

## Insuring the Uninsurable for Poverty Alleviation in Nigeria: What Micro-Insurance can do?

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### Abstract

*The populace in developing countries be it better or worse offs are exposed to a variety of risks like illness, disability, death, unemployment, or crime vulnerable to become poor. Low income households, however, are less able to prevent and mitigate risks and so they are less able to cope with the consequences. The developmental role of conventional insurance service any nation is pivotal. This is because economic development focuses attention upon the development and use of recourses to increase supply and improve the distribution of economic goods. However, in Nigeria where there is low insurance patronage and instead the vast majority of the citizen are exposed variants types of risk. The resulting effects are poverty, economic insecurity, insurgency, and social vices. Micro-insurance is considered as one of the most effective means of reducing the vulnerability of the poor from the impacts of disease, theft, violence, disability, fire and other hazards. This method of insurance can protect against unexpected losses by pooling the resources of the many to compensate for the losses of the few, the more uncertain the event the more insurance becomes the most economical form of protection. Micro-insurance moreover, can break the cycle of poverty experience in Nigeria by providing low-income households, business and farmers with access to post disaster liquidity, thus protect their livelihoods and providing for reconstruction. Therefore, insured households and firms are more credit worthy; these kinds of insurance can also promote investments in productive assets and higher risk yield crops. As a result, this study recommends the establishment of micro-insurance in Nigeria. While setting the micro-insurance caution should be exercise to make it in conformity with social, cultural and religious setting of the populace for it to gain recognition and acceptability otherwise it is likely to get low patronage.*

**Keyword:** Micro-insurance, poverty, risk, unemployment, economic development

### 1. Introduction

The poor are faced with many risks and are highly vulnerable to fluctuations in their income and expenses arising from health costs, property theft and fire, violence, death, disability and catastrophes. Micro-insurance is considered as one of the most effective means of reducing the vulnerability of the poor from the impacts of disease, theft, violence, disability, fire and other hazards. Insurance protects against unexpected losses by pooling the resources of the many to compensate for the losses of the few, the more uncertain the event the more insurance becomes the most economical form of protection (Brown and Churchill 1999). Policyholders only pay the average loss suffered by the group rather than the actual costs of an individual event; insurance replaces the uncertain prospects of large losses with the certainty of making small, regular, affordable premium payments (Brown and McCord 2000, Brown and Churchill, 1999). The primary function of insurance is to act as a risk transfer mechanism, to provide peace of mind and protect against losses. Risk can be handled by; assumption, combination, transfer or loss prevention activities. Insurance schemes utilize the combination method by persuading a large number of individuals to pool their risks into a large group to minimize overall risk (Ali, 2000). In the developed world insurance is part of society, such that some forms of cover are required by law. In developing countries the need for such a safety net is much greater, particularly at the poorest levels where vulnerability to risks is much greater and there are fewer opportunities available to recover from a large loss (Brown and McCord 2000).

All households in developing countries whether better or worse off are exposed to a variety of risks, such as illness, disability, death, unemployment, or crime. Low income households, however, are less able to prevent and mitigate risks; they are less able to cope with the consequences (Churchill, 2006). They are therefore more vulnerable to risks i.e. they are more likely to experience a significant decline in well being at the event of any crises (World Bank, 2001). Besides, poor in developing countries lack property ownership that micro-insurance might insured (Ikopolati, 2008).

One major obstacle that hinders the performance of micro-insurance is the level of illiteracy among rural dwellers. Most targeted audience of micro-insurance do not understand the concept of insurance, let alone the terms and conditions of the contract, and are therefore, reluctant to pay in advance for the service they may not receive (Cohen and Sebstad, 2006). Along this line, Tomchansky (2008) argued that educating consumers by creating awareness through the use of pictorial posters, local folk arts and street theatres might be useful to explain the mechanisms of micro-insurance. Micro-insurance is universally recognised as a way of reducing the suffering of the rural poor, but in Muslim dominated areas they are usually faced with resistance (Yusuf, 2006). Against this background, thrust of this paper is to examine the role of micro-insurance in spurring economic development rural Nigeria. The paper is divided into five sections including this introduction which is section one, section two examine the developmental role of insurance, section three presents the constraints of insurance in Nigeria. Section four explores the relationship between insurance and poverty alleviation while the last section concludes the paper.

