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## Traditional Risk Coping Mechanisms and Microinsurance of Selected Rural SMES in Northern Ghana

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### **Abstract:**

Every misfortune such as illness, death, accident and natural disasters, no matter how minor, threatens the very existence of the poor, resulting in deeper poverty. According to World Bank 2013 annual report, more than 1 billion people worldwide are still destitute and victims of inequality and social exclusion. The poor in their attempt to cope with these vulnerabilities over the past have adopted some strategies to reduce its impact. Recently however, microinsurance has been identified as the best form of protection for the poor, with affordable insurance products. SMEs in Northern Ghana are identified to be vulnerable to all forms of risks ranging from robbery, fire to bad weather conditions. These risks in addition to the traditional coping mechanisms employed, result in their inability to break the poverty cycle, however, these coping mechanisms are still in more demand than microinsurance in the region. According to Trais Ghana, only five institutions in the region offer microinsurance with total coverage of 3.99% of the population. This study, therefore sought to identify the best form of risk protection to ensure rural SMEs' sustainability from the perspective of SMEs owners. Also, further analysis would give insight into the traditional mechanisms that would further inform future microinsurance policies to make them more acceptable to the working poor. Purposive sampling technique was used to select 50 SME respondents and 3 microinsurance institutions. Data was collected through the administering of questionnaires and interviews. The findings of the study showed that, though comparatively, microinsurance was identified to be superior to traditional coping mechanisms especially in the area of reliability and sufficiency, SMEs still preferred the latter. This preference was attributed to most SMEs distrust for financial institutions and the perception of the complexity of insurance payments in general. It is therefore ideal for microinsurance providers to adopt the identified superior features of traditional coping mechanisms so as to roll out more acceptable microinsurance policies, thereby increasing microinsurance demand, which would further result in a long run break in the poverty cycle.

**Keywords:** Microinsurance, Risk, SMEs, Ghana, Poor

### **1. Introduction**

Small and Medium Scale Enterprises (SMEs) contribute significantly to every country's Gross Domestic Product (GDP) by ensuring poverty reduction, employment, income stability and economic growth. This is evidenced in most developing countries like Ghana, where SMEs make up 92% of all businesses (Abor & Quartey, 2010; Ayyagari, Beck & Demirguc-Kunt, 2007). More than 95% of enterprises across the world are said to be SMEs, accounting for approximately 60% of private sector employment (Ayyagari, Demirgüç-Kunt & Maksimovic, 2011). Though SMEs in general contributes to every country's development, poverty, one of the major motivations for the development of most SMEs in developing countries, is still a persisting issue. Earlier studies had shown that, direct access to financial services affects productivity, asset and income formation as well as food security of the poor (Woller & Woodworth, 2001; ILO, 2009; Bob, 2011). This has resulted in most governments and non-governmental organizations adopting microfinance as a means of financing SMEs to reduce poverty. As at December 31, 2010, the Microcredit Summit Campaign reported a total increase of over 205 million borrowers, of whom 137.5 million were among the poorest living on less than \$1.25 per day (Bob, 2011). Despite this business improvement, most of these enterprises are still vulnerable to various forms of risks. The slow process of increasing income and building assets, characterizing the road out of poverty by the active poor, is usually affected by shocks, which make the escape from poverty harder to achieve (Cohen & Sebstad, 2003). Poverty is mostly reinforced by vulnerability and vice versa. According to Churchill (2006), poverty and vulnerability reinforce each other in an escalating downward spiral. These shocks can be lifecycle-related, financial, political, societal, or natural disasters like floods or fire (Churchill, 2006). However, the capacity of the active poor (such as SMEs owners) to deal with such risks is often very limited (Radermacher & Brinkmann,

2011). Hence, access to finance is essential to SMEs' development and living conditions improvement in most especially less developed areas. However, if proper risk coping strategies and policies are not developed to protect beneficiaries and their assets against potential risks, they are most likely to be drawn back to the same poverty state they were trying to reduce or eliminate. SME owners in their effort to cope with shocks are most likely to use informal risk coping strategies such as borrowing, saving, selling of productive and non-productive assets and reducing expenditure such as withdrawing children from school and reducing daily meals as well as employing ex-anti risk strategies such as avoiding risky activities (Lloyds, 2009). Various governments and non-governmental organizations have therefore seen the insurance gap in this sector, hence the introduction of microinsurance policies (Churchill, 2003). Microinsurance as a new sector is believed to have a lot of potential for both improved standard of living of the poor and industrial growth for the insurance sector as a whole. Most studies have shown that micro insurance can result in poverty reduction and general economic growth (Magnoni & Zimmerman, 2011; Mathur, 2010; Reinhard, 2012). This is evidenced among the rural poor in India and China. A study undertaken by UNDP in partnership with Allianz AG and GTZ in 2006 clearly showed that access to microinsurance by SMEs and disadvantaged population could contribute immensely to the attainment of the Millennium Development Goals.

