Social Finance Brief

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Financial services to enhance resilience

Combining savings, credit and insurance to manage risks more effectively

Key points

- An integrated risk management solution enables small enterprises to tackle ever-increasing risks.
- Savings products can serve as a secure anchor for risk management, providing longer-lasting protection.
- If financial service providers want to design effective risk solutions, they should consider strategic partnerships, incentives for good financial habits and digital technology for cost-effective scale.

Low-income households and small enterprises, often operating in the informal economy, are more vulnerable to risks than the rest of the population and yet they are the least able to cope when crises occur. Shocks and the destruction wrought by disasters, which are being exacerbated by climate change, can reduce income while increasing expenses.

An integrated risk management approach

In Financial institutions serving micro and small enterprises can play a critical role in assisting their client base to manage these risks. Many banks, credit unions, microfinance institutions and other financial service providers (FSPs) have been testing new approaches and innovative products intended to assist the working poor to manage risks more effectively. While the pathway chosen by the provider depends on its strategic vision and objectives, an overarching principle applies: FSPs, whether commercially or socially motivated, need to take a holistic view of their clients' risk management needs and design a combination of insurance and other financial and non-financial services. Effective risk management includes activities that enable risk prevention and preparation, as well as risk transfer. This leads to an improved risk profile over time, which benefits small enterprises and the FSPs that are serving them.

Understanding client needs

To identify priority risks, a financial institution can start by examining the major causes of delinquency in its loan portfolio. However, to validate insights gleaned from the desk research, it is necessary to speak with clients to determine the risks that are the most important to address. The research could gather responses to gauge the risk vulnerabilities and existing coping mechanisms being deployed by clients, eventually setting the context for innovations to offer suitable platforms and product solutions. This research could determine the existing gaps that low-income households face from adverse events and plugging these gaps in the most cost-effective and reliable manner.

Anchoring the solution on savings

The starting point with any effort to provide protection is to ensure clients are enrolled in the relevant social security schemes and the financial services can fill in any gaps around what is provided by the government. To fill those gaps, FSPs could offer various elements – savings, insurance, emergency loans and financial education – as separate, standalone elements. Alternatively, they could explore ways of integrating them to provide a more comprehensive risk management solution.

An integrated approach to risk management empowers low-income households and small enterprises

Building integrated solutions use savings as an anchor, which has three main advantages over credit as the entry point. First, most people need savings and hence savings-linked products can appeal to a wider pool of clients, not just the subset of people who borrow money. Second, savings products typically have a longer duration, providing a platform for FSPs to offer more permanent protection and build customer loyalty. If loans were the anchor, what would happen when the loan term ends if the client is not ready to re-enrol immediately? Third, taking a loan is risky for borrowers to begin with, so it is incongruent to think that a risk-management solution could be built on a risk-taking activity.

Hence, combination products that allow enterprises to turn assets or equity into cash may be an appealing solution. For example, rather than drawing down on a contractual savings account during a time of need, people may prefer to borrow using their accumulated savings as collateral. Bundling an emergency loan product with a contractual savings account allows clients to cover small expenses and smooth consumption, although these need to be managed carefully to avoid over-indebtedness.

Design considerations for integrated solutions

The process of providing integrated risk management support to low-income households, small businesses and the working poor is not easy. The following are some design considerations that FSPs need to consider when offering such solutions.

- **Mix and match.** Financial institutions should complement what is available from the government and from social service providers, with financial services that manage risks. The starting point is to enrol in whatever government programmes are available and targeted for the population in question.
- **Savings partnerships.** Not all financial institutions are permitted to mobilise deposits. To offer integrated risk management solutions, microcredit NGOs for example will need to partner with organizations that can take savings, like banks or mobile network operators. When considering prospective partners, it is essential to assess the levels of service that they are willing and able to provide. If the process of making deposits is not seamless, then it will be difficult for low-income households to amass any significant sums. Plus, if the partnership results in a negative customer experience, the FSP that is the face of the savings solution to the customer will suffer the consequences.
- **Carrots and sticks.** It is quite natural that the preparation for risk management does not always get the most attention in a household's financial planning. To ensure that the preparation activities are given sufficient attention, it is important to offer a heavy dose of incentives to reward good behaviours of making regular deposits and signing up for insurance. Similarly, to prevent the use of funds for purposes other than risk management, early withdrawal penalties may be in order.
- **Staff implications.** The introduction of new services might significantly impact the job descriptions and workload of frontline staff. If staff perceive this as extra work without sufficient compensation, it will be doomed to fail. Similarly, if staff incentives are tied to loans without any key performance indicators for savings and insurance, then the field staff will naturally focus their attention on the lending activities at the expense of effective risk management solutions.
- **Digital solutions.** The business case for small deposits and small-ticket insurance policies can be challenging in an all-cash economy. But the emergence of mobile

money and the digitization of back-end processes create opportunities to reach scale in a cost-efficient manner. Digital technology can be leveraged to educate clients about the integrated solutions, enable cross-selling through direct sales to customers, facilitate payments and reduce transaction costs.

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The Impact Insurance Facility contributes to the agenda of Social Finance by collaborating with the insurance industry, governments and partners to realize the potential of insurance for social and economic development.

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