A MODEL OF MICRO INSURANCE:AN INNOVATIVE DIMENSION FOR ETHIOPIA

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ABSTRACT

Poverty is not just a state of deprivation but has latent vulnerability. For Ethiopia to reach its rightful place as a developed nation it must financially empower its entire population. A key element of this empowerment is a base risk cover that covers elements of life, disability and health. This empowerment can only be achieved through the collaborative efforts of the government, regulators and private enterprises, which must be able to build commercially viable and scalable models. The key issues and challenges impending growth Ethiopia from the perspective of the key stakeholders - the un-reached customer, the distribution intermediary and the insurance company, can be addressed by way of structural regulatory and policy changes coupled with extensive leverage of emerging technologies. Micro insurance should, therefore, provide greater economic and psychological security to the poor as it reduces exposure to multiple risks and cushions the impact of a disaster. There is an overwhelming demand for social protection among the poor. Micro insurance in conjunction with micro savings and micro credit could, therefore, go a long way in keeping this segment away from the poverty trap and would truly be an integral component of growth of the country. The suggested measures will aid in increasing micro insurance penetration in the country which can be achieved through focused efforts and suitable partnerships across the industry and government bodies.

Key words: *Micro Insurance, Life Insurance, Social Security, and Welfare.*

INTRODUCTION

Micro-insurance is considered by low premium and low coverage limits and sold as typical risk-pooling and marketing arrangements and designed for low income people and businesses not served by typical social or commercial insurance. As per Churchill-"Micro-insurance is the protection for the low -income population against specific dangers in exchange for regular payments of proportional premiums to the probability and costs of the involved risks". Micro-insurance is thus designed with the objective of protecting poor people and also designed with the environment that surrounds them, their needs, and possibilities. It is necessary that the product is developed for people ignored by traditional insurance markets.

We review experimental evidence collected from a framed micro insurance field experiment using poor subjects in rural Ethiopia. We find the shape of demand for index insurance. The pattern of demand is consistent with recent experimental evidence from developing countries suggesting an S-shaped probability weighting function, with underweighting of extreme events. Additionally, we find that higher background risk is associated with higher indemnity insurance take-up and that participants choose more insurance cover in the group index and indemnity decision problems than in the individual decision problems.

Micro Insurance has the potential to assist poor people in developing countries in coping with shocks such as health shocks, death, crop loss and natural hazards (Dror and Jacquier, 1999; Dercon, 2005). Poor people often lack the financial reserves to cope with these risks and its consequent shocks. Uninsured risk has welfare implications which go well beyond consequences for short-term consumption; and is a cause of persistent poverty (Townsend, 1994; Dercon 2004).

The inability to deal with these shocks may reduce a society's capacity to accumulate, innovate and develop (Fafchamps, 2003). In recent years Micro Insurance has been introduced as a mechanism with the potential to assist the poor in dealing with risk. Micro Insurance as a mechanism to assist the poor in coping with risk is receiving increasing attention among governments, donors, policymakers and NGOs.

NEED OF THE STUDY

2.4 billion People around the world live on $2 a day or less. They face daily hardships like poor nutrition, short life expectancy, poor education, and substandard housing. In the rural there is a death in the family, the cost of a funeral can amount to several months' wages. In rural areas, drought can cause crop failure that brings starvation and even death. It is estimated that only eighty million of the poor are now covered by some form of micro insurance. Most remain without access to this critical financial service. In Ethiopia, where organizations are estimated to serve nearly 30 million micro insurance clients each, the percentage of poor lives insured hovers below 3%. It comes as a surprise to many people, but micro insurance is an important tool in the alleviation of poverty. With micro insurance, the rural poor can mitigate those risks that would otherwise cause them to slide back into the poverty they seek to escape.

The study is intended to provide insights into issues surrounding the management of risks by low-income households and will serve as the basis to design a micro-insurance strategy for low-income households in Ethiopia and develop demand-driven risk managing financial products. The study is intended to address the following research questions:

a) What economic stresses make low-income households in Ethiopia vulnerable?
b) What coping mechanisms do low-income households use to alleviate the impact of economic stress?
c) How do low-income households view micro-insurance?
d) Is there a potential demand for micro-insurance?
e) Who are the micro-insurance providers in Ethiopia?
f) What is the capacity of existing micro-level technical service providers?