The Ghana Living Standard Survey (GLSS5) data showed that 25 percent of household income in Ghana is generated from self-employment. The increasing recognition of the economic contributions of Small Scale enterprises to the development of Ghana has stimulated both Governmental and Non-Governmental Organizations (NGOs) to pursue several courses of action aimed at addressing the problem of risks inhibiting the private sector. Among which is the journal named "Promoting Microinsurance in Ghana" put together by the National Insurance Commission of Ghana (NIC) and the Gesellschaft fur Internationale Zusammenarbeit (GIZ) as well as the conference held by the NIC on May 2012, to emphasize on the relevance and need to develop microinsurance in Ghana.

On the topic of microinsurance, country specific literature is limited in Ghana since the field is relatively new. To improve the microinsurance sector, some research has been undertaken to explore the area of need, supply, distribution channels and impact analysis (Baidoo & Buss, 2012; Buabeng & Gruijters, 2012). However, the penetration is still very limited, in a learning session presented by Munich Re Foundation, approximately 20 microinsurance products are currently on offer in Ghana, provided by 15 different insurance companies.

According the 2012 Ghana Microinsurance Conference, the National Insurance Commission is therefore actively spearheading the development of the microinsurance market in the country. The slow penetration of microinsurance products and policies is identified to be attributable to the fact that, it is difficult to estimate the demand and practical impact of microinsurance since the field is very new. Globally, not many people have microinsurance and most of those who have it have not had it for long (Roth, J., McCord, J. M., & Liber, D. 2007). For microinsurance to be accepted and meet the needs of the large numbers of rural SMEs there is a need to investigate to attain an understanding of the various employed informal risk coping mechanisms, as well as SME's perception of microinsurance. A study conducted to investigate the various types of risks and the effectiveness of informal coping mechanisms have been conducted by some researchers such as Cohen & Sebstad (2003), however, in Ghana, a study into the effectiveness of informal coping mechanisms and the superiority of microinsurance is yet to be investigated.

Interest in the role of SMEs in the development process especially in rural areas, continues to be at the forefront of policy debates in most countries (Sarpong, 2012; Carsamer, 2009; Abor & Adjasi, 2007; Feeney & Riding, 1997). In Ghana, many regulatory bodies as well as financial support bodies have been established since 1981 to assist and promote the development of these SMEs. However, SMEs are faced with several risk and vulnerability related challenges. As indicated in the Ghana millennium development goals report (2010), the country is highly vulnerable to both external and internal shocks such as commodity prices and demand, aid flows, droughts, floods and bush fires. These shocks have repercussions on the economy especially on SMEs, which tend to affect the attainment of poverty reduction and other developmental goals. According to the Ghana National Fire Service, in the first quarter of 2011, Ghana lost GHc1.47 million to 704 fire outbreaks, with most of the victims being market women with small shops. These challenges, therefore, need to be addressed to ensure the attainment of poverty reduction and reduction in inequality between regions, districts and within districts (UNDPC & UNDP, 2010).

In an effort to reduce the vulnerabilities of poor SMEs, Microinsurance has been concluded by most studies to be the best form of a risk-coping mechanism. Most studies have, therefore, been concerned with areas such as, demand, supply, regulatory, and potential impact analysis (Akotey et al., 2011; Eling et al., 2013; Mathur, 2010, Baidoo & Buss, 2012; Buabeng & Gruijters 2012). As much as microinsurance is essential, there has been so far no identified research undertaken to provide clear evidence that it is more superior to competing traditional coping mechanisms, as well as ex-anti risk management tools used by rural SMEs owners up until the introduction of microinsurance in Ghana. This is reiterated by Baidoo (2012).

The northern part is noted as one of the poorest areas in Ghana (Feyemi et al., 2003). The region is exposed to floods, droughts, epidemics, pests and infestations. The 2007 catastrophic floods in the North affected more than 325,000 people with about 100000 requiring assistance in some form to restore livelihoods. The floods followed immediately after a period of drought that damaged the initial maize harvest (Amoako & Ampofo, 2009). Also, in November 2010, 55 communities in the Central Gonja District located in the northern part of Ghana were affected by floods, about 700,000 people were displaced, 3,234 houses collapsed, 23,588 acres of farmlands were destroyed at the cost of 116,340.22 USD (NADMO, 2010). Though over the past decades, poverty trends in Ghana has declined from 51.7% in 1991 to 28.5% in 2005 (GSS, 2005), the period has also seen evidence of deepening vulnerability and exclusion among some groups, especially women (Awumbila, 2007). Therefore, SMEs' vulnerability to natural hazards is a major contributor to the poverty situation in the region.

