Social Finance Programme

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InFocus Programme on Boosting Employment through Small Enterprise Development

Working Paper N° 33

South African Microinsurance Case-Study

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Foreword

This study on microinsurance in South Africa was completed thanks to the generous funding of the Dutch Government as part of the Dutch Partnership Program with the International Labour Organization (ILO). This paper forms part of a multi-country project that seeks to understand the risks that low-income entrepreneurs face, their coping strategies, and the potential role that insurance can play in managing those risks.

Low-income entrepreneurs are particularly vulnerable to risks. Lacking adequate financial and other assets, the poor are exposed to the smallest economic shocks. Their vulnerability is exacerbated by the fact that low-income persons tend to live and work in riskier environments than wealthier people, with a greater likelihood of illnesses, accidents and thefts. Furthermore, low-income entrepreneurs do not usually have access to effective risk management strategies.

The paper reviews the regulation of the South African insurance industry. It provides and account of some interesting developments in the industry, that are likely to become increasingly significant in other countries if the microinsurance industry continues to grow. The paper argues that for the most part microinsurance in South Africa consists of funeral insurance, although the author provides an account of the emergence of a range of microinsurance products that are targeted at household enterprises, including hire-purchase insurance.

The author surveys SME operators in South Africa, to assess the risks that they face, and then explores the possibility of insuring those risks. He concludes that there is an important, albeit limited, role for microinsurance (especially life insurance) and provides suggestions as to what MFIs could do to provide microinsurance. For many of the risks that are difficult to insure, the author suggests a range of possible non-financial services that could help SME operators reduce their risk, such as the provision of various business development services.

Many of the lessons learned in this study have been incorporated into a training manual developed by the Social Finance Programme (SFP) with the InFocus Programme on Boosting Employment through Small Enterprise Development (IFP/SEED), which will be used to train the managers of microfinance institutions in introducing and managing microinsurance products.

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1. Introduction

1.1 Background and purpose of this study

In 1998 the International Labour Conference adopted Recommendation No. 189 on "Job Creation in Small and Medium-sized Enterprises". The recommendation stressed the importance of small and micro-enterprises (SMEs) in fighting poverty by providing employment to low income and other marginalised sections of society. One of the major factors in constraining the growth of the SME sector among low-income entrepreneurs is a culture of risk aversion. In general the poorer one is the more severe the consequences of any income loss and hence the more risk averse one is. This was recognised in the above-mentioned recommendation that stated that the ILO should seek, “through appropriate means, to encourage a more positive attitude towards risk-taking”. Microinsurance is one such means through which risk-averse culture and practice among poor entrepreneurs can be reduced. Insurance provides a buffer against risk.

Over the last few years a new category of insurers has emerged that cater specifically to the needs of SMEs. These institutions are still in their infancy. In order to promote and develop these institutions the ILO’s SEED and SFP have jointly undertaken a multi-country study of microinsurance institutions, to map the frontier of these new institutions and begin to develop a set of best practice guidelines for them. The first of this series of country studies is being conducted in South Africa.

South Africa has a variety of microinsurance services available to low-income groups. These services are offered by a variety of formal and informal institutions, and cover a spectrum of different insurables. The provision of microinsurance by formal sector institutions in particular sets South Africa apart from most other developing countries. South Africa thus presents a rich opportunity to study the microinsurance sector. However, despite the evident need and role for microinsurance in South Africa, few South African not-for-profit micro-finance institutions (MFIs) presently supply microinsurance. Discerning the reasons for this is one of the purposes of the present study. Understanding the constraints that have inhibited the spontaneous development of for-profit microinsurance would provide valuable insights into the necessary conditions for promoting non-profit MFI-based microinsurance schemes.

Most investigations into microinsurance focus on its role in smoothing consumption. While this is indeed paramount, the specific function of microinsurance in facilitating enterprise development has been relatively neglected. This project seeks to correct for this imbalance, by identifying both the direct and indirect linkages between risk mitigation, and the sustainability of SMEs.

Overall, there are four primary objectives of the present project:

- First, the project aims to identify and categorise the range of existing microinsurance products available in South Africa, and establish the extent to which they help low-income groups improve their small and micro-enterprises.

- Second, the project aims to learn from these schemes in order to provide practical guidelines to MFIs that wish to introduce new microinsurance products, or refine existing ones.

- Third, the project seeks to provide a direct input into the ILO's initiative to develop a microinsurance best-practice manual for MFIs.

- Finally the project will feed the research results about insurance varieties and good practice back to established South African MFIs to assist them to develop their microinsurance products.

1.2 Definitions

For the purposes of this paper, we define **microinsurance** as insurance that caters to low-income people or their enterprises. Microinsurance is defined in terms of the client, and is not therefore taken to mean insurance that is furnished by a 'small institution'.

We understand a **micro-finance institution**, or **MFI**, to be a not-for-profit institution that provides financial services to low-income individuals primarily for the purpose of social upliftment. For the most part, therefore, we draw a distinction between such MFIs and, say, the large number of "micro-lenders" that provide financial services to low-income people primarily to derive a profit. We acknowledge, however, that this distinction is not always a viable or meaningful one.

By **small and micro-enterprises**, or **SMEs**, we mean enterprises that have five or fewer employees. These SMEs tend to be in the informal sector, in the sense that they are not legal entities for the purposes of conducting business, are not registered for purposes of VAT, etc., but this is by no means always the case.

1.3 This paper

The purpose of this paper is to report findings of the ILO's study into microinsurance in South Africa. The paper is organised as follows. Section 2 presents a brief overview of the South African insurance industry, stressing the current market trends, organisation of the industry, and the regulatory environment in which it operates. Section 3 focuses on the extent to which for-profit insurance providers serve the needs of low-income people and SMEs. A case-study of the funeral insurance sub-sector is used to provide pointers about how formal sector institutions can successfully extend their reach to new clienteles. Section 4 relates the findings from a cursory survey of MFIs about provision of and perceptions of microinsurance. The findings of a survey of SMEs are reported in section 5. Section 6 summarises and concludes, by way of reflecting on the scope for SME-oriented microinsurance in South Africa, and recommendations for next steps. The appendices report some additional statistics regarding the SME survey, and also provide information on the Microinsurance Workshop held on 22 January 2001 in Johannesburg.

2. Overview of the South African Insurance Industry

2.1 Nature of and trends in the SA insurance industry

In 1999, the South African insurance industry had a total gross premium income of R123.9 billion (US $16.5 billion). This can be divided between long-term insurance (life, death/disability), with total premium income of R101.2 billion ($13.5 billion), and short-term insurance (motor, property, accident and health, etc.) of R22.7 billion ($3.0 billion). Altogether, as of the end of 2000 there were 63 registered long-term insurers, including 6 reinsurers, and 89 registered short-term insurers, including 7 reinsurers (FSB, 2000a). It must be recalled that long-term insurance is also frequently used as an investment vehicle, thus the large premium value does not reflect only payment for insurance cover per se.

South Africa's insurance industry is dynamic and highly competitive. Particularly since 1994, with South Africa's reintegration into the international economy, changes have taken place at a rapid pace. Among the important trends characterising the insurance industry are the following:

- Increasing consolidation among insurance companies (and brokers) while smaller insurers focus more on niche markets (*Financial Mail*, 11 September, 2000; Temkin, 2000). This is consistent with international trends in the insurance and financial services industries, and is related to the simultaneous trend in South Africa towards bancassurance (Thomas, 2000; Temkin, 2000). This consolidation is mainly responsible for the 21% decline in total employment in the insurance industry between 1996 and 1999 (FSB, 2000b).

- Intense cost-pressure on short-term insurers due to rising claims and high rate of fraud. Over 40% of short-term insurance is for vehicles, and the extent of fraudulent claims is estimated to be around R500 million ($67 million) per year (*Business Day*, 27 November 2000; another estimate is that 1 in 10 motor theft claims is fraudulent - Otto, 1999). A global estimate is that the total extent of insurance fraud is 10% to 20% of total premium values, or R12 to R25 billion per year, or $1.6 to $3.3 billion (*Business Day*, 20 September and 27 November 2000). In 2000 the floods in Northern Province and Mpumalanga, and fires in Western Cape and KwaZulu-Natal, boosted claims significantly. The fact that the short-term insurance industry is highly competitive is underlined by the fact that short-term insurers have attempted to keep premium levels low even at the expense of incurring underwriting losses (Temkin, 2000).

- Cost-pressure on long-term insurers also exists due to a surge in foreign entrants since 1994 and the high rate of surrenders and lapses (FSB, 2000a). The high rate of surrenders, whereby life policies are terminated prematurely, and of lapses, whereby termination of payment causes one's cover to cease, apparently relate to clients' economic difficulty with maintaining payments (Smith, 1997). This highlights another feature of the insurance industry, namely that writing of new policies represents a significant share of total costs.

- The demand for funeral insurance is booming due to HIV/AIDS (Temkin, 2000). The other side of the coin is that health insurance is becoming more difficult to provide. Insurance companies increasingly rely upon HIV testing. Insurers are pursuing a strategy of increasing market segmentation over-all, especially in health and motor insurance (*ibid.*).

- A proliferation of marketing strategies and distribution channels, including more emphasis on direct marketing (e.g. "Hollard Direct", "Guardian Direct"), use of call centres (Temkin, 2000), and e-commerce (*Business Day*, 26 October 2000; however, the use of e-commerce for insurance is off to an inauspicious start in South Africa, with the first such venture, "Cura", closing in October 2000). There is also an increasing use of self-insurance through cell captives and wholly owned captives (*Business Day*, 19 November 2000). (The functioning of captive cells is explained in section 4.3.)

Notwithstanding the evidently large size of the insurance industry, the population as a whole is under-insured. One estimate is that fewer than 10% of all vehicles are insured (CTU, 2000). Among 'black taxies' (i.e. minibus taxis that largely cater to the commuting needs of black South Africans), the estimate is that fewer than 5% are insured (*ibid.*). Unfortunately, the industry does not collect statistics by race or by income group, but the 1995 *Income and Expenditure Survey* of Statistics South Africa showed that, for that year, the average African household spent (or had spent on its behalf by an employer) R134 (or $33 at 1995 exchange rates) on premiums for life or endowment policies, R110 ($15) for funeral cover, R22 ($3) for medical insurance, R20 ($2.70) for house insurance, and R23 ($3) for motor insurance. The corresponding figures for white households were, respectively, R1663, R197, R276, R422, and R482 ($416, $49, $69, $105, and $120). Notwithstanding the fact that white households comprised only about 16% of all households in 1995, they accounted for almost two thirds of all personal insurance cover in that year.

2.2 South Africa's regulatory framework for insurance

There are two main pieces of legislation that have a bearing on the insurance industry and, by extension, on microinsurers: the Long-Term Insurance Act 52 of 1998, and the Short-Term Insurance Act 53 of 1998. These Acts replaced the Insurance Act of 1943, which covered both short-term and long-term insurance. These pieces of legislation, together with the corresponding body of regulations: i) govern the process and requirements for becoming legally registered as a short-term or long-term insurance provider (a single insurance company cannot be both, though a short-term and long-term insurer can form part of the same group, i.e. as subsidiaries); ii) define what sort of services can be marketed as insurance; iii) stipulate minimum absolute capital requirements (a minimum of R5 million, or $660 000, depending on the type of insurance business to be pursued) and capital adequacy rules; iv) establish certain reporting requirements; and v) institute and provide for certain consumer (policyholder) protection measures.

Unless a company is registered as a short-term or long-term insurer with the relevant insurance registrar, it cannot provide a service deemed to be insurance. Every year, one or two companies face legal proceedings for failing to be properly registered. One notable exception to this rule is for Friendly Societies, which may render insurance-like benefits to their members, provided they are not in excess of R5000 ($667) per member. A friendly society can only qualify as such in terms of the Friendly Societies Act 25 of 1956, which requires registration with the relevant registrar.