OBJECTIVES OF THE STUDY

In the study following objectives have been tried to achieve:

- To through a light on the risk management needs of the poor and Micro Insurance as a risk management alternative.
- To critically review the factors responsible for the uptake of demand for Micro Insurance.
- To study the importance of Micro Insurance for the upliftment of rural poor's and alleviation of poverty in Ethiopia.
- To study the initiatives taken by private and public insurance companies for the growth of rural Ethiopia.
- To suggest the future research direction.

REVIEW OF LITRATURE

- The present study embodies a brief review of the research done in the area of micro insurance. The purpose of reviewing the earlier studies is to economize the historical and present prospective of the present work and the related studies which have been taken cognizance of one or more variables includes in the study.

- **Syed Abdul Hamid& Roberts & Paul Mosley (2010)** in the study shows that there is a positive impact of micro health insurance in the reduction of poverty among rural households of Bangladesh. Micro health insurance has a significant beneficial effect on food sufficiency of poor's and has a dynamic improvement in the health status of poor rural households.
- **Gunita Arun Chandhok (2009)-** The result of study indicates that there is a huge untapped market for micro health insurance and majority of population are aware and understand the importance of micro health insurance. Thus, micro insurance will go a long way in eradicating poverty. If the various micro insurance models are implemented effectively by Insurer, MFI‟s, SHG‟s, NGO‟s, Health institutions, Donors and Co-operatives the BPL population will lead a peaceful and secure life.
- **Prof. M. Ziaulhaq Mamun (2007)** the study concluded that there are three basic models of micro insurance this is Provider model, Insurer model and Linked model. As per the study, linked model is the best suitable model for the improvement of the poor's conditions in Bangladesh, but presently they are using Insurer model, which is less productive for the poor's social security.
- **Ahmed, M. (2006)- "Market Research on Micro Insurance Demand" –** this report provided findings of a market research on micro insurance demand in Sri Lanka. The research revealed that usage of micro insurance is quite low amongst the low income households in spite of high awareness about insurance and the insurers. The report recommended for designing of micro insurance products that are better suited to low income groups and also recommended for an insurer agent model of partnership of high reputation players.

RESEARCH METHODOLOGY

The study used both qualitative and quantitative information gathered from secondary and primary sources. The secondary data were obtained from the Ministry of Agriculture, Federal Cooperative Agency (FCA), Association of Ethiopian Microfinance Institutions (AEMFI), Association of Ethiopian Insurance Companies (AEIC), National Bank of Ethiopia (NBE), Central Statistical Authority (CSA), International Food Policy Research Institute (IFPRI), Ethiopian Economic Association (EEA), Ministry of Health, insurance companies, commercial banks, MFIs, cooperatives, and other reports from various sources.

MICRO INSURANCE IN ETHIOPIA

The population of Ethiopia, according to the 2007 Population and Housing Census of the Central Statistical Agency (CSA), was 73.9 million. Taking a population growth rate of 2.6 percent per annum and 83 percent of the population living in rural areas, Ethiopia have more than 81 million people, making it the second most populated country in Africa. Ethiopia is recognized as one of the world's oldest civilizations and is endowed with a rich diversity of natural resources. However, Ethiopia is one of the poorest countries in the world. About 23 percent of Ethiopians live on less than one dollar a day (PPP adjusted); while 76 percent live on less than two dollar a day; and about 44 percent of the population lives below the nationally defined poverty line of 1,075 Birr (about 107 USD) (UNDP 2008).

Ethiopia has seen a significant decline in its fiscal deficit (from 4.2 percent of GDP five years ago to 1.3 percent). Better regulatory and institutional frameworks, such as improved business registration procedures and requirements, have helped strengthening investor confidence. Large investments in infrastructure—reaching about 6 billion USD (20 percent of GDP), which is large relative to the economy's size—have helped to fuel domestic demand and enhance the economy's productive potential. Positive external factors include rising remittances, increasing international commodity prices, and a range of special incentives have helped exports to grow at an average annual rate of 10.5 percent between 2004 and 2009 and contributed to the economic boom (Ali 2011).

Historians and researchers in social systems speak affirmatively the existence in history of the various forms of traditional social form of Institution based on family, region, tribal, national and other parochial lines in Africa continent meant to combat fortuitous types of accidents in a daily life. In line with the above facts, in our country, Ethiopia, there were and still are traditional institutions of society welfare known as "IDIR and EKUB".

