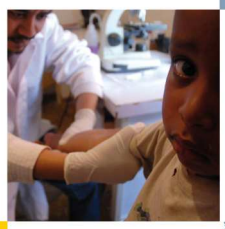
access to insurance initiative

Opportunities and challenges for microinsurance in Ethiopia

An analysis of the supply, demand and regulatory environments



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List of abbreviations

AEMFI	Association of Ethiopian Microfinance Institutions
FGD	Focus group discussions
GoE	Government of Ethiopia
ILO	International Labour Organization
MFI	Microfinance institution
MIS	Management information systems
PRA	Participatory rapid appraisal
RUFIP	Rural Financial Intermediation Program
SACCO	Savings and credit cooperative
WISE	Women in Self-Employment
WHO	World Health Organization
UNCDF	United Nations Capital Development Fund

Executive Summary

Introduction

Microinsurance may support poverty alleviation by protecting the assets, income and productivity of low-income households. This study considers the potential role, opportunities and challenges for developing a microinsurance market in Ethiopia. The aim of the study is to develop as comprehensive as possible an information base of the current market dynamics as well as an assessment of the opportunities and challenges for microinsurance in Ethiopia. This will serve as starting point for a larger process to bring the relevant stakeholders (government, the insurance sector, potential clients and donors) together for a process of dialogue on actions required to develop the Ethiopian microinsurance sector.

Context

High poverty levels. Despite experiencing high levels of economic growth of more than 4% per annum in recent years, Ethiopia faces large poverty and development challenges. The Ethiopian environment is characterised by low levels of income and high levels of economic vulnerability. Out of a total population of 79 million in 2005, 23% of Ethiopians lived on less than US$1 per day (PPP adjusted), while 76% lived on less than US$2 per day. About 44% of the population lives below the nationally defined poverty line of 1075 Birr[1] (about US$107) per adult per year.

Large rural population with low number of cell phone users. In 2008, the total Ethiopian population was estimated to be 83m people, of which 86% live in rural areas and 46% are younger than 15 years. Compared to other African countries, the telecommunications sector (one way of increasing rural-urban linkages) is still very under-developed. Ethiopia has about 1m landlines and around 2m cell phone users. However, while the cell phone network may have reached its limit for current clients, it is in the process of being upgraded to accommodate up to 10m cell phone users.

Low formal employment, tied with inefficient agricultural sector. Only 2.4m Ethiopians, 7.9% of the labour force or 5.8% of working age Ethiopians, were formally employed in 2005. Of this group, the largest category was employed by government or parastatal organisations (almost 1m Ethiopians). By implication, about 92% (29m) of the 32.2m labour force were informally employed. Of this group, the majority (55% or 15.8m) are unpaid family workers mostly employed in the agricultural sector. The majority of rural, agricultural households engage in subsistence, rainfed agriculture and are unable to produce a surplus – 85% of the population rely on subsistence farming for their livelihoods. In 1996 about 53% of rural households were net cereal buyers, implying that they were unable to produce a sufficient amount of cereal on their landholdings to fulfil consumption needs. Furthermore, the agricultural sector is fragmented, in terms of both the size of landholdings and cattle ownership. About 56% of total agricultural households (13.3m) have landholdings less than or equal to 1 hectare in size, while about 83% have holdings smaller or equal to 2 hectares in size.

Low levels of financial services usage. Based on estimates of the financial products used in Ethiopia, it is unlikely that more than 5m adults (about 11% of adults) in Ethiopia use any form of financial product. This figure is based on the existence of 2.9m bank accounts in June 2007, with microfinance institutions (MFIs) serving about 1.7m individuals (2006) and cooperatives serving 0.38m individuals and assumes that there is limited overlap between these groups. Estimates by industry players

[1] Note that this represents 2000 data – the latest available survey data. The UNDP does not indicate the actual poverty line in its tables. According to the Woldehanna, 2004, the official Ethiopian national poverty line is 1075 Birr in 1995/96 constant national average prices.

indicate that there are probably no more than 0.3m individuals that use any kind of formal insurance products. There is likely to be a significant level of overlap between individuals that have a bank account and own an insurance product.

Insurance regulatory framework

Bank of Ethiopia the insurance policymaker, regulator and supervisor. The Licensing and Supervision of Insurance Business Proclamation (No. 86 of 1994), together with the Monetary and Banking Proclamation (No. 83 of 1994), designate the Bank of Ethiopia as the policymaker, regulator and supervisor of the insurance industry in Ethiopia. The Bank has an Insurance Supervision Department that is responsible for all insurance policy, regulation and supervision activities. This implies that the insurance supervisor is not independent from the Central Bank as required by the International Association of Insurance Supervisors (IAIS). As result, membership of the IAIS has not been open to the Bank of Ethiopia.

No separate definition or regulatory framework for microinsurance. Ethiopia currently does not have a separate definition for microinsurance and, accordingly, the regulatory framework and Proclamation do not currently make any concessions to microinsurance.

No obvious obstacles to microinsurance market development, but regulation can be improved. The current regulatory framework does not present any significant barriers to domestic players in developing a microinsurance market, with the exception of the prohibition of foreign participation and partnership, and limits on the placement of investments offshore. However, there are some gaps to be considered as a new regulatory framework for insurance is currently debated in Ethiopia. Thus, for example, the Insurance Proclamation does not currently allow cooperatives to write insurance – the only institutional entity able to register as an insurance company is a share company. Consideration also needs to be given to the establishment of appropriate consumer protection regulation but care should be taken to minimise regulatory costs and compliance burden and ensure a flexible intermediation environment. There is a need to strengthen the industry and improve efficiencies through modernisation of management and information infrastructure. However, in doing so it is again important to avoid unnecessarily increasing the regulatory burden on insurance companies and ensure that the sector is able to serve the lower-income market. The possibility of partnership with foreign insurers should also be considered as it will facilitate the transfer of international learning and business models, while allowing the placement of insurers' investment funds off-shore may relieve the constrained investment environment and incentivise market expansion.

The insurance market in Ethiopia

Small market, with very small life insurance market. Insurance premiums (including both life and general insurance) totalled US$105m in the 2006/07 financial year (ending June 2007), equating to about 0.2% of GDP. Life insurance premiums constituted only US$6m or 6% of total premiums in 2007, while general insurance premiums totalled US$99m or 94% of total premiums. Almost half (43%) of total insurance premiums derived from motor vehicle insurance.

Limited experience to date with retail and life business. Similar to the banking industry, the majority of insurance business in Ethiopia is targeted at the corporate market and focused on general insurance business. At less than 5% of total premiums, the life insurance industry is still very small and a recent addition to their core business of general insurance for most private insurers. The

corporate focus implies that, to date, insurers have little experience in intermediating products to individuals and cost margins have not yet been tested against the more cost-sensitive retail business.

Young industry at early stages of development with limited skills, capacity and incentive to push market extension. With fewer than an estimated 0.3m individual formal insurance clients, the insurance sector is small and underdeveloped with many small insurers displaying high levels of inefficiency. Few, if any, insurers have implemented electronic management information systems (MIS) and most still operate using paper-based systems. Although there has been strong growth in the private sector since liberalisation in the 1990s, the state-owned insurance company, Ethiopian Insurance Corporation (EIC), still remains the dominant player. The sector is also characterised by low and potentially overstated solvency levels due to, amongst other reasons, limited risk assessment and management capacity, limited and illiquid investment options and the pervasive practice of selling insurance on credit (with uncollected premiums eventually resulting in bad debt). Furthermore, the sector displays a heavy dependence on the banking sector for both referral credit insurance business and returns on investment from shares held in banks. The limited availability of technical skills for product development and management (e.g. actuaries) also restrict the development of new products. This is further exacerbated by limited availability of data (e.g. mortality data, weather data), making product design difficult.

Indication of demand for insurance in the low-income market

Illness, death and drought are the biggest risks for Ethiopian households. While focus group discussions allowed for the exploration of a variety risks to which Ethiopians are subject in their everyday lives, three top risks (depending on the livelihood of participants) emerged. Crop and livestock failure due to drought emerged as the top livelihood risk facing most households, while unforeseen expenditure and death related to illness was the most commonly cited risk by focus group participants. Death in the family also imposes a huge burden on households. Burial expenses can account for up to 25% of the average low-income household's yearly consumption expenses.

A wide variety of coping strategies are used, including community-based mechanisms. Focus group research revealed that households tend to rely on community-based mechanisms such as iddir (funeral societies that help cover death-related expenses), iquub (rotating savings schemes) and cooperatives (as a source of credit) to cope with unexpected expenses. The focus group further found that iddir and iquub are ranked as the most popular risk management strategies for urban Ethiopians, with iquub being mentioned as the top risk management strategy for coffee farmers.

Familiarity with informal insurance mechanisms means that insurance is not a foreign concept. Due to households' familiarity with iddir that tend to operate on insurance-like principles, focus group participants quickly understood the concept of insurance and did not have a problem with the possibility that their premium will not be returned if no claim occurs. One agro-pastoralist explained:

> *"We don't care if the premium is not refunded. We aren't allowed to withdraw what we have contributed for iddir if death does not occur. A person may contribute to iddir the whole of his life and not get anything if he wants to change his residence to other areas."*

The potential market for microinsurance

What, then, is the potential for the development of the microinsurance market in Ethiopia?

Short-term opportunities (next 5 years):

- *Serving the formally employed*: The formally employed market in Ethiopia constitutes 2.4m individuals, or about 5% of adults[2]. While all of these individuals may not have sufficiently large incomes to be able to afford a typical life insurance policy, most will have regular incomes, while a sizable proportion is likely to be wealthier than the average Ethiopian. 40% (about 1m) of these individuals are employed by the Ethiopian government or parastatal organisations.
- *Cross-selling insurance to those currently banked*: Based on information of the Central Bank of Ethiopia and our own estimates, it is likely that up to 2.9m Ethiopians (about 6% of adults) have some type of bank account. This implies that there is a relatively easy premium collection mechanism or point of client contact in place. The fact that these individuals have bank accounts also signals a potentially good level of financial understanding which would make the insurance sales process easier.
- *Formalising the informal insurance market*: As discussed above, it is likely that up to 2.1m (nearly 5% of adults) people have some form of informal insurance cover through their MFI or SACCO. If insurance companies were to work together with these financial institutions, it would mean that potentially another 2.1m people could be formally insured.

The available data does not allow for the consideration of overlap between these groups. However, if a conservative approach is used, it is likely that in the short-term up to 3m people could be added to the currently insured market.

Medium-term opportunities:

- *Cross-selling insurance to iddir members*: The focus group research highlights that some iddir members are interested in supplementing or, in some cases, even replacing their iddir membership with a formal insurance products. While we do not have nationally representative data on iddir membership in Ethiopia, it is clear that the majority of Ethiopians belong to iddir.

The potential for the development of the microinsurance market can also be considered by category of insurance:

Life insurance: The above discussion on estimates of market development opportunities indicates that up to 3m Ethiopians are within immediate reach of the insurance sector. If all these opportunities were to be successfully pursued over the short-term , it would mean that the number of individuals served could grow up to 1,000%, i.e. the insurance sector could grow up to ten-fold. Given that life and credit life insurance are relatively simple products to develop and imply lower levels of risk than some other products, this would be a good starting point to expand the sector. All of the 3m individuals that are currently within the relatively easy reach of the insurance sector could be considered the potential target market for small life insurance products. However, it is important to bear in mind that this estimate does not include the full group of individuals that currently belong to iddir. While it is unlikely that insurance will be able to fully replace iddir membership due to its importance social function, it is possible that some members will choose to supplement their iddir

[2] According to the Ethiopian Labour Force Survey of 2005. The survey used a total population estimate of 63.2m individuals. However, here we use a total population estimate of 83m Ethiopians (2008) and 45m adults (CIA World Factbook, 2008), to calculate an estimate of percentage of adults.

membership with life insurance and some may even give up their iddir membership if an appropriate life insurance product was available.

Credit life insurance: Simply formalising the current informal insurance market is likely to add at least up to 2.1 m individuals to the currently insured. This includes the clients of MFIs and SACCOs.

Agricultural insurance: On the client side, the success of agricultural insurance (cattle and crop) is dependent on there being a group of farmers with sufficiently large land and/or cattle holdings to yield surplus income for the purchase of these products and to make insuring the sources of their agricultural livelihood worthwhile. Ethiopia has a very fragmented agricultural landscape, with many farmers having only a very small landholding or few cattle. Only 17% (2.3m) of all households with land holdings in Ethiopia (13.3m) have land holdings of a size of more than 2 hectares[3]. Of this group, the majority (2m) have land holdings of 2-5 hectares, with only 0.2m having landholdings in excess of 5 hectares. In terms of cattle holdings, only 6% of all cattle holdings have 10 or more heads of cattle, equating to about 0.8m cattle holdings out of a total of 13.1m. Of this group, only about 0.13m have holdings of 20 cattle or more.

We therefore estimate the potential market for crop insurance to be no larger than 2.3m potential policyholders, while the market for crop insurance is unlikely to exceed 0.8m farmers.

Health insurance: A successful health insurance market is not only dependent on the income of potential insurance clients, but also on the availability (and proximity) of health infrastructure necessary for the servicing of clients. Health infrastructure in Ethiopia is limited, with services mainly provided by government (but not with sufficient reach) and some limited private sector presence. This implies that long-term investment in the development of health infrastructure and facilities would be a prerequisite for the development of a vibrant health microinsurance market. At this stage, it would also be difficult for Ethiopian insurers to successfully develop and sell health microinsurance products on a commercially viable basis, given their limited capacity in even more basic types of insurance. Despite the strongly articulated need for health insurance, we do not foresee immediate opportunity in the area of health microinsurance.

[3] In order to derive orders of magnitude that provide an indication of the market potential for agricultural insurance, we use rules of thumb on the scale of land- and cattle holding required to make these insurance products viable. While the actual numbers used for the rules of thumb may be considered arbitrary and therefore debatable, we are of the opinion that land and cattle holdings below these thresholds would be unlikely to provide sufficient surplus income to allow their owners to sacrifice consumption for the purchase of insurance. The rules of thumbs used here is a minimum landholding size of 2 hectares and a minimum cattle holding size of 10 heads of cattle. Below these thresholds, we do not believe cattle and crop insurance to be commercially viable.

1. Introduction

Ethiopia is characterized by extreme levels of poverty and vulnerability, exacerbated by the fragmented and under-developed state of agriculture, the primary source of livelihood for most Ethiopians. Of the total population of 79m in 2005, 23% (18.2m) of Ethiopians lived on less than US$1 per day (PPP adjusted), while 78% (61.4m) lived on less than US$2 per day (United Nations Development Programme, Human Development Indicators, 2008). About 44% (35m) of the population lives below the nationally defined poverty line (United Nations Development Programme, Human Development Indicators, 2008). Given its low income levels, Ethiopia qualified for debt relief from the Highly Indebted Poor Countries (HIPC) initiative in November 2001 and in December the IMF voted to forgive Ethiopia's debt to the body in 2005 (IMF, 2005). Similar to the economy as a whole, the financial sector is also underdeveloped and, in many ways, still young given that it only recently emerged from a communist period.

Defining microinsurance. Microinsurance may support poverty alleviation by protecting the assets, income and productivity of low-income households. This study considers the potential role, opportunities and challenges for developing a microinsurance market in Ethiopia. Microinsurance is defined by the International Association of Insurance Supervisors as insurance that is "accessed by [or accessible to] the low-income population, potentially provided by a variety of different providers and managed in accordance with generally accepted insurance practices". Microinsurance could play a role in protecting the assets and incomes of low-income households where they are exposed to insurable risks. This prevents them from falling further into poverty as a result of having to take children out of school to work, utilise savings, sell hard-earned assets, and obtain credit or other expensive means of post event risk management available to them. This does not, however, imply that microinsurance (and particularly formal microinsurance) is the appropriate risk-management tool for all low-income individuals. Some may never be able to afford microinsurance, while others may opt for other risk management mechanisms at their disposal. For those at very low levels of income, microinsurance may not be able to fully replace the need for government-funded social protection[4].

This study forms part of a larger project funded by the United Nations Capital Development Fund (UNCDF) and managed by the International Labour Organisation (ILO) to promote microinsurance development in several African countries. The goal of this particular project is to map the microinsurance landscape (this includes supply, demand and regulatory dimensions) in Ethiopia and to facilitate a process for the development of an inclusive insurance (and microinsurance) market in Ethiopia.

Methodology. Various sources of information were used in compiling this study. This includes a review of available secondary data and literature, interviews with key stakeholders in the insurance and financial sectors and government during ten days spent in Addis Ababa, a review of available insurance-relevant regulation and a number of focus group discussions conducted with the aim of understanding Ethiopians' risk management strategies and perceptions of insurance.

Microinsurance context. While microinsurance products are targeted at a specific lower-income population, it should not be completely separated from the conventional insurance market or the

[4] However, microinsurance can be a useful tool in the provision of social protection in cases where governments are unable to do this themselves or, even in cases where governments are able to afford the provision of basic social protection, microinsurance vehicles can allow for the more efficient provision of these benefits than if these services were to be directly provided by governments (Jacquier, Ramm, Marcadent & Schmitt-Diabate, 2006).

larger financial sector context. There is a need for an integrated approach to microinsurance development on several levels:

- *Risk management*. While microinsurance is a product designed for the lower income market, it is still an insurance product that presents particular risks. These risks still need to be managed, but given that it is lower risk than for traditional business a different level of regulation may apply. If an integrated approach to microinsurance and traditional insurance is not taken, there exists the risk of a gap between these two markets with a middle-segment remaining excluded.
- *Level playing field and consistent regulation*. Another reason to avoid separating the microinsurance and conventional insurance markets is to ensure level playing fields and a coherent regulatory framework that allow a variety of players to operate in this space and regulated according to risk.
- *Variety of players*. By considering the larger financial sector context, traditional insurers, MFIs, cooperatives as well as new alternative providers may be allowed to play in this space. An integrated approach will avoid ghetto-ising microinsurance.

This study maps the *supply and regulatory contexts* for microinsurance in Ethiopia by focusing on the existing insurance industry, its regulation, the larger financial sector context and other market characteristics that impact on development such as available infrastructure. While reading the study, it is important to keep in mind that the potential for microinsurance is not only determined by supply and the regulation that governs supply, but also demand for microinsurance.

The remainder of this document is structured as follows:

- **Section 2** provides an overview of the general Ethiopia country context – the salient features that determine the potential for, but also the nature of required microinsurance products.
- **Section 3** provides an overview of the key features of the non-insurance financial sector: commercial banks, microfinance institutions and cooperatives.
- **Section 4** sets out the insurance regulatory framework and its key implications for the development of a microinsurance market.
- The insurance market in Ethiopia is reviewed in **Section 5**. This review includes consideration of the players and features of the formal underwriting market, products offered and their distribution.
- **Section 6** provides an overview of the informal insurance or risk management market in Ethiopia.
- In **Section 7**, the demand side for microinsurance is discussed by providing evidence on Ethiopian households' main financial risks, their coping mechanisms and attitudes towards insurance as a risk mitigation mechanism.
- **Section 8** addresses the question of the potential target market for microinsurance in Ethiopia and provides suggestions on market opportunities.
- Lastly, **Section 9** concludes by providing a summary of the opportunities and challenges for microinsurance in Ethiopia.

2. Country features

Indicator	Source	Data
Total population (millions)	AfDB & OECD 2008	83
Population living below nationally defined poverty line	CIA World Factbook, FY2005/06 est.	39%
Population living below US$2 per day	UNDP, Human Development Indicators, 2008	76%
Population living below US$1 per day	UNDP, Human Development Indicators, 2008	23%
Gross Domestic Product (GDP) - Billions	World Bank (2008a), IMF (2008b)	US$19
Urban population	Population Reference Bureau (2008)	16%
Life expectancy at birth, total years	World Bank Development Indicators, 2007	52
Primary school completion rate, total (% of relevant age group)	World Bank Development Indicators, 2007	46%
Agriculture as % of GDP	World Bank Development Indicators, 2007	46%
Agriculture as source of livelihood/employment	CIA World Factbook, 2008	80%
Agriculture as % of total exports	CIA World Factbook, 2008	60%
Connectivity: combined fixed and mobile-cellular teledensity (per 100 persons)	CIA World Factbook, 2008	2

Table 1: Key development indicators for Ethiopia
Source: Various sources (see table)

Recent emergence from communism and significance of government involvement in economy. The recent political history of Ethiopia is characterized by three main phases:

- **The imperial regime**, characterised in the latter part by the rule of emperor Haile Selassie, which ended in 1974 with a military rebellion;
- **the military (communist) regime** from 1974-1991 (under the command of Lieutenant Colonel Mengistu Haile Mariam) which changed the market-based economy to a communist system; and
- **the return of a market economy** when the military regime was overthrown by the Ethiopian People's Revolutionary Democratic Front (EPRDF) in 1991. The process of liberalisation is still on-going. Certain markets (e.g. commodity markets) were liberalised in the 1990s, but the financial sector remains closed to foreign participation (see below).

The above implies that all existing private financial institutions and the main supporting financial sector regulation were only established after 1991 with many of the private insurers only established after 2000. These institutions are thus still grappling with issues such as ensuring financial stability while managing the demands of a growing economy for credit and provision of other services. Furthermore, the communist era has left a legacy of significant government involvement in various markets of the general economy (see the discussion on the role of Ethiopian government in agricultural value chains below).

High levels of poverty, both in terms of total GDP and other income measures (see Table 1*)*. In 2007, Ethiopia generated gross domestic product (GDP) to the order of US$19 billion (at the official exchange rate) (World Bank, 2008a; IMF, 2008b)[5]. Adjusted for purchasing power, this increases to about $62bn (World Bank, 2008b; IMF, 2008b)[6]. This equated to about US$230 GDP per capita in nominal terms, or about $800 per capita PPP adjusted (World Bank, 2008b; IMF, 2008b)[7]. This ranked Ethiopia 157th (out of 178 countries) (World Bank estimates) or 168th out of 179 countries (IMF estimates) in 2007, making Ethiopia one of the poorest countries in the world. 23% of Ethiopians live on less than US$1 per day (PPP adjusted), while 76% live on less than US$2 per day (United Nations Development Programme, Human Development Indicators, 2008). About 44% of the population lives below the nationally defined poverty line (United Nations Development Programme, Human Development Indicators, 2008). Given its low income levels, Ethiopia qualified for debt relief from the Highly Indebted Poor Countries (HIPC) initiative in November 2001 and in December the IMF voted to forgive Ethiopia's debt to the body in 2005 (IMF, 2005a).

The country has experienced strong economic growth in recent years. Since 2004, real GDP growth has remained above a minimum of 4%, with Ethiopia experience real growth in GDP of 8.2% in 2006/07 (AfDB & OECD, 2008). The experienced growth benefited all economic sectors, with industry, agriculture and services expanding. It was projected that growth in real GDP would be 7.5% in 2008 (AfdB & OECD, 2008). Given the high levels of economic growth, a strong demand for credit to fund expansion in various economic sectors has emerged (see below).

Ethiopia has a large and young population. The total estimated population for 2008 is 83m individuals (AfDB & OECD, 2008). Of this total, 46% of individuals are younger than 15 years (CIA World Factbook, 2008). Although the large population size implies a large potential market for microinsurance, this is constrained by the very low income levels in the country (see above).

The majority of the population resides in rural areas. Only 16% of the total population live in urban areas, with the remaining 84% residing in rural areas (Population Reference Bureau, 2008). This, together with poor road infrastructure and limited telecommunications infrastructure (see below), implies that the majority of the population is not within easy reach of financial institutions (itself with limited distribution network in rural areas).

A very small proportion of the adult population is formally employed. According to Figure 1 (below), only 2.4m Ethiopians, 7.9% of the labour force or 5.8% of working age Ethiopians, were formally employed in 2005 (LFS, 2005). Of this group, the largest category was employed by government or parastatal organisations (almost 1m Ethiopians). By implication, about 92% (29m) of the 32.2m labour force were informally employed. Of this group, the majority (55% or 15.8m) are unpaid family workers.

[5] World Bank estimate: $19.395bn; IMF estimate: $19.431bn
[6] World Bank estimate:$61.629bn; IMF estimate: $62.193bn .
[7] World Bank estimate (from World Development Indicators database): $779.; IMF estimate (from World Economic Outlook Database): $806.553

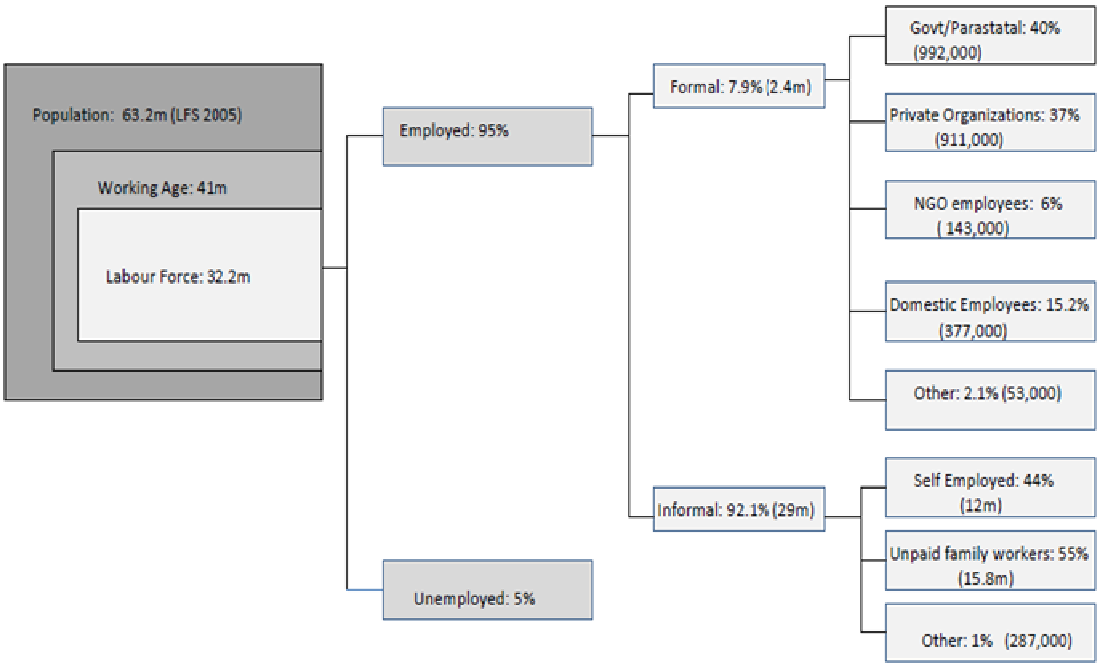


Figure 1: The structure of employment in Ethiopia*

Source: Ethiopian Labour Force Survey, 2005

Working age definition: The LFS (2005) defines this as the total number of Ethiopians aged 10 years and above.

Labour force definition: The LFS (2005) defines this as the part of the population aged 10 years and above that is engaged or available to be engaged in the production of goods and services during a given reference period.

Total population estimate: It is important to note that the total population estimate used by the LFS is much smaller than that estimated by other information sources. The World Bank population estimate for 2006 was 77.2m, while CIA Factbook estimates the total 2008 population as 82.5m.

Although currently limited, the telecommunications network is expanding. Ethiopia currently has about only 1m landlines (CIA World Factbook, 2008) and around 2m cell phone users (Ethiopia Telecommunications Department, 2008), of which less than 60,000 are contract subscribers. The majority of cell phone users are thus pre-paid customers. While the cell phone network can only accommodate 2m users (the current number of estimated users), it is in the process of being expanded to accommodate up to 10m users. The expansion process is part of a three year programme being undertaken by the Ethiopian Telecommunications Department (the only cell phone network provider) and a Chinese partner. It is envisaged that at the end of this expansion process, geographic network coverage will have increased to 85% of the country (Ethiopia Telecommunications Department, 2008).