In practice, funeral insurance is treated as a type of long-term insurance. However, the Short-Term Insurance Act allows that "accident and health" policies may be part of a short-term policy, and these in turn are defined as a contract, which triggers benefits if the insured person suffers a disability event, a health event, or a death event. However, if the policy benefits "are something other than a sum of money" (1(d)(i)), then the contract is not considered an insurance policy. This raises the question whether certain funeral policies, which confer mortuary, transport, and catering services, rather than a sum of cash, are technically insurance, and must abide by the Acts. The fact that in 1999 a number of funeral insurers were investigated and considered for criminal prosecution for not being registered

(FSB, 2000a), suggests that this is not the industry watchdog's prevailing interpretation of the law.

The entity responsible for supervision of the insurance industry according to the above-mentioned Acts is the Financial Services Board (FSB), which is an industry-financed statutory body that acts in an advisory capacity to the National Treasury (formerly the Department of Finance). The FSB’s primary role is to ensure compliance with legislation and regulations. The FSB is a member of the International Association of Insurance Supervisors, and, broadly speaking, seeks to conform to international norms and standards in respect of insurance supervision and regulation. During 1999, the FSB undertook inspections of 8 short-term intermediaries and 2 shorter-term insurers (FSB, 2000b), as well as 13 long-term intermediaries and 1 long-term insurer (FSB, 2000c). However, the FSB can and does play an active role in proposing changes to the regulatory framework, and facilitating the consultation process around new legislative or regulatory initiatives. The FSB also undertakes on-site visits of insurers to study the adequacy of their risk management practices. Short-term and long-term insurance are but two of the half dozen or so non-banking spheres in which the FSB has supervisory responsibilities. The registrars for short and long-term insurance, as well as for friendly societies, also reside within the FSB.

As in other countries, there is also a measure of self-regulation in the insurance industry. There are a number of industry organisations, which seek to provide for self-regulation, such as the Life Offices’ Association, which has a system for essentially blacklisting intermediaries who are found guilty of dishonesty or unethical conduct. The South African Financial Services Intermediaries Association performs a similar role in respect of intermediaries, including insurance brokers.

One of the key trends in the regulatory environment affecting insurance, is consumer protection. The most visible expression of this trend is the drafting of Policyholder Protection Rules, which aim to improve conduct by insurers and brokers towards their clients, especially in terms of disclosure and clarity. It is expected that the Policy Protection Rules will be signed into law in July 2001. To complement the regulatory initiatives promoting consumer protection, are various consumer education campaigns. The FSB is championing its own consumer education campaign, while the industry is also directly involved, as with the Life Offices' Association's consumer education programme.

The other side of the coin of fuller disclosure is an initiative, also pending further consultation, to remove the cap on commissions that can be earned by insurers and brokers. The feeling of the FSB and others is that the introduction of rules around disclosure, in combination with the de-regulation of commissions, will put South Africa in sync with international norms.

Historically, insurance brokers ('intermediaries') have not been required to register with any supervisory body, and are not subject to specific pieces of legislation. Policyholder protection therefore has much to do with the conduct of brokers, which will also be affected by the promulgation of Policyholder Protection Rules. Another measure that will have far-reaching consequences for brokers is the Financial Advisory and Intermediary Services Bill, which may have to wait until 2002 to be enacted (*Cover*, November 2000). One of the more important aspects of the Bill will be to require brokers to register with a recognised professional association, which will hopefully have the effect of raising standards across the industry, or at least limit the number of 'fly-by-night' brokers operating in the sector. Current regulations to the Short-Term Insurance Act do however require intermediaries who collect or handle premiums to have in place a recognised guarantee, such as that purchased from the Intermediaries Guarantee Facility. The purpose of such guarantees is to ensure that a paying policyholder's cover does not lapse due to a mishap with her premium in the hands of the intermediary.

Two other important features of the regulatory environment are the short-term and long-term insurance ombudsperson. Both ombudspersons operate under the auspices of voluntary arrangements with the insurance industry, by which they are financed. The function of the ombudsmen is to try to resolve grievances, generally of policyholders against insurers. In 1999, there were 2025 and 6141 complaints received by the short-term and long-term insurance ombudsmen, respectively (*Business Day*, 19 October 2000). One limitation of the services provided by the ombudsperson, is that they apply only to those insurers that choose to subscribe to the arrangements. As most of the larger insurance companies are subscribers, however, this limitation is not too great. A second limitation is that the volume of complaints is such that many complaints take a great while to be attended to (e.g. "Claimants who want the benefit of the Ombudsperson’s services must.....be prepared to be extremely patient"; FSB, 2000d).

One final note in respect of the regulatory environment relates to the so-called "demarcation dispute" that preoccupied the insurance industry for much of 2000 (*Business Day,* 27 March 2000). The dispute pertained to the attempt by two insurance companies (Fedsure Health and Discovery Health) to introduce 'hybrid products' that combined aspects of medical aid schemes and health insurance. The strategy of the insurance companies was to ensure that their policies abided by both the relevant insurance act and the Medical Schemes Act of 1998. However, the Registrar of Medical Schemes asserted that this represented a violation of the Medical Schemes Act on the grounds that the insurance-like aspects of the hybrid products do not, by definition, conform to it. The deeper issue appears to have been the concern that a proliferation of such hybrid products could have the effect of weakening the medical scheme system, which, unlike insurance proper does not permit discrimination of the basis of age and health status. By facilitating the migration of lower risk individuals from traditional medical aid schemes to health insurance, hybrid schemes would have the effect of leaving a more costly pool of individuals in the medical aid scheme system. Ultimately, the dispute was resolved in favour of the Registrar of Medical Schemes, and both hybrid products were withdrawn from the market.

However, this distinction between medical aid schemes and health insurance in terms of the ability to discriminate may become a thing of the past. The Promotion of Equality and Prevention of Unfair Discrimination Act of 2000 (known as the 'Equality Act'), in principle outlaws 'discrimination in business', which insurers say would mean, if strictly interpreted, that they would no longer be able to function effectively by matching the right premium to the right risk (Temkin, 2000). That is, insurers would be forced to adopt the principle of ‘community rating’, and would not be allowed to apply underwriting principles that take into account age, gender, etc. However, the actual implications of the Equality Act for the insurance industry, are not yet clear. Although the legislation has been passed into law, its inception date has not yet been announced. The FSB has compiled a document setting out the concerns of the insurance industry, which has been submitted to the Minister of Finance.

2.3 *The implications of the regulatory framework for microinsurance*

We consider the implications of the regulatory framework for microinsurance, by examining two questions: i) what types of institutions are favoured or disfavoured by the present regulatory framework?; and ii) how adequate are the regulations and institutions in terms of safeguarding the interests of microinsurance clients?

The present regulations governing the insurance industry clearly favour large companies that are able to meet the minimum capital and surplus asset requirements. For short-term insurers, the minimum capital requirement is R5 million ($660 000), and the minimum surplus asset requirement is the greater of R3 million ($400 000) or 15% of the insurer's net premium income. However, larger minima may be required depending on the particular types of insurance business the company wishes to pursue. While these may not be large sums by the standards of most commercially-oriented financial institutions, they are large for certain institutions - like NGOs - that may be interested in serving low-income households and SMEs in particular. This means that most NGOs, for instance, would not be able to become insurers in their own right (though other options are open to those that wish to improve access to microinsurance among their clients - see section 4.3). This also means that insurance developed specifically for this market is likely to be an extension of insurance products developed for the middle-income market. For established insurance companies to become involved in microinsurance, there will need to be innovation - new types of intermediaries, specialised underwriting, and new products. It is argued below that MFIs have potential to extend the frontier of microinsurance provision, precisely by assisting in these three areas.

One serious concern is that, of the small amount of microinsurance presently provided in South Africa, a large share is probably technically illegal. In particular, a fair number of the funeral parlour-based insurers would probably, if scrutinised, be declared in violation of the insurance legislation. And yet, many of these provide a valuable service, and operate in areas where other insurers would not care to venture (see section 3.2). The fate of these insurance providers is quite unclear.

In terms of safeguarding the interests of microinsurance clients, the present regulatory framework is probably not very adequate, although it may be improving. One of the respects in which it is inadequate, is that it is not geared to respond quickly to policyholders' complaints. Neither the insurance ombudsperson nor the FSB, have the capacity to deal with complaints quickly. Worse, it requires a certain amount of sophistication and resources to lodge a complaint in the first place. Low-income households in particular will likely not know where to go with their grievances. Also, since the FSB's investigations are triggered by complaints, this may mean that insurers and brokers serving low-income households are the least likely to receive scrutiny. There is indeed anecdotal evidence that a high proportion of fraudulent insurers are those that specifically target low-income people, for instance the 'seasonal' funeral insurance providers of KwaZulu-Natal. These funeral parlour-based insurance providers typically do not have enough resources to keep their mortuary equipment functioning, much less meet surplus capital requirements. It is perhaps partly on account of the proliferation of such fly-by-night insurers and brokers that many poor South African's harbour negative attitudes about insurance in general (see section 5.5). Therefore, a useful complementary measure to the existing system of insurance supervision would be pro-active investigation of insurers serving the so-called emerging market. This however would require additional capacity to that which already exists. Also, as suggested above, a large number of extra-legal funeral insurers are actually providing a valuable service, and it would arguably not be in the social interest to apply the law too strictly to them. How a proper balance could be struck is an open question.

Two developments that will improve the extent to which microinsurance clients' interests are served, are the forthcoming Policyholder Protection Rules, and the Financial Advisory and Intermediary Services Bill, discussed above. On the other hand, the Equality Act, if put into effect in its present form, would likely damage the prospects of extending formal sector insurance to low-income households, as such households would inevitably have to be rationed out of the market in order for the insurers to remain profitable.

In summary, a number of outstanding issues must be noted in respect of the regulatory and institutional environment, especially when new regulations or new institutional arrangements are introduced:

- *Special exemptions for capital adequacy requirements* - The question of special exemptions to promote non-standard insurers is one natural response to the under-supply of insurance to low-income households and SMEs. While there are other options for promoting microinsurance, this one may bear further scrutiny. Alternatively, means of circumventing the capital adequacy requirements may be expanded and exploited, for example via the Friendly Societies or through financial cooperatives.

- *Consumer education* - How to target prospective and actual low-income insurance clients, so that they improve their uptake of appropriate insurance, and know to whom to turn for advice and redress of grievances?

- *Pro-active supervision of insurers and brokers* - Should supervisory bodies assume more responsibility for ensuring good microinsurance practice? This would involve devising an inspection strategy that would not depend solely on complaints.

- *Dealing with extra-legal microinsurers* - How will existing small-scale insurers be dealt with who do not operate in strict conformity with the legislation? These insurers are engaged in meaningful entrepreneurial activity and perform a vital service, but are at risk of being closed down.

3. Microinsurance from the For-Profit Insurance Sector

3.1 Availability of micro-insurance to low-income households and SMEs

As mentioned in the previous section, insurance cover is heavily skewed towards white households. The average household total premium expenditure for 1995 was R382 ($95) for Africans, R765 ($191) for coloureds, R2147 ($537) for Indians, and R4118 ($1030) for whites. (Unfortunately, more recent data are not yet available from Statistics South Africa.) The same pattern would presumably apply to business-oriented insurance, though no data exist to back this up.

In order to establish what sort of insurance is available to low-income households, different tactics were pursued. First, popular publications (*Bona*, *Drum*, *The Sowetan*, *TV Talk*, *True Love*, etc.) were perused for insurance adverts. Second, researchers physically searched for insurance providers and brokers in low-income neighbourhoods (Mamelodi, Mabopane, Shoshonguve, Kwathema, Johannesburg CBD, Soweto). And third, the SME survey, discussed in section 5, asked low-income people operating SMEs about their use of insurance.