The contribution of insurance sector in the country for gross domestic product is insignificant for several years and number of people employed in the sector is very few when compared to other countries. Moreover, such underdevelopment of insurance is much more in life insurance division. Moreover, although not supported with up to dated empirical data still such underdevelopment of life insurance in the country is an ongoing event that most insurance marketers face including the Ethiopian Insurance Corporation, where this case study is going to be conducted. Therefore it would be necessary to see brief back ground of EIC as follow.

Back ground of the Ethiopian Insurance Corporation

The Ethiopian insurance corporation (EIC) was established in 1976 by proclamation No.68/1975.

The corporation came in to existence by taking over all the assets and liabilities of the thirteen nationalized private insurance companies with Birr 11 million paid up capital aiming the following objectives.

_ Engage in all classes of insurance business in Ethiopia.

_ Ensure the insurance services reach the broad mass of the people.

Subject to the provision of Article 18 of the Housing and Saving Bank establishment proclamation 60/1975, promote efficient utilization of both materials and financial resources.

EIC was operating the business for about nineteen years under protected monopolistic system as state owned-sole insurer. After the demise of the Marxist regime in mid-1991 a fundamental change has taken place and there was a shift in political, economic and social orientation from totalitarianism to that of liberalism. Therefore, EIC was re-established as public enterprises under proclamation number 201/94 with Birr 61 million paid up capital.

Upon re-establishment of the corporation in 1994 as state owned enterprise, the law covers the following new objectives to the Corporation:

1. Engage in the business of rendering insurance service; and
2. Engage in any other related activities conducive to the attainment of its purposes.

Therefore, the life insurance department and division, is one of the major sections dealing with the provision of different types of life insurance policy including endowment, term, and whole life and other types to the market.

In line with this, therefore, this study has investigated buyer's attitude towards life insurance policy purchase by taking selected sample buyers from Ethiopian Insurance Corporation (EIC).

Major Risks, Coping Strategies, and Willingness to Pay by Low-Income Households

This section synthesizes the evidence of existing literature pertaining to the varying coping strategies low-income households use to mitigate variable risk factors and the willingness of households to pay for insurance in Ethiopia. In order to gain a more comprehensive perspective of the potential for micro-insurance in Ethiopia we complemented our analysis with the results of research from several regional and national micro-insurance studies conducted in Ethiopia and analyzed them within the context of extenuating risk management instruments poor households employ to reduce risk and vulnerability.

Major Agricultural Risks Facing Low-Income Households

A category of agricultural risk that represents another important source of uncertainty for agricultural producers is institutional risk. Institutional risk constitutes of risks generated by changes in legal frameworks or regulations that affect producer activities (e.g., agriculture policies, food safety, and environmental regulations). Changes in regulations can have significant impact on the profitability of farming activities. For instance, both Huirne et al. (2000) and Hardaker et al. (2004) indicate that government actions and rules such as laws governing disposal of animal manure or the use of pesticides, tax provisions, and payments can impose great costs on smallholder farmers. Swain and Floro (2008) indicate that vulnerability is prevalent in rural low-income households because the magnitude of risk that they face is striking, particularly for those who live in the rain-fed areas, and their subjective judgment regarding the likelihood of shocks is high. The threat of loss of or decline in farm earnings is brought about by environmental conditions that affect their output such as weather leading to drought or floods, and pests, and by market fluctuations that lead to changes in input and product prices. Yield risks are especially significant when agricultural price and other supports are inadequate or non-existent.

Risks as identified by households

Human death	Livestock loss	Coffee and enset disease	Illness of family members
Crop failure	Human illness	Price fluctuation	HIV/AIDS
Livestock loss	Human death	Natural disaster	Death of family members
Human illness	Fire	HIV/AIDs and TB	Lack of income or employment

Source: Oxfam America and MDTCS (2009).

Regulatory Framework to Deliver Micro-Insurance in Ethiopia

Expanding and improving the quality of micro-insurance services in Ethiopia requires a clear legal and regulatory framework. The objectives of micro-insurance regulation is expected to include: (i) safeguarding the solvency of institutions involved in the provision of insurance policies or ensuring the stability of the sector; (ii) protecting clients or policyholders; (iii) increasing the competitiveness of the insurance market and its efficiency (including the adoption of new technologies and innovations); (iv) developing the insurance market, including formalizing insurance services to low-income clients; and (v) supporting other strategies (non-insurance) objectives such as compliance with international standards or law enforcement (IAIS and CGAP 2007). The intention of regulation and supervision should focus on creating a more conducive environment to the expansion of micro-insurance, thereby stimulating the development without compromising prudential aspects.