## **2. Insurance and Economic Development in Nigeria**

The role of insurance industry in the economic development of any nation is pivotal. This is because economic development focuses attention upon the development and use of resources to increase supply and improve the distribution of economic goods (Hilliard 1967). Along that line Madora (2001) observed that insurance industry plays a vital and pivotal role in financial markets as well as in economic development by supplying funds to variety of financial and non-financial organizations as well as government agencies. Increased interest has emerged for using finance-based means of managing risk for vulnerable households. New evidence shows that the finance trinity (i.e. savings, credit, and insurance) can be used not only to assist capital accumulation but also to help smooth consumption and improve risk-bearing (Zeller, *et. al.* 1997; Sebstad and Cohen, 1999; Rutherford, 2000).

The business of insurance in Nigeria has witnessed substantial growth in the recent past; the industry now occupies a unique position in the socio-economic development of the country. The growth of industry is evidenced in the increase in premium income of over 10billion Naira in the last decade, and the large number of insurance companies that are quoted on the Nigerian stock exchange (Bisi, 2004). This growth came about partially as a result of the promulgation by the federal Government of two decrees in 1997 aimed at strengthening the industry. The National Insurance Commission (NAICOM) was established to replace the National Insurance supervisory Board (NISB) through decree No 1 of 1997. The NAICOM is mandated to ensure the effective administration, supervision, regulation, and control of insurance business in Nigeria, conferring regulatory and supervisory power over insurance companies.

Chukwulozie (2006) contended that apart from the social role it plays by relieving government of some burden of meeting the financial security needs, insurance can assist economic development generally and the development of the capital market in particular. He further argues that because they have thousand of policy holders insurance companies are able to amass a considerable quantum of funds that are important in supporting investment in an economy. Accordingly, greater resources and a safety net the borrower can take on a greater risk to achieve higher income and stimulate outside investment. They can also market their product outside of the local market achieving a better price for goods and raw-materials. Insurance enables the policy holder to save a portion of his income, without the need to use it on medication, fire, theft and death; it can instead be invested in child's education.

The primary function of insurance is to act as risk transfer mechanism, to provide peace of mind and protect against losses. Risk can be handled by either, assumption, transfer or loss of prevention activities. Insurance schemes utilized the combination method by persuading a large number of individuals to pool their risks into a large group to minimize overall risk (Ali, 2000). Access to adequate insurance protection can assist poor to achieve sustainable growth and prove them with capability to attain a better standard of living (World Bank, 2000). It can mitigate the impact of personal and national calamities on the build up of assets, providing escape from the vicious circle of poverty that engulfs each new generation.

### **3. Constraints of Insurance Service in Nigeria**

In spite of the growth of the insurance industry in Nigeria, there are still problems militating against the realization of its full potentials. For instance, the level of awareness of insurance business in Nigeria is still very low (Aliero and Shu'aibu, 2012). This is, however, not peculiar to Nigeria. It is a worldwide phenomenon. According to a 1975 survey carried out in the United Kingdom to ascertain the level of awareness of insurance business among the populace. It was discovered that only 23 percent of the policy holders actually knew what they were carrying about as insurance policy or cover. Apart from the lack of awareness among the populace, there are other problems which include high level of poverty, low capital base of the operators in the industry, perceived unwillingness to pay legitimate claims, and low level of enforcement and compliance with insurance laws (Iyoha and Richard, 2004).