The search for adverts revealed very few insurance products aimed specifically at low-income households, and none aimed at SMEs. Adverts fell into two categories: those placed by major insurance companies (Hollard, Sanlam, Old Mutual, etc.) for a variety of types of insurance; and those placed by brokers providing funeral insurance (21st Century Funeral Brokers, Letsatsi Cash Loans and Funeral Society, QwaQwa Funeral Parlour). During the week of 13 November 2000, *The Sowetan* specifically carried only four insurance-related adverts: an advert from Hollard Direct for funeral cover; an advert from 21st Century Funeral Brokers; an advert from Letsatsi Cash Loans and Funeral Society, but mainly advertising their cash loan services; and an advert from Leza Legal Wise for funeral cover.

The 'street survey' revealed a similar pattern. Funeral insurance is widely available in areas where low-income people reside or work, but virtually no other sort of insurance is evident. The brief of the researchers was to speak to all funeral insurance providers and cash loan agencies and ask if staff were aware of any (other) types of insurance available in the area. The uniform response to these queries was that only funeral insurance was available, because 'we blacks don't have money for those other kinds of insurance'. A few exceptions were encountered (e.g. Money Wise's 'Care Benefits') which will be elaborated upon below. On five occasions, the researchers came across insurance brokers or agents who appeared to cater mainly to white clients, and attempted to find out what types of insurance products were available from or through them. The researches - two young black men posing as potential clients - were in three of these instances refused the opportunity to speak to a staff member, and were also sent away without any written information or business card. In other words, there appears to have been active discrimination against these 'potential clients', either as a matter of racial prejudice, or on the presumption that they were low-income individuals who would not have been able to pay.

Thus, with the singular exception of funeral insurance, microinsurance is neither widely used nor widely available in South Africa. Nonetheless, there does appear to be some change, albeit from a minuscule base. For instance, there are instances of low-cost health cover, life cover, and legal cover, all aimed at – or at least inclusive of - low-income clients. One of the most obvious examples of this is Money Wise, which has accessible offices in a number of cities and towns around the country. The primary business of Money Wise is micro-lending, but borrowers may pay an additional fee (R49 per month, i.e. $6.50) to subscribe to its 'Care Benefits' plan, which includes funeral cover (underwritten by Hollard), emergency medical cover (underwritten by Medical Rescue International), and legal assistance (similar to legal cover but in fact much more limited). Pick-N-Pay Financial Services, linked to the major supermarket chain, is planning in the next few months to add insurance products to its menu of services, presumably also only for clients, in this case those with savings deposits. An important example of insurance that specifically targets emerging entrepreneurs - and in fact the only one that was discovered in the course of this research - is that to the 'black taxi' industry via Clarendon Transport Underwriters, which is a member of the Fedsure Group. CTU has made in-roads to providing insurance to the black taxi industry by means of linking up with and supporting hundreds of township-based insurance brokers. In effect, the vehicle insurance product is not novel, but the mechanism to reach an otherwise ignored clientele is. Of course, this does not truly constitute microinsurance. The economy 'Zimele' plan, for example, has minimum excess for own damage of R4000 ($533), and for hijacking of R7000 ($933). These are well beyond the means of most SME operators.

Another interesting type of insurance which is increasingly accessible to low-income households, is so-called ‘retrenchment insurance’. Furniture and appliance retailers that sell their wares on a hire-purchase basis to low-income people, typically either have retrenchment insurance as an option, or in fact as a condition of being granted the hire-purchase contract. The purpose of the insurance is to indemnify the buyer against future hire-purchase instalments, in the event he loses his job. The cost of such insurance is usually around 12% of the stated cash price of the good being purchased, and of course presumes one has formal sector employment. Usually, one cannot make a claim within the first three months. Proof of retrenchment must be furnished in the form of a letter from the former employer, stating the reasons for the retrenchment, and explicitly excluding retrenchment due to a misdeed by the employee. The relatively up-market retailers (e.g. Royal, Ellerines, Town Talk, Railway), usually make this insurance mandatory, and generally individuals earning less than R1500 ($200) per month are not be eligible. Among the less up-market retailers (e.g. Lubners, Morkels, Beares, and Lewis), the insurance is not mandatory. In essence, this insurance is a form of credit-life insurance adapted for the specific needs of the hire-purchase industry. Similar policies are increasingly being made available to borrowers of micro-lenders. Credcor, for example, provides credit-life insurance, which includes coverage for permanent disability, death, and retrenchment. As of the end of 2000, 38% of Credcor's borrowers were also taking out the insurance, or roughly 84 000 people (Credcor, 2001). African Bank Investments Limited, of which African Bank and King Finance are subsidiaries, offers credit-life insurance through another subsidiary, namely Standard and General (Stangen). Underwriting income for these policies was R347 ($46) million in 2000.

Notwithstanding the impressive pace of development of new markets and new products, for the most part insurance to low-income individuals strongly favours people with regular formal sector employment, either because this is a condition for acceptance as a policyholder, or because these policies are arranged through the workplace. Statistics South Africa's *October Household Survey 1999*, for example, shows that of African and coloured households with a member in formal sector employment, 29% have a member with life insurance, whereas for households relying only on members employed (or self-employed) in the informal sector, only 10% have any life cover (Statistics South Africa, 2000). In addition, payment of premiums for these types of insurance is typically through debit-order, which effectively excludes a large share of those who work in the informal economy, even if they do have bank accounts. Insurance that might specifically assist SMEs is even more rare. The linking of insurance products to loan products (as with Money Wise), means that they are apt to cater to personal rather than business needs, since the majority of micro-lenders concentrate on loans to people who can produce a payslip. On the other hand, however, this may not be as limiting as it appears, since many people operating SMEs may be able to access loans, and in principle similarly insurance, via a family member who does have formal sector employment.

Given the still very limited nature of microinsurance from the for-profit sector, what lessons can be derived for MFIs? We look to the funeral insurance industry for guidance. In particular, we look at the overall structure of the industry, and at the strategies used by the different participants in the industry to reach low-income clients.

3.2 Independent funeral parlour-based insurers

There are number of different types of funeral insurance providers. We discuss first of all the independent funeral insurance providers. These are mainly funeral parlours that service low-income clients. The insurance scheme is provided so as to enable clients to afford the funeral parlour's services. In essence the scheme is a non-refundable funeral pre-payment. In the absence of this, few households would have the cash resources on hand to finance a funeral for a family member on short notice. Characteristic features of these independent funeral insurers include the following:

- *Benefits are provided in kind rather than in cash* - This is what one would expect of funeral insurance provided by a funeral parlour, but this also reflects the preference of many clients. (With the possible exception of traditional burial societies, absent in low-income communities are a significant number of schemes that pay out cash in expectation that the beneficiary will seek the services of the funeral parlour of his choice.) A small amount of cash may be provided as part of the scheme's benefits, e.g. to pay for groceries for the deceased's family for one or two months. The preference for in-kind benefits seems to relate to the desire to resolve arrangements as quickly as possible, in effect most decisions relating to the material aspects of the mortuary services, coffin, burial services, transport, etc., are made in advance. In-kind benefits are also preferred allegedly to prevent family conflict that might erupt if instead the family was paid out in cash. From the perspective of the insurer, this also allows the face value of the policy benefits to exceed the cost of providing those benefits.

- *Monthly payments are paid in person in cash* - This is the preference of most low-income clients, who pay through debit-order rarely even if they have bank accounts, and do not typically have credit cards. From the perspective of the insurer, it promotes frequent personal contact, which is important to minimise the lapsing of memberships.

- *Coverage extends to family groups* - Membership is typically for a group rather than for an individual or even a couple. The latter are possible with some enterprises, and some insurers set premiums based on the number of family members covered; but the more common situation is where up to a certain number of family members are covered by the membership, and possibly even non-family. Older people may usually be added to the scheme for a modest surcharge. When a family (or group) member dies, the policy continues as before, but usually that person is not replaced - i.e. if there were up to 10 people covered initially, now it will be the remaining 9 covered by the policy.

- *Marketing depends on street-presence, direct contact, and/or word-of-mouth* - Funeral parlour-based insurers rely largely on fliers, door-to-door marketing, and having premises in areas well-trafficked by prospective members. The most important measure for attracting more business is to employ very new, very expensive cars for the funeral procession. These are observed by people attending burial services as well as other members of the community. The quality of the hearse and other vehicles contribute to the perceived dignity and prestige of the funeral.

- *Emphasis on community responsibility* - Funeral insurers claim that they are willing to incur risks that normal formal sector insurers would not, e.g. by including the elderly, and that this is done out of a sense of 'community responsibility'. One respondent indicated that he had no difficulty rendering benefits to a client who had committed suicide, while by contrast mainstream insurers would be careful not to. Community spirit is also captured in the names (e.g. “Ubuntu Funeral Services”, where *ubuntu* translates roughly as 'community spirit') and mottos (“There to serve the nation conveniently”; "For service beyond ubuntu"; "Never stand alone"). Second only to the quality of the hearse and other vehicles, is being extremely courteous to members and prospective members. Insurers report that in such a competitive industry, being “nice”, respectful, and accessible are essential.

- *Qualifying criteria and scheme options are simple* - Funeral parlour-based insurers impose almost no criteria on those applying for membership. There is no health questionnaire, no examination, and no proof of economic means (e.g. payslip).

Different possible options are defined by the different nominal values of the funeral packages, and/or specifics such as the number of buses and chairs made available for mourners. The basic parameters defining a scheme are: joining fee (usually around R150-R200, i.e. $20-$27), monthly premium, number of months before one can lodge a claim, number of members covered, and nominal value and particulars of the benefit package. The minimum time before a claim can be lodged varies greatly from one insurer to another, with the minimum being around 3 months and the maximum being 12 months.

- *Financial formula is derived from trial and error, simple math, and by borrowing from competitors, rather than actuarially* - Smaller, independent insurers do not rely on actuarial principles to derive the financial parameters of their schemes. Rather, they have regard to basic considerations such as the actual cost of providing a funeral, and what competitors charge and offer. Adjustments are made over time through trial and error.

Some of these features obviously relate to the specific case of funeral insurance, but there are also a number of pointers to sound insurance practice that could be generalised to other types of microinsurance. First and foremost, the precautions against adverse selection are simple but potent. The key guards against adverse selection are: i) the mandatory waiting period before which a family cannot make a claim, even though it must pay the premium; and ii) the fact that the 'member' is most usually a family group rather than an individual, which has the effect of 'averaging out' the riskiness among the members of the family. This is the same principle observed by a number of MFIs providing microinsurance in other countries. Surprisingly, the funeral insurers interviewed did not regard HIV/AIDS as a particular challenge to their stability - nor as an opportunity to be exploited. This bears further study, but the implication is that their precautions against adverse selection are, for the time being, sufficiently sound.

The second main theme is simplicity. Costs, benefits, and conditions of member policies offered by funeral insurers, are straightforward relative to those that are typical of policies offered by major insurance companies. This reduces the scope for dispute and engenders less suspicion among potential members. As will be shown in section 5 on the SME survey, mistrust of insurers is common.

The third theme is transactions costs. Typically in the insurance industry, the transactions costs associated with client-contact are considered to be one of the biggest contributions to total costs, next to claims. This is exacerbated when policies lapse or are surrendered, because effort was made in initiating a policy which is not maintained. One consequence is that client contact is a specific area in which mainstream insurers and brokers are seeking to minimise costs, e.g. through call centres and internet sales, as mentioned above. However, it could be argued that small-scale funeral insurers are intensive with client contact, but in a manner that lowers rather than amplifies transactions costs. For example, funeral insurers sometimes dispense with the documentary proofs (e.g. to prove the identity of family group members), which they substitute with casual encounter and familiarity by virtue of being part of the same community. In addition, as suggested above, repeated contact with the same clients may have the effect of reinforcing their commitment to the scheme, thus reducing lapses. Other measures to keep transactions costs low include the simplicity of options, rules, and procedures, already mentioned, as well as the group nature of most memberships, which of course has the effect of reducing the per individual cost considerably. In terms of transactions costs to the client, it is clear that the key is remaining on a cash basis and situating offices where they are convenient to local community members. It is not necessarily whether transactions costs are ‘low’ or ‘high’, but whether they are appropriate to the client.