The Licensing and Supervision of Insurance Business Proclamation No. 86 of 1994 governs all insurance activities in Ethiopia. Insurance sector players in Ethiopia fall under the regulation and supervision of the National Bank of Ethiopia (NBE). As per the Proclamation No. 86 of 1994, NBE is empowered to formulate policy to promote the business of insurance in the country and issue directives related to various areas of insurance business. The minimum paid up capital to establish an insurance company in Ethiopia is low. For an insurance company to get involved in general insurance, the paid up capital requirement is 3 million Birr (177,514 USD). On the other hand, establishing an insurance company providing long-term and life insurance requires 4 million Birr (236,686 USD); and 7 million Birr (414,201 USD) is required for both a general insurance and long-term insurance business license (composite). According to the proclamation, only a share company fulfilling the minimum capital requirement is allowed to write insurance policies. As per the law, foreign insurance companies and investors or partial foreign ownership are not allowed to operate and invest in the insurance sector. Moreover, insurance companies are prohibited in the placement of investments offshore.

There is no separate definition of micro-insurance in Ethiopia and accordingly the regulatory framework and proclamation do not make any concessions for micro-insurance. However, the regulatory framework does not restrict insurance companies from expanding into the micro-insurance market. On the other hand, the new microfinance proclamation No. 626 of 2009 allows deposit-taking MFIs registered under NBE to deliver micro-insurance services to the excluded. Since the insurance companies in Ethiopia have limited capacity to serve the low-income households, the revised microfinance law in 2009 has given MFIs the legal bases to issue insurance policies to excluded populations. Moreover, MFIs have registered remarkable growth and performance in the last ten years and can complement the delivery of loans, saving, and money transfer services with micro-insurance products. Cooperatives are not allowed to directly issue insurance policy to their members. Given the limited capacity of cooperatives, particularly in rural areas, it would be appropriate to link them with insurance companies, as agents, at this stage. In general, the current framework may not be considered a stumbling block to expand micro-insurance services in Ethiopia.

Ethiopia's legal framework regarding the insurance sector is devised of a hierarchy of proclamations, codes, and directives that outline its policies, governing structure, management, administration, and supervision. Except for a few insurance-relevant definitions in the Commercial Code of 1960, the insurance activities are governed and guided by the Licensing and Supervision of Insurance Business Proclamation. However, a number of regulatory directives from NBE as well as several other pieces of legislation also form part of the framework and help to determine who may write insurances (Smith and Chamberlain 2009). These pieces of legislation include the following: (i) Commercial Code of 1960; (ii) Monetary and Banking Proclamation No. 83 of 1984; (iii) Licensing and Supervision of Banking Proclamation No. 84 of 1994; (iv) Licensing and Supervision of Microfinance Institutions Proclamation No. 626 of 2009; (v) Cooperative Societies Proclamation No. 147 of 1998 and Societies (Amendment) Proclamation No. 402 of 2004; and (vi) Vehicle Insurance Against Third Party Risks Proclamation 559/2008.

Ethiopia's insurance industry regulation framework

Legislation	**Applicable sector**	**General framework**
Licensing and Supervision of Insurance Business Proclamation No. 86 of 1994	Insurance Sector	Governing proclamation for insurance sector. Addresses institutional set-up, prudential and some basic market conduct regulation. Institution must be a share company to be an insurer; does not allow institutional form of a financial cooperative to become insurer. No separate definition for or special treatment of micro-insurance.
Commercial Code (1960)	Insurance Sector Commercial Business	It has a negative impact when insurance policies are sold on credit. Relevant sections that currently apply are definition of insurance and insurance policy (Article 564) and section on payment of premiums (Article 666). New Commercial Code currently being drafted. It's likely that relevant insurance sections of the Commercial Code will be moved to the new insurance Proclamation.
Monetary and Banking Proclamation No. 84 of 1994	Financial Sector	Proclamation establishes National Bank of Ethiopia as separate and independent from national government. Proclamation provides Banks with the power to supervise insurance industry.
Microfinance Proclamation No. 626 of 2009	Microfinance sector	Promotes loans and saving services to the excluded population. Allows MFIs to issue insurance products.
Cooperative Societies Proclamation No. 147 of 1996	Cooperative Sector	Governing proclamation for Cooperatives sector. Places no limits on ability of cooperatives to an insurance company or intermediary.
Vehicle insurance against third party risks	Insurance Sector	Makes third party liability insurance compulsory.