Cooperatives and MFIs play an important role in both agricultural and financial sector. Given the fragmented and widely distributed nature of the population and specifically also the agricultural sector, client networks and aggregators will play a critical role as distributors of potential financial services. Cooperatives and MFIs provide some of the largest networks available in Ethiopia.

Government of Ethiopia plays a key role in agricultural value chains. Agricultural value chains are important not only for the provision of services and inputs to different players in the agricultural industry, but also for their potential to act as distribution channels for other products and services,

e.g. microinsurance. The significant role of government in the economy is also reflected in the agricultural sector where the government is a dominant player. For example, in 2004 70% of maize seed was produced by the Ethiopian Seed Corporation (ESE), a government-owned parastatal body, while for other crops ESE is the only formal producer of seeds (Byerlee, Spielman, Alemu & Gautam, 2007). Similarly, the Ethiopian government also forms the dominant player in the import, wholesale and retail markets for fertilizer (Byerlee, Spielman, Alemu & Gautam, 2007).

Absence of a stock exchange. Ethiopia had a well-functioning stock market during the Imperial regime, but this market stopped operating during the Derg period and there is currently no formal stock market. Shares are traded on an over-the-counter basis. The fact that shares have to be traded on a one-on-one basis imposes large transaction costs and this, together with few investment opportunities, makes it difficult for companies to easily invest their funds. Furthermore, the absence of a stock exchange that assists in facilitating transparent and rigorous valuation of shares implies that current investments in companies may be overvalued.

Closed nature of the financial sector, together with high levels of financial sector growth, may lead to capital constraints. Given high economic growth levels, the Ethiopian economy is characterized by a high demand for credit for various infrastructure and other development projects and traditional private purposes. However, since no foreign ownership of formal financial institutions is currently allowed, the demand for credit can only be addressed using domestic resources. The limited level of domestic financial resource mobilisation (limited by the constrained ability of banks to mobilise deposits, as well as the absence of a stock market) implies strong competition for available domestic investments (particularly between financial sector players, including banks and insurance companies). In the current situation, a limited amount of further credit extension can be achieved before banks have to face the challenge of extending their deposit base. Given much higher returns achieved in the banking sector, the insurance sector is struggling to attract and retain capital (see Section 5.1).

Very low levels of financial services usage. Based on estimates of the financial products used in Ethiopia, it is unlikely that more than 5m adults (about 11% of adults[8]) in Ethiopia use any form of financial product. This figure is based on the existence of 2.9m bank accounts in June 2007, with microfinance institutions (MFIs) serving about 1.7m individuals (2006) and cooperatives serving 0.38m individuals and assumes that there is limited overlap between these groups[9]. Estimates by industry players indicate that there are probably no more than 0.3m individuals that use any kind of formal insurance products. There is likely to be a significant level of overlap between individuals that have a bank account and own an insurance product.

Technology that would allow transfer of value via airtime not currently in place. While some banks are using short message services (sms) to communicate information such as bank balances with their clients, the technology that would allow the transfer of value from one cell phone to another is not yet in place (Ethiopia Telecommunications Department, 2008). This implies that it would not yet be possible to develop an insurance product that collects premiums via the transfer of airtime.

[8] There are about 45m adults (individuals aged 15 years and older) in Ethiopia.

[9] Given the possibility that bank account holders may have multiple bank accounts and that the same individuals may hold accounts with banks and MFIs, our estimate of usage of formal financial services in Ethiopia should be viewed as an optimistic upper bound.

3. Country context

3.1. Financial sector (non-insurance)

3.1.1. Banking sector

Structure and size of banking sector. Ethiopia has 11 banks, of which three are government-owned (two of these are commercial banks[10]) and eight are privately owned commercial banks[11]. The eight privately owned banks include Cooperative Bank of Oromia[12].

At the end of the second quarter of the 2007/08 reporting year (ending June 2008), the total capital of the banking sector was approximately Birr 9.8 billion (about US$[13] 1 billion, approximately 1.5% of GDP[14]). Of the total capital amount, 31.6% is owned by private banks (National Bank of Ethiopia, 2007). Although this seems low, it has to be kept in mind that private bank assets grew from 0% in 1994, the year when the first private bank[15] was established (after the end of the communist era) in the Ethiopian banking sector.

Bank branches growing but still concentrated in urban centres. Eighteen new bank branches were opened during the second quarter of the 2007/08 reporting year. This increased the total number of bank branches in Ethiopia to 522, with a reported population to bank branch ratio of 147,753 (National Bank of Ethiopia, 2007). There is thus less than one bank branch per 100,000 of the Ethiopian population[16]. Of the total number of branches, 38% of branches are located in Addis Ababa. The share of private banks in total branches is 51% (National Bank of Ethiopia, 2007).

Bank account usage low and limited to higher-income individuals. At the end of March 2007, the National Bank of Ethiopia reported a total of 13.5 billion Birr (US$1.4 billion) of deposits and 2.9m bank accounts in the smallest range reportable (deposits less than 100,000 Birr or US$11,200)[17]. The average deposit size of these accounts was US$4,572 (Wiedmaier-Pfister et. al., 2008). Although this average amount seems very high, the minimum opening balance of the Commercial Bank of Ethiopia is only 50 Birr (about US$6) and there is some anecdotal evidence of lower-income individuals using bank accounts and Wiedmaier-Pfister (2008: 18) concludes that this "leaves room for speculation about the true number of poor people with bank deposits". Given a total account figure of 2.9m and the possibility of overlap between these accounts (i.e. an individual having more than one account), it would imply that fewer than 2.9m individuals in Ethiopia have bank accounts.

[10] These three banks include the Development Bank of Ethiopia (DBE) and the two state-owned commercial banks, the Commercial Bank of Ethiopia and the Construction and Business Bank (CBE).
[11] These banks are Awash International Bank, Dashen Bank, Abyssinia Bank, Wegagen Bank, United Bank, Nib International Bank, Cooperative Bank of Oromia and Lion International Bank.
[12] This bank was registered as a commercial bank in 2004. The original intention with the bank was for it to serve as a bank for cooperatives, owned by cooperatives. However, Wiedmaier-Pfister, et al. (2008: 3) argues that "the profile of the shareholders – which are all individuals - does not reflect the original idea of setting up a cooperative bank where, for example, primary cooperatives are owners". Due to the absence of regulatory framework for cooperative banks, the bank had to adopt the institutional form of a share company.
[13] The conversion from Ethiopian Birr to US Dollars was made using the 6-month Birr/USD exchange rate of Birr 9.97/USD as obtained from Oanda.com on 8 January 2009.
[14] At the World Bank's 2007 PPP-adjusted GDP for Ethiopia
[15] Awash Bank
[16] This is a low average compared to the average for sub-Saharan Africa (2.6 branches per 100,000) and is even low when compared with the average of low-income countries in Africa (1.2 branches per 100,000). The average branch-to-population ratio for middle-income countries in Africa (excluding South Africa) was 5.6 per 100,000 in 2005 (IMF, 2005).
[17] The size of these bank accounts most likely implies that they are retail bank accounts. If corporate bank accounts were to be included, the number of total bank accounts in Ethiopia would therefore be larger than 2.9m.

High demand for credit to finance infrastructure and other business projects, credit extension mainly limited to business and wealthy individuals. The outstanding loan volume in Ethiopia doubled between 2003 and 2006 from 15-16 Birr to 26.8 billion Birr (about 14% of GDP in 2007). The share of public banks in total outstanding loans also decreased from 95% in 1998 to 59% in 2006. Furthermore, of all new credit extended in the second quarter of FY 2007/08, about 63% was extended by private banks. This implies that the growth in credit extension in Ethiopia is currently being driven by private banks.

Credit extension mainly limited to business and wealthy individuals. There were approximately 61,400 loans outstanding in March 2007 (Wiedmaier-Pfister, 2008) at an average of about US$43,000[18] per loan. These loans were extended to "larger companies, relatively wealthy individuals and especially the GoE; the largest segment of the population, the poor is excluded from access to finance" (Wiedmaier-Pfister et.al. 2008: 18). It is reported that banks do not consider loan sizes of less than Birr 100,000 (about US$10,000) as profitable emphasizing the fact that they are only serving the wealthy and corporate clients (Amha, 2008). It is important to note that banks in Ethiopia do not offer home loans or vehicle finance (or to a very limited degree). This is one reason why some cooperatives have recently started to offer housing loans to their members.

Credit expansion incentivises deposit mobilisation. The loan-to-deposit ratio for the banking industry as a whole is relatively low but varies significantly between private sector and government banks. While the loan-to-deposit ratio for state banks tends to be quite low, the same ratio for private banks, in some instances, is as high as 90%. At the end of 2007 it was report that Nib Bank had a loan-to-deposit ratio of 93.5%, higher than the 75% target set by the National Bank of Ethiopia in 2004 (Meseret, 2007). Given the rapid expansion of credit and the limited experience of banks in the credit market, this may raise some concern over the quality of the loan portfolio. This exacerbated by the absence of a credit bureau to share credit profiles within the banking industry. The IMF Article IV Consultation of 2008 concluded that "financial sector soundness indicators are not signalling problems, but because this is probably the high point of the economic cycle, continued close scrutiny by supervisors will be important" (IMF, 2008: 17). In order to address the issue of liquidity, many private banks are actively trying to expand their deposit base, mainly by building more bank branches and by trying to expand into rural areas.

Limited payment infrastructure. Ethiopia does not currently have an electronic payment system and this is one of the focus areas of the World Bank's Financial Sector Capacity Program. The program intends to develop the payment system in three phases from its current paper-based form (World Bank, 2006):

- Phase 1 will entail the development of payment system framework;
- while Phase 2 will be focused on creating a new paper-based payment system; and
- Phase 3 will entail the establishment an electronic large-value payment system.

The above implies that there are currently no electronic debit orders in Ethiopia. Payments can thus not be collected automatically and all amounts owed must either be paid in cash or in cheque. This has large transaction cost implications not only for purely banking transactions, but also for transactions on non-banking financial products, e.g. insurance products.

Banks realizing large returns on investments for shareholders and the most popular investment in Ethiopia. Private commercial banks in Ethiopia are currently realising returns on equity (ROE) in the

[18] This amount was calculated using the total loan book value.

order of 30-40%, with some banks even realising returns in excess of 40%, and therefore a very popular investment. This implies that the returns of other financial institutions such as insurance companies are often compared to those of banks and these organizations are under pressure to realise similar returns in order to attract investment.

3.1.2. Microfinance sector

Comparatively large, concentrated MFI sector: There is currently a total of 29 microfinance institutions (MFIs) in Ethiopia, of which two[19] were newly established in 2007 (National Bank of Ethiopia, 2007). The microfinance industry is highly concentrated, with four MFIs accounting for 82% of capital, 86% of saving, 84% of credit and 84% of total assets of the microfinance industry in Ethiopia at the end of December 2007 (National Bank of Ethiopia, 2007).

At the end of December 2007, capital held by the microfinance industry totalled almost 1.2 billion Birr (about US$120m or about 0.2% of GDP), savings totalled just more than 1.2 billion Birr (US$0.2 or about 0.2% of GDP), while total credit extended was equal to 3.2 billion Birr (US$0.32 billion or about 0.5% of GDP) and total assets to 4.3 billion Birr (US$0.43 million or about 0.7% of GDP).

Rural based client base, focused on the active (or working) poor. By the end of June 2007, MFIs in Ethiopia had a total of 1.73m active clients (Amha, 2008). Relative to the banking sector this presents a significant client base. According to Amha (2008), the average loan sizes of MFIs reveal that they target their products on the "active" or working poor, while a survey by AMEFI during 2001 found that the majority of MFI clients are "rural poor"[20] (Amha, 2008). According to the National Bank of Ethiopia (2007), only 12 of the total 29 MFI are located in Addis Ababa.

Product mainly limited to compulsory savings and group lending. While MFIs tend to provide two types of savings products, compulsory and voluntary, savings are mostly limited to the compulsory savings as this is required in order to access to a loan from the MFI. Compulsory savings are generally required to be in the order of 5-10% of the total loan amount. MFIs provide an interest rate of 3-6% on voluntary savings (Wiedmaier-Pfister, 2007 quoting Amha, 2007), while the lending interest rate of MFIs in Ethiopia varies between 9% per year (calculated as a declining rate) or a 24% flat rate (Amha, 2008). While the Bank of Ethiopia did away with all interest rate ceilings in 1998, "most MFIs still maintain a low rate of interest for various reasons, including political pressure, cheap funding from public or other sources and failure to allow for inflation" (Wiedmaier-Pfister et al., 2008). The different categories of loans extended include agricultural (input) loans, micro-business loans, small enterprise loans, employee loans (payroll-based), package loans (or so-called food-security loans) and housing loans (Wiedmaier-Pfister et al., 2008).

Group loans dominate, but individual loans are gaining ground. The predominant loan methodology is group loans, with all MFIs relying on this methodology. MFIs were initially compelled by regulation to use the group loan methodology but this requirement was recently relaxed. Some MFIs have, therefore, started to offer individual loans, but this is mainly still limited to micro and small enterprise loans (Wiedmaier-Pfister et al., 2008). The early experience with individual loans suggests that MFI clients may prefer those over group loans.

[19] Lefayeda and Saving Institution and Tesfa Micro-finance Institution

[20] It is not clear how poverty was defined for the purpose of the survey and whether the nature of MFI clientele changed in the period between 2001 and 2008.

MFIs starting to implement electronic management information systems (MIS). It is reported that some MFIs currently are in the process of either implementing electronic management information systems (MIS) or are considering the implementation of these systems. Many banks and insurers are still using paper-based systems and have only recently started to move to more advanced MIS systems. The result is that some MFIs have more advanced management systems than banks or insurers. The ability that such a system provides in terms of client and risk management will provide significant benefits to the MFI as well as any bank or insurers that may partner with them.

Largest MFIs owned by government. MFIs in Ethiopia receive various kinds of support from regional and national government. The governments of five regions[21] have major shareholdings in some of the largest MFIs of Ethiopia[22] (Bekele and Amha, 2001 as quoted in Wiedmaier-Pfister, 2008). According to Bekele and Amha (2001, as cited in Wiedmaier-Pfister, 2008) "government-backed MFIs in Ethiopia receive significant assistance and cooperation from the regional and local government administrations. This assistance comes in the form of capital injections, guarantees, funding lines and personal assistance from extension or other government workers."

3.1.3. Cooperative sector

Cooperatives are defined by the International Co-operative Alliance (ICA) as "autonomous association[s] of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise" (ICA, 2008). They are thus member-based organizations that seek to meet the common benefit of their members. This common benefit may be sector-specific, e.g. agricultural and financial. Thus, for example, cooperatives can be created with the objective of pooling resources in the agricultural sector or a specific agricultural sub-sector, e.g. fisheries or dairies cooperatives. Cooperatives can also fulfil a purely financial function, e.g. providing a safe place to save money that can be pooled and used for the extension of loans.

Cooperative development linked to political history. In Ethiopia, the development of cooperatives has been strongly influenced by the country's political history. It is possible to distinguish between the following three phases of cooperative development (Gessese, 2007; Byerlee, Spielman, Alemu & Gautam, 2007):

- **Imperial phase (pre-1974):** This phase was characterized by the promotion of cooperatives (by both government and employer bodies) in line with the spirit of cooperatives, i.e. genuine participation by members for the mutual benefit of all members. Insurance cooperatives were also established and were regulated by the Cooperative Societies' Proclamation No. 241/1966. This proclamation provided the basis for the formation of cooperatives, but failed to create an appropriate home for financial cooperatives (savings and credit and insurance cooperatives). However, this approach, with an initial focus on the development and regulation of agricultural cooperatives, is not different from the cooperative development path followed in other countries. By the end of 1973, there were 100 cooperatives in Ethiopia.
- **Military regime phase (1974-1991):** The fall of the imperial regime and introduction of a new military regime ushered in an era where cooperatives were subject to political intervention and used as a state instrument of development. A new piece of legislation, Proclamation No. 71/1975 replaced the previous proclamation and focused on the "formation of peasant

[21] Amhara, Tigray, Oromia, Awassa and Addis City Administration

[22] These MFIs include Addis MFI and OMO MFI (with regional governments having shareholdings in excess of 80% in these two MFIs) and ACSI, DECSI and Oromia MFI (regional governments hold 25% of total shares in these MFIs) (Bekele & Amha, as cited in Wiedmaier-Pfister et.al., 2008).

associations in which the objectives, powers and duties of agricultural producers and service cooperatives were stipulated" (Kassa et al., 2007). As a result of the military government's strong focus on creating cooperatives throughout the country, there were 3,723 producer and 4,052 services cooperatives with 10m members in the early 1990 (Byerlee, et al., 2007). However, despite the large number of cooperates, "genuine participation of members" was absent since the artificial approach to the development of cooperatives (used by the military government) tended to ignore the real needs of the members and was simply used as an instrument for political control (Gessese, 2007),

- **Current government phase (since mid-1991):** Following the return to a market-based economy, the development and formation of cooperatives once again seems to be driven by genuine cooperative principles with limited government intervention. However, it is important to mention that while cooperatives are no longer used as official channels of government control government involvement still remains significant through programmes such as the Rural Financial Intermediation Program (RUFIP)[23] drawing into question the true independence of these entities. According to Amha (2008:10) some local governments are also "pushing to implement the food security package loan through multi-purpose cooperatives".

Significant membership. Although the main focus of this section is savings and credit cooperatives, it is important to place their number and membership size within a broader cooperative context. In 2006 there were a total of 20,406 registered primary cooperatives with a total membership of 4.6m in Ethiopia. The largest categories of cooperatives were multi-purpose cooperatives (5,104 cooperatives or 25% of cooperatives), savings and credit cooperatives (5,437 cooperatives or 27% of cooperatives) and housing cooperatives (5,896 cooperatives or 29% of cooperatives) (Kassa, et al., 2007). Multi-purpose cooperatives account for 80% (3.7m) of the total cooperatives membership size (Kassa, et al., 2007). Apart from these categories of cooperatives, there are 18 other categories, mainly focused on specific agricultural sub-sectors, e.g. dairy cooperatives, gum cooperatives, beehives product cooperatives and grain and forestry seeds cooperatives.

In 2006 SACCOs had an official membership size of 0.38m, with total contributions and savings of about 995m Birr (about US$100m), equating to an average contribution to savings of Birr 2,610 per member (Gessese, 2007 using data from the Federal Cooperative Agency). However, industry insiders estimate that the membership base of SACCOs may actually be much larger than the official figures. Estimates suggest that there could be as many as 1,000 active SACCOs in Addis Ababa alone with a membership base of as much as 800,000.

Mainly urban-based and focused on payroll lending. Although SACCOs can be found in both the urban and rural areas of Ethiopia, urban-based SACCOs dominate. Rural SACCOs are a new phenomenon that only emerged after 2003 with the Rural Financial Intermediation Programme (RUFIP) (Wiedmaier-Pfister et. al., 2008). Their growth and presence can thus be viewed as the result of government and donor involvement in the development of SACCOs. Mid-2006 there was 1,166 rural SACCOs, accounting in number (but not in membership) for 21.5% of all SACCOs. However, in terms of membership, about 92% of SACCO members are urban wage earners (World Bank, 2006). Furthermore, of the total number of SACCOs, about 53% of SACCOs are situated in the City Administration of Addis Ababa. These SACCOs and other urban SACCOs are mainly work-based cooperatives using the methodology of payroll lending for loan repayment collection. The fact that

[23] The Rural Financial Intermediation Programme is described as a programme "funded by the International Fund for Agricultural Development (IFAD) and the African Development Bank (AfDB), supported by the Ethiopian government and implemented by the Development Bank of Ethiopia (DBE)" (Wiedmaier-Pfister et. al., 2008: 40). It provides funding and capacity building to MFIs and rural SACCOs (RUSACCOs), but only MFIs have received funding since none of the rural SACCOs have been able to meet the minimum funding eligibility criteria.

the majority of urban SACCO members (and therefore also the majority of SACCO members) are employed allows for the practice of uncollateralized lending (a type of lending not offered by commercial banks in Ethiopia). Some estimates suggest that up to 70% of government employees (employed individuals receiving regular wages) may be members of savings and credit cooperatives.

Financial products offered. SACCOs require members to first build up a minimum compulsory amount of savings before being able to access any credit amount, generally a multiple of the level of compulsory savings. This multiple varies between SACCOs, but loan amounts may be up to twice the size of members' savings (World Bank, 2006). Some cooperatives are now starting to experiment with quite innovative loan products such as leasing products (see Box 2) and home loans.

Serve higher-income market than MFIs. Given that SACCOs are mainly urban-base and the urban-based market focuses on payroll lending for formally employed individuals, it can be argued that SACCOs tend to serve a higher-income market than MFIs. This is also supported by the higher savings balances of SACCOs relative to MFIs. The average loan size for a MFI was Birr 1,547 (US$155) and average savings was Birr 551 (US$55), respectively, in June 2007, compared to average savings of Birr 2,610 (US$262) for SACCOs in mid-2006 (Amha, 2008; Kassa et. al., 2007). Unfortunately a comparable average loan size for SACCOs was not available.

Process underway to organise cooperatives in federation structure. There is currently a process underway to organise cooperatives into a federation structure of cooperatives (primary level), cooperative unions (representing cooperatives on the secondary level) and federations (in turn, representing cooperative unions on the tertiary level). A draft cooperative policy (prepared by the Federal Cooperative Agency) indicates the intention to establish 17 federations, of which 3 will be financial cooperative federations. As the policy sets out, it is intended that 3 federations will include a savings and credit cooperative federation, an insurance cooperative federation and a cooperative banks federation (Gessese, 2007).

3.1.4. Remittance market

More than US$1 billion in remittances potentially sent to Ethiopia, the majority through informal channels. It is estimated that about 1m Ethiopians live abroad and that the majority of these individuals send money back to Ethiopia (Tensay & Hadgu, 2008). According to the World Bank, the total formal remittance inflow for Ethiopia in 2007 totalled US$172m. However, the Bank of Ethiopia's data indicates that US$632.5m was remitted through formal channels into Ethiopia during the FY2006/7 (Tensay & Hadgu, 2008). Estimates for the total remittance market (formal and informal flows) indicate that remittance inflows could total as much as US$1.1 billion per year. Given the range of formal remittance inflows, this means that the informal inflows could constitute as much as 40%-85% of total remittance flows.

Commercial banks dominate the formal remittance space and tend to be limited to urban areas. According to Tensay & Hadgu (2008), commercial banks and money transfer operators such as Western Union and Money Gram are the main formal remittance providers. Commercial banks dominate the formal remittance landscape and tend to serve mainly large users and on a limited basis, some lower-income individuals. A key constraint with commercial banks' ability to serve low-income individuals is that they are mainly limited to urban areas. There are no estimates on the number of individuals currently using formal channels to receive money remitted to Ethiopia.

Remittance flows may offer opportunities for microinsurance – both from distribution and premium payment perspective. There is little information available on the remittance market in Ethiopia. However, it seems as if most formal MTOs are limited to urban areas, with informal providers being the dominant provider category in rural areas. While formal MTOs may extend the available formal footprint for the distribution of insurance products in urban areas, tying microinsurance products to remittance flows is useful from another perspective. The regular sending of money by Ethiopian diaspora creates a steady income flow that can be used for premium payments. Also, money senders may find it desirable to be able to direct the spending of their funds towards what they view as offering value, e.g. paying for a health insurance product for their family in Ethiopia.

Box 1: Linking remittances and insurance in Ethiopia: Saint Yared Health Maintenance Plan

Global Financial Exchange Holdings LLC, a US-based Ethiopian American company, started to provide online money transfer services from the United States, United Kingdom and Canada to Ethiopia during August 2007. The company, operating as BirrituExpress.com, offers money senders the opportunity to initiate online money transfers using their debit or credit cards. The money is paid out to recipients at branches of Oromia Cooperative Bank and the Ethiopia Postal Service (Alemayehu, 2007).

The owners of the money transfers company have also established a private health clinic, Saint Yared Higher Clinic, in Addis Ababa. For a minimum amount of US$25 per month, money senders can purchase a health insurance product for family members living in Ethiopia (Alemayehu, 2007).

Depending on the benefit structure and premium of the plan, policy holders and beneficiaries are able to access in- and/or out-patient services as Saint Yared Higher Clinic as the need arises. There are three types of plans (Saint Yared Health Maintenance Plan, 2008):

- **Silver Plan:** This is the most affordable plan and costs US$300 (equivalent to a monthly fee of US$25) per individual covered per year. The plan provides covered individuals with access to basic primary care services, referral to specialty services and radiological services
- **Gold Plan:** The plan comes at an annual cost of $600 per individual covered (equivalent to a monthly fee of US$50) and, in addition to the services provided under the Silver Plan, also provides access to surgical services at the Saint Yared Higher Clinic.
- **Diamond Plan:** This is the most comprehensive and most expensive plan and requires an up-front annual payment of US$900 per individual covered (equivalent to a monthly fee of US$75 per month). In addition to the benefits provided by the Gold Plan, members of the Diamond Plan receive a 40% discount on all medication listed in the formulary of the Saint Yared Higher Clinic.

Although the marketing material of the Saint Yared Health Maintenance Plan refers to monthly fees, it is required that the full annual fee of all three health plans are paid in advance at the beginning of the year. To purchase cover for one person under the Silver Plan would thus require an up-front payment of US$300.The plans do not provide discounts for children. A 5% discount applies in cases where coverage is purchased for a family of 3 or more persons (Saint Yared Health Maintenance Plan, 2008).

3.2. Agricultural sector

In this section, we consider the functioning of the agricultural sector both as a source of income and aggregation (in terms of agricultural networks), as well as a source of potential income and asset risk to be addressed through microinsurance products. The section focuses on the general importance and nature of agriculture in Ethiopia, with more specific reviews of, in particular, the grain and livestock (cattle) markets.

Agriculture is a major source of income for Ethiopia and the majority of the population derive their income from agricultural activities. Agriculture accounts for 46.3% of GDP (World Bank, 2008a), 60% of total exports and 80% of employment (CIA World Factbook, 2008). This dependence on agriculture implies a high level of exposure to both weather risks and price risks in international agricultural markets.

Majority of rural, agricultural households engage in subsistence, rainfed agriculture and are unable to produce a surplus. The principal crops produced in Ethiopia include coffee, pulses (such as beans), oilseeds, cereals, potatoes, sugarcane, and vegetables. Ethiopia is Africa's second biggest maize producer and coffee is the country's largest foreign exchange earner (Wikipedia, 2008). Yet the majority of Ethiopian farmers do not produce any cash crops – 85% of the population rely on subsistence farming for their livelihoods (Reuters, 2008). As at 2008, only about five percent of cultivated land in Ethiopia is irrigated[24]. Furthermore, in 1996[25] about 53% of rural households were net cereal buyers, implying that they were unable to produce a sufficient amount of cereal on their landholdings to fulfil consumption needs (World Bank, 2005). Ethiopia is furthermore prone to drought, exacerbated by what the World Bank vice-president recently called "backward farming methods" (Reuters, 2008). The result is that Ethiopia receives more food aid than almost any other country in the world (Levinsohn & MacMillan, 2005).

