

Two steps back: how low-income Kenyans think about and experience risk in their pursuit of prosperity

Briefing Note

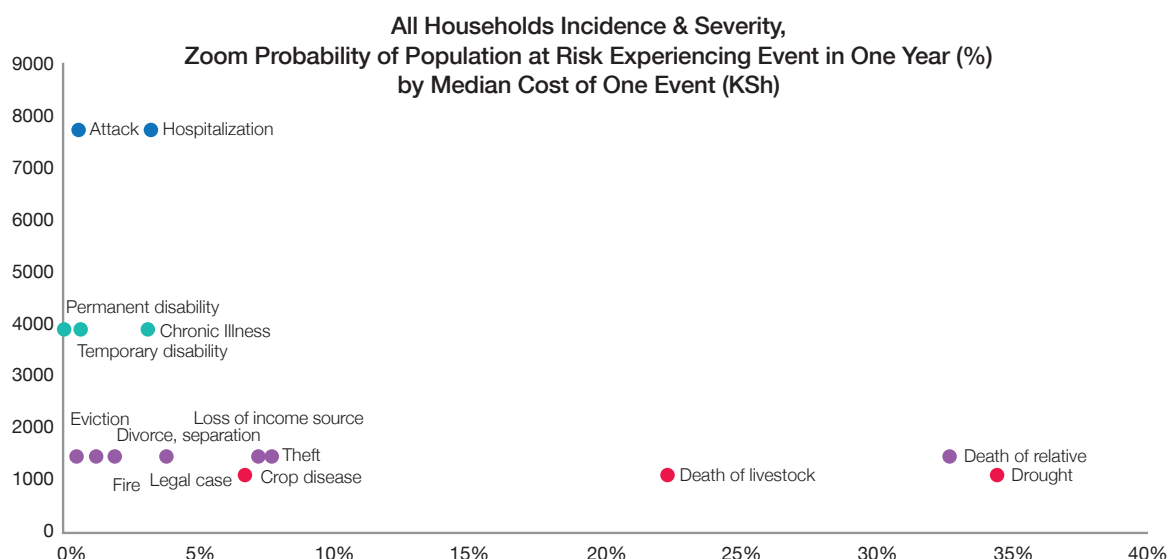
This brief presents highlights from an analysis of risk within the Kenyan Financial Diaries, considering how 300 low-income people think about, experience and prepare for risks in their lives.

EXPERIENCE WITH SHOCKS

Low-income people face high levels of income and expenditure volatility in everyday life, not just when beset with crises. The median household's monthly income fluctuated +/- 54 per cent per month. Expenditures were similarly volatile, fluctuating by 43 per cent from month to month.

Households face a large number of moderate probability and moderate severity risks. The sum of the annual burden of all risks (Ksh 7,943) was higher than the median monthly income for the sample of households. While the death of the main income earner stood out as the risk that entailed the heaviest costs, it is a shock managed relatively well - at least in the immediate aftermath - by the social network. While outpatient medical events had the highest frequency, these risks had the lowest associated costs. Households faced many other moderate frequency and moderate severity risks, such as fire, theft, and drought. The diversity of moderate risks makes it difficult for low-income people to insure against the entire range of risks simultaneously.

Accounting for the full costs of risks is difficult, especially when costs are non-financial in the form of forgoing or postponing necessary expenditures (e.g. taking children out of school, delaying treatment). By only calculating impact of shocks as dips in consumption, analysts may underestimate the true cost of risks and their long-term impacts on families.



PERCEPTION OF RISK

Respondents seem to undervalue losses and place more emphasis on new costs associated with a shock. Sixty-three per cent of respondents who experienced crop failure felt it had no impact on them, failing to recognize their lost inputs and labour or accounting for lost yields.

Levels of worry about a particular risk seem to be more closely tied to the new costs associated with an event more than its probability. Respondents felt particularly underprepared for high cost episodes, like the death of the main income earner. The only risk most respondents felt prepared to face was outpatient treatment, which for a single visit tended to require only a minimal cash outlay.



COPING WITH RISK

Low-income people face trade-offs in their financial management strategies between managing risk and investing in the future. Faced with the tough balancing act between ensuring liquidity from day to day and investing in the future, we observed a preference to save for investment and to rely more heavily on very small liquid savings, small-scale informal borrowing, and social network gifts to fulfil the liquidity function.

Savings is the main coping strategy for small shocks, but big ones typically draw on resources from the social network, which typically has a larger capacity. Even though gifts from the social network represented the most used and most substantial coping mechanism for moderate to large shocks, the coverage it provided was imperfect. We observed networks reacting slowly for certain types of shocks, covering some types of households and individuals better than others, and shifting burdens to the moderately better-off, who are also struggling to get ahead. Sometimes networks are simply too small to generate the sums needed to overcome the most costly shocks.

Failure to manage risk can have long-term repercussions for families' economic trajectories. Some respondents—parents of young children—died during the course of the study because they were unable to quickly finance and receive medical care for life-threatening illnesses.

TWO SUGGESTIONS FOR INSURERS (more in the full paper)

Putting aside resources for an uncertain claim in the future is much more attractive if consumers feel that their money is “working” for them today. Risk management strategies will be more attractive if the benefits feel clear, certain, and to some extent, immediate. Think value-added services and confirmations of coverage even in the absence of claims. By offering products whose structures and marketing messages resonate with how consumers feel about risk and risk management, insurers are likely to see much greater interest in their products.

The large number of moderate risks seems ill suited for single-purpose insurance products, and composite products and blended products incorporating elements of credit, savings, insurance, and social fundraising may be more suitable. For example, a blended savings/insurance product that provides a clear lump sum upon the occurrence of a verifiable trigger event could offer something akin to a “start-over” fund to boost existing savings and help a family navigate through the worst of times.

Housed at the International Labour Organization, the Impact Insurance Facility enables the insurance industry, governments, and their partners to realise the potential of insurance for social and economic development. The Facility was launched in 2008 with generous support from the Bill & Melinda Gates Foundation, and has received subsequent funding from several donors, including the Z Zurich Foundation, Munich Re Foundation, the World Bank Group, USAID and AusAID. See more at: <http://ilo.org/impactinsurance>