**

**Lack of datasets such as**

✓ Exposures by geographic area, crop, & livestock productivity
✓ Historical losses by type and severity of natural hazard
✓ Claim settlement history
✓ Crop-specific natural catastrophe ratemaking
Crop Loan Insurance Scheme

Ministry of Finance introduced the Mandatory Crop Loan Insurance Scheme for five major crops in July 2008

**Provided to:** All bank borrowers receiving production loans for Wheat, Cotton, Rice, Sugarcane & Maize

**Insurance Cover:** Based on per acre borrowing limits

**Period Covered:** From Sowing to Harvest

**Fee Charge to Customer:** Free

**Distribution Channel:** Banks and MFBs

**Coverage for following instances:**
- Natural calamities like Excessive rain, Hail-storm, Frost, Flood and Drought.
- Crop related diseases like viral & bacterial attacks, or damage caused to the crop by locust attack etc.
The End