The agricultural sector is fragmented, in terms of both the size of landholdings and cattle ownership. About 56% of total agricultural households (13.3m) have landholdings less than or equal to 1 hectare in size, while about 83% have holdings smaller or equal to 2 hectares in size, as indicated in Table 2:

Size of land (measured in ha)	Total households	% of total households	cumulative %
All	13,279,659	100.0	100.0
Under 0.10	876,928	6.6	6.6
0.10-0.50	3,323,170	25.0	31.6
0.51-1.00	3,284,912	24.7	56.4
1.01-2.00	3,513,544	26.5	82.8
2.01-5.00	2,096,126	15.8	98.6
5.01-10.00	174,396	1.3	99.9
Over 10	10,583	0.1	100.0

Table 2: Distribution of land holdings by size
Source: Central Statistical Agency of Ethiopia, 2007

The FAO (2004) states that Ethiopia has one of the largest livestock populations in Africa. However, cattle ownership tends to be very fragmented with many households each owning few cattle. 72% of agricultural households have holdings with fewer than 4 cattle, while 94% of agricultural households have 9 or fewer cattle (see Table 3). There are only 2,603 holdings in Ethiopia with more than 100 cattle.:

[24] According to Ethiopia's State Minister of Water Resources quoted in the Ethiopian News Agency (2008).
[25] Note that this is the latest information available.

Number of cattle per holding	number of holdings	% of total holdings	cumulative %
Total	13,120,767	100.00	100.00
Holdings with no cattle	2,590,914	19.75	19.75
1-2 heads	3,478,057	26.51	46.26
3-4 head	3,356,546	25.58	71.84
5-9 head	2,906,563	22.15	93.99
10-19 head	661,112	5.04	99.03
20-40 head	117,380	0.89	99.92
50-99 head	7,586	0.06	99.98
100-199 head	2,123	0.02	100.00
>=200 head	486	0.00	100.00

Table 3: Distribution of cattle holdings by size
Source: Central Statistical Agency of Ethiopia, 2007

These statistics create a picture of a fragmented rural agricultural landscape. The fragmented nature speaks to both distribution issues, as well as households' ability to purchase insurance. If a surplus is not generated (which is the case if land and cattle holdings are too small) then there is nothing to insure and no way of paying the premium. The remainder of the section focuses on the existence of value chains or other client aggregators in the agricultural sector, thereby providing a high-level overview of distribution opportunities in the agricultural sector.

3.2.1. Grain (cereal) market

Grains the biggest food source in Ethiopia. Cereals or grains form the major source of food in Ethiopia. It accounts for about 70% of caloric intake, out of which two thirds are provided by teff, wheat and maize (Lirenso, 1993 as quoted in Gebremedhin & Hoekstra, 2008). These grains also form the three biggest contributors to total cereal production area and total cereal area.

Inputs:

The Ethiopian government has a dominant presence in the market for seed. 70% of maize seed is produced by the Ethiopian Seed Corporation (ESE), a government-owned parastatal body, while for other crops ESE is the only formal producer of seeds (Byerlee, Spielman, Alemu & Gautam, 2007).

Similarly, the Ethiopian government also forms the dominant player in the import, wholesale and retail markets for fertilizer. Byerlee et al. (2007: 21)) note that in the import market for fertilizer, "the share of private firms operating in the market went from 33 percent in 1995 to zero in 1999. Since that period, the Agricultural Input Supply Enterprise (AISE) has taken a dominant share in the market, "followed by 'private' companies closely affiliated with or owned by the governing party

and, more recently, cooperative unions" (Byerlee et al, 2007:21). While the phase of market liberalization during the 1990s led to a number of private fertilizer wholesalers emerging, by 2001 the AISE has regained a majority share, followed by companies affiliated to the governing party. Since early 2000, the public sector and cooperative have been the main distributors of fertilizer in the retail market (Byerlee et al, 2007).

Outputs:

Small proportion of grain produced nationally is traded and not directly consumed. In 1997, the national proportion of maize, wheat and teff sold by smallholders were 30, 31 and 28% (Negassa & Jayne, 1997 as quoted in Gebremedhin & Hoekstra, 2008). Gabre-Madhin (2001) states that only 28% (2.6m tones) of grain produced is traded and not directly consumed by farmers. However, in districts displaying a distinct market orientation, these percentages increase to as high as 47% for wheat and 60% for teff (Gebremedhin & Hoekstra, 2008).

Traded grain marketed via a relatively short, informal marketing chain. This chain is described here with reference to the farmer's potential interaction with different parties in the chain. The relative proportion of grain traded by the farmer with various intermediaries and parties in the value chain is estimated as follows (Grabre-Madhin, 2001):

- 31% of grain traded by the farmer is sold directly to consumers;
- 12% of grain traded by producers/farmers is sold to assemblers (rural assemblers are farmer-traders that purchase grain from farmers in rural markets with the goal of reselling the grain to consumers or regional traders);
- 36% of traded grain is sold by farmers/producers to regional traders ; and
- 20% of traded grain is sold directly to retailers.

While some farmers may thus have contact with formal middlemen and retailers, the overall percentage of total grain produced that is traded through formal channels are very low.

3.2.2. Livestock and cattle market

Ethiopia has one of largest livestock populations in Africa. The FAO states that Ethiopia has one of the largest livestock populations in Africa, with livestock providing livelihoods to more than 80% of the rural poor (FAO, 2004). In the highlands of Ethiopia where 75% of livestock can be found, cattle provide traction for 95% of grain production and also serve as source of meat, milk, transport, manure (soil management and fuel) and provide funding against financial risks, e.g. droughts (FAO, 2004).

Livestock a significant contributor to GDP and available cash income. The livestock sector in Ethiopia contributes 12-16% and 30-33% of the total and agricultural gross domestic product, respectively (Solomon et al, 2003). The sector is responsible for 12–15% total export earnings. Of the total household cash income that derives from crop and livestock, livestock provides 37–87% in different parts of the country (Solomon et al, 2003).

However, cattle holdings tend to be fragmented and small. As mentioned, 72% of agricultural households have holdings with fewer than 4 cattle, while 94% of agricultural households have 9 or fewer cattle (CSA, 2007). There are thus many farmers with relatively few cattle.

Livestock production in Ethiopia not market-orientated. According to Solomon et al., (2003:3): "there is little evidence of strategic production of livestock for marketing except some sales targeted to traditional Ethiopian festivals. The primary reason for selling livestock is to generate income to meet unforeseen expenses. Sales of live animals are taken as a last resort and large ruminants are generally sold when they are old, culled, or barren. In the highlands, large numbers of cattle are kept to supply draft power for crop production whereas prestige and social security are the predominant factors in the lowland pastoral areas".

Inputs:

Use of feed from commercial sources still limited. The use of commercial feed is limited to urban areas, particularly to urban cattle activities such as farming and fattening. In general, the commercial marketing of feed is still very underdeveloped (Gebremedhin, Hoekstra & Jemaneh, 2007).

Limited contact with veterinary services. In general, veterinary services are limited in availability and is "often far below demand by farmers" (Gebremedhin, Hoekstra & Jemaneh, 2007). Farmers are unlikely to have regular contact with this category of services.

Outputs:

Formal dairy industry not well developed. The dairy value chain in Ethiopia is still very under-developed. Only a very small proportion of all milk produced is "processed into milk, butter and cheese by large-scale commercial processors" (Staal, Nin Pratt & Jabbar, 2008: 41). These processors are generally limited to urban areas, with the largest milk processors, Sebeta Agro-Industry and Dairy Development Enterprise, located in Addis Ababa. Most milk is either consumed directly or processed by farmers on-farm into butter and soft cheese for home consumption or direct sale to customers (Staal, Nin Pratt & Jabbar, 2008).

Of the livestock that is exported, the majority exported through informal channels. Jabbar, Negassa & Gideyelew (2007:9) note that "historically, the bulk of livestock exports from Ethiopia occurred as informal trade". Estimates cited by Jabbar, Negessa & Gdelyelew indicate that informal cattle export market could be at least twice as big as the market for formal cattle exports. In 2005-06, 163,380 animals (of which 75% were cattle) were exported through formal channels to Egypt, Yemen, the United Arab Emirates (UAE) and Saudi Arabia, while estimates for informal trade during the same period are 328,000 cattle and 1.1m shoats (young pigs).

Limited involvement from farmers' associations or agricultural cooperatives in local markets. In a recent study focused on assessing livestock supply chains in the four regional states of Tigray, Amhara, Oromio and the Southern Nations, Nationalities and Peoples Region (SNNPR), Gebremedhin, Hoekstra & Jemaneh (2007) find that famers associations or cooperatives are generally absent in the woreda markets, the district level- markets of which each district generally has two to four. The Woreda markets form a first point of interaction of famers with the marketing chain.

However, more abbatoirs being established with unions playing role in marketing members' products. However, agricultural cooperatives seem to play a bigger role in selling their members' livestock to abattoirs. According to Gebremedhin, Hoekstra & Jemaneh (2007), there are currently six operational abattoirs (5 located in Oromio and 1 abattoir in SNNP), with three new abattoirs under construction in Oromoia, Tigray and Amhara). It is not clear what percentage of livestock

traded is currently sold to these abattoirs, but the cooperatives and farmers' unions seem to play a stronger role in marketing their members' outputs to these organisations than they do in local markets (Gebremedhin, Hoekstra & Jemaneh, 2007).

3.3. Health sector

In this section, we provide a high-level review of the Ethiopian health sector. The successful design and roll-out of health insurance products are dependent on the existence of a well-developed health services sector. Although it would probably be possible to develop the health financing and services sectors concurrently, this would make it difficult to successfully market the benefits of health insurance products to potential clients.

Ethiopian health services system is poorly developed. The WHO reports that in 2000 the Ethiopian health system provided healthcare for only 52% of the population, with most of the rural population having only very limited access to healthcare. It is estimated that only 75% of urban households (only 15% of the total population) and only 42% of rural inhabitants had access to health facilities (WHO, 2002). According the Federal Ministry of Health, potential[26] health service coverage reached 64% of the population in 2004, but the utilisation rate of health services remained low with only 0.36 outpatient visits per capita (Federal Ministry of Health, 2005).

In 2003, there were only 1,936 medical doctors in Ethiopia, implying a density of 0,027 per 1,000 population members – this is about 10 times smaller than the average density for Africa (WHO, 2006). The density for nurses and midwives was 0,220 per 1,000 population members – almost 5 times smaller than the average for Africa (WHO, 2006). Only 6% of women that gave birth in 2000 had the birth attended by skilled health personnel (WHO, 2006).

Ethiopian population has poor health status relative to other low-income countries. Given the under-developed health system and high poverty levels, it is not surprising that Ethiopians have poor health status. Ethiopia has one of the highest maternal mortality rates in the world, with 871 mothers dying for every 100,000 births (Federal Ministry of Health, 2005). Furthermore, the Ethiopian Welfare Monitoring Survey of 2004 found that almost about 47% of children under the age of 5 were stunted, while 36.1 were underweight (Federal Ministry of Health, 2005).

Health facilities have been increasing in number, but access still very low in some regions. Although there has been an increase in the number of health facilities in Ethiopia over recent years, Table 4 (below) indicates that in many regions the ratio of the population to a particular health facility is still very high. Thus, for example, the population to hospital ratio in Amhara is more than 1m individuals per hospital, while one health centre has to serve, on average, more than 250,000 people in Somali. Table 3 also indicates that Ethiopia has a total of 1,578 private clinics, owned by various NGOs and private entities.

[26] According to the Federal Ministry of Health, "potential health service coverage is calculated by multiplying the total number of primary health care facilities by the strategic goal of number of individuals to be served by a primary health care unit and dividing this by the total population (Federal Ministry of Health, 2005).

Region	Population (P)	Hospital (H)	P/H	Health Center	P/H	Health Post (HP)	P/H	Private Clinic (PC)	P/H
Tigray	4,223,014	15	281,534	48	87,979	211	20,014	31	136,226
Afar	1,358,718	2	679,359	9	150,969	59	23,029	3	452,906
Amhara	18,626,047	18	1,034,780	126	147,826	1,421	13,108	304	61,270
Oromia	25,817,132	30	860,571	185	139,552	912	28,308	672	38,418
Somali	4,218,297	6	703,050	16	263,644	121	34,862	2	2,109,149
Ben.-Gumz	609,509	2	304,755	11	55,410	65	9,377	19	32,079
SNNPR	14,489,705	17	852,336	161	89,998	1,316	11,010	116	124,911
Gambelli	240,394	1	240,394	8	30,049	22	10,927	7	34,342
Hareri	189,550	5	37,910	2	94,775	7	27,079	21	9,026
Addis Ababa	2,887,615	32	90,238	29	99,573	43	67,154	382	7,559
Dire Dawa	383,529	3	127,843	5	76,706	34	11,280	21	18,263
National	74,043,510	131	557,584	600	121,739	4,211	17,346	1,578	46,289

Table 4: Regional distribution of health facilities and their ratio to Ethiopian population, 2004/05
Source: Federal Ministry of Health, 2005

About 50% of health expenditure in Ethiopia derives from private sources. While the Ethiopian government and donors together provide 49% of total health expenditure, the remainder is funded by private entities. These include out-of-pocket expenditure (33%), funding by private enterprises such as employers (4.5%) and NGOs (about 10%).

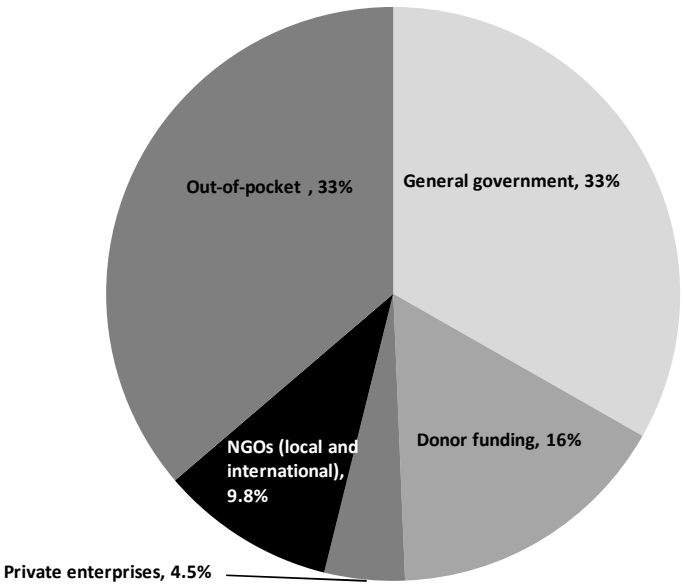


Figure 2: Sources of health funding in Ethiopia
Source: Ethiopia National Health Accounts 1999/2000 data as contained in Federal Ministry of Health, 2005

Risk pooling in the health financing space is limited. Insurance-type funding makes a relatively small contribution to overall health funding in Ethiopia. According to the World Health Organization's

statistics, “private prepaid plans” only constituted 3% of all private expenditure on health in 2005 (WHO Health Statistics, 2008).

Intention of establishing compulsory contributory health insurance for formally employed. The Federal Ministry of Health’s Strategic plan for 2005/6-2009/10 mentions the design and implementation for social health insurance for formal sector employees during the strategy’s time period, as well as the design and piloting of community health insurance. It is not clear how far the Ministry of Health has progressed with these goals, but during February 2009 the Ethiopian media reported that the Ministry were working on a draft bill that would make the provision of health insurance compulsory for all employers in the public and private sector (Alemu, 2009).

4. The insurance regulatory framework in Ethiopia

The Ethiopian legal system is based on a system of proclamations and codes, the main pieces of legislation, and directives, the supporting or sub-legislation to the proclamations and codes. The regulation to the core pieces of legislation are thus contained in directives.

Although the Licensing and Supervision of Insurance Business Proclamation (see Section 4.1) is the main piece of legislation constituting the insurance regulatory framework, several other pieces of legislation also form part of the framework and help to determine who may write insurance. A summary of the legislation that constitutes the insurance regulatory framework is provided in Table 5 below. These other pieces of legislation include the following:

- Commercial Code of 1960
- Monetary and Banking Proclamation No.83 of 1994
- Licensing and Supervision of Banking Business, Proclamation, No.84 of 1994
- Licensing and Supervision of Micro Financing Institutions Proclamation No.40 of 1996
- Cooperative Societies Proclamation No. 147 of 1998
- Cooperative Societies (Amendment) Proclamation No. 402 of 2004

Legislation	Year issued	Sector to which it applies	General framework, main issues
Licensing and Supervision of Insurance Business Proclamation No.86 of 1994	1994	Insurance	• Governing proclamation for insurance sector, with some definitions contained in Commercial Code (see below). • Addresses institutional form, prudential and some basic market conduct regulation. • Only institutional form able of being insurers is share company – does not allow the institutional form of a cooperative to become insurer. • No separate definition for or special treatment of microinsurance • New insurance proclamation currently being drafted.
Commercial Code	1960	Insurance, but also other sectors of economy. All commercial business.	• 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. • Likely that the relevant sections on insurance that are currently contained in the Commercial Code will be moved to the new insurance proclamation.

National Bank of Ethiopia Establishment (as Amended Proclamation), No.591 of 2008	2008	Financial sector	• Establishes National Bank of Ethiopia as separate and independent from national government. • Provides Bank with power to license and supervise insurance companies.
Banking Business Proclamation, No.592 of 2008	2008	Banking sector	• Governing proclamation for banking sector. • Places no obvious limits on banks for engaging in insurance business.
Licensing and Supervision of Micro Financing Institutions Proclamation No.40 of 1996	1996	Microfinance institution (MFI) sector	• Governing proclamation for MFI sector. • Places no restriction on ability of MFI to be insurance company or intermediary.
Cooperative Societies Proclamation No. 147 of 1998	1998	Cooperatives, also savings and credit cooperatives sector	• Governing proclamation for cooperatives sector. • Places no restriction on ability of cooperative to be an insurance company or intermediary.
Cooperative Societies (Amendment) Proclamation No. 402 of 2004	2004	Cooperatives, also saving and credit cooperatives sector	• Amendment proclamation to governing proclamation for cooperatives sector.

Table 5: Summary of the legislation that constitutes the insurance regulatory framework
Source: Author's own

4.1. Licensing and Supervision of Insurance Business Proclamation, Proclamation No.86 of 1994

The Licensing and Supervision of Insurance Business (LSIB) Proclamation No. 86 of 1994 (hereafter referred to as the LSIB Proclamation) governs all insurance activities in Ethiopia and is supported by definitions contained in the Commercial Code of 1960.

It is important to note that before October 1975, during the Imperial regime, there were thirteen insurance companies operating in Ethiopia. In November 1975 these thirteen companies were all nationalised and consolidated into one company, the Ethiopian Insurance Corporation (Ethiopian Yearbook, Insurance Section). When the Derge regime ended in the early 1990s, the establishment of private insurance companies was once again allowed. Before the 1975 change and during the Derge regime, the activity of insurance was governed only by the Commercial Code of 1960. However, the new phase called for new insurance regulation and the Licensing and Supervision of Insurance Business Proclamation No. 86 was promulgated in 1994.

Bank of Ethiopia the insurance policymaker, regulator and supervisor. The LSIB Proclamation together with the Monetary and Banking proclamation (No. 83 of 1994) designate the Bank of Ethiopia as the policy-maker, regulator and supervisor of the insurance industry in Ethiopia. It is important to note that while the LSIB Proclamation defines the functions of the Bank with respect to insurance, it is actually the Monetary and Banking Proclamation No. 83 of 1994 that establishes the Bank of Ethiopia as an entity independent from government and with the power to supervise the banking and insurance sectors. In addition to defining the functions of the insurance supervisor, the Insurance Proclamation also provides the Bank with the power to issue directives relating to various areas of insurance business (Chapter Two, Article 42). The Bank has an Insurance Supervision Department that is responsible for the above. This implies that the insurance supervisor is not

independent from the Central Bank as required by the International Association of Insurance Supervisors (IAIS). As result, membership of the IAIS has not been open to the Bank of Ethiopia.

Mandate of insurance supervisor also to "promote insurance business". The Insurance Proclamation defines the primary function of the Bank of Ethiopia as it relates to insurance as to "formulate policy to promote the business of insurance in Ethiopia" (Chapter Two, Section 3(a)). This mandate leaves room for not only pursuing prudential stability, but also for market development and therefore (by implication) the facilitation of a microinsurance market. The secondary functions of the Bank are "to formulate policy in respect of reinsurance and of investments of insurance funds" (Chapter Two, Section 3(b)) and "to formulate policy on such other matter as may be conducive to the attainment of sound insurance business in Ethiopia" (Chapter Two, Section 3(c)).

Insurance policy defined in the Commercial Code. According to the LSIB Proclamation an "insurance policy" or "policy" has the definition assigned to it in Article 654(1) of the Commercial Code of Ethiopia (Chapter One, Section 12). The Commercial Code has a chapter (Book III, Title III) dealing specifically with certain insurance definitions and provisions and, although it has been replaced by the LSIB Proclamation as the main piece of insurance legislation, certain of the definitions and provisions still remain active[27]. The Commercial code defines an insurance policy as being "a contract whereby a person called the insurer, undertakes against payment of one or more premiums to pay to a person, called the beneficiary, a sum of money were a specified risk materializes" (Article 654(1)). It continues to state that "where damages are insured, the insurance policy shall extend to the risks affecting property or arising out of the insured person's civil liability" (Article 654(2)) and "where persons are insured, the insurance policy shall extend to risks arising out of death or life, or to risks arising out of injury to the person or illness" (Article 654(3)).

Provisions in Commercial Code has, in some instances, facilitated phenomenon of large amounts of uncollected premiums. The treatment of "payment terms" in the Commercial Code of Ethiopia (1960) has had negative implications for cases where insurance policies are sold on credit[28]. The Commercial Code (Article 666 (1)-(6)) sets out a number of duties for the payment of premiums applying to both the beneficiary of the policy and the insurance company. Specifically, it is states that "the policy shall not terminate as of right when the premium is not paid in due time. The insurer shall demand payment." (Article 666(2)). In the case where a policy is not paid, the Code provides steps to be followed by the insurance company before the policy can be terminated. Sub-article 3 of Article 666 states that "the policy shall be suspended after one month from a demand under sub-art (2) where the premium is not paid" and "where the period of one month has expired, the insurer may claim payment of the premium or require the termination of the policy" (Article 666(4)). In cases where the premium is eventually paid, it is required that "the policy shall re-enter into force on the day of payment" (Article 666(5)). Interestingly, the provisions of this article do not apply to life insurance (Article 666(6)) – life insurance is explicitly excluded from these provisions. Given the common practice in Ethiopia of selling insurance policies on credit in order to win clients in a heavily contested market, this article and its sub-articles have led to complications with the collection of unpaid premiums (see Section 5.1).

The implication of the definition of payment terms, given normal business practice, is that insurance companies have to follow a lengthy process to try and collect the unpaid premium before cancellation of an insurance policy. It has also facilitated a situation where large percentage of

[27] This particular provision seems to be the main component of the Commercial Code that has a direct impact on the way insurance business is currently being conducted in Ethiopia.
[28] Policies sold on credit refers to cases where cover is provided to the insured before the premium has been collected.

premiums written in any one year are, in fact, uncollected premiums that may have to be written off as bad debt in the future. See Section 5.1 for more information on this. As indicated in Appendix A, at least three Ethiopian insurance companies have net trade debt to equity ratios exceeding 50% (the internationally accepted maximum value), while the industry average is 55%.

Proclamation distinguishes between two main classes of insurance business: general and long term. General insurance business is defined as "all kinds of insurance business other than Long term insurance business" (Chapter One, Section 7). Long term insurance business is defined as "insurance business of all or any of the following classes; namely life insurance business, annuity business, pension business, permanent health insurance business[29] and, in relation to the insurer, personal accident and/or sickness insurance business carried on by that insurer as incidental to any of the businesses first named within this sub-article" (Chapter One, Section 16).

Medical or health insurance written as long-term business, while personal accident insurance forms a category of general insurance business. Since health insurance tends to involve actuarial considerations of a nature similar to life insurance (Savage, 2009), it is written as a category of long-term insurance business. Cover extends beyond one year and the insurer cannot withdraw cover on the grounds of adverse risk experience which was under-estimated. In contrast, personal accident insurance is written under the category of general insurance since it is a product managed on a short-term basis, with insurers able to adjust the premiums of the product to reflect current experience and with the pay-out being a fixed amount upon the occurrence of a specified accident event.

No separate definition or regulatory framework for microinsurance. Ethiopia currently does not have a separate definition for microinsurance and accordingly the regulatory framework and Proclamation do not currently make any concessions to microinsurance.

Only a company can write insurance. According to the Proclamation, only a share company fulfilling the minimum capital requirements is allowed to write insurance (Chapter Two, Section 4(a)).

Definition of company prohibits foreign ownership of insurance companies. The Proclamation defines a company as "a share company as defined under Article 304 of the Commercial Code of Ethiopia in which the *capital is wholly owned by Ethiopian nationals and/or organizations wholly owned by Ethiopian Nationals* and registered under the laws of and having its head office in Ethiopia" (emphasis added) (Chapter One, Section 2(3)). Even partial foreign ownership of insurance companies in Ethiopia is therefore not allowed.

Minimum capital requirements do not seem excessive by international standards. The Proclamation sets out three levels of capital (Chapter Two, Section 4(b)):

- Birr 3m (approximately US$0.3m) for a general insurance business license;
- Birr 4m (approximately US$0.4m) for a long term insurance business license; and
- Birr 7m (approximately US$ 0.7m) for both a general insurance and long term insurance business license. Composite insurers are, therefore, allowed.

[29] The LSIB Proclamation does not explicitly define permanent health insurance business. However, the general definition that seems to apply to this category of insurance business is a type of insurance "that provides an income in the event of the policyholder contracting a long term illness or injury. There is no payment on death" (http://www.finance-glossary.com/terms/permanent-health-insurance-(PHI).htm?id=1116&ginPtrCode=00000&PopupMode=). It is thus effectively disability insurance.

Reinsurance may be placed offshore. The Insurance Proclamation treats the issue of reinsurance as something to be specified in the insurance directives issued by the Bank. No directive on this particular topic has yet been issued by the Insurance Supervision Department. Insurers are required to file their reinsurance agreements with the Insurance Supervision Department, but they are free to place their business with any reinsurer which they see fit to receive their business (i.e. allowing foreign reinsurers).

Infrequent actuarial evaluations. Insurers doing long term insurance business are required to have an actuarial investigation once every year for the first five years of operation and, thereafter, one investigation at least once every three years (Chapter Two, Article, 19(1)). No actuarial evaluation is required for general insurance companies.

Annual audit requirements apply. It is required that the financial statements (including the "balance sheet, profit and loss account and the revenue account") of every insurer undergoes a formal audit on an annual basis (Chapter Two, Article 18(1)). However, according to industry stakeholders the absence of a set of national accounting standards and standard setting body has led to a situation where the reliability of the audited financial statements is questionable.

Investment restrictions biased towards Treasury Bills. Directive No. 25 of 2005 limits the types of assets[30] in which general insurance funds may be invested to the following:

- Not less than 65% of admitted assets may be invested in Treasury Bills and bank deposits, "provided, however, that aggregate bank deposits (checking, savings and time deposits) held with any one bank shall not exceed 25% of total admitted assets";
- No more than 15% of admitted assets may be invested in company shares;
- No more than 10% of admitted assets may be invested in real estate; and
- 10% of admitted assets may be invested in "investments of the insurance companies' choice".

For the funds of long-term insurers, the types of assets that may be invested in are limited to the following:

- Not less than 50% of admitted assets may be invested in Treasury Bills/Bonds and bank deposits, "provided that aggregated deposits (checking, savings and time deposits) held with any one bank shall not exceed 25% of total admitted assets";
- No more than 15% of admitted assets may be invested in company shares;
- No more than 25% of admitted assets may be invested in real estate; and
- 10% of admitted assets may be invested in "investments of the insurance company's choice".