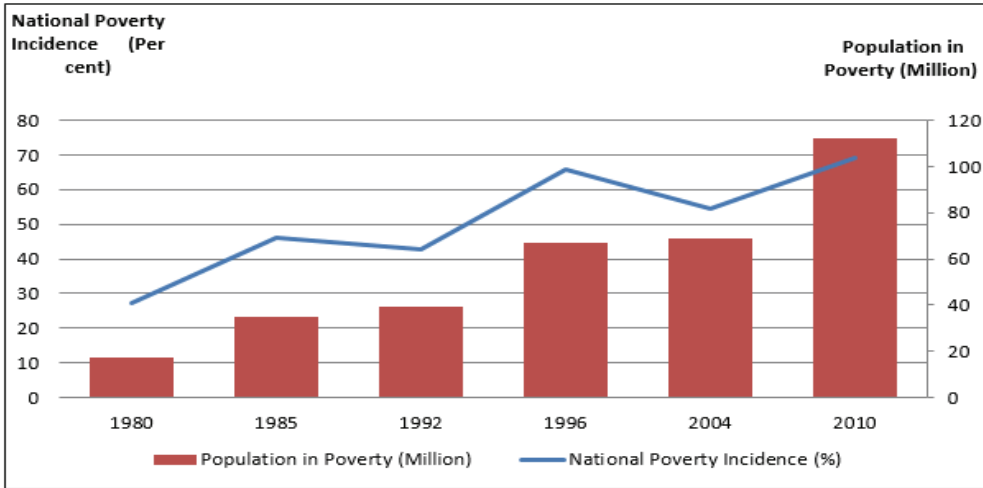
Chukwulozie (2006) observed that low level of income and general poverty in emerging economies militates against life insurance. Life insurance consumption rises with the level of income. Therefore, steady rise in the income of individual creates a greater demand for life insurance (Mortality cover) to safeguard the income potential of the insured and expected consumption of his or her dependants. Life insurance belongs to the category of products or goods which economists classify as "superior goods" where the demand curve is positively correlated with the income level. Rising income results in increasing ability to direct a higher share of income towards retirement and investment related life insurance products. More over, the overhead costs associated with administering and marketing insurance make bigger size policies less expensive per Naira of insurance in force, which also lower the price of life insurance policies. Studies have shown that the positive relationship between demand for life insurance and income level is true irrespective of whether we use aggregate national income data or individual household income data.

In a study by Ikpolati (2008) argued that high rate of inflation: which characterized developing countries, is a definite obstacle to the development of insurance as life insurance savings products typically provide monetary benefits over the long term, monetary uncertainty has a substantial negative impact on these products expected returns or yields. Moreover, where fluctuating interest rates cycles affect financial intermediation in the financial markets, it has a disruptive effect on the insurance industry.

### **4. Micro-Insurance and Poverty Alleviation**

Poverty is massive and pervasive in Nigeria. Since the return of democracy in 1999, there were hopes by the peasants related to the possibility of transferring the trust puts by them to elect leader by embarking on developmental projects geared to improve the quality of their live. However, it turn out that the severity of poverty is ever increasing. For instance data from NPC (2011) shows relative poverty and absolute poverty rates increased to 69.0% and 60.9% in 2010 respectively from 54.4% and 54.7% in 2004. This implies that the population in relative poverty grew by a compound annual growth rate of 8.56% above the average growth rate of 7.2% per annum since 2004, indicating further that the economy must increase above 8.56% per annum for economic growth to trickle down to alleviate poverty to an acceptable level. However, there was a slight decline in the percentage of population below one dollar per day by Purchasing Power Parity (PPP) from 62.8% in 2004 to 61.2% in 2010.

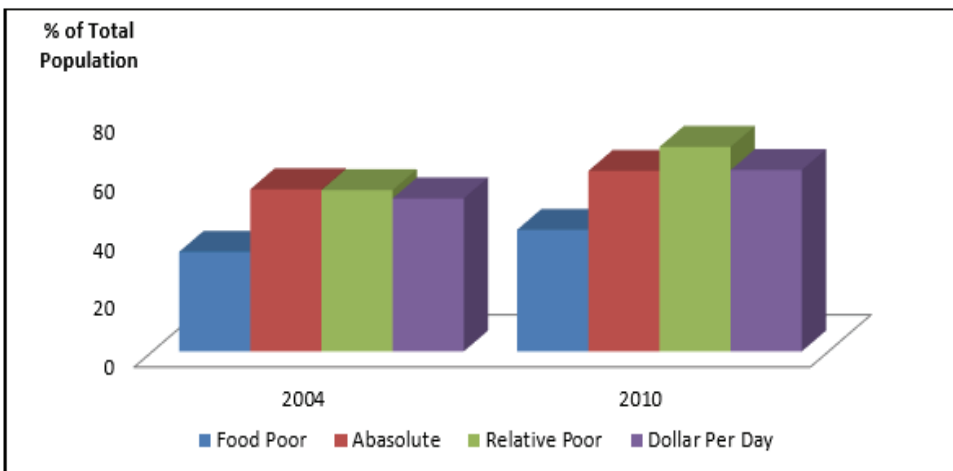
**Figure 1** National Poverty Incidence (1980-2010)