The fourth and final theme is defence against fraudulent claims. However, this is perhaps where funeral insurance provides a poor example for other sorts of insurance. Scope for fraud in funeral or life insurance is not as great as with other types of insurance cover, thus it is unclear whether the weak controls over fraud that are characteristic of funeral insurers provide any useful guidance to, say, MFIs that would wish to provide microinsurance over a variety of business-related risks. In funeral insurance, virtually the only opportunity to cheat the insurer is to bury someone who was not genuinely a member of the insured family group. In most circumstances, this is not very plausible, especially if the insurer is also the provider of the mortuary and funeral services. Arguably the main defence against fraud for which local funeral insurers offer some support is their community orientation, as mentioned above. Much as village banks and community-based financial service cooperatives rely on mutual responsibility as an incentive for loan repayment, one becomes a "member" of a funeral insurance scheme rather than strictly a "client".

Many of the township-based funeral insurers are single, independent entities started and run by a single entrepreneur. Others are branches of a chain of such insurers, such as Prestige Burial Services and Martins, each with almost ten branches in different locations. These larger chains seek to preserve many of the same characteristics of the unitary enterprises, particularly the focus on low-income households, group memberships, premium payments in cash, and benefits in kind. Funeral insurers such as Prestige and Martins also have in common with their smaller counterparts, that they are not linked to a major insurance company. They are still essentially funeral parlours that use membership schemes as a means of making their services affordable to their clientele.

3.3 Funeral insurance agents and brokers

The other main source of funeral insurance to low-income communities comes through agents and brokers. Batho Batsho Bakopane Funeral Services, for example, has branches in 15 communities, and is underwritten by Prosperity. Letsatsi Funeral Society, with 10 branches, is underwritten by Safrican; 21st Century Funeral Brokers, with over 20 branches, is underwritten by Metropolitan Life; Methburial, with 10 branches, is underwritten by Avbob. While these entities are generally presented as brokers, their typically one-to-one relationship with an insurance company is more characteristic of an agent. Regardless, they serve as the principal link between insurance companies and the low-income communities in which the former do not have a visible presence.

In numerous respects, these intermediaries function very much like their independent counterparts: they offer very similar policies, with almost identical menu options, waiting periods, and family group emphasis; they provide the bulk of their benefits in kind rather than in cash; and they receive monthly payments mainly in cash, though sometimes also offer the option of debit order. The main differences are that they tend to be large, i.e. have a large number of branches, so as to create a volume of business that will be worth the while of an insurance company to engage with; and the actuarial work is undertaken by the insurance company.

The purpose of drawing attention to this distinct category of funeral insurance provider is to demonstrate the manner in which insurance companies provide their services to low-income communities. It is fair to say that insurance companies would struggle to open their own cost-effective, client-intensive branches in these communities, and would not be able to reap the advantages of community presence that brokers/agents and independent funeral insurers are able to. (Those pursuing 'direct writing', such as Hollard Direct, target middle class more than low-income people; they conduct their business largely over the telephone and rely on debit-order arrangements for payment.) *What is perhaps most remarkable is the extent to which the policies they underwrite mimic those that have already been available in low-income communities.*

3.4 Conclusion

Given that insurance companies have found the means to provide funeral insurance to low-income households via brokers and agents, and to do it successfully, why is their indirect provision of insurance almost completely limited to funeral insurance? Unfortunately, we are not in a position to answer this question. All we can do is offer the beginnings of a possible explanation that could be the subject of further study. First, as is well known, life/funeral cover is easier to provide than most other kinds of insurance. The actuarial issues for life/funeral cover are relatively simple, and, as indicated above, the danger of fraud is not too great. Funeral insurance is thus a logical place to start, and it may be that insurance companies see it as a uniquely profitable opportunity for expansion into low-income communities. Second, cultural imperatives are such that many low-income communities offer a significantly bigger market for funeral insurance than for other kinds of insurance, such as car insurance and household insurance. (The country’s most widely read newspaper, *The Star*, is presently running a promotion whereby first-time subscribers are automatically enrolled for ‘free’ funeral cover underwritten by Hollard.) On the other hand, it may be a chicken-and-egg situation, whereby the absence of insurance marketed in low-income communities means that people there do not become aware of it, and thus do not express a demand for it, so that in turn insurers have little incentive to figure out how to make it available. For funeral insurance, by contrast, the market was already well established, and insurers risked little in trying to capture some of it.

One paradoxical situation encountered in the course of the research for this report, emerged in discussion with some of the independent, single-outlet funeral parlour-based insurers. They were asked whether they, as individuals and business owners, had insurance. After all, as entrepreneurs that provide insurance, they certainly understand the principles of insurance, and presumably its value as well. These respondents sometimes had life insurance with a major South Africa insurance company, but did not by and large have any insurance against theft or property damage. This is notwithstanding the fact that their on-site inventory of coffins was easily worth over R100 000 ($13 000). When asked why he did not insure his assets, one man indicated that he preferred to maintain on-site security, i.e. guards, to prevent anything from happening in the first place. Another suggested that his vehicles were not that valuable and so were not "worth insuring". Whatever the exact reason, there appears to be a tendency to dismiss the need for insurance other than funeral cover, even among those whom one would least expect to.

4. Microinsurance From MFIs

This section of the report summarises the results of a cursory survey of South African MFIs as to their involvement with and perceptions of microinsurnace. Discussions were held with about 25 MFIs, as well as half a dozen other institutions working to support the SME sector. The discussions ranged from brief informal exchanges, to more in-depth interviews. The main purpose of the survey was to establish whether South African MFIs are providing microinsurance to their clients; whether they perceive a role for microinsurance if not; and what obstacles they perceive to be hindering the introduction of microinsurance.

4.1 Provision of Microinsurance by MFIs

A handful of MFIs are providing microinsurance to their clients. Of the 25 MFIs surveyed, 5 offer credit-life (loan) insurance, 3 offer funeral insurance, and 4 others reported having taken some steps towards finding out how to introduce insurance (e.g. having discussions with brokers), particularly credit-life insurance.

The purpose of credit-life insurance is to insure against the borrower's inability to complete loan repayment in the event of death. Credit-life therefore benefits both the lending institution - which no longer has to worry about non-repayment for this particular eventuality - and perhaps the deceased borrower's family, were the institution inclined to attempt to recover repayments from it. Indirectly, credit-life insurance can benefit the broader community that looks to the institution for financial services, to the extent it can assist stabilise the institution. Credit-life policies usually cover only that share of one's outstanding balance that is not in arrears.

The relatively advanced interest in credit-life insurance among South Africa's MFIs appears to reflect this need to boost stability where possible. One respondent MFI indicated that their recent interest in credit-life insurance is motivated by the worsening AIDS epidemic, which they feel is having a noticeably negative effect on the mortality rate of its borrowers.

The involvement of MFIs with funeral insurance relates to the high demand for funeral insurance among MFIs' clients or members. When asked why MFIs should bother to introduce the one kind of insurance cover that seems to be readily provided by the private sector already, the reply was that decent, affordable funeral insurance is not in fact accessible in some areas. In deep rural areas, particularly, funeral insurance is not always available, and traditional burial societies may not be adequate.

The MFIs who reported offering insurance are in fact operating in the role of a broker in liaison with an insurance company, or in liaison with a normal insurance broker. That is to say, the actual provider of the insurance to the MFI's clients is not the MFI, but an insurance company. The MFI acts as a facilitator or a conduit. As with brokers generally, the role of the

MFIs in the provision of insurance differ. Some perform all of the relevant tasks - save the actuarial work - such as collection of premiums, processing of claims, etc.

One MFI apex institution, SACCOL (South African Credit Cooperatives League), has formed a "joint venture insurance programme" with an insurance company that involves some form of profit sharing (NCASA/CCA, 2000). Forming this arrangement was initially a painstaking process for SACCOL, which had previously enjoyed a very favourable insurance arrangement with CUNA (Credit Union National Association, based in USA). When CUNA terminated its involvement in Africa in 1998, SACCOL engaged in discussions with no fewer than five South African insurance companies, finally finding one that was willing to flexible and affordable (albeit far less affordable than CUNA). SACCOL acts as a broker to member cooperatives, which in turn are secondary brokers to their members. By virtue of performing some of the administrative tasks associated with processing of applications and claims, SACCOL receives a share of the profits with the insurance company. Another example of this was raised at the workshop by FSA, which earns an agent's fee for the funeral cover accessed by members of its member village banks.

MFIs generally have not attempted acting in the role of the insurer, because of the onerous demands of complying with the legislation and regulation governing registered insurance companies.

When asked what kinds of insurance they would like to see more widely available to their local SMEs, the MFIs surveyed mentioned a large variety. Probably the most commonly mentioned was insurance against the loss of productive assets, such as tools, sewing machines, etc. Theft and fire were mentioned as the most serious threats to productive assets. Natural disasters such as floods were also mentioned. The next most frequently mentioned type of insurance was health insurance, and finally life (as distinct from burial) insurance, that is, having an endowment aspect.

Overall, MFIs appear to have three distinct motives in either offering or wishing to offer insurance products to their clients. First, some MFIs regard insurance as a valuable financial service no less than lending, and thus wish to enhance the extent to which their clients have access to it. Second, offering insurance to clients is a way of creating an additional income stream for the MFI, for example by keeping some share of the premium as a commission. And third, as particularly with the credit-life insurance described above, the introduction of insurance can serve as a means of creating more financial stability for the MFI, e.g. in view of the risk of premature death of borrowers.

4.2 Obstacles to Introducing Microinsurance

A number of obstacles to introducing or maintaining microinsurance were identified by the MFIs surveyed. We organise these into five main types:

- *Lack of interest among insurers and brokers* - Two of the MFIs indicated that they had struggled to find an insurance company or broker, which was interested in discussing the MFIs' aim of introducing insurance to their clients. The insurance companies appeared to assume that there was little in it for them. This was not the experience of all the institutions interviewed, however. One SME support institution, for example, indicated that it had established a very strong relationship with a particular broker, to whom it frequently referred clients. Also, one MFI had developed a very good relationship with an insurer for its credit-life insurance, which it claimed was very affordable and easy to manage.

- *Prohibitively high cost of insurance* - One MFI that was trying to find an insurance company to provide credit-life insurance, was shocked at the high cost quoted to it by a number of insurance companies. Only after much searching and some negotiation was it able to find an insurer that could meet their needs at an acceptable cost. One proposal that has been mooted is whether some MFIs could band together in order to improve their bargaining power relative to an insurance company or broker.

- *High transactions costs* - High transactions costs together with low volumes may be one reason insurance companies have not been aggressive in trying to establish partnerships with MFIs. However, high transactions costs affect MFIs as well. One MFI has devised an innovative system for collecting insurance premiums for several periods at once, so as to prevent a situation whereby the cost of transferring the premiums to the insurer exceeds the premiums themselves. Where volumes are low due to a small client base, the challenge of keeping transactions costs low is especially great. Of course, as with lending, group insurance can be another effective means of reducing per-client transactions costs, as with the example of family funeral cover discussed above.

- *Lack of information* - A major reason some MFIs had not gotten further in exploring the options for introducing microinsurance, was a lack of information about how to proceed, whom to speak to, what to look for, how to negotiate, etc. Helping to relieve this constraint is of course one of the main rationales for the present project.

- *Lack of demand among clients* - A large number of the MFIs interviewed felt on the one hand that microinsurance would appear to have a very valuable role to play to support the SME sector; and yet, there was also wide recognition by MFIs that there is not a very strong demand among SMEs for insurance. Thus even if the insurance were to be made available at a reasonable cost, it is not clear that there would be many SMEs that would voluntarily sign up for policies. The lack of demand among potential clients was generally ascribed to a 'need for education', presumably meaning that SMEs tend not to be sensitised to the potential benefits of having insurance. This interpretation is supported by the findings of the SME survey discussed in section 5.