The relatively high percentage of assets required to be in Treasury Bills and bank deposits has been raised as a problem for insurance companies, given the relatively low returns of these assets. However, as will be discussed, available investment opportunities in company shares are limited and the high investment requirement for Treasury bill and bank deposits may actually be the only option for investment of these funds.

Limit placed on the percentage of shares of an insurance company to be held by any one party. The Proclamation specifies that "no person shall hold more than twenty per cent (20%) of the company's share with his spouse and/or with any person who is below the age of 21 and related to him consaguinally in the first degree relationship" (Chapter Two, Article 5(1)). It is not clear what the

[30] It is required that all investments need to be made in local companies or property.

rationale for this restriction is. However, since there are few secure, high-yielding investment opportunities available in Ethiopia a case can probably be made that individual investors should be able to make larger investments. Interestingly, the restriction biases towards individual rather than institutional (e.g. pension and investment funds) shareholders. The latter type of shareholder typically has large funding pools available for investment and is therefore able to purchase larger proportions of shareholding. Institutional shareholders are also likely to be better equipped to exercise shareholder's rights than individual shareholders.

Brokers and agents established as intermediaries. The insurance regulatory framework distinguishes between two categories of intermediaries: agents and brokers. While agents are restricted to selling the insurance products of one insurer, brokers are able to place insurance business with more than one insurer. Both are required to be Ethiopian Nationals or institutions fully owned by Ethiopian Nationals.

Insurance agents: Insurance agents are required to be licensed by the Insurance Supervision Department of the Bank of Ethiopia. Their licensing requirements are specified by Directive No. SIB/18/98. Insurance agents (natural persons) are required to be Ethiopian nationals and to have completed at least their "secondary level of education and have sufficient[31] experience and/or training in insurance business". Experience gained as insurance agents is the only educational requirement in cases where individuals have worked as insurance agents for a minimum of 7 years but are unable to provide proof of the completion of their secondary education. Furthermore, insurers are required to provide a refresher course of a minimum of 30 hours for their licensed agents on an annual basis. The Directive also allows for the registration of juridical persons (institutional entities) as insurance agents in cases where these entities have "unlimited liability", have their "head office in Ethiopia and fully owned by Ethiopian Nationals" and the Chief Executive of the Agency is able to meet "at least...the education experience and other requirements" that apply to natural person agents.

Insurance brokers: Insurance brokers are required to be licensed by the Insurance Supervision Department of the Bank of Ethiopia. Their licensing requirements are specified by Directive No. SIB/29/2007. Insurance brokers are required to be Ethiopian nationals or an Ethiopian business organization[32], have no criminal record, be persons "with honesty, integrity, diligence and reputation to the satisfaction of the Bank"[33]. They are, furthermore, required to "hold, at least, a diploma in insurance or any of the business related fields from an institute, college or university acceptable to the Bank" and have "a minimum of eight years reputable managerial experience acquired through working at the head office of an insurance company with a responsibility to oversee operational areas of underwriting and claims". The duties and responsibilities of insurance brokers are listed in the same directive. Brokers are required to "clearly explain the differences and relative costs of the principal types of insurance to the client and provide advice on the types of insurance cover that best suit the client's needs" (Section 7(1)(f)). In addition, brokers are required to "offer a particular risk to at least three insurers and carry out a thorough analysis of each insurer's proposal" (Section 7(1)(g)).

[31] A sufficient level of training and experience is not explicitly defined.
[32] This allows for the registration of brokerage firms.
[33] The stated requirements are typical fit-and-proper requirements that generally apply to intermediaries. While an insurance agent is explicitly required to not have any convictions for offenses involving dishonesty, the stated fit-and-proper requirements are not included in the directive for the licensing of insurance agents. However, we can assume that these requirements also (at least implicitly) apply to insurance agents.

Uncapped commission levels. Neither the insurance proclamation nor any of the insurance directives place limits on the percentage of commission that an insurance broker or agent may earn by selling an insurance policy. However, insurance companies are required to submit a commission schedule (that sets out commission levels for different products) to the Insurance Supervision Department. Companies are required to not pay more commission per product category than the commission levels stated in the schedule, but this is not actively enforced by the Insurance Supervision Department. The Ethiopian Insurers' Association has voluntarily agreed on rates of commission for each class of insurance business and these agreed rates are captured in the individual commission schedules of insurance companies.

Insurance proclamation and total regulatory framework for insurance currently being revised. As part of the World Bank's Financial Sector Capacity Building Program (see Section 3.1.1), the Canadian insurance consulting firm, Lawrie Savage & Associates has been appointed to conduct a review on the "modernisation" of the Ethiopian insurance sector, focused specifically on improved prudential regulation rather than market development and the facilitation of microinsurance.

Motor Third Party Liability (MTPL) Insurance likely to be made compulsory. There is currently a process underway to make motor third party liability insurance (MTPL) compulsory in Ethiopia. The Ministry of Transport has issued a legal framework for this insurance and it is planned that this is to be implemented in the near future. Ethiopia has the highest per capita rate of car fatalities in the world (190 deaths per every 10,000 vehicles) (Ehrenkranz and Kushner, 2008) and it is therefore an important priority for government to be able to ensure that the victims of motor vehicle accidents are provided for.

4.2. Banking Business Proclamation, Proclamation No. 592 of 2008

The Banking Business Proclamation No. 592 of 2008[34] sets out the main regulatory requirements (e.g. prudential requirements) that apply to banks.

Bank legislation of limited direct relevance to the insurance regulatory framework. The banking regulatory framework is of limited relevance to the insurance regulatory framework since it does not directly promote or prohibit banks (or their holding companies) from distributing insurance. However, it is important to keep in mind that banking regulation and policy may also indirectly limit or facilitate insurance development. Thus, for example, there currently exists no policy or regulatory framework for an electronic payment system (this is only now being developed – see Section 3.1.1) while a policy and regulatory framework for branchless banking and e-money has also not yet been developed. This latter framework would facilitate the development of the insurance industry through allowing collection of insurance premiums via networks such as cell phones, airtime vendors or retail stores.

4.3. Proclamation to provide for the establishment of Cooperative Societies, Proclamation No. 147 of 1998

Regulation establishes FCA as development agency and regulator. The above proclamation regulates all categories of cooperatives, including agricultural cooperatives and savings and credit cooperatives (SACCOs) in Ethiopia. It also establishes the Federal Cooperative Agency (FCA) that is mandated to both promote, and regulate and supervise cooperatives. The Federal Cooperative Agency is not part of the Bank of Ethiopia and is a division of the Ministry of Trade and Industry. Its

[34] It replaced the earlier Licensing and Supervision of Banking Business, Proclamation No. 84 of 1994.

dual role of both promoter and supervisor has led to some criticism and a call for the separation of these functions.

Institutional entity. The Proclamation defines a "cooperative society" as a "society established by individuals on voluntary basis to collectively solve their economic and social problems and to democratically manage the same" (Article 2(2)). It sets out the broad guiding principles of cooperative societies (Article 5) and distinguishes between two broad categories of cooperatives (Article 7): cooperatives focused on production and cooperatives focused on services. Cooperatives are further defined as an entity having "juridical personality" (Article 10(1)) and with limited liability (Article 10(2)). The latter implies that the members of cooperatives' liability only extend up to the value of their initial investment in the cooperative. Each cooperative is required to specify its own set of by-laws addressing, inter alia, the objectives and activities of the society, requirements for membership, the powers, responsibilities and duties of management bodies and allocation and distribution of profits (Article 11(1)-(2)).

Cooperative societies currently not allowed to write insurance business. The Insurance Proclamation identifies the share company as the only institutional form able to write insurance business and become a licensed insurer. By implication, cooperative societies will not be able to become insurers or write insurance business while retaining their institutional form and would have to transform to a share company, thereby losing their mutual nature (or at least the mutual nature as captured in their institutional form)[35]. However, another option for a cooperative wanting to engage in insurance business would be to establish a share company insurer 100%-owned by the cooperative or to register as insurance intermediary. The former option, however, may not be viewed as attractive given the experience of Oromia Cooperative Bank. The share capital nature of the instituted resulted in an eventual movement away from its original intention to be a bank that serves cooperatives and may be viewed as a drifting away from cooperative principles (see Section 3.1.1).

Membership size. A minimum of ten individuals is required for the formation of a cooperative society (Article 6(2)). There is no maximum set in regulation.

Audit requirement. The Proclamation requires the accounts of all cooperative societies to be audited by "the appropriate authority" or "by a person assigned to it" at least once a year (Article 36(1)). The enforcement (or rather, lack of enforcement) of this requirement has been subject to much criticism. The accounts of very few cooperatives are audited on an annual basis and this is ascribed to the lack of sufficient numbers of auditors to execute this requirement. (Gessese, 2007).

Reserve fund. The Cooperative Proclamation requires each cooperative to maintain a reserve fund, with cooperatives societies having to "deduct 30% of the net profit obtained" (Article 33(1) and keep this amount in the reserve fund. It is required that this fund should be used for reserving purposes, "for the expansion of work" and "for social purposes". Only after the reserve fund amount has been deducted from profits may the remaining profit be divided between shareholders of the cooperative (Article 33(2)). A number of problems have been experienced with the reserve fund requirement. Firstly, the requirement is not actively and comprehensively enforced by the regulator. Secondly, the Proclamation does not specify how the reserve fund should be shared amongst members upon dissolution of the cooperative society (Wiedmaier-Pfister, 2008; Gessese, 2007). The result is that

[35] The main constraint in allowing cooperatives to become insurers does not lie with the Cooperatives Proclamation, but rather with the LSIB Proclamation that limits becoming and operating as an insurer to share companies. If this part of the LSIB Proclamation was to be amended, cooperative would be able to register as insurers.

many cooperatives have opted not to create a reserve fund or set funds aside to meet prudential requirements. It is also not clear how the 30% requirement relates to the risk exposure of different types of cooperatives. It is furthermore not clear how the reserve fund may be used and it is often used to fund loans to members.

Amendments introduced in 2004 proclamation. Proclamation No. 402 of 2004 (Cooperative societies (Amendment) Proclamation) was issued in a response to, inter alia, issues on the issuing of and payment for shares[36] and to allow for the formation and promotion of higher forms of cooperatives, e.g. secondary and tertiary cooperatives. It also amends the requirement relating to the reserve fund of cooperatives by specifying that the reserve fund should not exceed 30% of the total capital of the cooperative and that it should be kept in a savings account (Article 4). It is not clear how this will work in practice (i.e. whether the cooperative will simply be required to set aside less than the required annual 30% of profits or whether some of the funds will be returned to cooperative members). The proclamation amends the relevant articles and sub-articles in the first Cooperative Proclamation and inserts some new article and sub-articles but does not replace it. Remaining questions and issues on the use of reserve funds (see above) were not addressed in the Amendment Proclamation.

Separate regulation of savings and credit cooperatives. Given their specific nature, there are current strong calls to regulate savings and credit cooperatives as a separate category of cooperatives under their own act. It is argued that having a separate act would also allow for the creation of more defined and specialized categories of savings and credit cooperatives, e.g. pure savings and credit cooperatives, cooperative banks and cooperative insurers (Gessese, 2007).

4.4. Proclamation to provide for the licensing and supervision of micro financing institutions, Proclamation No. 40 of 1996

Regulation and regulator. With the issuing of Proclamation No. 40 of 1996, the government of Ethiopia established a new financial sector entity, the microfinance institution, capable of mobilizing savings and extending credit to individuals not served by commercial banks. Before the issuing of the proclamation, this type of credit need was being addressed by NGOs that engaged in direct lending. However, the MFI proclamation made direct lending by NGOs illegal and also did not allow for ownership of MFIs by non-Ethiopians. NGOs responded with different strategies: some NGOs established an independent MFI (with their Ethiopian employees as shareholders), while others provided funding to MFIs on a wholesale basis with the MFI simply acting as manager of the funds (Wiedmaier-Pfister et al., 2008). MFIs are regulated and supervised by the Microfinance Supervision Department in the Bank of Ethiopia.

MFIs' institutional form does not prohibit them from becoming insurers. Similar to insurance companies, MFIs are required to be share companies. Given the requirement that an insurance company has to be a share company, this means that MFIs will not have to change or transform their fundamental institutional nature (unlike cooperatives) to become an insurance company. While it is unlikely that the same company will be allowed to underwrite insurance and extend loans, at least having to establish a separate share company for insurance purposes will not be in conflict with the fundamental institutional form of MFIs (as opposed to cooperatives that operate on mutual principles).

[36] This includes provisions on the maximum percentage of shares that any member may hold, the payment medium (cash or in-kind), etc.

5. The formal insurance market in Ethiopia

This section provides an overview of the formal insurance market in Ethiopia, the distribution models utilised in this market and the products offered. It is necessary to understand the context of the overall insurance market in order to understand the development (or the potential development) of the microinsurance market. The description of players and distribution thus focuses on the insurance market as a whole, noting specific examples related to microinsurance where relevant.

5.1. Insurance underwriting: players and market features

Very small insurance industry, both in absolute and relative terms. Insurance premiums (including both life and general insurance) totalled US$105m in the 2006/07 financial year (ending June 2007), equating to about 0.2% of GDP[37]. Compared to some other African countries (see Table 6 below), this is a very low level of insurance penetration and indicative of the under-developed state of the insurance market in Ethiopia.

Country	% of GDP
South Africa	15.3
Namibia	8.1
Botswana	3.9
Morocco	3.4
Kenya	2.5
Tunisia	2.0
Angola	1.4
Egypt	0.9
Nigeria	0.6
Algeria	0.6
Uganda[38]	0.6
Ethiopia	0.2

Table 6: Insurance penetration (total insurance premiums as percentage of GDP) in some African countries in 2007

Source: Insurance Supervision Department, Bank of Ethiopia, 2007; Swiss Re Sigma, 2007; Bester, Hendrie & Smith, 2008

Current players. Ethiopia has a total of ten insurance companies[39] (see Table 7) of which one, the Ethiopian Insurance Corporation (EIC), is government-owned. According to market share based on gross premiums, the EIC is also the largest of the companies, with about 42% of the general and 62% of the long-term insurance market. Of these companies, seven[40] had composite insurance licenses (able to write long term and general insurance) during the 2007/08 financial year. Two new

[37] At the World Bank PPP-adjusted GDP value for Ethiopia in 2007.

[38] Please note that all of the data in this table (excluding Uganda and Ethiopia) derive from Swiss Re Sigma (2008) and is total insurance premiums relative to GDP for 2007. The Uganda data is total insurance premiums relative to GDP in 2005 and derives from Bester, Hendrie and Smith (2008), while the data for Ethiopia is total insurance premiums relative to GDP in 2007 based on calculations using data supplied by the Insurance Supervision Department of the Bank of Ethiopia.

[39] This includes Ethiopia Insurance Corporation (EIC), Nyala Insurance, United Insurance Company (UNIC), Awash Insurance, Nile Insurance, Africa Insurance, Global Insurance Company, NIB Insurance Company, National Insurance Company of Ethiopia and Universal Insurance Company.

[40] Ethiopia Insurance Corporation, Nyala Insurance, United Insurance Company (UNIC), Awash Insurance, Nile Insurance, Africa Insurance and NIB Insurance.

companies are in the process of being licensed, of which one is reported to be a life insurance-only company, the first such company in Ethiopia.

	Ethiopian insurance companies	General	Long term	Market share* (General-2008)	Market share (Life 2006)	Gross premium in '000 of Birr	Gross Premiums In 000' US dollars**
1	**Ethiopian Insurance Corporation**	√	√	41.8%	62.0%	496,501	52,484
2	**Nyala insurance company S.C.**	√	√	8.2%	5.2%	97,907	10,350
3	**United Insurance Company S.C.**	√	√	9.3%	13.2%	110,390	11,669
4	**Awash Insurance Company S.C.**	√	√	8.5%	3.2%	100,747	10,650
5	**Global Insurance Company S.C.**	√		1.3%		15,320	1,619
6	**National Insurance Company of Ethiopia S.C (NICE)**	√		3.4%		40,480	4,279
7	**Africa Insurance Company S.C (AIC)**	√	√	9.0%	7.7%	107,409	11,354
8	**NIB Insurance Company S.C (NIB)**	√	√	8.4%		100,188	10,591
9	**Nile Insurance Company S.C**	√	√	9.0%	7.0%	106,909	11,301
1	**Lion Insurance Company S.C**	√		1.0%		12,812	1,354

Table 7: Registered insurance providers in Ethiopia during FY2007/08

Source: National Bank of Ethiopia, 2008. *General Conditions of Insurance Companies*. October. Unpublished document.

*Market share based on gross premiums

** Average Exchange rate for June 2008 is 1US$ to Birr 9.46 (Source: Mbendi, 07 July 2009, available at: *http://www.mbendi.com/cyexch.htm*)

General insurance sector dominates, with motor insurance forming the largest category of general insurance. Life insurance premiums constituted only US$6m or 6% of total premiums in 2007, while general insurance premiums totalled US$99m or 94% of total premiums. Almost half (43%) of total insurance premiums derived from motor vehicle insurance (see Figure 3). Despite the large proportion that motor insurance constitutes of all general insurance premiums, it is reported to be a loss leader for most insurance companies. The two next largest categories of insurance are marine insurance (14% of total insurance premiums) and engineering insurance (9% of total premiums).

Majority of business is corporate. The largest categories of insurance in Ethiopia demonstrate that the majority of insurance business in Ethiopia is sold to corporate clients insuring their assets (motor vehicle, fire), business (aviation, engineering and marine) and staff members (accident & health, life/long-term and workmen's compensation). As result, intermediation (see Section 5.2) is geared towards corporate clients and very little insurance is intermediated on an individual retail basis. There is very little product innovation and the products available are not geared towards the retail market with much of it still based on products sold prior to 1976.

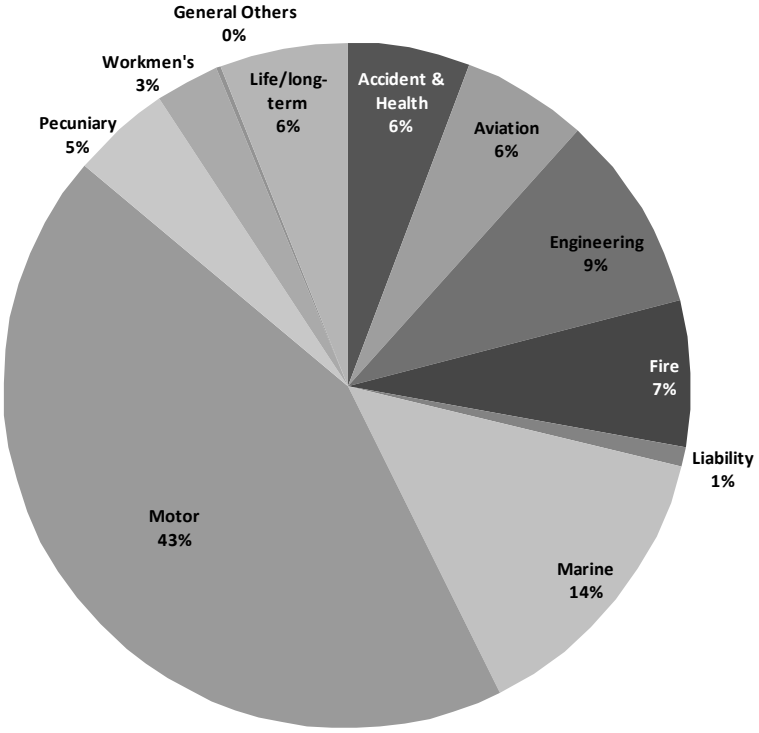


Figure 3: Relative sizes of different categories of insurance
Source: Insurance Supervision Department, Bank of Ethiopia, 2007

All or most insurers are matched with an Ethiopian bank. Most insurance companies in Ethiopia have a relationship with a bank. This relationship is generally for the purpose of obtaining referrals from the bank on credit insurance business, but may also entail cross-shareholding. See below for more information on the nature and implications of this relationship between insurers and banks.

Relatively high profits reported but with potential concerns about true performance. The insurance sector reports relatively high profits, but lower than that generated in the banking sector. Between 2002 and 2007, general insurance companies generated an average return on equity of 16.5% (Insurance Supervision Department, Bank of Ethiopia, 2008), while the general insurance industry return[41] for FY2007/08 was 23% (see Appendix A). The reported returns may, however, be overstated and there are a number of factors that need to be taken into account when interpreting the reported profits:

- **Restricted investment options and concentration:** As will be noted below, insurers are over-exposed to banks in their investments and rely on returns from these investments for a large proportion of their income.
- **Absence of stock market and the impact on equity valuation and liquidity:** As there is no stock market in Ethiopia investments have to be made directly in firms and traded on an 'over-the-counter' basis. As there is no regulator and transparent trading of these shares, it makes it difficult to assess the market value of investments. The over-the-counter nature and low liquidity will also make it difficult to realise its potential market value as buyers may not be available.

[41] Excluding Lion Insurance, a general insurance company only established during FY2007/08.

- **Credit premiums:** In Ethiopia premiums written on credit are generally shown (in the financial statements) as premiums collectable, but have in most cases already reached the point where this has turned into bad debt. The practice of selling insurance on credit is so pervasive and problematic that a very large percentage of some insurance companies' premiums remain uncollected (and potentially in default) in any year. Given the high levels of credit premiums, writing these off will have a significant impact on profitability and solvency[42]. The solvency of Ethiopian insurance companies are threatened by this practice since while a company may appear to have sufficient assets to meet all its liabilities on paper, financial reporting that does not take into account the quality of the assets (i.e. uncollected premiums that have passed the point where it turns into bad debt) may hide that a company may actually not be able to meet all its liabilities. The World Bank has identified this as "a major problem threatening solvency" (World Bank, 2006: 21). As can be viewed in list of industry indicators (see Appendix A), three companies have an undesirably high level of uncollected premiums, with the industry average above the international best practice standard, half of equity.
- **Reliability of financial reporting**. There is also currently no accounting or auditing institute that regulates financial reporting standards in Ethiopia and audit firms can therefore follow different standards. This impacts the comparability of financial information from company to company and also on the reliability of financial data provided to shareholders and submitted to the Insurance Supervision Department for compliance purposes.

The combination of the above factors may impact significantly on the profits reported.

Dependence on banking industry. The insurance sector is dependent on the banking sector for much of its new business as well as returns from their investments in banks. Most insurance companies in Ethiopia have a sister bank (they often also share the same name and may be part of the same holding company). It is common for these banks to refer their clients to their sister insurance company but this is still largely restricted to insurance related to credit, e.g. insurance for vehicles bought on credit. Industry players estimate that as much as 30-40% of total insurance premiums derive from insurance products related to credit (not only credit life insurance, but also asset and project insurance) typically referred to them by their sister bank. Also, insurance companies tend to derive a large proportion of their total income from investments in banks. For example, NIB insurance had an investment of about Birr 23m (US$0.23m) in Nib International Bank in the financial year of 2006/07 (almost 100%, apart from a small investment in Agar Micro Finance, of its total equity investments). On this investment it realised a return of about Birr 4m (about US$0.4m), equal to 20% of its total income revenue in the financial year of 2006/07. Banks, in turn, often have shareholdings in their sister insurance companies. The co-dependence of these sectors was also flagged by a recent World Bank review as concern: "The stability of the insurance sector is closely tied to that of the banking sector. Insurance companies are dependent on banks as a marketing source. The balance sheets of insurance companies are also over-exposed to and over-concentrated in the banking sector, with over 40% of assets exposed to the banking sector." (World Bank, 2006: 20-21).

[42] "International practice is to give no credit for solvency purposes for premium amounts overdue by more than 90 days. In Canada these amounts are actually written off when assessing solvency if they are outstanding more than 65 days, whether or not they are actually overdue under the contract. The principle of insurance breaks down when premiums are not remitted because there is extreme anti-selection: the only cases where premiums are actually received is when there is a claim, which defeats the whole point of pooling premiums so that, in the traditional British insurance parlance, "the premiums of the many can pay for the losses of the few"" (Savage, 2009).

Concerns regarding liquidity of insurance companies. A number of insurance companies in Ethiopia have lower liquidity ratios[43] than the internationally accepted minimum of 1.25 (i.e. current assets are required to exceed current liabilities by 25% - see Appendix A). Four general insurance companies have a liquidity ratio of less than 1, meaning their current liabilities exceed current assets while both the weighted and unweighted industry averages are less than 1.

Claims and expense ratios relatively high, but not excessive. The claims and expense ratios experienced during FY2007/08 are on the high side, but not excessive (see Appendix A). On average, general insurance companies experienced a claims ratio of 65% (excluding Lion Insurance which only started its operations during FY2007/08), indicating that the industry is returning a fair share of premiums collected to clients in the form of claims paid. During the same period, the general insurance industry experienced an average expense ratio (excluding Lion Insurance) of 22%, which is not excessively high given the many infrastructural and transaction cost challenges which Ethiopia faces.

Limited reinvestment of dividends leaves little room for market exploration. The financial statements of Ethiopian insurance companies reveal that very little of the returns generated is reinvested. This is most likely the result of the combination of shared ownership and the inability of insurers to compete with the returns currently generated in the banking sector. In an environment where capital is scarce, there is little incentive for the shareholders to reinvest dividends in the insurance sector and it is, instead, channelled back to the banking sector or other higher yielding investments. This makes it difficult for insurance companies to invest in the modernisation of its infrastructure (e.g. management information systems) or to explore new (and potentially risky) markets. Even if insurers were able to retain more of their returns for reinvestment, it will still not provide much resource for market exploration and modernisation of systems.

Market extension not a strong priority. The implication of the above dynamic is that market extension is not a strong priority for insurance companies in Ethiopia. This is evidenced by a number of characteristics of the current insurance market:

- A large proportion of bank clients (2.9m retail deposit accounts), even higher-income clients, remain unserved by insurers despite all the insurers being partnered with banks (see Section 7 for an estimate of the size of the insurance market). Insurers are also not tapping the client information databases of banks to use this data to identify possible clients.
- The retail life business is almost non-existent and most life/long-term policies are only sold to corporate clients to cover their workforce.
- Insurance companies have a limited and outdated product offering, with no perceived need for or interest in creating innovative products.
- Many untapped distribution networks remain (see Section 6). Despite MFIs and SACCOs carrying credit risks and having to underwrite these risks informally, insurance companies have not actively gone out to try and obtain the business of these organizations. As demonstrated by the story of Africa Village MFI (see Box 2), even in cases where MFIs have tried to obtain formal insurance products from insurance companies, these companies have been disinterested in trying to meet the needs of MFIs.

Increased competition for existing market. Instead of seeking new markets, competition is increasing for the existing market. Not only are the insurance premiums of certain insurance products declining, but insurers are jeopardising profitability to retain and/or attract clients. Thus, for

[43] Current assets/current liabilities

example, the 2006/06 Annual Report of Nyala Insurance notes (on the issue of decreasing insurance premiums and premiums written on credit) that " 'price war' and 'credit sales' are increasingly becoming the decisive factors that most clients and/or their Brokers consider to select the insurer" (Nyala Insurance Company, 2007). In response to this phenomenon, the World Bank (2006) notes that declining premiums have played a role in decreasing return on assets (ROA) of insurers from an average of 6% in 2002 to 3% in 2004. Companies also persist in selling motor vehicle insurance despite it being reported as a loss making category of insurance[44]. As noted above, insurance companies also continue to sell insurance policies on credit.