Source: Adopted from Smith and Chamberlain (2009).

The micro-insurance is a priority in Ethiopia. Moreover, micro-insurance providers need to make a commitment to serve the low-income households. This needs the decision of the executives and the board members of micro-insurance providers who are convinced that expanding the micro-insurance market will meet developmental and financial objectives of the institutions. To this end, regulators and supervisors should embrace certain strategic elements in their policies and actions, and thereby foster an environment that makes micro-insurance sustainable and feasible in an integrated manner by combining, among others, the following aspects:

1. Develop a micro-insurance policy or strategy and promote and monitor its implementation
2. Facilitate the availability of key information/statistical data on micro-insurance business
3. Promote learning processes and dialogue among relevant sector stakeholders

4. Enact clears laws and directives in accordance with internationally accepted standards that encourage insurance coverage for low-income households and its compliance while limiting regulatory arbitrage
5. Limit moral hazard and fraud by promoting awareness, and putting in place controls and incentive systems

SUGGESTIONS

1. More awareness should be created about the benefits of micro insurance to poor people.
2. The insurance providers must train their employees in a proper and effective manner in order to sell the micro insurance to the poor and needy people.
3. Premium flexibility must be given to the respondents.
4. The development of the distribution channel into the rural areas is very important for the overall development of insurance in Ethiopia. Therefore, a proper distribution channel is required to develop.
5. Advertisement campaigns must be made and advocated all over the country.

CONCLUSION

In Ethiopia, the livelihood of the poor (particularly the rural poor) is susceptible to high production, marketing, and health risks. These risks cause persistent/relentless poverty in the country. Unless they are managed properly, they not only reduce the current welfare of low-income households, but also threaten opportunities for future income growth, discourage risk taking and innovation (avoid more profitable and riskier investments) in the long-run, and thus perpetuate poverty. Moreover, short-term shocks can have long-lasting effects. Micro-insurance is one of the tools to break the link between poverty and risk. Financial instruments—that make it easier for low-income households to save and borrow—and informal networks of assistance play a role in protecting the poor households, complementing micro-insurance tools. By increasing access to assets and providing transfers when shocks occur, social protection programs can play an important role in insuring poor households. Insurance is not necessarily the best policy intervention to deal with many types of risk, especially in the context of high poverty. First, rather than insurance, risk reduction and management may be the most relevant response for many types of risk—the obvious examples are conflict and crime. Other examples of risk reduction are preventive health measures, water management, and environmental protection. Second, many types of risk are not easily insurable, simply because they cannot be actually priced (as in the case with many of the more common risks in developing countries because even basic data on health, longevity, and climate are often incomplete) or because the risks are unknown (as in the case of rare natural disasters or catastrophes). Third, offering insurance does not remove the need to find ways of actually lifting the poor out of poverty; insurance will prevent a worsening of poverty and may allow more risk-taking by the poor, but it is not a substitute for more general policies to promote income growth.

The main unrecognized challenge in rural financial instruments in Ethiopia is the problem of overcoming the systemic risks arising from the undiversified nature of the local economies. This limits the opportunity for diversification for both the smallholder farmers and finance providers. Facing a spectrum of risks—the most frequently cited of which are price, weather, production, health—farmers respond by adopting low-risk and low-yield crop production patterns to ensure minimum income at the expense of growth and accumulation of capital. Alternatively, in the absence of insurance markets, farmers try to cope with price and other risks by: (i) asset accumulation, saving, and access to credit; (ii) income diversification; (iii) sale of assets; (iv) reduction of consumption; (v) increase labor market participation; (vi) informal insurance arrangements, etc. Although systemic risk affects all households in a given geographic area, it adversely affects only the poor. For example, a drought might lead poor households, who are rainfall-dependent, to sell assets to richer, non-rainfall-dependent neighbors. When agricultural commodity prices decline, everyone faces a lower price for their produce. Drought reduces yields and results in spatially correlated risks affecting the entire community. Traditional insurance contracts are more difficult to offer when risks are covariate. Finance providers such as banks, MFIs, and financial cooperatives have limited capacity to handle the effects of covariant risks, particularly in agriculture. As a result, some of the finance providers tend to avoid agricultural lending or drastically limit their loan exposure to smallholder agriculture. Some of the government supported MFIs in Ethiopia have taken a rational decision through loan diversification to minimize credit risks. Instead of ex-post coping strategies, farmers preferred risk management strategies through affordable micro-insurance services.

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