Above and beyond these specific hindrances faced by MFIs that might wish to offer microinsurance, is the fact that many MFIs are presently mainly absorbed in consolidating their other activities, e.g. lending. Indeed, a number of the MFIs surveyed have been in operation for less than one year, leaving little opportunity to pursue things other than their core business.

4.3 Options for Improving Provision of Microinsurance to SMEs

In concluding this section, we outline some of the main options available to an MFI that wishes to make microinsurance accessible to its SME clients. We identify four main options.

The first option is for the MFI to *become an insurer in its own right*. This would require the MFI to register with the appropriate insurance registrar (short-term or long-term), or with the Registrar of Medical Schemes if seeking to provide health assistance not having a strict insurance character. Any of these would have huge implications for capital requirements and other resources, i.e. so that the MFI could convince the registrar of its competence and financial soundness. For most MFIs, these requirements would be prohibitive, and thus this option is not much of an option at all. The main advantage of this option is that the MFI would have maximum control over how the microinsurance was structured.

The second main option would be for the MFI to *initiate a captive facility*. There are two main alternatives in this regard. The more ambitious alternative would be to create a *cell captive*, which is formed when a company (e.g. an MFI) seeking to self-insure purchases shares in an insurance company that have been set aside for this specific purpose, i.e. the 'cell'. The cell captive becomes an insurer in its own right, whose policyholders are the employees and perhaps customers of the company. The assets and liabilities of the captive are ringfenced from those of the host insurance company. The advantage to the client company is that it has wider discretion in formulating its own insurance policies and does not have to share an insurance pool with 'undesirable partners'. Also, by virtue of linking to an existing insurance company, it does not need to acquire its own insurance license or abide by all of the regulations to which the insurance company is subject. Meanwhile, the client company shares the overhead costs with the insurance company, as well as the underwriting profits accruing to its own insurance cover. The second, related, alternative is for the company seeking to self-insure to establish a *rent-a-captive facility*, which is where the client pays a fee to the insurance company rather than purchases shares. This also allows the client company to rely on the insurance company for its expertise and its insurance licence. However, the client company does not need to have the same amount of capital to get started, and it still enjoys the advantage of being able to negotiate an insurance package that suits it and that otherwise might not have been available. The cell captive and rent-a-captive options are particularly attractive to companies that wish to pursue parallel risk management strategies with their employees such as 'wellness management'. Despite their various advantages, the cell captive and rent-a-captive options might still be overly exacting in terms of requiring technical expertise, and would certainly only be viable if the number of policy holders was large. On the other hand, cell captives are becoming more common in South Africa, and it may be only a matter of time before rent-a-captive facilities also become commonplace.

The third option is the one that has already emerged as the most likely for the majority of MFIs, that is, where the MFI *acts as a broker or agent* linked to an insurance company or a professional insurance broker (sometimes referred to as the 'partnership model'). The main advantage of this option is that it is generally feasible for most MFIs, provided they can attract an insurance company or broker to participate. Another advantage is that the MFI can combine, if desired, different kinds of insurance from different insurance companies, as in the example of Money Wise provided in section 3, or some of the MFIs interviewed for this study. The main disadvantage is that the MFI may not be in a strong bargaining position to secure the sort of affordable insurance that ultimately it would like to provide. Moreover, control over decisions such as when to honour a claim, ultimately rest with the insurance company.

The fourth and final option is that the MFI develop the capacity to provide useful *advice to SMEs about where to go to meet their insurance needs*. This admittedly simple notion can be quite efficacious. One of the institutions surveyed indicated that it does precisely this, and with some success due to having a good relationship with a good broker. The SME survey discussed in the next section, also, revealed that among the small number of entrepreneurs who did have insurance, most had received it with a major insurance company on the advice of another institution that knew where to direct them. Of course, the downside of this option is that it provides the MFI very little control or clout in trying to help client SMEs get insurance. More importantly, it does not actually make microinsurance more accessible, but rather merely helps SMEs know where they can try to access it. For smaller SMEs in particular, this may be of limited use.

5. Findings of the SME survey

5.1 Introduction

The purpose of the SME survey was to establish to what extent South African SMEs make use of insurance, as well as to understand the risks they face. The survey was conducted in two rather different areas, namely Winterveldt, a peri-urban township near Pretoria, and Gazankulu, a semi-rural former homeland area in Northern Province. Winterveldt and Gazankulu are thus characteristic of the distorted settlement pattern created by apartheid, whereby Africans were restricted to designated areas from which they usually had to commute (or migrate) for gainful employment.

The number of SMEs included in the survey was 73 in Winterveldt, and 45 in Gazankulu, making a total of 118. The survey was conducted by means of a standardised questionnaire, which was piloted in Winterveldt. Respondent SMEs were selected so as to ensure that a variety of different 'typical' SME types were covered in each study site. The survey does not constitute a statistically representative sample for either area, thus the results must be interpreted with caution. In all instances, the person mainly responsible for the SME was interviewed.

5.2 Background information on sample

This initial section presents background information on the SMEs and entrepreneurs represented in the sample. Tables 1 and 2 below show the composition of the sample for both study sites, in terms of gender and SME type, respectively (see appendix for more demographic information about the sample):

Table 1: Gender composition of sample, by site

	Women (no.)	Men (no.)	Total (no.)
Winterveldt	28	45	73
Gazankulu	14	31	45
Total	42	76	118

Table 2: Composition of sample by SME type, by gender

SME Type	Women (no.)	Men (no.)	Total (no.)
Crèche	5	2	7
Dress making	3	0	3
Farming	0	9	9
Hair care	6	12	18
Mechanic/panel beater/etc.	0	12	12
Retail	17	11	28
Tavern/shebeen	1	3	4
Taxi owner	2	19	21
Telephone	8	5	13
Welding	0	3	3

The breakdown according to SME type is probably where the non-rigorous nature of the sampling is most potentially misleading. For instance, in the sample at hand, taxi owners are almost certainly over-represented, and retailers under-represented. This must be borne in mind when considering statistics that are not reported according to SME category.

In the Winterveldt sample, the average number of non-earners staying in the household was 1.7, while in Gazankulu the figure was significantly higher at 3.7. (By "non-earners" we mean those earning neither a wage nor deriving an income from self-employment or a social grant.) On average, the Winterveldt respondent households have a much more favourable dependency ratio (2.1) than their Gazankulu counterparts (3.2), though in Gazankulu there is a significant difference between households with women-run SMEs (3.7) and men-run SMEs (3.0). Looking at the two areas together, we attempt to gauge the importance of the SME for the sustenance of the household, by looking at the extent to which the person operating the SME is mainly responsible for different categories of household expenditure. The results are summarised in Table 3 below:

Table 3: Responsibility of SME operator for household expenses

	Food		Food, school fees, medical, rent, and energy		
	Self	Other	All self	Some self	None self
Women	69%	31%	50%	40%	10%
Men	71%	29%	51%	42%	7%
Both	70%	30%	51%	42%	7%

The table reveals the importance of the SME to the upkeep of the household, and also that there is little difference between women who run SMEs versus men who run SMEs, in terms of such responsibilities. About 70% of the respondents indicated that they are the household members who are mainly responsible for paying for the household's food needs. Similarly, around 51% of the respondents said that they are the person in the household who are responsible for paying for food, school fees, medical expenses, rent, and electricity/paraffin.

Finally, a few basic questions were asked to gauge respondents' use of financial services other than insurance. In particular, it was established how many SME operators had savings accounts, and how many had loans outstanding. Table 4 reveals that the overwhelming majority of respondents keep savings accounts.

Table 4: Incidence of savings accounts among SME operators

	Have a savings acct.	Do not have savings acct.
Women	93%	7%
Men	89%	11%
Both	91%	9%

Use of loans is rare. In all, 26 respondents (22%) reported having an outstanding loan at the time of the interview. Of these, 20 had loans for productive purposes (17%), and of these, a disproportionate number, 8, were from Vodacom to assist entrepreneurs purchase Vodacom equipment, and another 7 were from the Land Bank for farming purposes. In other words, of the 103 respondents who do not operate Vodacom-equipped public telephone booths or have Land Bank loans for farming, only 5% had an outstanding loan related to their enterprise.

5.3 Personal Risk and Illness

A number of questions were asked to try to discern what the respondent SME operator feared in terms of personal calamities, and also whether they ever experienced periods of ill health that interfered with their ability to conduct their business activities. Table 5 below reports the main risks identified by respondents in response to the question, “What are the main kinds of emergencies you worry about?” Respondents were free to mention more than one concern, and were not obliged to mention any (though almost all did), thus the percentages do not sum to 100%.

Table 5: Personal fears of SME operators

Fear/concern	% of sample mentioning
Death of self or family	81%
Sickness or injury	15%
Natural disaster	6%
Crime/theft	3%
Other	10%
None	3%

Given the predominance of the concern about death in the family, it is not surprising that a number of the respondents either have life/funeral cover through a formal sector insurance company (22%), or belong to a burial society (44%), or both (8.5%). Altogether, about 53% of the respondents have some sort of formal or informal sector funeral insurance. In addition, a large number of respondents (41%) report either actually maintaining precautionary savings, or struggling to do so, precisely to prepare against these anticipated crises. A third of all respondents belong to a stokvel (ROSCA). Broadly speaking, these results support the tenet of risk aversion that is one of the core premises of the present research project.

Although illness did not rate anywhere near as high as death as a feared emergency, it nonetheless presents a serious problem, particularly if the person falling ill is the SME operator who is a major breadwinner for the household. Respondents were asked if illness ever prevented them from conducting their work, to which 32% replied that it did. When asked how many days the respondent was unable to work due to illness in the previous 12 months, answers varied from 1 day to 150, with a mean of 24 days, and a median of 10 days. All but one of those respondents who could not work themselves relied on someone else to run the business in their absence, almost always a family member. Roughly one third of those whose illness prevented them from working in the past 12 months had medical aid, usually through a family member. On the basis of these few bits of information, it is difficult to evaluate how serious illness is in general for one's ability to maintain the SME and therefore not be deprived of income. The seriousness of the problem appears to be attenuated by the fact that family members can take over in one's absence, though this is not necessarily sufficient to maintain income at its usual level.

5.4 Perceived SME-related risks

A series of questions were asked about the main risks the respondent perceives as actually or possibly affecting the income stream from her or his business. Respondents were first asked to identify any business-related risks that came to mind, and then the same set of questions was asked in respect of each of these identified risks, for up to three risks. Respondents were prompted as little as possible in the identification of risks. All but two respondents identified risks related to their enterprise: 62 related one risk, 46 related two risks, and 8 related three risks.

The table that follows seeks to summarise the frequency with which different categories of risks were perceived, according to SME type. The risk categories (non-payment, theft, etc.), were created by the researcher *ex post* to best capture the spontaneous replies provided by the respondents. The table reports the number of times different risks were mentioned. The figure in brackets in the left-hand column with the name of the SME types, indicates how many respondents there were of that type in total (see Table 2), so as to enable one to gauge the magnitude of the number of mentions. For example, only three dress-makers indicated that they perceive theft or robbery to be a risk, but as there were only three dress-makers in the sample, this is rather significant.

Table 6: Perceptions of risks by risk categories and SME types

SME type	Non-payment	Robbery/ Theft	Accident, injury, etc (Self or Client)	Death (self or client)	Disaster	Business risk	Other
Crèche (7)	0	0	7	5	0	0	0
Dress making (3)	0	3	0	0	0	0	0
Farming (9)	0	1	0	0	6	7	3
Hair care (18)	2	7	8	0	3	2	3
Mechanic/etc. (12)	5	6	3	0	0	2	1
Retail (28)	3	5	5	2	0	18	5
Tavern/sheb'n (4)	0	3	4	3	0	0	0
Taxi owner (21)	0	21	7	4	0	2	6
Telephone (13)	0	13	0	0	0	5	2
Welding (3)	2	1	3	0	0	0	0
Totals (118)	12	60	37	14	9	36	20

We discuss each of these risk categories in turn, and highlight situations where the risk is particularly great or the circumstances instructive. (We omit the "other" category, however, because these are either of such a disparate nature, or were so difficult to interpret, as to preclude a meaningful summary.)