Box 2: Insurance experience of Africa Village with their leasing product

Africa Village is a private MFI started in 1999. It receives no support from government and did not grow from a parent-NGO. It serves 10,800 clients and has a credit portfolio (loans outstanding) totals Birr 17m. It is estimated that about 60% of their clients earn less than US$1 per day, while the remaining 40% earn less than US$2 per day. Approximately 60% of their loans are extended to individuals living in rural areas just outside Addis.

It uses the group loan methodology to offer business loans to clients that have clustered themselves into "productive groups". They do not extend new business loans to more than one person in the group at a time. All group members are required to have an existing business.

African Village was the first non-government MFI to offer clients a leasing product. It first started to issue leasing loans in December 2005. 21 clients currently use this product. Africa Village helps clients source the business equipment they require (it has agreements with different equipment providers) and provides the credit to purchase the equipment. By acting as facilitator in the purchase process, it is able to secure free training for clients from providers on how to use the equipment. So far, some of the purchased equipment has included water pumps, television sets, three-wheeled motorbikes, sewing machines and briquette machines. As a loan prerequisite, Africa Village requires clients to obtain asset insurance on the purchased product.

In assisting clients to obtain insurance on the leased equipment, Africa Village has experienced that most insurance companies are simply not interested in insuring a single, relatively small-valued asset. The only insurance company that has been willing to insure these products is the Ethiopian Insurance Corporation (EIC). While it has thus identified an insurable risk that underlies its (and those of its clients) everyday business operations, almost no formal insurance companies have been willing to address this need.

5.2. Insurance distribution

In Ethiopia, there are three categories of insurance intermediaries:

- salaried insurance company staff (no commission) that sell insurance policies to a walk-in clients of the insurance company.
- insurance agents that tend to sell insurance on a part-time basis and receive commission; and
- brokers that earn commission-only.

[44] The fact that it is a loss leading category of insurance is not only due to the high motor accident rate in Ethiopia, but also to the outdated risk rating practices of Ethiopian insurance companies. It is reported that insurance companies only vary the premiums of motor insurance policies according to the make and model of the car and the gender of the driver. The age of the driver and number of years driving is not taken into account when determining the premium of a policy.

There are currently 38 registered insurance brokers in Ethiopia and more than 1,500 active sales agents (Insurance Supervision Department, Bank of Ethiopia, 2008). These statistics do not include the category of salaried insurance company staff that sell policies to walk-in clients.

Given the nature of the majority of insurance business in Ethiopia (insurance sold to corporate entities to insure their business interests), Ethiopian insurance intermediaries have not had to actively go out and convince individuals[45] of the value of retail insurance. The problem of intermediating insurance on a low-cost basis to low-income individuals has thus not even begun to be explored.

Premium collection. In the absence of an electronic payment system, premiums are collected in cash or cheque and clients either go to the insurance company to pay their premiums or it is collected by the broker or agent. This process has contributed to the preference of insurance companies for annual insurance premiums payments. However, microinsurance clients are generally only able to afford small insurance premium payment, implying the need for more insurance premium payments (e.g. on a monthly basis) than only once per year. If microinsurance policies were to be sold on a group basis with the premiums collected by the group aggregator, e.g. a MFI or SACCO, only one premium payment would have to be collected by the broker. This would then assist in overcoming the absence of an electronic payment system.

The structure of the Ethiopian insurance market, as well as the way that distribution currently takes place, does not bode well for the development of a microinsurance market. Even if insurers decide to pursue new and lower-income markets, there are a number of challenges that they will face:

- **High transaction costs:** The insurance industry still relies on cash or cheque collection of premiums with no debit orders available. Companies tend to have limited awareness of transaction costs across different product categories as they generally do not follow cost-centre approach. Although transaction costs may be less of an issue with corporate clients, it is likely to become a bigger problem as companies start to move into individual retail business.
- **Limited distribution opportunities:** Ethiopia is characterised by the absence of other large networked industries. However, the still limited utilisation of insurers' relationships with banks for indentifying insurance sales opportunities and exploiting customer data, as well as insurers' limited engagement with client aggregators such as MFIs, cooperatives, labour unions and the Ethiopian cellular airtime provider does imply that there are still significant unutilised distribution opportunities.
- **Limited technical capacity:** Many of the insurance companies indicate that skills development and the absence of an experienced technical skills base is a major obstacle to expansion. For example, it is reported that there is no actuary in Ethiopia, not even in the insurance supervision department. Foreign actuarial expertise is contracted in as and when required making product development a cumbersome and expensive exercise.
- **Absence of electronic management information systems (MIS*)*:** Most insurance companies, if not all, still rely on paper-based administrative systems. During consultation with insurance companies, it was mentioned that some companies have started to investigate the possibility of implementing electronic management information systems (MIS), but that implementation has not yet commenced. Reliance on a paper-based system adds significantly to the costs of administration and makes the extraction of client or future client information for sales purposes difficult.

[45] Where life insurance has been sold it is often in the form of group policies to employer groups.

5.3. Microinsurance products

This section explores the product and features of different types of microinsurance in Ethiopia. Many of these products are still in an experimental stage and have, therefore, not yet been extensively rolled out.

5.3.1. Weather-index insurance

Given Ethiopia's dependency on the agricultural sector for employment and income and its exposure to weather risks, there have been a number of insurance pilot projects in Ethiopia that attempt to address especially the risk of variable rainfall and drought. These pilot projects all involved some experimentation with index-based insurance. Index-based insurance pays out to all policy holders in a geographic area, irrespective of their individual losses, "when certain conditions are reached in the proxy or index". The index is selected to closely correlate with actual losses, e.g. crop or livestock losses, and is based on historical patterns, and should be objective and easily observable (Roth & McCord, 2008: 13). According to Roth & McCord (2008), index-based insurance either relies on a meteorological trigger (such as a specific rainfall level as measured by weather stations) or area yield triggers. Area yield triggers will pay out when the yield (e.g. specific crop yield) of a pre-selected area falls below a certain level.

Below, we describe three recent pilot projects or experiments with weather-index insurance in Ethiopia.

World Bank crop insurance pilot

During the 2006 crop season, the World Bank facilitated a pilot project on weather-based index insurance for rainfall risks associated with maize production in the Alaba woreda[46] of the Southern Nations, Nationalities, and People's Region (SNNP). The Ethiopian Insurance Corporation (EIC) was selected to provide underwriting for the insurance project, while product marketing was facilitated by two cooperatives in the region. Farmers living close to the weather station in the Alaba woreda were identified as potential clients. While, ultimately, individual famers would be the policyholders, the cooperatives were used as client aggregators to facilitate the transaction with farmers. Given that only 28 farmers decided to purchase the product, no reinsurance was obtained (AFTS2 & CRMG, World Bank, 2006).

Upon completion of the pilot, it was concluded that significant challenges still remain for the development of a large weather-index insurance market in Ethiopia.

- **Weather data:** While sufficient weather data was found for a number of districts in Ethiopia (including the district in which the pilot was run) the absence of an extensive, sufficient quality weather station network (spread over most geographical regions with little missing data) remains a challenge.
- **Intermediary networks:** The absence of an intermediary network with commercial incentive to distribute this insurance product beyond the cooperatives included in the pilot was also identified as an obstacle.
- **Limited penetration of agricultural credit:** Weather index products are often distributed via agricultural credit providers who are incentivised to encourage (or compel) the client farmer to take up cover as it also covers their credit risk. In this respect, the overall state of the agricultural

[46] A political administrative unit of Ethiopia, equivalent to a district.

finance and the limited penetration of agricultural credit were also identified as key challenges: "the general promotion of rural and agricultural credit markets would need to be improved in order to promote a conducive environment for weather insurance products" (AFTS2 & CRMG, World Bank, 2006: 59).

- **Impact on incentives:** At the time of the pilot, the Ethiopian government's fertilizer guarantee scheme, provided guarantees on fertilizer that were provided to farmers on credit. The guarantee covered a variety of risks including drought thereby largely eliminating weather variability as a risk for the credit provider. There was, therefore, little incentive for farmers to take up any additional cover. (More information on the fertilizer guarantee scheme is provided in Box 3 below.) While it may seem that we are arguing that farmers should rather be left to pay for insurance to fund their own risks, this is not the case. It may, in the end, be better for farmers to receive credit guarantees from government.
- **Capacity of cooperatives:** Furthermore, it was concluded that most cooperatives have limited capacity and skills to administer large-scale weather insurance projects.

Box 3: Ethiopian government's fertilizer guarantee scheme

In 1994, Ethiopian regional governments started a credit guarantee scheme to ensure the take-up of fertilizer-seed packages. Under this scheme, 90% of fertilizer is provided to farmers on credit at below-market interest rates. The fertilizer is offered as part of packages (incorporated with extension programmes) and this government-provided fertilizer and credit to purchase it has largely displaced retail sales of the private sector – even a large share of cash sales (Beyrlee et. al., 2007). In order to provide financing for seed-fertilizer technology packages, credit is extended by the Bank of Ethiopia (state-owned bank), cooperatives, local government offices and MFIs. The presence of this guarantee scheme is believed to act as disincentive for credit providers to provide crop insurance. The programme has now reached the level where it serves about 4m farmers with guaranteed credit of about US$70m. It is reported that credit recovery was "generally successful until the collapse of maize prices in 2001 and the subsequent drought" (Byerlee et. al, 2007: 23). Because of the impact of the drought, credit repayment dropped from an average of 80% pre-2001 to 60% in 2002. However, it seems this scheme will now be done away with by the Ethiopian government and if indeed the case, this will create a strong need for crop insurance, at least on the credit provider level.

Most fertilizer and seed in Ethiopia is distributed by government or government-owned entities. The presence of government as player in the credit industry could have a negative impact on market dynamics and incentives. As the sample above illustrates, not only did it gradually lead to a decrease in market share for private players in the industry, but also impacted on the incentive of credit providers to manage their credit risks efficiently.

Nyala Insurance crop insurance pilot

During 2007, the Ethiopian composite insurer, Nyala Insurance, in partnership with Swiss Re, piloted an agricultural insurance product for low-income famers that are members of the Lome-Adama Farmers Cooperative Union (LAFU). LAFU operates in 3 woredas east of Addis Ababa. The major crops in this area include teff, wheat, beans and maize. LAFU has 24 primary farmers' cooperatives with a total of 20,000 members (approximately 80,000 family members if an average family size of 4 is assumed) (Meherette, 2007). The union provides various inputs (including tractors, better yield

seeds and pesticides) and after-harvesting services (storage and marketing support) to farmers. One of the main reasons for selection of LAFU for the pilot was its proximity to 5 weather stations which had 20-35 years of historical rainfall and temperature data.

With the assistance of Swiss Re, Nyala developed a hybrid between a multi-peril and index insurance product that covers teff, wheat and beans produced on farms of a minimum size of 0.5 hectares. The policy provides cover for the crops while still growing, while being transported to a storage facility and while being stored (Meherette, 2007). An excess is payable. The policy covers a number of risks and perils, including rainfall risks (drought and excessive rainfall), fire, windstorms, fire and lightning, explosion and certain special perils such as hail, floods, impact of aircraft/aerial devices (Meherette, 2007). However, the bulk of the risk cover provided is centred around rainfall. While an index approach was used for rainfall risks, the other perils and risks would require loss adjustors to visit the farmers and assess the damage. Farmers are given a choice about whether they want to insure their product on a cost or revenue basis. Typical premiums are dependent on the excess amount selected by the client. For production cost cover, premiums would range from 0.8% to about 13% (depending on the level of cover and excess selected), while premiums varied between 1.3% to about 22% (depending on the level of cover and excess selected) for cover on the revenue basis (Meherette, 2007).

120 members of LAFU elected to purchase the product. No claims were experienced during the pilot period (Meherette, 2007). During 2008, Nyala extended its pilot to include a second union.

World Food Programme (WFP) humanitarian insurance

Experimentation with macro-level weather-index insurance. In 2006, the world's first humanitarian assistance insurance policy was purchased by the United Nations World Food Programme (WFP) from Axa Re. The policy provided for up to US$7m cover in emergency assistance in the case of an extreme drought in Ethiopia during the 2006 agricultural season (World Food Programme, 2006). The pilot policy was developed with assistance from the World Bank Commodity Risk Management Group and was constructed around calibrated rainfall data from 26 weather stations in Ethiopia. Payment on the policy was to be triggered by a significant drop in rainfall below historic rainfall averages in the period March to October 2006. The policy thus attempted to mitigate weather-risks not on the individual but macro-level. If a drought had occurred during the covered period, Axa Re would have paid US$7.1 million to the WFP for a premium of US$930,000, which would then have transferred the funds to the Ethiopian government. These funds would have been disbursed as cash assistance to households. The reach of the benefits of the policy would thus have been dependent on the Ethiopian government's ability to effectively distribute the funds to households in need.

No drought occurred during the 2006 agricultural insurance and therefore no funds were paid out. However, the project was still considered a success and the WFP is currently experimenting with the same type of insurance to provide cover for the 2009-2011 period. It is estimated that it would cost about US$5m to cover 1.5m people with a possible US$60m payout for the 2009-2011 period (IRIN Africa, 2007).

5.3.2. Health insurance

Although formal health microinsurance products are not currently being provided, health microinsurance products are being provided on an informal basis. Box 4 sets out the experience of the Organization for Women in Self-Employment (WISE) with their health insurance product.

Box 4: Organization for Women in Self-Employment (WISE) health insurance product

The Organization for Women in Self-employment (WISE) is a non-governmental Ethiopian organization, established in 1997 with the purpose of eliminating "the facets of urban poverty and the realization of sustainable livelihoods among poor urban women". It does the aforementioned by providing training and development to poor urban women on various topics (including business skills, leadership and management skills, health education and rights-related topics), assisting with the start-up and financing of savings and credit cooperatives SACCOs and participating in various networking and advocacy forums.

WISE currently serves 9,000 women through its 37 affiliated savings and credit cooperatives (SACCOs). Of these 37 SACCOs, 11 are now self-sustaining. In addition to the small business loans that are offered to women once they have reached a certain level of compulsory savings, these SACCOs also offer a voluntary health insurance product to its members. Any person that is an active member of a WISE-affiliate SACCO can purchase the product. The basic prerequisite for access to the product is having at least some savings with the SACCO. Approximately 1,800 SACCO members (20% of total membership) have opted to take this product.

Women that have selected the health insurance product are required to pay a monthly premium of Birr 5 (about US$0.50) in exchange for which they are offered primary healthcare cover of up to Birr 500 (about US$50) per year. WISE uses the services of private clinics and laboratories, often staffed by volunteers and with some of these health providers providing free services. Health insurance clients can also visit government clinics (where user fees apply). Health policy holders are refunded any primary health expenses that they have incurred by WISE.

It is important to note that this product is not underwritten by a formal insurer and is managed on a self-insurance basis. WISE has been able to manage their product (until now) on a break-even basis, with total premiums mostly being equivalent to total claims paid.

In addition to the self-insured health product, WISE SACCOs also require its borrowers to take a credit insurance product, totalling 2% of the total value of their loan. The credit insurance premium is charged up-front and added to the total loan amount. Like the health product, this product is also not formally underwritten.

Source:
Personal interview. *Organization for Women in Self-employment*. August 2008.

Organization for Women in Self Employment (WISE). Corporate brochure. November 2005.

5.3.3. Credit life insurance

As will be described in Section 6, most MFIs and many SACCOs are currently self-insuring their credit life risks and it is therefore considered as informal cover. The premiums of these products tend to be 1%-2% of the total value of the loan and cover the outstanding credit amount in the case of the client's death.

6. The informal insurance market in Ethiopia

This section provides an overview of the involvement of various categories of financial institutions in the informal insurance market.

Informal insurance sector serves more individuals with insurance (or risk management) products than the formal sector. A few categories of financial institutions, serving millions of Ethiopians, are currently involved in either providing informal risk management products (as done by the iddir) or informal insurance products (as done by MFIs and SACCOs). The difference between these

categories of pay-outs is the level of certainty around the premium and pay-out. While iddir may tend to vary their contributions and pay-outs depending on the risk experience of the iddir and the level of contributions received, MFIs and SACCOs will normally set their premiums at a fixed level (a percentage of the total loan amount) and cover the outstanding debt of clients. While this approach may work for relatively predictable risks, any risk that is higher than predicted (see Box 5 for Oromio MFI's experience with high malaria prevalence) or catastrophic will wipe out the insurance funds of these institutions and, if they are unable to cover the value of outstanding loans affected by the risk, negatively impact on the financial soundness of their business and their clients' trust in the institution.

Iddir:

Iddir or eder are informal member-based organisations originally established to provide social and emotional support at the time of death and to conduct the burial[47], but over time these burial societies have evolved to become informal financial risk management tools that not only address death-related financial impacts. While the phenomenon of iddir in Ethiopia originally started in rural areas, it gradually spread to urban areas. Emana et al. (2005: 18) suggests that "the expansion of Iddir is perhaps the result of growing social insecurity" and cites Salole (1986) as noting that access to iddir may be "one of the most significant survival strategies or coping mechanisms adopted by Ethiopian urban populations". Iddir membership is not only limited to low-income individuals; high income individuals also belong to and actively participate in these organisations.

Provision of funeral insurance. The primary purpose of most iddir is to provide both social and financial assistance in the case of death in the family of their members. Iddir members typically meet once or twice a month to make a small contribution, Birr 1-2 (US$0.10-0.20), to the risk pool fund. If an iddir member passes away or a family member of the iddir member dies, the iddir provides a payout to surviving family members (Dercon, 2008). The median payout amount in a surveyed group of rural households[48], viewed as generally representative of the Ethiopian rural population, was found to be Birr 100 (US$10) (Dercon, 2008). In an earlier study, Dercon (2006) finds that in a sub-sample of the Ethiopian Rural Household Survey, the average payout of iddir is around Birr 200, equating to about 40% of total monthly household consumption in the survey area. Iddir not only contribute to the funeral financially, but also alleviate the impact of death in the family by contributing labour (for funeral arrangements) and provide labour to assist with a few days farm and other work (Dercon, 2006).

Usage level. Although exact data is not available to confirm this, iddir membership seems to be pervasive. One survey found that nearly 90% of households from a sample considered being relatively representative of the Ethiopian rural population reported to belong to at least one iddir (Dercon, 2008). Households often belong to more than one iddir to increase the likely pay-out in the case of the iddir member's death or that of a family member.

Health iddir. There is evidence of some iddir also providing a type of health insurance or financing for health risks. In a survey of 1,200 households on kebele-level (village-level) within two regions of Ethiopia (Amhara and Oromia), almost 22% of households indicated that they use their iddir to part-finance their health expenditure. 86% of respondents in the household survey indicated that they would be interested in participating in iddir health-base schemes. Dercon (2008) investigated the

[47] There are very few, if any, funeral parlours in Ethiopia since iddir traditionally take care of the body of the deceased and the burial.
[48] Dercon (2008) draws information on average contribution amounts and average payouts from the Ethiopian Rural Household Survey (EHS), a longitudinal survey, conducted since 1989.

phenomenon of health iddir in more depth by administering a questionnaire on the functioning of iddir that provide health insurance in four Ethiopian villages[49] (these villages included a total of 33 surveyed iddir). The survey revealed that while the primary purpose of the iddir was not the provision of health insurance, if members experienced health shocks that translated into unexpected expenditure they would assist with these expenditures if members approached them before the expenditures were incurred. Furthermore, assistance with health expenditure is limited to direct health expenses - loss of income and supplementary labour (on the land or in the household) is generally not funded for.

Short-term loans. Some iddir also provide short-term loans to fund unexpected expenses. Dercon et al. (2006: 690) notes that "members have to present a case for obtaining a short-term loan, and the most commonly accepted reasons are additional funeral spending, illness and destruction of a house".

Other insurance. In a sample of 78 rural iddir in seven villages[50], 64% of iddir were found to offer other types of benefits (i.e. non-funeral). This included insurance for destruction of a house (40% of iddir), illness (30%), fire (28%), death of cattle (24%) harvest (14%) and weddings (14%) (Dercon et al., 2006). In all of these cases, the premium for these products was included with the basic membership premium and no additional amount was charged.

Possible role as distribution channel. Given the high prevalence and presence of iddir in Ethiopia, they hold potential as distributors of not only insurance but also other financial products. However, it is important to note that despite their organised internal structures, iddir are not externally organised into federations and apex bodies. Formal financial institutions may thus find it difficult to easily establish contact with large number of iddir at the same time and may have to gradually establish contact on community-level. Dercon et al. (2005: 699) cautions that "the group dynamics may well be upset when additional administrative and managerial requirements emerge, undermining the groups' stability and continuity". At the least iddirs are raising awareness of insurance as potential risk management tool.

MFIs and SACCOs

Most MFIs in Ethiopia are self-insuring their credit life risks. A survey undertaken by Amha (2008) on the microinsurance products being provided by microfinance institutions found that the cost of these products tends to range between 1-2% of the total value of the loan. This finding was confirmed at a meeting with several MFIs (representing different categories of MFIs in the industry) during August 2008. The insurance provided by these entities are generally limited to credit life risks, but Box 5 describes the experiences of one MFI that ventured beyond credit life insurance to provide additional life cover to credit clients.

SACCOs also offer credit life insurance products. According to industry insiders, most SACCOs self-insure the life risks of their credit products by charging an additional 2% of the value of the loan amount. Although SACCOs are currently doing this on an individual basis, it is planned that at some stage the Addis Saving and Credit Union will start providing centralized insurance services to its member unions. It is not clear whether this will be in partnership with a formal insurance company.

[49] These villages were not randomly selected, but form part of the villages in which the Ethiopian Rural Household Survey, a longitudinal household survey, has been conducted since 1989.
[50] A sub-sample of the Ethiopian Rural Household Survey.

Box 5: The credit insurance experience of Oromia Credit and Savings Institution (OCSI)

Oromia Credit and Savings Institution (OCSI) started operating in August 1997. It offered small business loans, using the group loan methodology, to clients. After five years, during the 2002/03 financial year, it introduced credit insurance on its loan products. Under the group loan methodology, group members were required to repay the loan of the deceased member in the group. In an attempt to recoup lost funds, group members often forced the remaining family members of the deceased to repay their loan and this led to negative experiences with the group loan methodology. Oromia therefore decided to introduce a credit insurance scheme.

Oromia initially offered two types of credit insurance products. The first type of product had a cost of 1% of the total loan value and provided cover for the outstanding amount of the loan. The second type of product had a cost of 1.5% of the total value of the loan and in addition to cover the outstanding loan balance also provided a small pay-out to family members of the deceased. While joining the microinsurance scheme was compulsory, clients were given a choice between the two insurance products. One year there was a malaria outbreak at one of the Oromio branches and mortality rates amongst members of the MFI spiked sharply. The 1.5% scheme was hard hit by this event and most of the microinsurance reserves of the specific branch were depleted. Given the risk experience of the one branch with the 1.5% product and an inability to accurately predict and manage the risks of other branches with this product, Oromio decided to discontinue the product.

When Oromia initially started offering credit insurance in 2002/03, it calculated that 0.5% of clients were likely to die in any year. Their actual risk experience, however, has been a mortality rate of around 0.13% (this includes the deaths as a result of the malaria breakout). Discontinuing the 1.5% product was, therefore, an overreaction that illustrates absence of actuarial management skills. They are currently operating their credit insurance scheme on a profitable basis and reconsidering whether they should bring back the 1.5% product with the additional death benefit for the family of the client.

Source:
Kebede, T., 2008 *Personal communication*. Oromia Credit and Savings Institution (OCSI). 22 August.

The presence of various informal insurance mechanisms bodes well for the potential development of a formal microinsurance market in Ethiopia. The existence of iddir indicates the presence of a need for a broader and more organised approach to the management of household financial risks, while it also points towards an existing level of knowledge on the operation of insurance mechanisms opens. The mortality risk management of MFIs and SACCOs presents microinsurance market development opportunities as these risks' management are likely to be optimised by formalising their management, i.e. having MFIs and SACCOs obtain underwriting from formal insurers or supporting these organisations in eventually establishing their own insurance companies.

7. The demand side for microinsurance in Ethiopia

In order to provide a summary of the demand-side findings on microinsurance in Ethiopia, this document copies directly from an input document prepared by Oxfam America, retaining elements of the original document structure. This section is a selective summary of the content in the Oxfam America document, relating the primary conclusions of the Oxfam report to the rest of the analysis on microinsurance in Ethiopia. More detailed information can be found in the original document[51].

The section discusses the demand-side findings by focusing on the following relevant issues:

- nature of poverty in Ethiopia;
- the risk experience of Ethiopian households;
- Ethiopian households' risk management or coping strategies; and
- Ethiopians' attitudes towards insurance.

7.1. Methodology

The methodology used in the Oxfam America study was primarily qualitative but, where possible, quantitative data and estimates (from secondary sources) are provided. The study was conducted through:

- A literature review of primary and secondary sources.
- Interviews with key informants and discussions with focus groups involving four different livelihood groups (urban workers, coffee farmers, pastoralists, and agro pastoralists) in three different regions of Ethiopia (Oromia; Southern Nations, Nationalities, and the People's Region (SNNPR) and Addis Ababa). More information on this is provided in Box 6 and Appendix B and further detailed information can be found in the original Oxfam America study[52].
- Research related to Oxfam America's **Horn of Africa Risk Transfer for Adaptation (HARITA)** pilot (see Appendix B).

Box 6: Livelihood groups selected for field research

Four different livelihood groups in three different regions were represented in field research conducted between August and September 2008. The research methods used were Focus Group Discussions (FGDs), Participatory Rapid Appraisals (PRAs), in-depth interviews and key informant interviews. 111 men and 57 women participated ranging in ages between 20 and 90, with about the half the group in the 18 to 40 age group. About 51% of participants were illiterate, 16% had completed primary education, 23% secondary education, and 10% college studies.

The livelihood groups constituted the primary sampling unit (PSU) while the regional location constituted the secondary sampling unit. In order to prioritize different administrative regions in Ethiopia, the study gives more weight to those locations where a large number of target clients are located and where prospective insurance distribution channels are dense (measured by the number of MFIs, insurance company branches, cooperatives, etc.). Based on these criteria, the administrative units of Omoria, SNNPR and Addis Ababa were

[51]The complete reference for the Oxfam America document is: Oxfam America, 2009. *Estimating the demand for micro-insurance in Ethiopia.* A report commissioned by the International Labour Organization and United Nations Capital Development Fund. January. Oxfam America: Boston, MA.

[52] More information on the focus group methodology can be found in Appendix B.

chosen.

Below we provide a brief description of each livelihood group:

Poor Urban Workers, Addis Ababa

Poor urban workers in Addis Ababa are generally involved in insecure and/or low return activities such as hair dressing, selling clothes, working in a cafeteria, carpentry, shining shoes, serving as parking attendants, housemaids and day labourers. Micro-entrepreneurs including taxi drivers, petty traders, and coffee shop owners also face relatively precarious livelihoods, but may be better off because they own their businesses.

Coffee Farmers, SNNPR

SNNPR is one of the primary coffee growing areas of the country with an estimated 15m people, with 91% (Wikipedia 2008c) living in rural areas. Ethiopia is hailed as the birthplace of coffee with an annual production of 220,000 tonnes. More than 1.2m coffee growers, 95% of whom are smallholders, and around 15m households depend on coffee for their livelihoods. Coffee is the leading export commodity, traditionally contributing about 65% of total export earnings. As an export cash crop, coffee provides income in the form flexible cash versus as a crop to be consumed for food, but it is more subject to the vagaries of the market – both local and international.