Source: NPC, 2011

The above figure shows the national poverty of Nigeria for 1980-2010. It could be discerned from the figure that the highest incidence of poverty in pre-democratic period was recorded in 1996 (about 95 million people in poverty) and with the coming of civilian rule there was drastic decline to approximately 80 million people in poverty. More so, global meltdown of 2007 and beyond adds more salt to the wound leading highest severity of poverty in the country both in form of food poor, relative poor and dollar per day poor (see figure 2).

**Figures 2:** National Poverty Incidence (2004 versus 2010)



Source: NPC, 2011

The unquestionable crucial question is how insurance can redress poverty? Scholars diverse in response to that, The popular view is held by UNDP (2000) argued that Human Development Index (HDI) measures welfare of people

using three factors, income (GDP per capita), and educational attainment and life expectancy at birth. Micro-insurance programs can increase HDI by providing lenders with greater security and incentive to provide credit to micro enterprises (World Bank, 2000).

Accordingly, Banerjee (2008) opined that many of the world's poor are caught in a vicious cycle of poverty with little hope of ever break out. For them micro-insurance may provide an innovative way to combat poverty. Still in its infancy, micro insurance represents a second wave, after microfinance, of development strategies aimed at alleviating poverty and promoting self sufficiency. Along this line Tomchinsky (2008) identified four distinct roles that micro-insurance play. Firstly, financial inclusion which is one of the several risk management tools to protect the most vulnerable populations and help them to retail the assets they work so hard to build. Secondly, social protection which complement or substitute for government protection mechanisms such as health insurance and pensions for low income workers. Thirdly, commercial where new market for commercial sector which has relatively low penetration worldwide and needs to expand to grow. Fourthly, macroeconomic, since insurance is a vital precondition for economic development, as it provides a reliable mechanism for individuals, institutions and governments to assume risks

Linnerooth-Bayer *et al*, (2006) opined that micro-insurance can break the cycle of poverty” by providing low-income households, business and farmers with access to post disaster liquidity, thus protect their livelihoods and providing for reconstruction. Therefore, insured households and firms are more credit worthy; these kinds of insurance can also promote investments in productive assets and higher risk yield crops. They emphasize that micro insurance can encourage investment in disaster prevention, if insurers offer lower premiums to reward risk reducing behaviours. Thus, arguably, micro-insurance can be seen as effective risk - transfer mechanism and integral part of overall disaster risk management strategy. Jutting and Ahuja (2003) observed that micro-insurance is considered to play important role of financing tool to protect poor from adverse financial consequence in the event of sicknesses or ill health. Devaux (2000) noted that micro-insurance enables credit and savings to be used more productively on generating employment opportunities.

## 5. Conclusion

Insurance in Less Developed Countries is very low and so their populace are much vulnerable whatever shock that may come their way. The resulting effect is enlarging the vicious circle of poverty to enable successful and smooth transmission from one generation to another. No doubts insurance can provide holistic way to combat poverty but only in advance economy. However, in LDCs there is very minimal hope for conventional insurance services to stamp their authority in alleviation of severity of poverty. Micro-insurance however, can break the cycle of poverty” by providing low-income households, business and farmers with access to post disaster liquidity, thus protect their livelihoods and providing for reconstruction. Therefore, insured households and firms are more credit worthy; these kinds of insurance can also promote investments in productive assets and higher risk yield crops. As a result, this study recommends the establishment of micro-insurance in Nigeria. While setting the micro-insurance caution should be exercise to make it in conformity with social, cultural and religious setting of the populace for it to gain recognition and acceptability otherwise it is likely to get low patronage.

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