- *Non-payment:* What we here call the risk of non-payment is when the entrepreneur agrees to be paid by the client later but in fact has difficulty procuring that payment. In some instances, the respondent expresses this risk, as 'customers want credit'. However, where this risk appears to be most serious is for those performing repairs on vehicles, because it is normal for the client to only pay when collecting the repaired vehicle. When the person owning the vehicle cannot pay, then he may plead to collect the vehicle anyway (in which case the mechanic may well have difficulty collecting payment after-the-fact), or the vehicle may remain with the mechanic, cluttering his workspace. A number of mechanics indicated that they dislike having to keep clients' vehicles, because then they face the risk that the vehicles may be stolen while in their possession ("Cars are stolen when their owners do not come to collect them")

- *Robbery/theft* : The danger of robbery and theft comes in different forms, of which the main two are risk of theft of cash proceeds and risk of robbery of stock, inventory, or productive property (e.g. taxis, tools). Dress-makers, tavern owners, taxi owners, and telephone-booth operators, appear to feel almost universally vulnerable to robbery and theft. Dress-makers fear having their sewing machines stolen, tavern owners fear being robbed of cash, taxi owners fear both hijackings and robbery of cash revenues from their drivers, and telephone-booth operators fear both cash robbery but even more so theft of telephone equipment. Taxi owners, interestingly, report that the risk of hijacking is directly related to how new or nice the taxi is, a clear disincentive to invest in newer vehicles. Hair cutters/stylists, mechanics, and retailers also appear to fear robbery and theft, though less intensely. Mechanics fear theft of or from clients' vehicles while on their premises, as well as theft of tools. Other entrepreneurs appear to not have great concerns about theft and robbery.

- *Accident/injury/illness:* The risk of accident means very different things depending on the SME type, and except for want of space would have been reported as distinct categories. For crèche (i.e. ‘day care’) owners, for instance, the fear of accidents relates to the danger that children may be injured while in one's care, or one child may be infected by another child who is sick. In essence therefore the crèche owner's concern is about liability to the injured child's parent. This fear is apparently so great that a number of crèche owners also reported concern children may be killed or die while in their care. For those providing hair care, the risk of accident is again of a liability nature. Two concerns predominate. One is that the hair cutter may accidentally cut or chemically burn the client (one respondent reported cutting off a part of the client's ear, and then being threatened with being reported to the police!). The other is that the client may be extremely unhappy with the result of her hair treatment, as with one woman whose hair fell out completely because the particular product used turned out to be too harsh for her hair. In these areas where there is a perceived liability, the nature of the liability may or may not be primarily legal. A non-legal liability case would be where the client directly demands cash compensation, perhaps immediately, maybe or maybe not backed up with a threat to make a report to the police ("I one day accidentally cut a client's flesh and I had to negotiate with them"). Tavern owners also face a version of this, because clients are so frequently engaged in 'drunken brawls' that personal injury (euphemistically categorised here as an 'accident') is practically inevitable. However, the result of these brawls can also impose costs on the tavern owner through destroyed property, e.g. tables and chairs. For taxi owners, the concern over accidents refers mainly to damage to vehicles through collisions, though there may also be some concern for passenger safety. For welders, finally, the danger of accidents relates to fires and personal injury, e.g. to one's eyes.

- *Death:* The risk of death is similarly various as with accidents. For crèche owners, the risk of death to children and infants has already been mentioned. For retailers, the risk of death appears rather minor, with only two respondents out of the 21 mentioning it. The two that did mention it sell street food, thus the fear is that a customer may fall fatally ill if the food is somehow tainted ("People become sick due to food poisoning and I often get accused of trying to kill them"). For tavern owners, the drunken brawls may well prove fatal ("Almost every weekend one person is killed in the tavern; when people are drunk they start fighting and end up killing each other"). Not surprisingly, the greatest concern about death to oneself is among taxi owners, a number of whom live in fear of hit-squads organised by rival taxi organisations, or simply rival owners regardless of association. One taxi owner respondent, for example, is a woman who owns 22 taxis, which she inherited from her husband who was murdered in the "taxi wars". Surprisingly, taxi owners are not more likely than other entrepreneurs to have funeral/life insurance or belong to a burial society (52% as against 53% for the entire sample). We can only speculate, but the reason may be that being a taxi owner is so lucrative, especially for those owning five or more vehicles, that funeral insurance seems superfluous.

Disaster: The risk of disaster did not emerge as a major concern among respondents from the sample. Farmers, not surprisingly, share a strong concern about drought and brush fires - i.e. natural disasters. Some hair stylists expressed a concern about the risk of fire, apparently due to the highly flammable nature of the hair products they keep on hand. It is somewhat surprising that there is not more general concern about events, which may damage one's business premises, for example fire damage to taverns and mechanics' quarters. Obviously, many SMEs do not maintain actual buildings (e.g. many mechanics operate on roadsides and in backyards), and perhaps others that do have buildings have invested little in them.

- *Business risk:* By business risk we mean normal risks incurred by entrepreneurs due to weak demand, excessive competition, or in the case of agriculture, poor yields. Retailers were especially prone to mentioning stiff competition as a source of concern. For fruit and vegetable hawkers, the concern was especially great, as these items would readily perish if they could not be sold in time, which in a situation of over-supply is not unlikely ("There are a lot of hawkers selling the same products"). The susceptibility of retailers to business risk very likely also relates to the fact that, among the SME types surveyed, retailing is generally the easiest to get into, requiring the least skills and start-up capital. SMEs requiring more in the way of either skills (mechanic, dress-maker, welder) or capital (tavern owner, taxi owner) are generally more remunerative and less risky in terms of market demand. A handful of respondents from across SME types mentioned that increased retrenchments are having a negative impact on business. For telephone booth operators, a very specific dynamic is unfolding, whereby those operating Vodacom booths (i.e. cellphone-based) have in some areas significantly displaced those operating Telkom booths (i.e.

landline-based), because the latter incur higher unit operating costs which they must pass on to their customers. (However, Vodacom has presently frozen its "community service programme" because it has not been accorded sufficient additional 'bandwidth'). While these types of business risks are not necessarily of interest to us from a microinsurance perspective (an issue to be discussed below), their inclusion in fact highlights the relative importance of the other types of risk mentioned; it is noteworthy that business risk receives more mention than other risk categories for only 2 of the 10 SME types covered, and for one of these - farming - only barely so.

One noteworthy feature of this overview of respondents' principal perceived risks, is what is missing: not one respondent listed as an enterprise-related risk the inability to conduct business due to personal illness. This is notwithstanding the fact that a number of respondents did report having to miss work due to illness in the previous 12 months.

Apart from trying to identify what kinds of risks different SME operators faced or perceived, we attempted to get some sense of how these risks are perceived in terms of severity, likelihood, and probable effect on one's business. This attempt was not altogether successful, perhaps because it required respondents to make assessments in the abstract or hypothetical. Possibly a better approach would have been to have obtained specific information about events or problems that had actually occurred, e.g. in the previous 12 months. Unfortunately, it was not realised until quite late in the course of the survey that these questions were not eliciting consistent information, as revealed for example in frequent internal inconsistencies. The questions put to the respondents for this section related separately to each risk the respondent identified:

a) In general, would you describe the effect of this event on your business as:
severe / somewhat severe / not so severe / mild?

b) In general, how would you describe the likelihood of this event happening once or more times in the next 12 months:
almost certain / highly likely / 50:50 / unlikely / very unlikely?

c) In general, how would you best describe the effect of such an event on your business?
__*it would reduce my income partially for a while*
__*it would reduce my income fully for a while*
__*it would put me out of business completely*

__*it would put me out of business completely, and I'd be in debt*

d) How often do you think or worry about this risk?
every day / once per week / once per week / rarely

Because of the potentially excessive volume of results (i.e. if we were to report the average responses to the above questions for each risk category for each SME type), we rather pick out results for the more significant risks for different SME types, as revealed in Table 6 above. Nine specific cases are reported in all. It must be borne in mind that the number of observations for each case tends to be very small.

Table 7: The perceived nature of risk for nine specific cases

Severity		**Likelihood**		**Effect on business**		**How often worry**	
Creche owners on accident risk (n = 7)							
Severe	86%	almost certain	29%	reduce inc. partial	43%	every day	86%
Somewhat severe	14%	highly likely	43%	reduce inc. total	14%	once per week	0%
not so severe	0%	50:50	29%	out of business	43%	once per month	0%
mild	0%	unlikely	0%	out of bus. + debt	0%	rarely	14%
		very unlikely	0%				
Farmers on disaster risk (n = 6)							
Severe	100%	almost certain	50%	reduce inc. partial	0%	every day	100%
Somewhat severe	0%	highly likely	50%	reduce inc. total	17%	once per week	0%
not so severe	0%	50:50	0%	out of business	67%	once per month	0%
mild	0%	unlikely	0%	out of bus. + debt	17%	rarely	0%
		very unlikely	0%				
Hair cutters/stylists on theft/robbery risk (n = 7)							
Severe	43%	almost certain	29%	reduce inc. partial	71%	every day	57%
Somewhat severe	0%	highly likely	14%	reduce inc. total	14%	once per week	0%
not so severe	14%	50:50	43%	out of business	14%	once per month	0%
mild	43%	unlikely	14%	out of bus. + debt	0%	rarely	43%
		very unlikely	0%				
Hair cutters/stylists on accident risk (n = 8)							
Severe	25%	almost certain	12%	reduce inc. partial	75%	every day	38%
Somewhat severe	12%	highly likely	38%	reduce inc. total	0%	once per week	0%
not so severe	25%	50:50	12%	out of business	25%	once per month	0%
mild	38%	unlikely	25%	out of bus. + debt	0%	rarely	62%
		very unlikely	12%				
Mechanics on theft risk (n = 6)							
Severe	67%	almost certain	33%	reduce inc. partial	17%	every day	100%

Somewhat severe	17%	highly likely	17%	reduce inc. total	0%	once per week	0%
not so severe	17%	50:50	50%	out of business	17%	once per month	0%
mild	0%	unlikely	0%	out of bus. + debt	67%	rarely	0%
		very unlikely	0%				
Retailers on business risk (n=18)							
Severe	61%	almost certain	56%	reduce inc. partial	61%	every day	72%
Somewhat severe	22%	highly likely	17%	reduce inc. total	22%	once per week	6%
not so severe	11%	50:50	28%	out of business	17%	once per month	0%
mild	6%	unlikely	0%	out of bus. + debt	0%	rarely	22%
		very unlikely	0%				
Tavern owners on accident risk (n = 4)							
Severe	75%	almost certain	50%	reduce inc. partial	0%	every day	75%
Somewhat severe	0%	highly likely	25%	reduce inc. total	0%	once per week	25%
not so severe	25%	50:50	25%	out of business	75%	once per month	0%
mild	0%	unlikely	0%	out of bus. + debt	25%	rarely	0%
		very unlikely	0%				
Taxi owners on theft/robbery risk (n = 15)							
Severe	100%	almost certain	80%	reduce inc. partial	60%	every day	100%
Somewhat severe	0%	highly likely	20%	reduce inc. total	27%	once per week	0%
not so severe	0%	50:50	0%	out of business	0%	once per month	0%
mild	0%	unlikely	0%	out of bus. + debt	13%	rarely	0%
		very unlikely	0%				
Telephone-booth operators on theft risk (n = 12)							
Severe	75%	almost certain	67%	reduce inc. partial	8%	every day	75%
Somewhat severe	17%	highly likely	0%	reduce inc. total	0%	once per week	8%
not so severe	0%	50:50	25%	out of business	33%	once per month	8%
mild	8%	unlikely	8%	out of bus. + debt	58%	rarely	8%
		very unlikely	0%				

Taking for example farmers' perceptions of the nature of the risk of disaster, we can see from the second panel within the table that farmers feel extremely vulnerable: the likelihood of serious disaster is high, and the consequences very dire indeed in that the probability of being forced out of business are high. It is probably no coincidence that these farmers are from an area of Northern Province that was badly hit by the flooding of early 2000. Taxi owners have an even more pessimistic view about the likelihood of being the victim of some sort of theft or robbery, but in contrast to the farmer respondents, they are less inclined to suppose that this event will be crippling. For whatever reason (probably that they have accumulated sufficient wealth), they expect to be able to survive such setbacks; perhaps the minority who indicated that they couldn’t do so, are those with only one taxi to begin with. Retailers - who represent a very diverse group - have a similar perception of business risk, in that they see the chances of their fears being realised as very great, but with only mild repercussions. However, the reasons are probably different to those that apply among taxi owners, i.e. because business risk is to be expected, and does not necessarily destroy one's earnings *capacity*, merely one's earning.