This research therefore seeks to explore and unravel some of the key risks coping strategies, both formal and informal, which are vital in protecting SMEs and ensuring sustainable development in rural areas. Analysis of the different options would give better insight as to the traditional procedures that need to be modified and maintained as well as inform future microinsurance policies to make them more acceptable to the poor in rural areas which, in the long run, would result in a reduction in unemployment and poverty levels. The study therefore seeks to address three questions. (1) What are the various informal risk coping mechanisms and microinsurance policies employed by rural SMEs in the Northern region? (2) What are the preferred forms of risk coping mechanisms of rural SMEs in the region? and (3) what are the challenges faced by rural SMEs in their attempt to access both informal risk coping strategies and microinsurance products?

## 2. Methodology

Primary data was collected through the administering of questionnaires, focus group discussion among SMEs, and interview with microinsurance institutions. Additional secondary supporting materials were made available by Trais Ghana.

Data collected from the survey was analyzed using descriptive statistics with the help of IBM SPSS software. Results are presented diagrammatically, using tables and charts. The analysis was based on the information gathered through questionnaires, interviews and focus group discussions conducted. To gain a deeper insight into the communication process between participants, the questionnaires were designed to contain several open ended questions and focus group discussion gave a more in depth knowledge as to the attitudes of participants to questions, which are difficult to capture by quantitative methods alone.

## 3. Analyses

### 3.1 Risk Factors of Respondents

Several factors, including bad weather, market fluctuation, capital shortage, and credit sales problems, lack of customers and goods shortage (this was linked to inflation) were identified. However, in the mix of all the factors identified, the risk factors that had the highest record were fire and robbery together, but fire as an individual risk was frequently added by most respondents hence, can be considered as the highest factor followed by robbery, capital shortage and credit sales payment problems respectively.

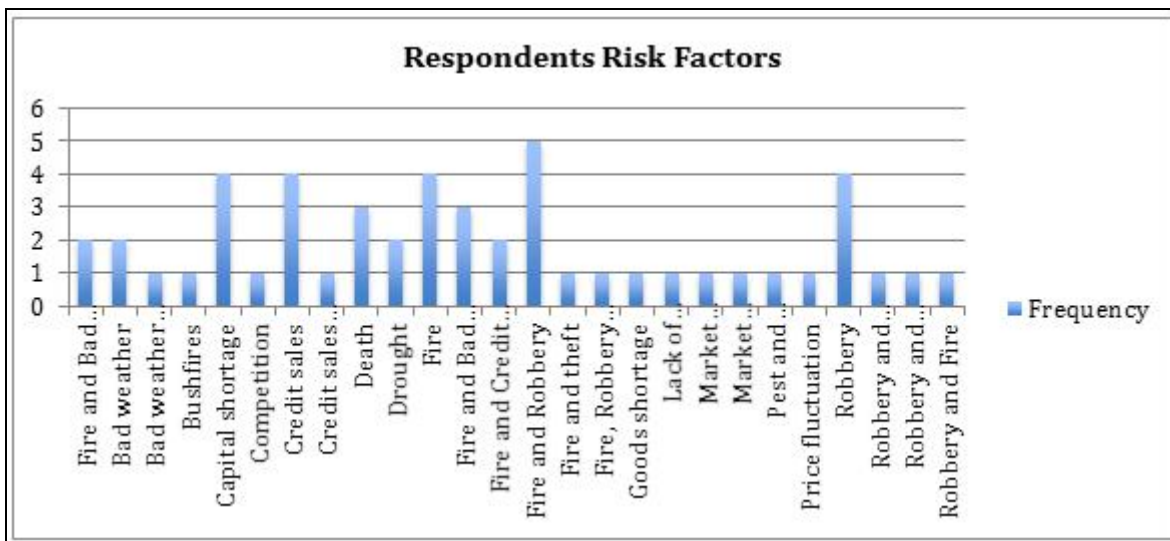


Figure 1: Risks Factors of Respondents (Field Survey, January 2014)

### 3.2 Consequences of Risks on Respondents

Extend to which risks affect the lives of people upon occurrence, is what makes coping strategies relevant. From the survey, the effects ranged from low business growth (12%) and emotional distress (12%) to potential business collapse, children school dropout, inability to provide family basic needs such as food, property loss and revenue loss. Emotional distress was emphasized by most of the women. The impact of risks has both direct and indirect effects on SMEs with the major impact being increased unemployment level thus, loss of revenue support which later feeds into poor living conditions and high poverty levels.