Pastoralists, Oromia

Ethiopia is one of the biggest exporters of livestock in Africa and the tenth largest livestock producer in the world (Embassy of Ethiopia, Washington DC, nd). Pastoralists depend entirely on livestock for their livelihood and account for about 35% of Agricultural GDP (Hatfield and Davis 2006). Pastoralists make up an estimated 12-15m people and reside across 61% of the country's area.

Pastoralists inhabit the dry and hot lowlands of the country where potential for crop cultivation is limited due to adverse weather. The pastoralists live a nomadic way of life in order to exploit the meagre and seasonally variable resources as well as to provide for their animals. Due to their nomadic way of life, the pastoralists' communities are generally underserved in terms of basic social and economic services like education, health, clean water supply, and infrastructural development.

Agro Pastoralists, Oromia

Agro-pastoralists are semi-sedentary people whose livelihoods depend both on cultivation of crops (usually annual varieties) and on rearing livestock including oxen, cows, sheep, goats, donkeys, horses, and mules. Many pastoralist areas in Ethiopia have slowly become more agro-pastoralist over time as nomadic communities have adapted to farming over the last few centuries - partly as a measure of economic diversification and also as a response to a decrease in grazing land.

In addition to the field research conducted, this study also draws on insights developed through the Horn of Africa Risk Transfer for Adaptation (HARITA) pilot project, a partnership between Oxfam America (OA) and Relief Society of Tigray (REST), which focuses on the indigenous aims to develop a demand-driven model for insurance that empowers communities in Ethiopia to adapt to climate variability and change.

7.2. Poverty in Ethiopia

As this is a demand-side analysis into the potential of providing insurance to low-income individuals and household in Ethiopia, it is important to have a closer look at the nature and distribution of poverty in Ethiopia. Poverty exerts a profound influence on the demand for microinsurance in a variety of ways. Poverty:

- *Increases the severity of risks*: A small earthquake kills more people than in a rich country due to inadequate access to safe housing by the poor
- *Increases the probability of risks*: The poor have a harder time protecting themselves. For instance, the inability to purchase a mosquito net increases the risk of contracting malaria
- *Decreases coping capacity*: The poor have fewer assets to serve as a cushion
- *Decreases awareness of financial tools*: Low levels of education and access to public services mean many poor people are unaware of financial needs
- *Decreases access to financial tools*: Financial providers believe that the poor cannot constitute a profitable market, and therefore have done little to try to reach them.

Poverty prevalent in Ethiopia. As discussed in Section 2 of this document, assuming a population size of about 79min in 2004 (UNDP, 2008) and using the three most common poverty lines, poverty is distributed in the following manner:

- **USD $1/day:** According to this measure 18.2m individuals (or 23%) live on less than USD $1/day[53] adjusted for purchasing power parity
- **Domestically defined poverty line:** Ethiopia defines the domestic poverty line by daily nutritional intake, set at 2,200 kilocalories, which translates roughly to ETB647.81 (USD $67.78)[54] per year. Using this benchmark, country wide poverty estimated at 44.2%, representing approximately 35m Ethiopians.
- **USD $2/day:** According to this measure, 61.4m individuals, or about 78% percent, live on less than USD $2/day[55] after adjusting for purchasing power parity[56].

Poverty skewed towards urban areas. While poverty is prevalent in both rural and urban areas, Shimeless (2005) demonstrates that in Ethiopia "poverty was more persistent in urban than rural areas...Exit and re-entry probabilities showed that it was easier for rural households to exit poverty as well as to re-enter it. Both exit and re-entry rates declined more for urban households over time." The urban-rural poverty link is further exacerbated by the high rates of rural-to-urban migration (leading to overcrowding and other ills in the city) and decreased food production resulting from fewer agricultural and livestock producers in the rural areas.

7.3. Risk experience of Ethiopian households

To design appropriate microinsurance products, it is key to understand the risk experiences of the poor. This section discusses the major risks facing low-income households in Ethiopia.

In analysing the risks experienced by Ethiopian households, it is important to distinguish between the risks that are generic to all Ethiopians and risks specific to a livelihood or region. The two major generic risks (as discussed below), are poor health or illness, and the death, while the two biggest

[53] At 1985 prices, equivalent to USD $1.08 at 1993 International Prices (UNDP, 2008).
[54] The prevailing exchange rate at the time was USD $1 to ETB 10.
[55] At 1985 prices, equivalent to USD $1.08 at 1993 International Prices (UNDP, 2008).
[56] Defined at 1985 International Prices, equivalent to USD $2.15 at 1993 international prices (UNDP, 2008).

risks relating to livelihood include crop failure (due to drought or other reasons) and cattle mortality (due to drought or diseases).

Because risk is a large part of daily life in Ethiopia, focus group discussion (FGD) participants seemed to possess a firm understanding of risks and threats to their livelihood.

With the exception of universal risks such as death and illness, risks appear to vary from region to region, especially between urban and rural areas. The results for the rural population show crop failure and livestock death (due to drought) are the main risks. This finding is consistent with prior studies by Dercon et al. (2008) that identify the main risks for rural households in Ethiopia in a similar manner.

Key informants in urban areas consider property loss due to damage (e.g. fire) and theft to be a risk second only to death of the household head and illness, particularly HIV/AIDS. Households in Addis Ababa are also concerned with a high cost of living and high unemployment rates.

Universal risks

The overall health of the Ethiopian people is poor and illness represents the most commonly cited risk in all the regions included in the study. Per capita health expenditure in Ethiopia is estimated at US$ $7.10, far below the minimum (USD $34.00) necessary for a developing country. The doctor to patient ratio is one-to-37,000 patients and more than 50% of households must travel 15 kilometres or more to reach the nearest health facility.

High prevalence of disease. The Centre for National Health Development CNHD) in Ethiopia estimates that as "much as 80% of the health problems are due to preventable communicable and nutritional diseases" (Earth Institute n.d). The CNHD cites malaria as the number one cause of outpatient visits and the disease is singly responsible for 8-10m annual clinical cases and many deaths. Furthermore, according to the IMF, Ethiopia has the third highest absolute number (after South Africa and India) of people living with HIV/AIDS. Most households in the study cited HIV/AIDS as the number one illness-related risk. Partly compounded by the prevalence of HIV/AIDS, Ethiopia also suffers from a high TB prevalence rate with 353 persons for every 100, 000 infected. Linked to the country's susceptibility to drought is malnutrition with the CSA reporting that 37% of children were underweight in 2007.

Due to ill health and nutrition, life expectancy is low. The life expectancy for men and women in Ethiopia is 53 and 55 years respectively. Poor health standards as previously alluded to are partly to blame for the low average age of death. However, participants in Oromia cited death to due to clan conflict as a problem. Violent clan conflict is particularly common in pastoralist and agro pastoralist areas where the shortage for water and fodder usually leads to skirmishes.

Death imposes a huge financial burden on surviving family members, especially when it involves the demise of a primary male breadwinner. On the other hand, given Ethiopia's strong emphasis on a dignified funeral, death can also have substantial short-term effects. Dercon (2003) estimates that burial accounts for 25% of the average low-income household's yearly consumption expenses. Surprisingly, pastoralists in the focus group discussions seem to view burial costs with a slightly more relaxed attitude. This may relate to the fact that they are an economically vulnerable group with few resources to devote to funerals. One group explained:

"There is not much ceremony involved in death. There is preparing for food and tea for those participating in the burial ceremony...There is no financial pressure, but there is a psychological effect on the family. [Death] involves some kind of ceremony but it is not a necessary condition."

Livelihood risks

Crop and livestock failure due to drought presents the most serious livelihood threat to the majority of Ethiopians. About 85% of all people in Ethiopia are engaged in smallholder, rural, rain-fed agriculture with the sector contributing nearly half of total GDP. Adverse shocks to the sector, therefore, do lead to widespread destitution among the poor. According to Amare (2003) "the most common way by which households became destitute was after they experienced severe or repeated crop failure due to drought or other natural causes leading to the sale or death of livestock assets". For more information on the severity of drought and its impact on the lives of Ethiopians, see Box 7.

Box 7: Drought risk

Academic literature and original research commissioned by OA suggest that Ethiopia's number one overall risk is drought which is responsible for inflicting severe direct damage to crops and livestock as well as increasing morbidity, mortality, and—arguably—unemployment in urban areas. Consider the following:

Impact on economic growth and development

- One survey indicates that between 1999 and 2004, more than half of all Ethiopian households experienced at least one major drought-related shock and that "had households been able to smooth consumption, then poverty in 2004 would have been at least 14 percent lower—a figure that translates into 11 million fewer people below the poverty line" (Dercon, 2005)
- A study of the microfinance institution DECSI found that of 21 different factors, a poor agricultural season and natural disaster (primarily drought) were the overwhelmingly predominant reasons for decreases in the project area's living conditions. Moreover, beyond problems with their land, households in the area mentioned lack of rain as the second most important constraint in both crop and livestock production (Borchgrevink, et al. 2005).
- In one economic study, experiencing a drought at least one time in five years resulted in roughly 20 percent lower per capita consumption (Dercon, et al. 2008).

Link to malnutrition and emergency relief

- According to CRED's database of emergency event statistics, drought was the cause of ten out of all ten top natural disasters in Ethiopia (CRED 2008), and has been nearly 6 times more economically damaging than flooding, the second-ranked most expensive type of natural disaster in the country (CRED 2008).
- There is a high degree of correlation (80 percent) between the drought index and the number of food aid beneficiaries nationwide (Hess, et al., 2006).
- In 2007, more than one million Ethiopians received drought relief assistance from international programs that registered on a climate disasters database. About seven million received support under a national program to protect nutrition levels in drought-prone areas (UNDP, 2007).
- According to a 2000 estimate by Sanford and Habtu, "the cumulative effective of drought has increased the number of pastoralists to 'depend' on food aid from 10 to 20 percent in [sic] 1990s to 50 percent in 1997/99 [sic]" (Sanford and Habtu, 2000).

- Children aged five or younger are 36 percent more likely to be malnourished and 41 percent more likely to be stunted if they were born during a drought. These figures represent about two million additional malnourished children in 2005 (UNDP, 2007).

Higher mortality risk for people and livestock

- A drought in 1888 led to death by famine of approximately *one-third of the entire population.* The drought was also followed by a rinderpest infestation that killed 90 percent of animals (Webb and Von, 1994).
- A drought in the 1970's set the stage for a famine in Wollo, in which 200,000 people perished. (Intergovernmental Authority on Development and the Climate Prediction and Applications Centre 2008). In the same period, drought-related famine reduced the livestock population of the Afar region by an estimated 72 percent (Sanford and Habtu, 2000).
- The most famous drought and famine in recent history in 1983/84 extinguished the lives of up to one million people and a significant number of animals (Intergovernmental Authority on Development and the Climate Prediction and Applications Centre, 2008).
- The 1984/85 famine reduced Borena's livestock by 60 percent; the 1984/85 famine reduced livestock by 78 percent in Somali; and Borena suffered a 78 percent drop in livestock during the 1995/97 drought (Sanford and Habtu, 2000).

Farmers in Hagere Mariam (agro-pastoralists) were primarily concerned about crop failure due to drought and disease and death of livestock. For crop loss, participants said a typical household could lose up to ETB 10,000 (about US$1,000) in revenue, while they might lose up to ETB 3,000 (US$300) for livestock loss.

For drought, participants expressed relative hopelessness compared to other risks, often saying they could only turn to the Almighty for help:

> *"Most of the risks we face are related to drought; hence we depend on God to save us."*
>
> *"We do not have any control over drought."*
>
> *"Drought is God's will—we cannot prevent it. I ask Him to save me."*
>
> *"All people whether male or female, rich or poor depend on God to save us from drought and loss of animals. We are Christians. People are becoming religious."*

Pastoralists in Yabello ranked drought as their primary risk, as it leads to loss of grazing land, water, animal mortality, low market prices (due to emaciated cattle), and human illness. Summing up, the group explained:

> *"Risk is drought that affects our livestock. When our livestock are affected by lack of food, we will also be affected by lack of food. We depend on livestock for every requirement in life. In our community loss of livestock is risk. We are nothing apart from our livestock. Our wealth and health is our livestock."*

Crop failure due to disease a very real concern for coffee farmers. Households in SNNPR, primarily populated by coffee-growing farmers, were particularly concerned about crop failure (specifically of

coffee and enset, a drought-resistant staple food in the south). Coffee-farmers are most threatened by crop damage at the hands of coffee berry disease and enset bacterial wilt. Other significant threats to participants in the area include death of the household head, illness, theft, and coffee price fluctuations. While there is no recorded evidence related to enset bacterial wilt loss for the major enset growing regions in Ethiopia, recent participatory research in SNNPR indicates that many farmers lost 40-50% of their enset crop due to this disease (Tadesse, et al. 2003). Participants estimated ETB 5,000-7,000 (about US$500-700) per season in losses per household due to diseases in this area. However, this appears to be an estimate on the high side.

Cattle mortality due to poor diseases and pests also a major risk. For the approximately 91m cattle, sheep, goats and camels, there are only 379 veterinary doctors and 2,687 health assistants and technicians with only 182 qualified to vaccinate the animals (CSA, 2007). The national annual mortality rates for cattle, sheep and goats are 8-10%, 14-16% and 11-16% respectively. Diseases and pests also cause considerable loss. In the southwest, about 10 cattle are permanently at risk of contracting trypanosomes (tsetse fly spread). In the late 1990s, an outbreak of RVF led to an 18 month Saudi embargo on all livestock imports from the horn of Africa.

One pastoral FGD placed the average cost of livestock loss at ETB 10,000 (about US$1,000). Livestock is the only dependable source of income for pastoralist communities so their livelihood is highly contingent upon it.

7.4. Risk management or coping strategies

To deal with risks, Ethiopians rely on three major categories of risk management or coping mechanisms:

- individual self-insurance;
- community-based arrangements; and
- external assistance.

Each of these categories contain possible ex ante and ex post measures that can be taken to actively manage and prepare for a risk event before it happens and cope with it after the fact.

The poor try to minimise the occurrence of loss through a variety of preventative measures. Besides the copings strategies here that generally rely on some formal or informal financial mechanism used to prepare for a risk or deal with it once it occurs, FGD participants also mentioned some behaviour-based changes used to prevent risks from occurring at all. FGD participants in Addis Ababa said they try to minimise loss by observing traffic rules, using locks on their doors, washing their hands to prevent infection and going to the doctor immediately upon falling sick. In rural areas, preventative measures take the form of planting drought-resistant seeds and creating soil bands to conserve fertility.

Many Ethiopians tend to leave risk management to God. The FGDs also revealed that in many cases Ethiopians are relatively fatalistic and look towards their religion and belief in God for comfort. About 94% of the population belongs to a religious grouping, with 61% saying they are Christian and 33% indicating they are Muslim (CIA , 2008). Looking to God for protection and in times of need is expressed in such cultural sayings as:

- *Egziabehere yawukale. ("God knows everything. Why should I worry?")*

- *Isu yekefetewune guroro sayezega ayaderem. (roughly translated "God opened our throat, we hope God shall close it or find a means for us.")*

Below, we discuss the three major risks management or coping categories.

7.4.1. Individual self-insurance

Self-insurance entails the retention of risk, meaning that any loss is absorbed and "compensated" by one's own assets. Here we briefly discuss the individual self-insurance mechanisms most frequently cited in risk management literature – savings and credit.

The establishment of microfinance institutions (MFIs) has helped low income households' ability to save in both rural and urban areas. MFI clients are often required to save and deposit about 10% of the loan amount thus strengthening their repayment capacity and also acting as insurance in case of default. As of 2007, MFIs had mobilised US$246m through collateral and voluntary channels in 7 years. Saving is arguably the most effective method for coping with the majority of economic shocks (Manje and Churchill, 2002) because they are easily adaptable and can be drawn upon quickly. Cash savings have the additional advantage of liquidity when there is no time to sell in-kind assets or when they face a low price. Other Ethiopians, however, continue to stash their savings in insecure boxes at home in order to avoid such requirements as photo identification, initial bank deposit and some degree of literacy.

Access to credit is an important self-insurance mechanism from both an ex ante and ex post perspective. Economic shocks are easier to weather when one is wealthy and credit, used wisely, can build wealth. Once a shock occurs, credit can be used to fund necessary and wise consumption such as emergency food. The Ethiopian government has recognised the importance of credit access by including it in the national Poverty Reduction Strategy Paper and by also formally establishing MFIs through a policy and legal framework in 1996. By the end of June 2007, MFIs in Ethiopia had a total of 1.73m active clients (Amha, 2008).

However, FGDs indicate that savings not frequently used by poor. The urban (Addis Ababa) FGD participants say that ex ante coping strategies such as savings are hardly ever practiced in their community. Participants explained that only relatively richer households could save as a precautionary measure, and the majority of families attempt to cope after a shock.

Among those who save, most prefer to keep cash at home. They also said obtaining credit from an MFI takes too much time and is not accessible when they need it. In addition, respondents fear debt repayment, another factor that contributes to their avoidance of credit as a coping strategy. Women in the group indicated they tend to save more than men, a finding that is consistent with academic literature on gender differences in savings behaviour.

Similar to the urban focus group participants, the coffee farmers, pastoralists and agro-pastoralists also rated savings as a less important and less frequently used risk management mechanism. One participant from the agro-pastoral FGDs explained that "we are too poor to save a sufficient amount." Moreover, saving with MFIs was thought to be relatively inaccessible as it cannot be easily withdrawn at the time of need (especially on the weekend when offices are closed).

7.4.2. Community-based arrangements

Insurance builds upon the principle that big risks are often better handled collectively than individually. Below, a short overview is provided of some of the three most important and prevalent community-based risk-sharing arrangements in Ethiopia:

- iddir (ex ante risk management);
- iquub (rotating saving schemes – ex ante or ex post management); and
- cooperatives (ex ante risk management).

We also include information on *busaa gonofaa*, a very informal ex post risk management mechanism.

Iddir the most popular risk management mechanism for funeral expenses. Iddir or eder are informal member-based organisations originally established to provide social and emotional support at the time of death and to conduct the burial, but over time these burial societies have evolved to become informal financial risk management tools that not only address death-related financial impacts. The primary purpose of most iddir is to provide both social and financial assistance in the case of death in the family of their members. Iddir members typically meet once or twice a month to make a small contribution, birr1-2 (US$0.10-0.20), to the risk pool fund. If an iddir member passes away or a family member of the iddir member dies, the iddir provides a payout to surviving family members (Dercon et. al., 2008).

While the phenomenon of iddir in Ethiopia originally started in rural areas, it gradually spread to urban areas. Emana et al. (2005: 18) suggests that "the expansion of Iddir is perhaps the result of growing social insecurity" and cites Salole (1986) as noting that access to iddir may be "one of the most significant survival strategies or coping mechanisms adopted by Ethiopian urban populations". Iddir membership is not only limited to low-income individuals - high-income individuals actively belong to and participate in these organisations. An estimate of up to 90% of rural households in Ethiopia participate in an iddir group (Dercon , et al. 2008), while Clark (2000) estimates that as of 2000, Addis Ababa alone had more than 3,000 iddir. More information on iddir can be found in Section 7, while the Oxfam America document also contains a detailed section on iddir and their role in risk management in Ethiopia.

Iquub. Iquub can best be described as rotating savings and credit organisations and are prevalent in Ethiopia. Iquub typically rely on members getting together and contributing a specified amount once a week or month with a payout equivalent to total funds collected rotating amongst members (Emana et al, 2005). While iquub are mainly used as a savings mechanism, in some cases they also extend credit to members.

In the FGDs, iddir and iquub ranked as the most popular risks management strategies for urban Ethiopians, with iquub being mentioned as the top risk management strategy for coffee farmers.

Cooperatives help their members deal with risks in a variety of ways. Cooperatives are organizations designed for collective action and, as such, are often good vehicles for pooling resources and managing risks. In Ethiopia, agricultural producer cooperatives provide important services, including "better market opportunities, higher bargaining power [which mitigates production price risks], and/or reduced transaction costs" (Bernard et al., 2007). Savings and credit cooperatives allow their members with access to a community vehicle to accumulate their savings and to obtain credit, if

required (see Section 3.1.3 for an overview of SACCOS in Ethiopia). In recent years, there has been a spike in the number of consumer cooperatives in Ethiopia, largely in response to the food price crisis. In Dire Dawa, for instance, 10 cooperatives have begun bulk purchases of basic commodities like flour, soap, oil, and sugar, and eventually bread, helping their members to more effectively deal with risks

Busaa gonoffaa an ex ante risk management mechanism that does not rely on risk pooling. Under the arrangement of busaa gonoffaa, fellow community and clan members contribute food and up to 10 heads of cattle per individual following a loss of livestock. Households that have lost all their cattle can expect to receive from their clan as many heads of cattle as they had before. However, those who have lost their cattle from mismanagement or negligence may receive only a few. This type of community-based coping mechanism that relies on ex post risk management without any risk pooling can be considered a form of pre-insurance in the evolution of insurance mechanisms. It is a community-based approach to dealing with risk typical of communities with insufficient resources for ex ante risk management.

Pastoralists who enjoy virtually no access to social and financial services say they look to God first, and then to buusaa gonofaa or dabare, although participants said that these social systems are beginning to break down as poverty seems to be increasing in the area:

> *"We are becoming poorer and poorer. During the good old days, what one community member had is for everybody. Nobody becomes hungry due to lack of food….We used to have a sufficient amount (cattle, grain) and even cash in case we face a problem. But we have too little now to save for emergencies. We save our cattle or purchase grain….Currently what we have is not enough to purchase grain for future use. Our cattle are becoming less valuable because they do not attract the attention of those who come to purchase them for business."*

7.4.3. External assistance

Finally, to manage risks, Ethiopians also turn to external assistance from institutions that are headquartered or supported by funds outside the area of intervention. External assistance also can also fall in the categories of ex ante and ex post interventions. Ex ante assistance covers a very wide range of initiatives including micro-entrepreneurial income generation, savings and credit-led schemes, environmental rehabilitation, agricultural productivity enhancements and other development projects. Ex post support focuses on response to emergencies that affect very large numbers of people at once (e.g. drought, flooding, ethnic conflict and cross-border war). Examples of actors operating in this space are the government, international or domestic non-governmental organizations (NGOs), international donors and religious institutions such as the development and relief arm of the Ethiopian Orthodox church.

7.5. Attitudes towards insurance

The analysis thus far has demonstrated a significant need for more robust risk management mechanisms in Ethiopia. However, need does not automatically translate into demand. This section looks at three factors, drawing on the field research and available literature, that are believed to influence attitudes (and willingness to buy) insurance:

- perception of the value of formal risk transfer or insurance as a concept;

- perceived and actual appropriateness (to the needs of potential clients) of insurance product; and
- trust in specific products and insurance providers.

Apart from focusing on attitudes towards insurance in terms of the above three factors, attitudes towards specific types of insurance cover and what this implies for product preference is also considered, while we also consider willingness to pay for insurance.

7.5.1. Perceptions on the value of insurance

Insurance viewed as something for the rich. Common attitudes identified through the FGDs and other complimentary qualitative research were that insurance is for "those who have money," "people with lots of business transactions," and "people with lots of property". For the few FGD participants who thought insurance was immediately relevant to the poor, they usually thought it was in the context of mandatory credit-life policies.

There is reason to remain optimistic, however. A number of study participants (urban workers, agro-pastoralists, and coffee farmers) welcomed the idea of compulsory insurance as collateral for loans. A group of agro-pastoralists explained "at first we didn't like [compulsory savings], but when we see other clients withdraw the money, it is a good lump sum which would not have been accumulated if not enforced." One pastoralist woman conveyed her experience with NGOs and kebele officials who told them to dig ponds for water conservation:

> *We didn't understand the importance of doing this. Nobody clearly told us about its importance and hence we resisted. But later, we ourselves understood its importance when we were affected by lack of water for our cattle, and I myself started to dig ponds. At this time, no assistance is made by the ones who told us to do this previously.*

Despite it being seen as a "rich product", insurance is still thought to be valuable. In all regions included in the FGDs, the low-income participants viewed the concept of insurance with enthusiasm. The following are representative statements from the field research:

> *"Insurance is very helpful and important as long as the payment is appropriate—we are eager to benefit from it." (Urban worker, Addis Ababa)*
>
> *"We expect this good idea to be reality." (Agro-pastoralist, Oromia)*
>
> *"Insurance is very important especially for Borena people, because every year we are under pressure of losing our livestock. Currently we don't have such a service. The only thing we know is government sometimes provides water and some medication for our cattle." (Pastoralist, Oromia)*
>
> *"We always face serious risks in relation to our coffee and enset and we need to have protection for them." (Coffee farmer, SNNPR)*

Existing knowledge of insurance

Some participants of the FGDs had existing knowledge of insurance. In Addis Ababa, people had heard of it from advertisements, NGOs like WISE, MFIs, friends, relatives, radio and television, while

in rural areas, some people had learned about it from truck drivers. Members of the Yirgacheffe Coffee Farmers Union YCFCU said they had learned about insurance from the cooperative management who had purchased insurance protection against fire and theft on behalf of the union. Agro-pastoralist households in Oromia also said they were well aware of vehicle insurance coverage from the truck drivers who pass through town, and they thought they would like to have a similar cover for their livestock. The agro-pastoralists also said they have learned about insurance from the local MFI, OCSCO, which has a credit-life scheme. The focus group facilitators noted that "participants easily understood the concept of insurance when introduced to them and even they started to talk about it before we introduced the concept of formal insurance."

Familiarity with iddir key to understanding insurance. In areas not already acquainted with formal risk transfer (areas without iddir) such as Yabello and Tigray, participants required much more explanation before being able to evaluate insurance's merits. In contrast, participants familiar with micro-finance and iddir quickly recognized the value of formal risk transfer through insurance.

Premiums not being returned in non-claim years do not appear to be a problem. While a few FGD participants said they would demand a refund of their premiums, in the vast majority of cases, they said they would not. Those familiar with iddir were particularly comfortable with the concept of premiums. As one MFI client put it:

> *"Risks impose a psychological problem and tension among a society. Actually it may or it may not happen, but you always suffer."*

One agro-pastoralist explained:

> *"We don't care if the premium is not refunded. We aren't allowed to withdraw what we have contributed for iddir if death does not occur. A person may contribute to iddir the whole of his life and not get anything if he wants to change his residence to other areas."*

In other words, iddir payments only provide certainty in the years during which the member contributes. Surprisingly, even pastoralists who are completely unfamiliar with iddir and micro-finance concepts said they would not be concerned if their premium were not refunded as it would simply indicate they had not been unlucky. Other FGD participants expressed the premium as a measure of social solidarity. As one agro-pastoralist explained:

> *"I don't care if the premium is not refunded. The company may use it to compensate other victimized persons in our society."*

7.5.2. Appropriateness of insurance products

For insurance products to be accessible, they must be both affordable and highly relevant to client needs.

The FGDs and other field research revealed that many prospective clients would be unhappy if insurance products were delivered only in groups (similar to the group lending methodology used by some MFIs). With the exception of an all female agro-pastoralist focus group[57], the vast majority of

[57] The methodology preferred by the participants was the group methodology because "we always want help each other in the payment of insurance in the same way we help each other in loan repayment when one of our member lags behind."

study participants say they would view group-based insurance with suspicion. Moreover, as pastoralists pointed out, insurance clients have different needs for protection:

Insurance *"should be delivered individually because there is an interest difference; some people want to insure their camel and others their cow and the payment may differ."*

7.5.3. Trust in insurance products and providers

For clients to agree to purchase an entirely intangible product like insurance, they must possess a high degree of trust in the insurance product and the insurer and/or potential intermediary. At its core, insurance is a simple promise, and anyone who is seen as unable or unwilling to honour that promise will not have a commercially viable product.