Telephone-booth operators appear far more dour about their ability to survive theft of their equipment. That they continue in business at all may reflect the fact that the business is otherwise very lucrative. However, it is also worth noting that these operators have a higher propensity to use formal sector insurance. Their answers to the question about how the theft would affect their business may in fact refer to how they would have been affected in the absence of the insurance, though this is only speculation.

Overall, however imperfect, the table above shows that risk interacts with SME profitability and resilience in a variety of different ways. Perhaps the most striking conclusion from this table is that entrepreneurs have an overwhelming sense of vulnerability towards various sources of risk, to the extent these are literally a daily preoccupation.

5.5 Strategies Employed by SMEs to Manage Risk, and Perceptions of Insurance

Given this acute sense of vulnerability, what do SMEs do in order to cope? In respect of each risk identified, respondents were asked first what they do to minimise or manage that risk, and secondly, if they had not obtained insurance, whether they had ever considered doing so, and why or why not. We summarise the responses for four of the main risks, namely theft/robbery, accidents, disasters, and business risks.

Among the 46 respondents that had cited theft or robbery as a main risk to which this question was put, there were four main risk management strategies. About one third addressed the risk through taking some sort of measure to improve security, that is either by improving their physical security (putting up burglar bars, installing an alarm, purchasing a gun), or by subscribing to a security service. Taxi owners were apt to join a taxi board, part of the function of which was to try to provide security to members and to search for stolen vehicles. Other entrepreneurs joined private security arrangements together with other local business people, usually for a fee of about R200 ($26.70) per month. Another response to the risk of theft (about 15%) was to establish a routine of trying to remove the vulnerable item from harm's way. Thus for example many of the telephone booth operators indicated that they would always pack up their telephone equipment and take it home with them in the evening, rather than leave it overnight in the booth, however secure the latter might have appeared. A third strategy mentioned (also 15%) consisted of a variety of management decisions to try to reduce risky situations or the value of vulnerable assets. For example, some car mechanics sought to limit the number of days during which a client could leave a car in their possession. One taxi owner indicated that he only used second-hand taxis, so that in the event of theft his loss was not so great. Other taxi drivers established strict routines whereby drivers would deposit cash proceeds directly to bank accounts, so as to limit the cash the owner had on hand at any given time. One tavern owner refuses to allow patrons to park their cars near his tavern. About 10% of respondents felt hopeless about managing risk.

Finally, about 22% of respondents indicated that they carry some sort of insurance that covers them against loss through theft. It is important to note, however, that two thirds of these are Vodacom telephone booth operators, in fact representing all but one of the Vodacom telephone booth operators included in the survey sample. Interestingly, most of these individuals state that they are insured directly by Vodacom itself. While Vodacom does provide loans for the acquisition of the equipment and also training, it does not provide insurance, but rather recommends to clients that they organise insurance themselves, generally through Hollard household cover. While these entrepreneurs' misapprehension about with whom they are insured is a bit puzzling, what this suggests above all is that these entrepreneurs are responsive to such advice. The other implication is that, in the absence of these Vodacom telephone booth operators, the share of respondents with insurance cover against theft would be around 7%, far less than are protected through security measures.

Managing accident risk is quite different. Among creche owners, the main strategy appears to be to improve management and communication, for instance to ensure adequate staffing, to require parents to provide more information about their children, and to be quick to ensure that an ailing child does not infect the other children. Among hair dressers, similar issues arose, for example with an emphasis on making sure that staff were well trained and that they understood the hair products they were using. Another main theme was that they simply had to be very cautious with sharp implements. Finally, two of the tavern owners who expressed concern about 'accidents', had subscribed to a security service on which they could try to rely to break up fights, etc.

Respondents concerned about disasters were mainly farmers. Here the predominate reply to the question about risk management was that there was nothing that could be done ("Nothing I can do"; "I hope for the best"). This is a bit surprising given that farmers typically adopt a number of different risk mitigating strategies. It may be that the questions were too broad to elicit detailed responses about such strategies, or perhaps that agricultural extension is so poor that in fact these farmers are not knowledgeable about these strategies.

Finally, in terms of business risks, respondents indicated a wide variety of different management-related strategies, whether reducing costs, increasing prices, decreasing prices, product differentiation, cultivating repeat customers, self-insuring through precautionary savings, etc. What this suggests is that these entrepreneurs are highly adaptive to their circumstances, within the ambit of the set of strategies of which they happen to be aware.

Given that use of insurance specifically for business purposes appears to be limited, it was important to try to assess respondents' attitudes towards insurance. Apart from those few that do have some sort of insurance, 33 (30%) indicated that they have at one time considered it. This could mean anything from having had an idle thought about it once or twice ("I thought about it"), to taking active steps to learn more about insurance possibilities ("I remember asking about such insurances but could not get more information"), to actually approaching an insurance company or a broker with an inquiry ("I was turned down because I could not pay the monthly premiums"). The majority of people who had 'considered it', fall closer to the first end of the spectrum, that is, people for whom it appears to have been a passing thought rather than an active investigation. In fact, the quote above of the person who inquired but was rejected appears to be the only respondent to whom this actually happened. Many more, however, seem to have presumed rejection, as will be shown below. Table 8 summarises people's main reasons for not having tried to get insurance (the question read, "Have you ever considered trying to get insurance to deal with this risk? Why or why not?").

Table 8: Expressed reasons for not having insurance

Reasons	Percentage
Cannot afford	38%
Can’t meet strict requirements	6%
Do not trust insurance co.'s	15%
Need information	19%
Interested, but need info.	2%
No insurance exists for this risk	6%
Never considered	6%
No need	2%
Tried but turned down	1%
Other	12%

The most common response was that insurance was not affordable. This was phrased in a variety of ways, including stating that one did not have enough money, or that one's income was not monthly and thus was not suited to paying a monthly premium, or that one's enterprise was simply 'too small'. The curious thing about the fact that this response was so common, is that of those that responded thus, exactly half have either funeral insurance or belong to a burial society. A number of others subscribe to security services for which they pay not less than R150 ($20) per month. It is not clear whether these people perceive insurance to be too expensive relative to its promised benefits, or rather whether they simply presume it is too expensive out of ignorance. The next most common response was that the person did not have information on insurance. As stated above, however, this would appear to be less because they had been frustrated in their efforts to get information about insurance, than that insurance had never been pushed their way. The lack of interest in insurance companies to seek their business is mirrored in a lack of interest from the entrepreneur. After this, the next most common response was that insurance companies were not trustworthy.

5.6 Conclusions from the SME Survey

The results of the survey bear out that use of microinsurance among SMEs is minimal, other than for funeral insurance. Risk-reducing measures are common (e.g. subscribing to a neighbourhood security service; taking one’s equipment home every evening), and around half of all respondents have some sort of funeral insurance for themselves and their family. However, cover for risks specific to one’s economic enterprise is very rare. The notable exception seems to be Vodacom telephone booth operators, who were encouraged by Vodacom to take out insurance with Hollard.

Lack of use of insurance is certainly not for lack of risk aversion. Most entrepreneurs are keenly aware of the risks they face. The most common risk is robbery and theft, whether of money or equipment, but another serious danger is bodily harm to oneself or one’s clients. Despite these common themes, a striking lesson from the research is the degree to which SMEs’ risks are very specific to the particular type of SME. This implies a potentially significant actuarial burden for any institution seeking to provide insurance to this market, or at least that policies have to be carefully tailored to the nature of the SME. Another consideration is that many of the risks are highly susceptible to moral hazard, especially in respect of one’s precautions against being robbed. Drawing on an earlier section, the main antidote to this sort of moral hazard may be to foster a sense of community and inter-dependence among those having insurance.

When asked if they had ever contemplated securing insurance against their risks, most SME respondents indicated that: they were suspicious of insurance companies, were ignorant of how one might obtain insurance, or assumed that insurance would not be affordable. Reading between the lines, there is a lack of widespread interest in insurance, a sentiment that is pretty well reflected in insurance providers' lack of interest in most SMEs.

6. Summary and Conclusions

6.1 The incidence of Microinsurance in South Africa

South Africa has a large and dynamic insurance industry. However, notwithstanding some change since 1994, it appears to remain overwhelmingly skewed in favour of the non-poor and those with formal sector employment. With the singular exception of funeral insurance, microinsurance is neither widely used nor widely available in South Africa. Microinsurance that tailors specifically to the needs of SMEs is almost unheard of.

The interesting exception is funeral insurance. The anomaly of funeral insurance is that it is the one area in which mainstream insurance companies manage to do business on a significant scale with low-income households that operate mainly in the cash economy. The secret is that they do so via township-based intermediaries who mimic the independent funeral parlour-based insurers. Issues of transactions costs, adverse selection, and to a lesser extent moral hazard, are dealt with through a combination of simple rules and community presence. This particular example of funeral insurance underwritten by mainstream insurance companies, perhaps provides some useful pointers that could be adapted by MFIs for other types of insurance cover.

6.2 The Insurability Of Risks Faced By South African SMEs

On the basis of information derived from the SME survey together with a consideration of basic insurance principles, we can make a preliminary attempt to gauge the 'insurability' of risks faced by South African SMEs. We focus here on four main risk categories, namely life cycle events, theft and robbery, liability, and disaster. In terms of the criteria of insurability, the following are considered: “1. Large number of similar units exposed to the risk; 2. Limited policyholder control over the insured event; 3. Existence of insurable interest; 4. Losses are determinable and measurable; 5. Losses should not be catastrophic; 6. Chance of loss is calculable; 7. Premiums are economically affordable” (Brown and Churchill, 1999).

Life cycle events – In this paper two main life cycle events are taken into consideration, namely death and illness. For the risk of death, it is eminently clear that such an eventuality is indeed insurable, as this is the one risk for which insurance is readily available to many low-income South Africans. Concerns have been raised (e.g. by MFIs) about the lack of availability of death cover in more remote rural areas, which is certainly a reflection of the higher costs of conducting business there. Nonetheless, at least in relative terms, it is clear that death cover is well provided for, and in a sense represents a benchmark against which the non-availability of other types of cover can be measured.

As for illness cover, the story is very different, with very little such cover available to low-income households. On the one hand, this could be because health cover is notoriously costly to provide, not least because of its complexity. Providing it to low-income households - especially those without formal sector employment - is particularly challenging. On the other hand, the important insight from the SME survey, is that ill-health is not felt to be a major problem for the viability SMEs, as family members or others can usually take over operation of the SME in the event of one's incapacity. A further consideration is that, SMEs aside, the demand for health insurance in South Africa might not be very strong due to the presence of the public health system. Notwithstanding its shortcomings, the public health system provides free primary health care for all South Africans, meaning public health clinics provide certain services free of charge. In addition, there is free health care to pregnant women and children up to the age of 6. And third, health services and certain medications (e.g. light painkillers) are subsidised, including those provided through the public hospitals and clinics. Narrowly interpreted, the implication is that for an MFI seeking to introduce viable microinsurance products that will have a large impact on SMEs, health cover should probably be a low priority.