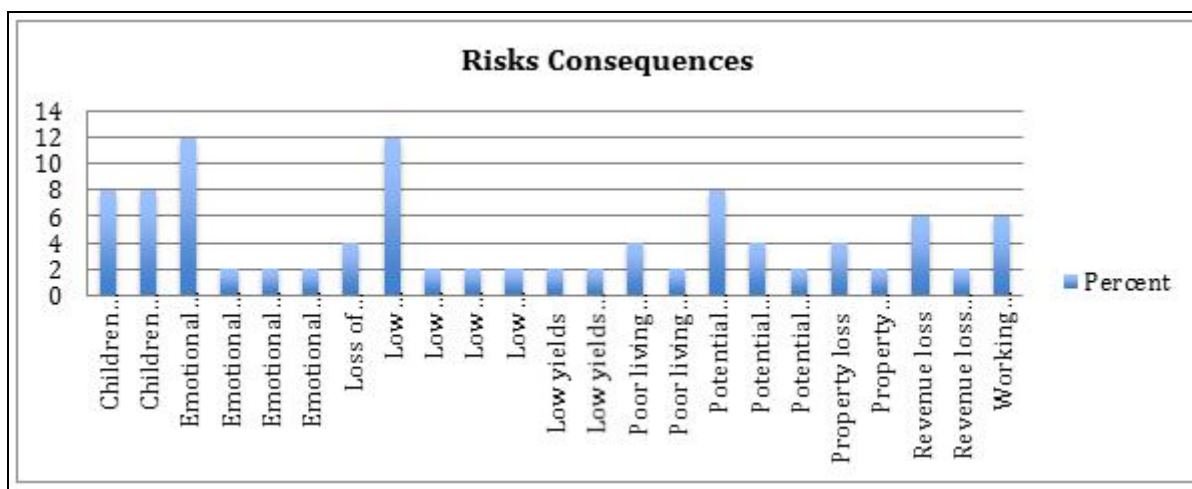


Figure 2: Respondents Risks Consequences (Field Survey, January 2014)

### 3.3 Challenges in Using Traditional Coping Mechanisms

Respondents were identified to face several challenges in their effort to access the traditional coping mechanisms upon the occurrence of risk. 22% of the challenge was attributed to delays, 20% recorded no challenges, 18% inadequate, 14% strict terms and conditions, 6% high interest rate, 4% lot of paper work, guarantee issues, lack of trust, short repayment duration all recorded 2% respectively and the rest were a combination of any two of the major ones identified. From this analysis, there is obviously a room for improvement if the effect of risk is to be managed or eliminated. In total, 80% face various forms of challenges as against the 20% with no challenges.

### 3.4 Respondents Awareness of Microinsurance

56% had no awareness of microinsurance whereas 44% were aware.

It was identified that awareness among the 44% of the respondents were created by Rural Banks (32%), Cooperative Society (6%), Insurance company (4%) and the remaining 2% from school. However, only 8% of respondents were actually covered by insurance (fire) and the rest of the 92% had no form of insurance except 1% of their microcredit held by the rural banks to protect their loans. The insurance policy held by the 8% of the respondents was identified as purchased by SMEs who were also dependent on commercial bank loans as a source of capital.

## 4. Summary and Conclusions

The findings of the research indicate that respondents commonly use traditional mechanisms to that of microinsurance. The coping mechanism most preferred by respondents was indicated to be traditional coping mechanisms, both prior and after being informed of what microinsurance concept was about. Evidence from the survey showed that, most people tend to prefer traditional coping methods to microinsurance mainly because of their lack of extensive knowledge of how it works as well as its benefits. Another major contributor was their lack of trust for financial institutions in general, mainly because of their experience with microfinance and, savings and savings and loan institutions whose officials run away with their monies. Also, the issue of lack of the savings component of microinsurance made it a turnoff for most respondents; thus, they just couldn't understand why they would not get their money back in the case nothing happens. Though vulnerability to risk is a major component of poverty, most poor people have become so use to it as part of their lives that they consider it as a natural phenomenon rather than something they can prevent. During the survey, respondents identified several challenging factors. These challenges are said to affect respondents in their effort to access both traditional and microinsurance. Most challenges identified in the area of traditional coping mechanisms ranged from inadequacy, delays, unreliable, lot of paper work and guarantee issues especially in using formal traditional coping methods such as loans. The main challenge in the area of microinsurance was the lack of awareness, trust, and availability of agents to educate and to sell policies.

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