

*Our latest note discusses the results of a pilot of an innovative insurance product, which aims to protect small firms from macroeconomic and political risk that might inhibit them from investing.*

### **Piloting Macroinsurance for Microenterprises in Post-Revolution Egypt**

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Policy uncertainty and macroeconomic instability are the two most common constraints to firm growth listed by firms in developing countries in the World Bank's Investment Climate Surveys, ranking ahead of taxes, regulation, corruption, and access to finance. Faced with such uncertainty, firms may be reluctant to make new investments or hire new workers, choosing to wait and see how their economy evolves. This concern may be particularly important for firms in much of the Middle-East and North Africa regions, which have faced dramatic increases in political and macroeconomic instability in the context of the Arab Spring.

#### **Macroinsurance for microenterprises**

Insurance is a natural financial instrument to help protect against risk. There has been a lot of attention devoted to developing insurance products for farmers, but to our knowledge, hardly any attention to developing insurance instruments that can protect other types of firms against the risks they face.

We worked with Alexandria Business Association (ABA), Egypt's largest microfinance organization, to develop and pilot an innovative insurance product to help protect its clients against the uncertainty they faced in the aftermath of the January 25, 2011 revolution which ended almost thirty years of rule by President Hosni Mubarak.

The insurance product was designed for microfinance clients who were deciding whether or not to take a new 12 month loan from ABA. The cost of the insurance was

then 0.5 percent of the value of this new loan. If a shock covered by the insurance occurred during the loan period, the payout would be two months of loan principal installments – one to ABA to cover that month's loan, and one to the client to give them cashflow to compensate for potential loss in business from the shock. If a second covered shock occurred in a subsequent month, the EPP would pay out an additional month's loan installment.

The insurance would pay out if any of the following shocks occurred:

- The Cairo Alexandria stock exchange being suspended for 5 days or more;
- A curfew of 14 hours or more imposed in Alexandria for 5 or more business days;
- Monthly CPI inflation rising to 4% or more.
- The official price of subsidized Benzene gasoline rising above a specified level.
- The official price of subsidized LPG gas rising above a specified level.

These shocks were identified through market testing as salient in the wake of the revolution, and likely to harm business owners either directly, or because of what their trigger would likely signal about economic and political chaos in the country.

#### **Piloting macroinsurance via a randomized experiment**

We worked with a sample of 2,961 microfinance clients, who were finishing one loan and about to decide on taking out a

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new loan between April and September 2012. These were randomly split into two equal sized groups: a treatment group who were offered the insurance product, and a control group who were not.

These firms were microenterprises, with most having no paid workers. Half were in retail, the rest in manufacturing or services. Median monthly profits were around US\$200, with an average loan size of around US\$800.

## Results

- Demand for the insurance product was relatively high: 36.7% of the firms in the treatment group purchased it. The insurance could only be purchased along with a new loan – 55% of those taking a new loan purchased the insurance.
- However, the insurance had no impact on firm investment behavior. Treated firms were no more likely to take a loan, did not take larger loans, and were no more likely to use their loan to make new capital investments. The sample is relatively large and confidence intervals small around zero, so this lack of effect is not a result of low statistical power.
- As a result profits and sales did not increase, if anything there is some evidence revenues fell.
- The insurance did not pay out (several of the events in Egypt came close to triggering payout, but did not exceed the thresholds). As a result, we can not see how much this

insurance protects firms when shocks do occur.

## Discussion and Policy Implications

The lack of effect appears to be because these microenterprises seldom make fixed capital investments anyway – their loans largely went to working capital. Since these investments are short-term and easily adjusted, they are less affected by uncertainty. Our results do suggest that despite firms complaining uncertainty is a constraint to business growth, this uncertainty does not appear to be preventing microenterprises from making profitable investments in machinery and equipment.

While the product did not change the investment behavior of firms, the demand for the product suggests firms might still value the protection it could provide when shocks do occur. The product could be more valuable for SMEs, who may be more likely to be considering lumpy capital investments that they defer because of uncertainty.

Insurance penetration is very low in Egypt, with regulations inhibiting the development of the sector. As a result, many firms have little understanding of the concept of insurance. This unfamiliarity with insurance does not appear to explain the results of our study, but does make it hard to launch new products and build an understanding of how they work. Given the enormous volatility in incomes for microenterprise owners in developing countries, we hope the lack of impact of our product in this pilot does not deter further policy and research efforts to develop better ways to help insure urban microenterprises against some of this risk.

For further reading see: [M. Groh and D. McKenzie \(2014\) “Macroinsurance for Microenterprises: A randomized experiment in post-revolution Egypt”, World Bank Policy Research Working Paper no. 7048.](#)

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