Theft and robbery - As shown in the SME survey, the risk of theft and robbery is across-the-board the most serious risk faced by SMEs. The most evident risk management practices put in place by SMEs are those aimed at reducing the risk of robbery and theft. The risk of robbery of productive assets meets most of the criteria of an insurable risk listed above. The criterion that is fulfilled least satisfactorily is probably that which requires the policyholder to have little control over the insured event (number 2). Simply by neglecting to protect one's productive assets (e.g. failing to lock doors with a good lock, or by failing to maintain surveillance against possible robbers, etc.), the likelihood of being the victim of a robbery is greatly increased. As with automobile insurance, this implies a two-fold approach on the part of the insurer. First, the insurer typically stipulates a sizeable excess (deductible) that must be paid by the policyholder in the event of a claim. And second, the insurer typically makes the insurance conditional upon certain precautions being taken. The Achilles' heel of this approach is the cost of verification (e.g. automobile insurers in South Africa are largely dispensing with physical checks on newly insured vehicles precisely for this reason). However, MFIs might better cope with the need for verification by means of having lower cost structures. Another approach that would have some of the advantage of property insurance would be insurance on the outstanding balance of a loan used for the purchase of productive assets. That is, if the asset is stolen, the borrower is relieved of the obligation of paying off the rest of the loan that was taken out to purchase that asset. Here the benefits to the policyholder are more modest, but the scheme may be easier to administer, not least because the moral hazard problem is reduced. All in all, there appears to be a fair amount of scope for introducing insurance against the loss of productive assets. The fact that many SME operators already pay large sums of money to prevent robbery is one indication. Another indication is the Vodacom booth operators, most of whom have insurance against the loss of their telephone equipment.

The risk of cash theft, however, presents far more difficulty. Here the problem is that it is virtually impossible for the insurer to ascertain the actual loss incurred by the SME. In the absence of well-developed accounting systems that are open to external checks, there is no means for the insurer to determine the amount of cash lost, and thus the insurer is completely vulnerable to fraud. It is unlikely that an insurer would consider venturing into this type of insurance. In this respect, SMEs' payments for security services rather than for insurance cover make a great deal of sense.

Liability - Much of SMEs' concern about accident and death relate not the SME operator or employees themselves, but to clients. In other words, the specific risk cited by the SME has the character of a liability, whether or not it would be interpreted as such in a formal legal sense. This feeling of vulnerability to liability is one of the motivations for people to take insurance with Legal Wise and Relyant Legal Coverage. This type of cover is generally easy for insurers to provide because the benefits are so finite, for instance, a certain number of minutes of consultation with an attorney, a certain number of letters written, phone calls made, etc. As with the example of Money Wise given above, such legal cover can also be offered as an add-on service, e.g. for a borrower. While a crèche owner would not be able to rely on legal cover of this kind to avoid all liability in the event of a child's injury or death (e.g. akin to malpractice insurance of doctors), she could probably meaningfully reduce the probability of legal action being initiated. (*Ex ante* legal advice might be even more valuable, e.g. on getting parents to sign indemnity forms with legal standing, etc. But these are not mutually exclusive.) Altogether, facilitating access to legal cover may be a very effective way for MFIs to assist certain categories of their SME clients.

Disaster - The main disasters that figured in the SME survey were those affecting agriculture. As is well known, insurance for farmers is very difficult to provide, because at least two of the insurance principles are not well satisfied, namely the measurability of the loss, and the lack of policyholder control of the event. Only in extreme disasters are these criteria close to being satisfied in an agricultural context, though there remains always a fair amount of uncertainty about the value of one's crop or herd prior to the disastrous event. Since the elimination of the state-subsidised multi-risk agricultural insurance scheme in the 1980s, only fire insurance and hail insurance are widely available in South Africa (Aliber and Ndimande, 1997). These are considered too expensive for most farmers, for whom the main form of 'insurance' remains *ad hoc* government relief programmes. The implication is that there is little chance that an MFI could introduce viable insurance cover against agricultural disasters for small-scale or medium-scale farmers. Other risk-mitigating measures have far more promise, most notably risk-reducing techniques and product diversification.

Taken as a whole, this section suggests that there is reason for some optimism that microinsurance can play a meaningful role in helping South African SMEs prosper, particularly in addressing property risks and liability risks. Together with the obvious scope for improving the availability of credit-life insurance, it would seem that there is much that microinsurance can do to improve the business climate for SMEs and the MFIs that serve them.

6.3 How MFIs Can Meet The Challenge

A handful of MFIs do presently offer microinsurance. The most common type of insurance is credit-life insurance, i.e. against the outstanding balance of a loan in the event the borrower passes away. Some MFIs also offer funeral insurance. In most instances, MFIs that 'provide' insurance are in fact intermediaries between the policyholders (SMEs) and the insurance company. However, the exact nature of the relationship may differ, with some MFIs playing a more active role and thus earning a larger share of the revenues from clients' premiums.

Among the majority of MFIs that do not presently offer microinsurance, most express an interest in perhaps someday doing so. A variety of different insurance types have been mentioned, with the one most frequently mentioned perhaps being insurance against the loss of SMEs' productive assets. This coincides well with the observations from the SME survey.

However, MFIs also report a number of obstacles to introducing insurance. One of the more discouraging problems is a lack of interest among insurance companies, presumably because - perhaps rightly - they do not perceive non-funeral microinsurance to present a lucrative opportunity. Combined with this is the fact that many MFIs do not have the resources to engage in negotiations with a series of would be insurance company partners, not to mention introduce insurance in their own right. Yet another perceived obstacle is the lack of demand among the SMEs themselves, a perception that was corroborated by the SME survey.

In the course of the background research for this report, as well as from the workshop on microinsurance, three concrete measures came up that address the identified obstacles. These are:

- If trying to identify an insurance company partner, MFIs can look first to those insurance companies that have proven to be most amenable to working with MFIs. In the course of the workshop, it became clear that, at least at present, the list of insurance companies that are willing to hold discussions with MFIs and offer reasable rates, is very short: Metropolitan Life, Hollard, Capital Alliance, and MIB.

- If they so choose, MFIs could band together to improve their bargaining power relative to prospective insurance company partners.

- The 'partnership model' is not the only option by which an MFI can seek to improve access to microinsurance for its SME clients; another efficacious way is to simply provide SMEs advice as to whom they could go in seeking insurance. As noted by many MFIs, part of the lack of interest in insurance relates to lack of knowledge and understanding about the value of insurance. MFIs can play a direct role in educating entrepreneurs, even where they are not channelling the insurance themselves. (Cell captives and rent-a-captives are probably not attractive alternatives at present, though perhaps they will become so some time in the future.)

In addition to these measures that MFIs can take, four clear principles also emerged about how new insurance products might best be structured:

- Insurance policies should be kept simple, in terms of procedures to follow, options to choose from, and measures for controlling moral hazard and adverse selection. This is a clear lesson based on how formal sector insurance companies are managing to provide funeral insurance to low-income households that operate mainly in the cash-economy.

- Insurance schemes should be rooted in the community, not least as a means of diminishing fraud and improving the quality of information available to the insurance agent.

- Where possible, one could seek to establish insurance cover for groups rather than individuals, as with family-based funeral cover. Microinsurance has been attempted in other countries on this basis and would appear to be an effective means of reducing transactions costs and moderating adverse selection.

- Insurance products can be offered as add-ons or as parts of well designed packages. This appears to be a successful formula for various micro-lenders, including some MFIs. It might be a good way also of promoting interest in insurance products that SMEs might otherwise not think of seeking, such as legal cover.

Singly or together, there is clearly a great deal that MFIs can do by way of improving SMEs' access to, and use of, microinsurance. Naturally, some of these initiatives may be more involved and long-term than others. In general, we might surmise that the more collectively MFIs act in trying to meet these challenges, the more quickly they will make progress in doing so.

6.4 Recommendations

There are three principal recommendations to be made. These emanate from the discussion above, but also to a large extent reflect the collective sentiment expressed at the Microinsurance Workshop that took place on 22 January 2001 in Johannesburg. They are:

1. MFIs should work collectively to try to improve their scope for introducing a range of different microinsurance products.

2. Further research is required to better understand the clientele of the MFIs, and their exact insurance needs and prospects.

3. The MFIs should receive some assistance in this regard, preferably from the ILO. This assistance would involve three main aspects: i) to assist in the practical coordination of the MFIs towards their common objectives, i.e. to form some sort of 'consortium'; ii) to negotiate on behalf of the MFI consortium, so as to enable the MFIs to secure better terms with insurance companies; and iii) to undertake further research as a means of assisting the MFI consortium demonstrate the insurability of its SME clients, and thus to improve the prospects of drawing in insurance companies.

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Appendix A: Further information on the demographics of respondents to the SME survey

Table A-1: Average ages of respondents, by site and gender

	Women	Men
Winterveldt	39.0	41.6
Gazankulu	38.4	39.8

Table A-2: First language of respondents, by site

Language	Winterveldt		Gazankulu	
	Number	Percent	Number	Percent
Northern Sotho	1	1.4%	2	4.4%
Ndebele	6	8.2%	0	0.0%
Pedi	13	17.8%	0	0.0%
Southern Sotho	1	1.4%	0	0.0%
Shona	1	1.4%	0	0.0%
Tsonga	11	15.1%	41	91%
Tswana	7	9.6%	0	0.0%
Venda	4	5.5%	1	2.2%
Xhosa	6	8.2%	0	0.0%
Zulu	23	31.5%	1	2.2%
Total	73	100.0%	45	100.0%

Table A-3: Average number of earners and non-earners,
by site and gender of SME operator

	Women		Men	
	Avg. earners	Avg. non-earners	Avg. earners	Avg. non-earners
Winterveldt	1.8	1.5	1.5	1.8
Gazankulu	2.1	3.9	2.1	3.6

Table A-4: Education level attained, by gender of SME operator

Education level	Women		Men	
	Number	Percent	Number	Percent
Std 5 or less	4	9.5%	12	15.8%
Std 6 to std 9	13	40.0%	27	35.5%
Matric	21	50.0%	27	35.5%
Post-matric	4	9.5%	10	13.2%
Total	42	100.0%	76	100.0%

Appendix B:Programme and list of participants of the Microinsurance Workshop

22 January 2001, Student City, Johannesburg

Programme

TIME	ITEM
08h00 – 08h30	Arrival, Tea, Registration
08h30 – 08h40	Welcome and Opening - Michael Aliber
08h40 – 08h55	Introductions
08h55 – 09h10	Workshop Objectives and Participants' Expectations - Pravienna Naidoo
09h10 – 09h30	Results of the ILO:SFU Survey - Michael Aliber
09h30 – 09h45	Discussion
09h45 – 10h40	Panel 1: MFIs PROVIDING MICRO INSURANCE ➢ Thomas Shaw: FINASOL ➢ Charmaine Oelofse: Beehive ➢ Paul Malcolm: Canadian Co-operative Association ➢ Petros Jele: Financial Services Association
10h40 – 10h45	Body Break
10h45 – 11h45	Panel 2: MFIs NOT PROVIDING MICRO INSURANCE ➢ Rosy Jethro: South Cross Business Development Trust ➢ Likhabiso Tina Notate: Matatiele Financial Services ➢ Ashley du Plooy: The Nations Trust
12h00 – 12h45	Lunch
12h45 – 13h10	Calmeadow / Ford Foundation Study on Micro Insurance in Four Countries - Peter Roussos: Vulindlela PRCS
13h10 – 13h30	Health Insurance for Low Income Groups - Dr Kabs Makaba: Faranani Health Solutions
13h30 – 13h50	The 'Cost' of Providing Micro Insurance - Dr Farhard Khan: Ubuzwe Health Systems
13h50 – 14h45	Discussion
14h45 – 15h15	Tea
15h15 – 15h45	Way Forward - Michael Aliber
15h45 – 16h15	Evaluation - Pravienna Naidoo
16h15 – 16h15	Closure - Michael Aliber

List of participants

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