No obvious mistrust of insurers. Fortunately, for potential microinsurance providers, the field research overall found a general positive or neutral attitude toward all potential suppliers. With a few exceptions, participants frequently generally had no experience or good experiences with all the distribution channels we tested: microfinance institutions, savings and credit cooperatives, agricultural cooperatives, *iddir,* insurance companies, and banks. Where scepticism was expressed, it was usually around cooperatives and *iddir.*

Insurance could be distributed by a variety of organisations. The urban clients of WISE, a MFI, indicated that most of them trust MFIs and "other" institutions. SACCOs were also trusted. Interestingly, *iddir* and cooperatives were viewed as slightly less reliable, while banks were either "trusted a lot" or "not trusted at all." Insurance companies were viewed as "somewhat trustworthy." Pastoralists expressed their preference to obtain insurance through a local NGO. Agro-pastoralists felt that the local MFI, OCSCO (a local MFI), and *iddir* are the most trustworthy institutions. Nonetheless they would prefer for insurance to be provided by a separate institution, adding "but if it is mandatory to come with other institutions it should be OCSCO, the only organization we trust."

7.5.4. Product preference

This section does not focus on ranking the product preferences of field research participants, but simply presents some views on different products expressed during the course of the field research.

Health insurance

Unfortunately the desirability of health insurance was not probed in the field research. However, a report by Mariam (2003) sheds some light on the question. Mariam's study focused on whether iddir could be used as an effective vehicle for health insurance. The majority of study participants were interested in the idea:

> *"The benefits that are most valued by the respondents were emergency services followed by drugs. It is obvious that people in rural areas where there are inadequate facilities for emergency services (including obstetric services) would be willing to join schemes that would facilitate the timely provision of these services. Among the other socioeconomic factors, education was not associated with willingness to join possible eder -based health insurance schemes"* (Mariam, 2003).

Crop and livestock insurance

As can be expected, livestock insurance was highly emphasized amongst pastoralists and agro-pastoralists. In Adi Ha, the majority of teff farmers surveyed in the demand assessment said they would be interested in purchasing crop insurance, with health and life insurance coming in a distant second and third.

Life insurance

FGD respondents in Addis Ababa and the clients of WISE emphasized their interest in life insurance. Although death is one of the most financially burdensome events for low-income households, it could be argued that life insurance might be less attractive as an insurance product given the almost universal existence of iddir across the country. Unlike insurance companies, iddir offer invaluable, albeit less tangible services in addition to money: comfort for the bereaved, attendance at the deceased's funeral, and help preparing for numerous visitors to the home. They also perform good works in the community and function as an extended family when needed.

Iddir provides more value than simply their monthly contribution of money. Members need to actively participate in the discussion of social issues:

> *"We clean rivers, clean rural roads, and construct houses of destitute women and the like. So we have labour service for iddir. You don't belong to iddir only by contributing the financial requirement. Iddir's fund may be used to lend to its members under special consideration of the applicant's situation. If a member faces a very urgent emergency problem and if he or she is very poor, he or she can borrow from iddir with an extraordinarily small interest rate."*

It was therefore surprising to find that respondents in the field research were as enthusiastic about life insurance, not only as a complement to iddir, but in many cases as a substitute for it.

An agro-pastoralist focus group came to the conclusion that:

> *"Insurance is more preferable to iddir because insurance is wide in scope. Iddir compensation is very small and cannot cover even half of the expenses related to death. We have a culture of decent burial ceremony which involves killing of animals, food and drink preparation."*

One member of an iddir in Addis Ababa said "I like life insurance. *Iddir* is traditional and cultural. With the ETB 10 (US$1) that I pay now for *iddir,* I can get better services from life insurance." Most urban participants preferred life insurance over *iddir* (assuming it performed as expected).

Another member of *iddir* worried about not recouping years of contributions and said moving to life insurance would be impossible as "I've already invested too many birr in it*."*

7.5.5. Willingness to pay for insurance

Measuring the actual willingness of Ethiopians to pay for microinsurance is extremely difficult. This demand study has been primarily based on qualitative data. As such, all that can be concluded with certainty is that there is strong interest in insurance across the country

Nearly all FGD participants said they would be interested in purchasing insurance, explaining that the main reason why that had not yet done so was that they had not been aware of the existence of insurance products. Some comments on what the FGD participants were willing to pay include the following:

- "Death: ETB200-300 (US$20-30) annually; illness: ETB 150-200 (US$15-20); fire ETB 150 to 200 (US$15-20); loss of property ETB 150 to 200 (US$15-20); and business failure ETB 500 (US$50)" (urban worker).
- "5% of my annual income" (urban worker).
- "One head of cattle to insure my 17 cows" (agro-pastoralist).
- "ETB 500 (US$50) per year for life, cattle, and crop insurance" (agro-pastoralist).

8. The potential market for microinsurance in Ethiopia

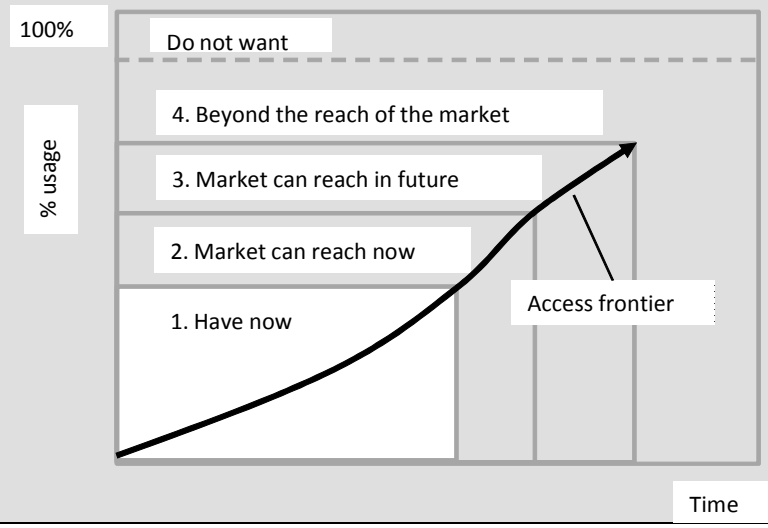
Given that microinsurance is defined as products that are "accessed by or accessible to the low-income population", the next logical question is who the "low-income" population in Ethiopia would be. While it is difficult to estimate the exact size of the potential market or target market for microinsurance, the access frontier concept (discussed below) is useful in defining the potential target market.

Insurance is one way of managing risk but not everyone will be able or want to use insurance as means to manage their risk. Some people may choose not to use insurance even though it is available to them. Those in the lowest income levels may simply never be able to afford the premiums required for even small insurance policies. There may also be restrictions on the ability of insurers to reach the market below certain levels of income. This creates a frontier (see Box 8) beyond which the combination of current business models, infrastructure, market characteristics and regulation does not allow the sustainable provision of insurance to low-income households. When considering the development of the microinsurance market it is, therefore, important to consider these restrictions and the potential market that emerges as result of that. Importantly, it is also necessary to recognise the limits of commercial microinsurance and to ensure that insurance solutions (as opposed to social security or other risk management solutions) are prioritised for markets in which it can sustainably operate.

Below we explore the access frontier[58] for Ethiopia in order to determine the outlines of a potential market for microinsurance.

Box 8: The access frontier concept

The access frontier (Porteous, 2005) seeks to map the current and potential market for financial products and providers. It also seeks to identify those segments of the market which will remain beyond the reach of the market and therefore falls within the scope of government social welfare. Four segments are identified as shown in Figure 4 below: the current market; the market enablement zone; the market development zone and the market redistributive zone.



[58] The access frontier concept can be applied to any category of financial services, formal or informal. In applying the access frontier concept to the market for microinsurance in Ethiopia, we combine formal and informal microinsurance services in one discussion.

Figure 4: The access frontier
Source: Porteous, 2005

The various blocks in the diagram can be explained as follows:

- **"Have now"**. The current market is defined as the individuals that are currently using the product, i.e. a measure of usage or effective access.

- **"Market can reach now"**. The market enablement zone comprises all the people who have access to the product but are not using it. As there are no explicit access barriers, this group is the most susceptible to improving the levels of inclusion for financial products. They could be incorporated into the market by addressing usage factors, without any regulatory changes needed.

- **"Market can reach in future"**. The market development zone includes all the people who do not currently have access to the product because of reasons such as proximity, affordability, eligibility, terms of the product or knowledge of the product. Regulatory changes, as well as product and distribution innovation can be used to extend the reach of the market to this segment.

- **"Beyond the reach of the market"**. The market redistribution zone is made up of all the individuals who are outside the scope of the market because they are simply too poor. These people cannot be sustainably be reached by the market without support from government and may remain dependent on social security. However, this does not mean that insurance or microinsurance could not play a role in the provision of social security benefits.

Implications of the access frontier. The access frontier is represented by the diagonal line on the diagram and represents the frontier beyond which market provision cannot sustainably reach leaving a proportion of the market dependent on social security and other government support. The diagram also shows the natural progression of market provision from block one, to block two and eventually to block three. The logical process of market extension is therefore to move along the access frontier rather than to jump over the next most profitable market segment to the very poor. This raises a number of key policy questions including: Where exactly is the access frontier? What happens if the regulatory definition of microinsurance limits provision to those that fall beyond the current access frontier? Should the government seek to push providers along the frontier or must they be forced to jump the gap into the market of the truly poor as defined and targeted by the government? Does regulation unintentionally inhibit or delay the progression of players towards the access frontier (e.g. by limiting entry and competition)? Given that it may take a long time for the market to serve all those within its reach, what should government's role be towards the unserved in the interim period? These questions are at the core of this analysis and will be considered in the rest of this document.

The exact income distribution and penetration figures for various insurance provider types are not available and the diagram below therefore serves as illustration of the concepts rather than an exact depiction of the Ethiopian environment. It is important to note that this diagram is merely an illustration of how the size of the microinsurance target market in Ethiopia could be approximately estimated

.

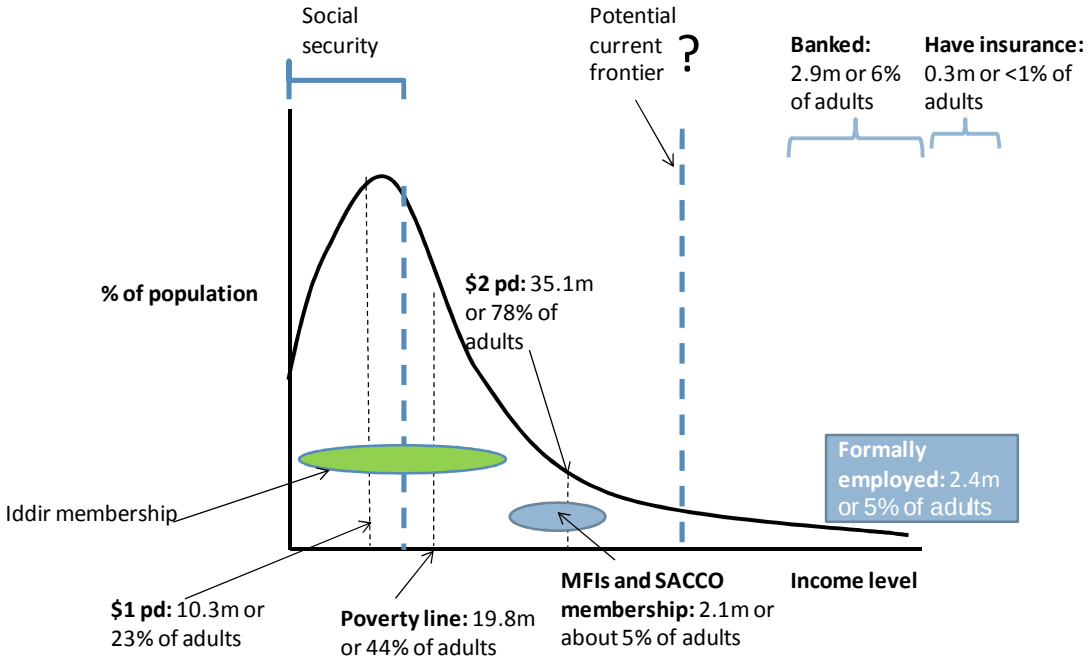


Figure 5: Reconciling income distribution and a possible target market for microinsurance in Ethiopia (for the adult population[59])

Source: Chamberlain & Smith, 2008 and authors' own

The key data points in
Figure **5** (above) are as follows:

Upper-bound: Given the low general income levels in Ethiopia, it may be appropriate to consider all those who are currently not served by the insurance sector as part of the potential microinsurance market. There may be a few higher-income individuals that are unserved but the bulk of his group will have income levels low enough to require small premium and benefit products.

Income lines: Exact data on Ethiopia's income distribution is not available. The curve therefore, represents the typical shape of distribution for a low-income country rather than the exact distribution for Ethiopia. A few data points on income distribution are available and are mapped onto this diagram: 78%, 23% and 44% of the population (and we assume therefore also the adult population) respectively fall below $2 per day (PPP adjusted), $1 per day and the nationally defined the poverty line.

Current insurance take-up: In the absence of demand-side survey, any discussion on the take-up of insurance products in Ethiopia has to be based on industry estimates. Based on information provided by industry players it is estimated that no more than 0.3m individuals (or less than 1% of adults) in Ethiopia have any form of formal insurance cover. Given the nature of the insurance

[59] Adult population is here defined as Ethiopians older than 15 years. In 2008, it was estimated that 54% of the total population of 83m was fifteen years or older (CIA World Factbook, 2008).

industry and products sold, it is likely that these products are mainly purchased by high-income individuals with a high level of overlap with the banked population in Ethiopia. Formal microinsurance is practically non-existent as much of the risk cover provided to low-income households is currently done on an informal basis.

Since most MFIs and SACCOs are self-insuring the credit life risks of their clients and members, it is possible that up to 2.1m individuals (liberally estimated) may have some form of informal insurance cover. 1.7m individuals are MFI clients while another 0.38m are members of SACCOs. It is important to note that the informal insurance usage estimate may be too high because of overlap in membership between SACCOs and MFIs. Also, not all SACCOs and MFIs are self-insuring. However, given uncertainty around membership figures of SACCOs and MFIs that, according to industry insiders, may be under-estimating membership or usage of these entities, we have opted to use an optimistic upper bound for informal insurance usage.

The exact income levels of MFI and SACCO penetration are not available, but given that SACCOs are mostly involved in payroll lending (and their members therefore formally employed) and MFI clients need to generate some type of surplus to repay their loans, it suggests that their penetration may be limited to the middle-income market and not extend far beyond the US$2 per day poverty line. It is important to note that while the blue ellipse in the figure denotes MFI and SACCO *membership*, it by implication also denotes the usage of informal insurance products by MFI clients and SACCO members (credit life insurance).

Although we do not have exact data on iddir[60] membership, the green ellipse in Figure 5 denotes the potential reach of iddir membership across income categories – informal member-based organisations originally established to provide social and emotional support at the time of death and to directly provide for the burial (see Section 6). Over time iddir have evolved to provide a type of informal risk mitigation mechanism. Nationally representative iddir usage figures are not available but anecdotal and qualitative evidence indicate that iddir membership is much more pervasive and common than SACCO and MFI membership.

If iddir membership is included in our calculation of total insurance (formal and informal usage), it would imply that a minimum of 2.4m individuals (5% of the adult population) in Ethiopia are using some type of insurance or insurance-like mechanism to mitigate financial risks.

Banked market: According to estimates, there are 2.9m retail bank accounts (implying that about in Ethiopia (see Section 3.1.1). This equates to about 6% of Ethiopian adults having a bank account.

Formally employed: 2.4m individuals in Ethiopia are formally employed (see Section 2).

Frontier: The position of this line has not been scientifically determined but indicates that given a number of restrictions on current suppliers, they may not be able to extend their penetration into the low-income market at any scale without making significant changes to their business model, products and/or environments. These restrictions include business models constraints[61] (have not developed a retail distribution model, limited product development skills, underutilisation of existing distribution partners such as banks, MFIs, cooperatives, etc.), infrastructure constraints[62] (absence of

[60] Iddir or eder are informal member-based organisations originally established to provide social and emotional support at the time of death and to conduct the burial , but over time these burial societies have evolved to become informal financial risk management tools that not only address death-related financial impacts, but also health and other financial risks.
[61] See Section 5.1 for more details
[62] See Section 5.2 for more details

electronic payment system, limited cell phone penetration and functionality, limited bank infrastructure) and regulatory[63] constraints. However, it is important to note that the depth of reach of MFIs, SACCOs and even, to some extent, bank markets provide traditional insurance companies with the opportunity to escape their own constraints and provide insurance beyond their frontiers.

The concept of the access frontier is central to this document since the fundamental goal of this project is to consider strategies to move the frontier lower (extend microinsurance to a larger percentage of the population) and to consider bringing the current informal providers and distribution partners into the formal sector.

Social security: While the exact income level is not clear at this stage, there is a level below which commercial formal insurance will not be able to operate on a viable basis. Beyond this level, provision and risk management for the poor remains the responsibility of government through a social security mechanism. Microinsurance can support such a social security mechanism (where governments utilise insurance mechanisms with some form of subsidy to deliver social security, for example, health insurance) but it can never by itself replace the broader social security mechanism. (Box 9) provide an overview of social protection benefits in Ethiopia.) An indication of the potential income level at which social security may be the priority is provided by the poverty lines. Traditionally poverty lines determine the levels below which direct government support and subsidies are triggered. This recognises the fact that households below this level can simply not provide for themselves by their own means through various market mechanisms. Whether poverty lines thus also present the line which separates the microinsurance market from the target market for social security is an issue that will require further data and research to clarify.

Box 9: Social protection in Ethiopia

Government-provided or facilitated social protection in Ethiopia falls into three main categories:

- ***Social assistance:*** The Ethiopian Productive Safety Net Programme (EPSNP) is now considered, next to the South African old age pension scheme, the second largest social transfer programme in Africa and the Ethiopian government's main social assistance programme. The EPSNP, first implemented in February 2005, was designed as a response to the 2002-3 food crisis in Ethiopia. It was the result of recognition by the Ethiopian government and donors that a longer term response to continuous food insecurity, generally addressed by annual emergency appeals, was required (DFID, 2007). The EPSNP, reliant on both government and donor funding, provides foods and cash transfers to 7.2m food insecure Ethiopians. It has two main components: a public works (conditional) transfer component and a direct (unconditional) transfer component. Most of the participants (an estimated 80-90%) are required to participate in public works programme and "are paid for up to five days per month, per household member, for six months each year" (DFID, 2007: 5). The amount transferred through this programme to each participant is limited to US$21 per year (the equivalent of about 15kg of grains per month for six months of the year). The households eligible for direct unconditional transfers are chronically food insecure households with no labour to contribute to the programme and include disabled individuals, the elderly and sick, orphans and pregnant or lactating women (DFID, 2007). The programme has a total annual cost of US$250-US$300m (DFID, 2007).

- ***Social insurance:*** Ethiopia's social insurance programme is limited to individuals employed by government, including military and police personnel and employees of government-owned enterprises. Employees contribute 4% of monthly income towards an old age pension, disability, work

[63] See Section 4 for more details

injury and survivor benefit insurance scheme, while the employer contribute either 6% (in the case of civilian government employees) or 16% (in the case of military personnel) of the employees monthly income (U.S. Social Security Administration Office of Policy, 2007).

- ***Health services:*** The Ethiopian government is the majority funder of the public health system, with the government contributing 55% of the annual health budget, donors 42.5% and user fees only 2.1% (WHO, 2002). It is not clear how user fees are applied in the public health system. In 2003, per capita total government expenditure on health was only US$3 (WHO, 2006). Access to public health facilities was limited, with only 75% of urban households (15% of the total population) and only 42% of rural inhabitants having access to health facilities (WHO, 2002).

8.1. Quantifying the potential target market for microinsurance

What, then, is the potential for the development of the micorinsurance market in Ethiopia? The discussion thus far leads us to the following conclusions about short-, medium- and long-term development:

Short-term opportunities (next 5 years):

- *Serving the formally employed*: The formally employed market in Ethiopia constitutes 2.4m individuals, or about 5% of adults[64]. While all of these individuals may not have sufficiently large incomes to be able to afford a typical life insurance policy, most will have regular incomes, while a sizable proportion is likely to be wealthier than the average Ethiopian. 40% (about 1m) of these individuals are employed by the Ethiopian government or its parastatals.
- *Cross-selling insurance to those currently banked*: Based on information of the Central Bank of Ethiopia and our own estimates, it is likely that up to 2.9m Ethiopians or about 6% of adults have some type of bank account. This implies that there is a relatively easy premium collection mechanism or point of client contact in place. The fact that these individuals have bank accounts also signals a potentially good level of financial understanding which would make the insurance sales process easier.
- *Formalising the informal insurance market*: As discussed above, it is likely that up to 2.1m (nearly 5% of adults) people have some form of informal insurance cover through their MFI or SACCO. If insurance companies were to work together with these financial institutions, it would mean that potentially another 2.1m people could be formally insured.

The available data does not allow for the consideration of overlap between these groups. However, if a conservative approach is used, it is likely that in the short-term up to 3m people could be added to the currently insured market.

Medium-term opportunities:

- *Cross-selling insurance to iddir members*: The focus group research (see Section 7.5.4) highlights that some iddir members are interested in supplementing or, in some cases, even replacing their iddir membership with a formal insurance products. While we do not have

[64] According to the Ethiopian Labour Force Survey of 2005. The survey used a total population estimate of 63.2m individuals. However, here we use a total population estimate of 83m Ethiopians (2008) and 45m adults (CIA World Factbook, 2008), to calculate an estimate of percentage of adults.

nationally representative data on iddir membership in Ethiopia, it is clear that the majority of Ethiopians belong to iddir.

Long-term frontier (beyond):

If we assume that the nationally defined poverty line presents a potential outer limit, this means that the potential target market for microinsurance is 55%[65] (or about 25m) of the adult population that are above the poverty line but not yet served by the insurance sector.

8.2. Scope for market development by category of insurance

In this section, we provide a high-level discussion and estimation of the likely market opportunities for different categories of insurance in Ethiopia.

Life insurance: The above discussion on estimates of market development opportunities indicates that up to 3m Ethiopians are within immediate reach of the insurance sector. If all these opportunities were to be successfully pursued over the short-term , it would mean that number of individuals served by could grow by up to 1,000%, i.e. the insurance sector could grow up to ten-fold. Given that life and credit life insurance are relatively simple products to develop and imply lower levels of risk than some other products, this would be a good starting point to expand the sector. All of the 3m individuals that are currently within the relatively easy reach of the insurance sector could be considered the potential target market for small life insurance products. However, it is important to bear in mind that this estimate does not include the full group of individuals that currently belong to iddir. While it is unlikely that insurance will be able to fully replace iddir membership due to its importance social function, it is possible that some members will choose to supplement their iddir membership with life insurance and some may even give up their iddir membership if an appropriate life insurance product was available.

Credit life insurance: Simply formalising the current informal insurance market is likely to add at least up to another 2.1 m individuals to the currently insured. This includes the clients of MFIs and SACCOs.

Agricultural insurance: On the client side, the success of agricultural insurance (cattle and crop) is dependent on there being a group of farmers with sufficiently large land and/or cattle holdings to yield surplus income for the purchase of these products and to make insuring the sources of their agricultural livelihood worthwhile. Ethiopia has a very fragmented agricultural landscape, with many farmers having only a very small landholding or few cattle. Only 17% (2.3m) of all households with land holdings in Ethiopia (13.3m) have land holdings of a size of more than 2 hectares[66]. Of this group, the majority (2m) have land holdings of 2-5 hectares, with only 0.2m having landholdings in excess of 5 hectares. In terms of cattle holdings, only 6% of all cattle holdings have 10 or more heads of cattle, equating to about 0.8m cattle holdings out of a total of 13.1m. Of this group, only about 0.13m have holdings of 20 cattle or more.

[65] This percentage excludes the less than 1% of adults that already have some type of formal insurance product.

[66] In order to derive orders of magnitude that provide an indication of the market potential for agricultural insurance, we use rules of thumb on the scale of land- and cattle holding required to make these insurance products viable. While the actual numbers used for the rules of thumb may be considered arbitrary and therefore debatable, we are of the opinion that land and cattle holdings below these thresholds would be unlikely to provide sufficient surplus income to allow their owners to sacrifice consumption for the purchase of insurance. The rules of thumbs used here is a minimum landholding size of 2 hectares and a minimum cattle holding size of 10 heads of cattle. Below these thresholds, we do not believe cattle and crop insurance to be commercially viable.

We therefore estimate the potential market for crop insurance to be no larger than 2.3m potential policyholders, while the market for crop insurance is unlikely to exceed 0.8m farmers.

Health insurance: A successful health insurance market is not only dependent on the income of potential insurance clients, but also on the availability (and proximity) of health infrastructure necessary for the servicing of clients. Health infrastructure in Ethiopia is limited, with services mainly provided by government (but not with sufficient reach) and some limited private sector presence (see Section 3.3). This implies that long-term investment in the development of health infrastructure and facilities would be a prerequisite for the development of a vibrant health microinsurance market. At this stage, it would also be difficult for Ethiopian insurers to successfully develop and sell health microinsurance products on a commercially viable basis, given their limited capacity in even more basic types of insurance. Despite the strongly articulated need for health insurance (see Section 7), we do not foresee immediate opportunity in the area of health microinsurance.

9. Opportunities and challenges for microinsurance in Ethiopia

This study forms part of a larger project funded by the United Nations Capital Development Fund (UNCDF) and managed by the International Labour Organisation (ILO) to promote microinsurance development in several African countries. The goal of this particular project is to map the microinsurance landscape (this includes supply, demand and regulatory dimensions) in Ethiopia and to facilitate a process for the development of an inclusive insurance (and microinsurance) market in Ethiopia.

In the above sections, we reviewed the demand, supply and regulatory dimensions of the current insurance and microinsurance landscape in Ethiopia. In this section, we summarise the key themes emerging from the analysis, as well as the implied opportunities and challenges captured by these themes.

Recently liberalised market in early stages of commercialisation. Ethiopia has recently emerged from a communist era and is still undergoing significant structural changes with the re-introduction of a market economy. Although the financial sector in Ethiopia has undergone a process of liberalisation and privatisation since the early 1990s, government is the dominant player and foreign ownership of financial institutions is not allowed. The agricultural sector has also undergone a gradual process of liberalisation, but in many value chains (e.g. seed market) the bias is still towards government dominance. In some cases, as in the fertilizer market, there has even been a regression from a gradual increase in privately owned firms to increased government involvement and ownership (Byerlee, et. al., 2007).

Large unserved market, but with very low income levels and challenging population distribution. The Ethiopian environment is characterised by low levels of income and high levels of economic vulnerability. 23% of Ethiopians live on less than US$1 per day (PPP adjusted), while 76% live on less than US$2 per day (United Nations Development Programme, Human Development Indicators, 2008). About 44% of the population live below the nationally defined poverty line of 1,075 Birr[67] (about US$107) (United Nations Development Programme, Human Development Indicators, 2008). Furthermore, the agricultural sector (the main source of livelihood for the majority of the population) is extremely fragmented, with most farms operating at a very low level and mostly at the subsistence level. It is also subject to both weather and price volatility. The challenge of making a microinsurance market in this environment is further exacerbated by low levels of public awareness of insurance and limited financial literacy.

Generally weak financial system with low level of penetration and contact with lower-income market. There are 2.9m clients (6% of adults) with retail bank accounts in Ethiopia. The private banking industry in Ethiopia is still young, with low levels of deposit account penetration and even lower penetration rates for loans. It is still largely focused on corporate business with only a recent move to include retail business. Thus, for example, it offers no payroll (unsecured) lending and very few, if any, vehicle finance or home loans. There has been limited, implementation of management information systems (MIS), resulting in high administration costs and inefficiences due to reliance on paper-based systems. The Ethiopian banking sector is currently the focus of a modernisation and development programme of the World Bank, which bodes well for its future.

[67] Note that this represents 2000 data – the latest available survey data. The UNDP does not indicate the actual poverty line in its tables. According to the Woldehanna , 2004, the official Ethiopian national poverty line is 1075 Birr in 1995/96 constant national average prices.

Young insurance industry at very early stage of development with limited skills, capacity and incentive to push market extension. With fewer than an estimated 0.3m individual formal insurance clients, the insurance sector is small and underdeveloped with many small insurers displaying high levels of inefficiency. Few, if any, insurers have implemented electronic management information systems (MIS) and most still operate using paper-based systems. Although there has been strong growth in the private sector since liberalisation in the 1990s, the Ethiopian Insurance Corporation (EIC) still remains the dominant player. The sector is also characterised by low and potentially overstated solvency levels due to, amongst other reasons, limited risk assessment and management capacity, limited and illiquid investment options and the pervasive practice of selling insurance on credit (with uncollected premiums eventually resulting in bad debt). Furthermore, the sector displays a heavy dependence on the banking sector for both referral credit insurance business and returns on investment from shares held in banks. The limited availability of technical skills for product development and management (e.g. actuaries) also restrict the development of new products. This is further exacerbated by limited availability of data (e.g. mortality data, weather data), making product design difficult.

Limited experience to date with retail and life business. Similar to the banking industry, the majority of insurance business in Ethiopia is targeted at the corporate market and focused on general insurance business. At less than 5% of total premiums, the life insurance industry is still very small and a recent addition to their core business of general insurance for most private insurers. The corporate focus implies that, to date, insurers have little experience in intermediating products to individuals and cost margins have not yet been tested against the more cost-sensitive retail business.

More people may have informal risk cover than formal insurance. There are an estimated 1.7m individuals clients of MFIs with another 0.38m estimated members of SACCOs. Most MFIs and SACCOs are self-insuring the credit life risks of their clients and members. It is, therefore, possible that up to 2m individuals may have some form of informal insurance cover (even before considering iddir membership). Nationally representative iddir usage figures are not available but anecdotal and qualitative evidence indicate that iddir membership is much more pervasive and common than SACCO and MFI membership. Compared to our upper-bound estimate of 0.3m individuals being insured through the formal market, it is evident that the informal risk cover market is much larger than the formal insurance sector. While this presents potential challenges for regulation, it also presents significant opportunity for the development of the insurance sector.

Unsupportive environment for intermediation. Ethiopia is characterised by limited infrastructure and the absence of networked commercial infrastructure (e.g. large retail store chains). Furthermore, Ethiopia currently has only about 2m cell phone users, with the current network infrastructure unable to accommodate many more. However, the network is in the process of being expanded and it is envisaged that after completion of the expansion process it will be able to accommodate up to 10m users. Better telecommunications coverage will improve efficiencies in the financial sector by making it easier to bring branches online. It will also open the opportunity of alternative distribution channels using mobile phone technology for communicating with clients and potentially even facilitating payment of premiums. Even the current 2m, mostly pre-paid, users are much more than the insured population and are served by a network of airtime vendors that could facilitate insurance intermediation and premium collection.

Limited health services infrastructure. The health services network, through which health insurance could potentially be intermediated and which is essential for the provision of services purchased

with this type of insurance is also under-developed. In 2000, it was estimated that only 75% of urban households (only 15% of the total population) and only 42% of rural inhabitants had access to health facilities (WHO, 2002).

BUT existing distribution options not fully utilized. Despite the limited distribution opportunities available in the form of client aggregators, insurance companies are not yet fully exploiting the available opportunities. For example, customer information databases of banks are not utilised to cross-sell their insurance products and insurers mostly only obtain referral business from banks where a client needs credit insurance. This presents significant opportunities for expanding insurance coverage that is within easy reach of the market. Furthermore, no attempts have been made to access the cell phone client base and airtime networks, unions, or MFI and Cooperative client bases.

Cooperatives and MFIs are leading the delivery of financial services to low-income households and, in terms of client numbers, present the only substantial client networks. Given the current insurance industry structure and the limited industry experience and infrastructure for selling insurance to individuals in the retail space, companies need to seek out opportunities to sell microinsurance through client groups such as cooperatives and MFIs. Ethiopia has a large number of MFIs of significant size, with some having more clients than banks and insurers. The cooperative sector has significant membership, but with relatively weak networking (e.g. federations still in the process of formation) and limited capacity (as, for example, illustrated by the capacity constraints noted in the World Bank weather index-insurance project), yet growing fast. While the Federal Cooperative Agency both regulates and promotes the cooperative industry, it is currently mainly focused on developing the sector. Limited supervision is, therefore, applied to cooperatives. This is particularly the case for financial cooperatives where the Federal Cooperative Agency has limited experience in prudential supervision. The industry is currently in the process of setting up cooperative federations, which will allow for more effective organisation and may take over some of the development role currently played by the Cooperative Agency. Federations may also enhance the efficiency and capacity of cooperatives by allowing the pooling of resources for more complex management activities (e.g. managing of insurance and credit portfolios). It will also make it easier for insurers to partner at the level of federations rather than having to seek out many small individual cooperatives for partnership. Cooperatives and MFIs present a very real distribution opportunity that has yet to be exploited by insurance companies. If these opportunities are not pursued, MFIs and cooperatives may even consider becoming insurers in their own right placing the incumbent insurance industry at a significant competitive disadvantage when it comes to the retail market.

Likely that any insurance development will be credit-led. Given the relative strength of credit expansion in banks but also cooperatives and MFIs compared with distribution challenges facing insurers, it is likely the insurance expansion will be largely done on the back of credit. This is also in line with international experience on microinsurance development. Credit-based insurance presents significant and easy-to-reach opportunities to enter into the low-income market. However, care should be taken to utilise the opportunity presented by MFI and cooperative distribution in a manner that ensures value, increased awareness and protection to clients. Given the typically compulsory nature of such products and the limited experience of both clients and insurers in this market, the regulator will need to carefully monitor developments in this market to ensure appropriate development.

While there is a clear and significant need for agricultural insurance, distribution will be difficult as there are few options for compulsion (e.g. based on credit) or bundling and voluntary demand for

insurance will be difficult to generate on an individual basis. Agricultural insurance is one of the most difficult categories of insurance to write and distribute on a sustainable basis. Even in developed countries with highly organised and advanced agricultural sectors, such products are often heavily subsidised as means of protecting strategic agricultural industries (Roth & McCord, 2008). While weather index products have addressed some of the challenges of managing such insurance products, there are still few successful examples and even fewer that have managed to scale initial pilot studies beyond a small community. To date international examples have only managed to achieve scale where the products are made compulsory on the back of credit (requiring the existence of a credit market of scale) or where there is a third-party buyer (e.g. government) that takes out cover for a group of people. Distributing and scaling up such products will be a particular challenge in Ethiopia. In addition to the challenges mentioned above, the Ethiopian agricultural sector is fragmented in terms of both land and cattle holdings and agricultural activities have generally not evolved beyond the subsistence level where even basic intensification methods such as the use of fertilizer are not always applied. The value chain is the focus of much development support and does not offer easy opportunities to distribute insurance with other inputs or extension services. The Ethiopian government plays a dominant role in agricultural value chains (e.g. seed market, fertilizer market) but may not have the capacity or the incentive to support insurance distribution. In the past, government support programmes have also in some cases unintentionally distorted market dynamics (e.g. the need for credit insurance on fertilizer lending being largely eliminated by the government's fertilizer guarantee programme). Despite their potentially distortive impact on the market, such support programmes may, however, be critical to support the welfare of farmers and in the greater Ethiopian economic context, it may not be appropriate to argue for the withdrawal of these in favour of market mechanisms. This will have to be carefully considered in the context of the overall liberalisation programme and its objectives. The net result, however, is that any initiative to extend insurance in this market would have to be done in partnership with the appropriate government agencies and aligned with the liberalisation process that is pursued across the value chain. It is also clear that the distribution of insurance will be very difficult, except for cases where there is some client aggregator such a cooperative or MFI available. It is also likely that the insurance would have to be made compulsory to achieve any sustainable scale.

Existence of iddir and iquub signals need for risk management, but much of it at a level difficult to serve by commercial players. The highly prevalent nature of iddir signals Ethiopian's risk management needs and some familiarity with insurance-like mechanisms that has been generated over time. There are indications that iddir are providing insurance-type cover that extends beyond only funeral, e.g. existence of health iddir. While this could bode well for future development of the insurance sector (if appropriately managed), it does not present an immediate demand for insurance and is unlikely to do so for the foreseeable future. The current premiums contributed to iddir and the benefits provided are very low and likely to be below levels that insurers can currently profitably serve (particularly given current levels of inefficiencies in the insurance sector). Although not formally considered as part of the cooperative regulatory framework, iddir are, in fact, a variety of member-based organisation not dissimilar to the cooperative form. Some consideration may have to be given to how they could be included in the regulatory framework for member-based financial institutions. This does not mean that they should be actively supervised but simply that a space should be created for them in the regulatory and development framework. While it may be a legitimate argument that iddir should not currently be subjected to regulation, some level of monitoring may have to be implemented to assess at what level regulation should step in and provide a development path for those iddir that grow into large organisations. This process should focus on initiatives to strengthen governance and institutional structures before moving in with potentially burdensome regulation.

Regulation in process *of modernisation with opportunity to create supportive regulatory framework.* The current regulatory framework does not present any significant barriers to domestic players in developing a microinsurance market, with the exception of the prohibition of foreign participation and partnership and the placement of investments offshore. However, there are some gaps to be considered as the new regulatory framework for insurance is debated in Ethiopia. Thus, for example, the Insurance Proclamation does not currently allow cooperatives to write insurance – the only institutional entity able to register as an insurance company is a share company. Consideration also needs to be given to the establishment of appropriate consumer protection regulation but care should be taken to minimise regulatory costs and compliance burden and ensure a flexible intermediation environment. There is a need to strengthen the industry and improve efficiencies through modernisation of management and information infrastructure. However, in doing so it is again important to avoid unnecessarily increasing the regulatory burden on insurance companies and ensure that the sector is able to serve the lower-income market. The possibility of partnership with foreign insurers should also be considered as it will facilitate the transfer of international learning and business models, while allowing the placement of insurers' investment funds off-shore may relieve the constrained investment environment and incentivise market expansion.

Although no specific policy on the development of the microinsurance market exists, the governing legislation provides the Insurance Supervision Department with the mandate to pursue market development. It will benefit the development of the industry if the regulator will build on this mandate to also develop a more formal policy in favour of microinsurance development. This will incentivise market players to seek and explore new markets particularly where the regulatory frameworks are still being clarified.

In conclusion, the Ethiopian market is faced with a number of challenges but also presented with a number of opportunities (see Sections 8.1 and 8.2). Exploiting the low-hanging fruit such as the appropriate utilisation of the opportunities presented by MFI and cooperative client basis will be an immense boost to the industry. Beyond these early opportunities the further development of the industry will rely on difficult and long-term structural changes, much of which falls beyond the insurance industry and the mandate of the insurance supervisor (e.g. banking sector infrastructure and development of cooperative sector). Given the long-term nature of the required changes it is therefore critical that the necessary processes be initiated as soon as possible. The current revision of the regulatory framework for insurance presents a significant opportunity in this regard.

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11. Meeting list

Organization	Person met	Position
Insurance supervision (NBE)	Mr Yewondwossen Eteffa	Directorate
Ethiopian Academy of Financial Studies	Mr Mesfin Gebreselassie	Director
Ethiopian Insurance Corporation	Mr Shiferaw Rufe	Division head
Cooperative Agency	Mr Abey Merka	Registrar
MFI Supervision Dept (NBE)	Mr Mulunehu	Department head
Nyala Insurance	Mr Nahu-Senaye Araya	Managing Director
Nyala Insurance	Mr Eyob Meherette	General manager
Nyala Insurance	Wro Sophia Belay	DGM, Underwriting and Product Development
Nib Bank	Mr Solomon Assefa	Manager: Planning and Business Development Department
Nib Bank	Mr Mulugeta Dinlesaw	Head: Planning and Research Division
NIB Insurance	Mr Selomon Assefa	Manager of planning and Business Development Department
NIB Insurance	Mr Shiferaw Bante	Underwriting and branch operations department manager
Mercy Corp	Mr Simon O'Connel	Country Director
Ethiopian Insurer's Association /African Insurance Company	Mr Kiros Jiranie	Chairperson (of Insurers' Association)/CEO (African Insurance)
Insurance Professionals Association	Mr Teferra Demiss	Member
Awash Insurance	Mr Berhanu Belaineh	Claims department Manager
Awash Bank	Mr Andualem Berhanu	Planning and business development department
Association of Ethiopian Microfinance Institutions (AEMFI)	Mrs Tigist Tesfaye	Programme Officer
ADCSI (MFI)	Mr Berhanu	Operations Manager
OCSI CO	Mr Teshome Kebede	Operations Manager
Wisdom MFI	Mr Worku Tsega	General Manager
Wisdom MFI	Mr Berhanu Negash	Marketing Coordinator
Aggar MFI	Mr Hailu Leta	General Manager
Harbu (MFI)	Mr Tesfaye Befekadu	General Manager
Ethiopian Telecommunications Corporation	Mr Andualem Teshome	Division Manager, Product Development
Confederation of Ethiopian Trade Unions	Mr Hailekiros Woldemichael	Social affairs' Division Head
Department for International Development (DFID)	Peter D' Souza	Economist
International Labour Organization	Mr George Okutho	Senior Specialist in Labour Statistics and Economics
WISE (NGO partner to Mercy Corps)	Wro Tsegay Haile	Director
Saving and Credit Cooperative Union	Aga Futa	Manager
General Insurance Broker	Wro Getenesh Haile Mariam	Managing Director, General Insurance Brokers & Consultants

Professor of Development Economics	Prof. Stefan Dercon	Centre for Study of African Economics, Department of Economics, University of Oxford
Lawrie Savage & Associates	Lawrie Savage	Insurance consultant
Lawrie Savage & Associates	Ian Webb	Insurance consultant
Lawrie Savage & Associates	Yoseph Aseffa	Insurance consultant
Save the Chilren	Adrian Cullis	

Appendix A: Industry performance table for Ethiopian general insurance companies (FY07/08)

Type of ratio	Description	International Standard	Ethiopian Insurance Corporation	Nyala Insurance Company	United Insurance Company	Awash Insurance Company	Global Insurance Company	National Insurance Company of Ethiopia	Africa Insurance Company	NIB Insurance Company	Nile Insurance Company	Lion Insurance Company	Industry average	Industy average (excluding Lion Insurance)	Weighted industry average excluding Lion
Return on Equity (ROE)	**Net Income for the year/Equity X 100**	Market	27%	16%	35%	21%	1%	14%	19%	52%	-10%	-39.58%	14%	23%	23%
Change In Equity	**(Current year equity - Prior year equity)/prior year equity**	-10 to 50%	-8%	-1%	26%	9%	3%	16%	3%	-37%	-8%	-		0%	-4%
Net trade Debt to Equity	**Net trade debtors /Equity X100**	Max of 50%	32%	39%	43%	44%	32%	60%	82%	115%	48%	-		55%	49%
Current (Liquidity) Ratio	**Current Assets/Current Liabilities**	Min of 1.25	1.01	0.96	1.38	0.82	1.15	1.05	1.02	0.77	0.67	1.38	1.02	0.98	0.97
Change in Net Writings	**(Current year Net Premium written - Prior year Net Premium Written)/Prior year Net Premium written X 100**	-33 to 33%	14%	25%	63%	15%	26%	8%	39%	56%	-2%	-		27%	24%
Change in Gross Writing	**(Current year Gross Premium written - prior year Gross Premium written)/ Prior year gross premium written X 100**	-33 to 33%	19%	17%	36%	16%	21%	16%	29%	51%	-1%	-		23%	22%
Gross Risk Ratio	**Gross premium written/Equity**	Max of 7	2.20	1.87	1.73	2.20	0.78	0.28	2.36	4.37	2.48	-		2.03	2.25
Net Risk Ratio	**Net premium written/Equity**	Max of 3	1.27	0.25	1.73	1.82	0.57	2.24	1.15	3.76	2.02	-		1.65	1.55
Net Claims Ratio	**Net claims incurred/Net earned premium**	Max of 0.7	0.60	0.68	0.46	0.65	0.51	0.66	0.82	0.63	0.87	0.92	0.68	0.65	0.64
Expense Ratio	**Total expenses/Net premium earned**	Max of 35%	23%	24%	13%	18%	47%	9%	13%	22%	32%	125%	33%	22%	21%
Underwritting Result	**Underwriting profit (Loss)/Net earned premium X 100**	-10 to 30%	41%	21%	40%	21%	50%	12%	8%	32%	14%	-93%	14%	26%	30%

Appendix B: Field research methodology

Four different livelihood groups in three different regions (see Box 6) were represented in field research in August and September 2008 involving several research methods including focus group discussions (FGDs), participatory rapid appraisal tools (PRA), in-depth interviews, and key informant interviews. In total, 111 men and 57 women participated ranging in ages between 20 and 90 with more than half under 40 but above 18 years of age. Women constituted 34 percent of the total sample. Sixty-seven percent were married; 23 percent were single; and 10 percent were widowed or divorced. Average household size in Addis Ababa was 3.8 in Hagere Mariam; 12.4 in Yirgacheffe; and 7.6 in Yabello.

About 51% of participants were illiterate, 16 percent had completed primary education, 23% secondary education, and 10% college studies. Pastoralist participants owned an average of 45 cattle, while agro-pastoralists owned an average of 18. Finally 62% of participants had between one and six children, while 32% had more than six, and the remaining did not provide this information.

The livelihood groups constituted the primary sampling unit (PSU) while the regional location constituted the secondary sampling unit (SSU).

We chose the PSU based on the assumption that clients from similar livelihood groups will have relatively similar needs for and attitudes toward insurance cover than clients in other livelihood groups. For obvious reasons, poor people working in the same occupations have similar income profiles (in terms of seasonality and magnitude), which affects their levels of poverty as well as their demand for insurance. For example, high-skilled, salaried, white collar employees of a formal company or government enjoy steady, predictable incomes that can easily absorb a regular insurance premium payment that can be deducted automatically through payroll. Four different livelihood groups in three different regions were represented in field research in August and September 2008 involving several research methods including FGDs, participatory rapid appraisal tools (PRA), in-depth interviews, and key informant interviews. In total, 111 men and 57 women participated ranging in ages between 20 and 90 with more than half under 40 but above 18 years of age. Women constituted 34% of the total sample. Sixty-seven percent were married; 23 percent were single; and 10 percent were widowed or divorced. Average household size in Addis Ababa was 3; 8 in Hagere Mariam; 12.4 in Yirgacheffe; and 7.6 in Yabello.

About 51 percent of participants were illiterate, 16% had completed primary education, 23% secondary education, and 10% college studies. Pastoralist participants owned an average of 45 cattle, while agro-pastoralists owned an average of 18. Finally 62% of participants had between one and six children, while 32% had more than six, and the remaining did not provide this information.

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company or government enjoy steady, predictable incomes that can easily absorb a regular insurance premium payment that can be deducted automatically through payroll.

They are also unlikely to face many occupational injuries in an office setting. In contrast, unskilled urban day laborers face fluctuating incomes (depending on what jobs are available) and possibly serious work-related injuries. These occupational differences naturally lead to different coverage preferences as well as differences in terms of the desire for insurance and, in the end, the ability to purchase it.

With the above in mind, samples were split into four of Ethiopia's major livelihood/socioeconomic groups as detailed in Sidebar A below. **All study participants were poor.** As a proxy measure, we considered any client of microfinance institutions (MFIs) and/or non-governmental organization focused on development or relief as relevant to the study.

Once the PSU was defined, three regions were chosen for focus group discussions. Ethiopia is currently divided into the following 11 administrative regions (see Figure 6):

- *Nine regions:* Afar, Amhara, Benishangul-Gumuz, Gambela, Harari, Oromia, Somali, SNNPR, and Tigray.
- *Two chartered cities:* Addis Ababa and Dire Dawa.

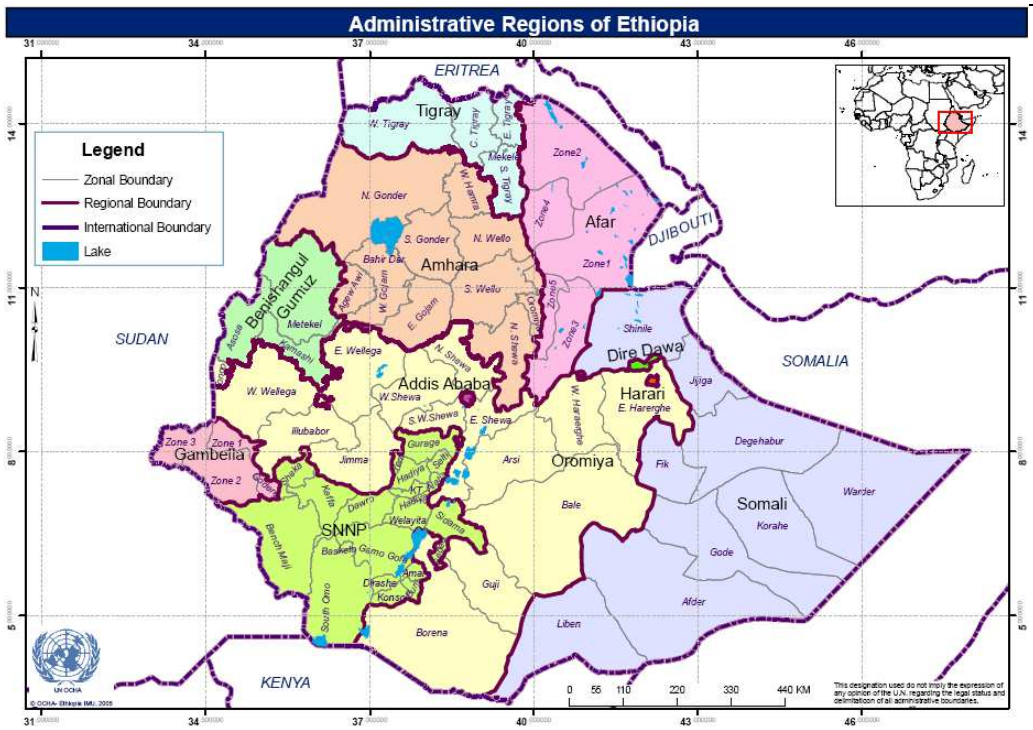

Figure 6: Administrative regions of Ethiopia
Source: United Nations Office for the Coordination of Human Affairs, 2005

In order to prioritize the administrative regions, we gave more weight to those locations where a large number of target clients are located and where prospective insurance distribution channels are dense (as measured by the number of microfinance institutions, insurance company branches,

cooperatives, etc.). Based on these criteria, we chose for the field research the three administrative units of Oromia, SNNPR, and Addis Ababa. Although other regions like Amhara and Tigray also fulfilled our selection criteria, we were unable to cover them due to time and budget constraints. (Note, however, that for Tigray, we draw on our other micro-insurance work in that region, described below.)

A total of 95 participants were involved in FGDs and PRAs covering various topics related to insurance demand. In addition, a total of 48 individual interviews, with approximately 10-12 individuals per region, were conducted in all study areas. Key informant interviews were also conducted with people from various institutions who are believed to have a good understanding of their community and micro-insurance concepts. Participants of the study included clients and non-clients (drop-outs, new entrants, and others) of Addis Credit and Savings Institution (ADCSI); Oromia Credit and Saving Share Company (OCSSCO); OMO Microfinance Institution; clients of the health micro-insurance scheme at Women in Self Employment (WISE); and beneficiaries of Action for Development (AFD), a local NGO which is a partner to Oxfam America (OA).

We also drew on research from Adi Ha in the Kola Temben *woreda* of Tigray. OA and the Relief Society of Tigray (REST) have been working with farmers in the water-stressed community of Adi Ha for more than a decade. In the fall of 2007, OA and REST began exploring the potential for and gauging the community's interest in micro-insurance. Toward that end, the project partners commissioned an independent demand study consisting of both qualitative and quantitative research led by Professor of Sociology Woldeab Teshome of Addis Ababa University in the community the following winter. We then began designing a pilot project centered on drought index insurance. In July 2008 Swiss Re, one of the world's largest reinsurers, agreed to a formal collaboration on the pilot. Project implementation began with technical assistance from the International Research Institute for Climate and Society (IRI) at Columbia University. Nyala Insurance Company, a local insurer, and Dedebit Credit and Savings Institution, the country's second largest micro-finance institution, are informal members of the product development design team. This innovative pilot, called Horn of Africa Risk Transfer for Adaptation (HARITA), will focus on the indigenous aims to develop a demand-driven model for insurance that empowers communities in Ethiopia to adapt to climate variability and change. The pilot will adopt an innovative, holistic approach to risk management, examining the suitability of weather index insurance and integrated risk management measures such as seasonal forecasting and credit for appropriate agricultural inputs. If weather insurance proves viable in Adi Ha, we will develop a prototype that could eventually be scaled to other villages across the country.

Livelihood Group	**Location**	**Identification Channel**
Poor urban workers	Addis Ababa	Founded in 2000, Addis Credit and Savings Institution (ADCSI) was established in 2000 as a microfinance institution in support of the city's vulnerable households. Through 10 branches in all Addis Ababa's sub city areas, ADCSI serves 30,000 people living, the vast majority of whom are women (82 percent). The institution's USD 20 million asset base supports lending for low income families' economic activities (Mix Market 2008) (Business Development Services n.d.). WISE is a non-governmental organization working with 14,000 urban poor women families in Addis Ababa on leadership, health, education and saving-credit issues. Its Yettena Iddir health insurance program allows participants to

		recoup half of their health expenses in exchange for ETB 5 per month with a total cap of ETB 300 per year.
Coffee farmers	SNNPR	The Yirgacheffe Coffee Farmers Union (YCFCU), which was formed in 2002 as an association of 23 primary cooperatives with over 44,000 members (Transfair 2008). Founded in 1997, OMO Microfinance Institution serves economically active poor households in SNNPR's rural and urban areas by providing shareholder capital, savings, loans, and grants to its clients (Mix Market 2008).
Pastoralists	Oromia (Yabello)	Action for Development (AfD), is an indigenous NGO established to help pastoral communities in the region live more sustainable lives. Oromia Credit and Saving Share Company (OSSCO) began as the Oromia Rural Credit Scheme Development Project and was founded in 1997 as a company. OSSCO provides loans, voluntary savings schemes, and credit-led insurance products to its clients (Mix Market 2008).
Agro-pastoralists	Oromia (Hagere Mariam)	AfD (see description above).

Table 8: Focus group identification channels
Source: Author's own

Access to Insurance Initiative
Hosted by GIZ Sector Project
Financial Systems Approaches to Microinsurance
German International Cooperation (GIZ)
Dag-Hammarskjöld-Weg 1-5
65760 Eschborn, Germany
Fon: +49 61 96 79-6466 Fax: +49 61 96 79-11 15
E-Mail: info@access-to-insurance.org

The Initiative is a partnership between:

Hosted by: