

# MICROINSURANCE PRE-FEASIBILITY STUDY

## AZERBAIJAN



*Prepared for:*

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## Contents

Contents .....	i
Figures .....	ii
Tables.....	ii
Acronyms and Abbreviations.....	iii
A note on Azerbaijan currency: .....	iv
Acknowledgements .....	v
Executive Summary .....	vi
Microinsurance .....	1
Microinsurance in the insurance sector.....	1
What range of products does microinsurance cover? .....	2
How is microinsurance delivered?.....	3
How does microinsurance fit within the broad policy environment?.....	3
The insurance sector in Azerbaijan .....	5
Insurance associations.....	9
Key events in the insurance industry.....	10
Risk management options for the poor .....	11
MFIs and banks in Azerbaijan.....	11
Credit unions .....	12
The social security system .....	13
The demand for risk management services in Azerbaijan .....	15
What types of risks are candidates for insurance and why? .....	15
Risk exposure.....	16
Importance of risks .....	16
Personal financial intermediation .....	18
Gaps in risk-management strategies.....	20
Insurance as experienced and perceived by low-income households .....	22
Usage .....	22
Knowledge.....	22
Attitudes towards insurance .....	23
Expectations of insurance product attributes .....	27
Willingness to buy .....	28
Market development projections and strategies.....	31
Market development projections .....	32
Strategies to tap the low-income market.....	34
Demand conclusions .....	35
Supplying microinsurance in Azerbaijan .....	37
Current and potential suppliers of microinsurance in Azerbaijan .....	37
What is the anticipated market evolution?.....	39
The Legal and Regulatory Environment.....	40
Developing a microinsurance sector in Azerbaijan .....	41
Donor coordination and stakeholder education.....	41
Creating demonstration models .....	41
Conclusions.....	43
Select Bibliography.....	45
Appendix 1: Macroeconomic and social data for Azerbaijan.....	46
Appendix 2: Research objectives and methodology .....	47
Appendix 3: Some examples of social security in Azerbaijan .....	49
Appendix 4: Microinsurance product concepts tested.....	50
Appendix 5: Information on Basak Insurance, Turkey.....	51
Appendix 6: Information on Groupama Insurance, France .....	52
Appendix 7: Institutions and people visited in Azerbaijan .....	53
Appendix 8: Some comments on qualitative versus quantitative research .....	56
Appendix 9: Glossary of selected insurance terms .....	57

## Figures

Figure A: Azerbaijan New Manat.....	iv
Figure B: Old Azerbaijan Manat .....	iv
Figure I: Insurance penetration .....	vi
Figure II: Total and low-income market size projections .....	viii
Figure III: The microinsurance supply chain in Azerbaijan.....	ix
Figure 1: Where microinsurance fits with an economy .....	1
Figure 2: Insurance premiums and penetration 2004-6 .....	5
Figure 3: Insurance penetration .....	6
Figure 4: Foreign company cover taken .....	8
Figure 5: Domestic company cover taken .....	8
Figure 6: Ministry of Finance organizational chart with a focus on insurance .....	10
Figure 7: Risk impacts.....	11
Figure 8: Frequency of risks.....	16
Figure 9: Ranking of risk perception for low-income population in Azerbaijan.....	17
Figure 10: Microinsurance opportunities for low-income people and insurers .....	18
Figure 11: Savings behavior.....	19
Figure 12: Attitudes to financial planning, saving, borrowing and financial institutions .....	19
Figure 13: Usage and stress related to coping mechanisms .....	20
Figure 14: Usage of any type of insurance.....	22
Figure 15: Knowledge of types of insurance .....	22
Figure 16: Knowledge of specific insurance companies .....	23
Figure 17: Attitudes towards insurance.....	25
Figure 18: Key market segments by attitude towards insurance.....	26
Figure 19: Key market segments by attitude towards insurance.....	26
Figure 20: Willingness to buy insurance products.....	28
Figure 21: Most important reasons for lack of willingness to buy.....	29
Figure 22: Market development projections for different microinsurance products (% of households).....	32
Figure 23: Market development projections for different microinsurance products (% of households) for total and low-income population .....	33
Figure 24: Total and low-income market size projections .....	33
Figure 25: Structure of market development zone by attitude towards insurance .....	34
Figure 26: The microinsurance supply chain in Azerbaijan.....	37

## Tables

Table 1: Claims ratios 2004-5 .....	6
Table 2: Insurance premiums 2004-6 .....	6
Table 3: Insurance indicators – top ten Insurers (millions of USD) .....	7
Table 4: Significant events in the Azerbaijan Insurance Industry.....	10
Table 5: Key microfinance data.....	11
Table 6: Main reasons for not using insurance in the past.....	23
Table 7: Price sensitivity.....	30
Table 8: Access frontier methodology and its application in this study .....	31
Table 9: Comparison of qualitative and quantitative methods.....	56

## Acronyms and Abbreviations

AMFA	Azerbaijan Microfinance Association
AR	Autonomous Republic
ASCA	Accumulating Savings and Credit Association
AZM	Azerbaijan Manat (withdrawn from circulation 31 December 2006)
AZN	Azerbaijan New Manat (introduced in stages throughout 2006)
CIA	Credit Implementing Agency
CU	Credit Union
DEG	Deutsche Investitions–und Entwicklungsgesellschaft mbH
DFID	Department for International Development (UK)
EBRD	European Bank for Reconstruction and Development
Est.	Estimated
EU	European Union
EUR	European Euro
FG	Focus Group
FGD	Focus Group Discussion
GoA	Government of Azerbaijan
GPA	Group Personal Accident
GTZ	Deutsche Gesellschaft für Technische Zusammenarbeit GmbH
IDP	Internally Displaced Persons
MFP	Microfinance Provider (includes MFIs, credit unions, banks, and other less formal financial structures)
NGO	Non-Governmental Organization
PPP	Purchasing Power Parity (in terms of macro-economic information)
PPP	Public-Private Partnership (in terms of microinsurance interventions)
ROSCA	Rotating Savings and Credit Association
SEWA	Small Enterprise Women’s Association (India)
SME	Small and Medium Enterprise
TACIS	Technical Assistance to the Commonwealth of Independent States
USD	United States Dollars
USAID	United States Agency for International Development
VAT	Value Added Tax

## A note on Azerbaijan currency:

**Figure A: Azerbaijan New Manat**



From January 1, 2006 the Azerbaijan New Manat (AZN), above, was put into circulation as decreed on February 7, 2005. At introduction, one AZN was valued at 5 000 old Azerbaijan Manats (AZM), shown below. The new currency has six banknotes (1, 5, 10, 20, 50 and 100 Manat) and six 'gapik' coins (1, 3, 5, 10, 20 and 50).

The new notes were introduced in stages. In January 2006, gapik coins and the 1 AZN and 5 AZN notes appeared. Then, in March 2006, the 10 AZN and 20 AZN notes were released, and finally in April 2006 the 50 AZN and 100 AZN notes were put into circulation. Old Azerbaijan Manats remained in circulation until December 31, 2006.<sup>1</sup>

This paper uses the following exchange rates where appropriate:

$$1 \text{ USD} = 0.91 \text{ AZN}$$

$$1 \text{ EUR} = 1.21 \text{ AZN}$$

$$1 \text{ AZN} = 1.09 \text{ USD}$$

$$1 \text{ AZN} = 0.83 \text{ EUR}$$

**Figure B: Old Azerbaijan Manat**



General Macroeconomic and social data for Azerbaijan are provided in Appendix 1.

<sup>1</sup> <http://www.un-az.org/undp/bulnews33/manat.php> (sourced 3 Jan 2007)

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Any errors, misunderstandings, or misinterpretations remain the responsibility of the authors.

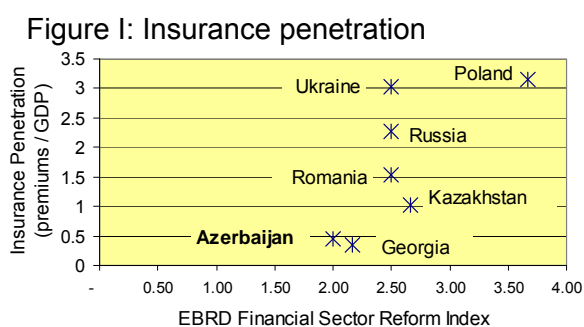
## Executive Summary

Microinsurance is the protection of low-income people against specific perils in exchange for regular premium payments proportionate to the likelihood and cost of the risk involved. Currently, microinsurance is essentially unavailable in Azerbaijan. To understand this situation, we first need to understand the Azerbaijan insurance market in general, and the population's demand for insurance.

The insurance industry in the country is rather undeveloped and focused on the upper income and corporate markets. The market actors are:

- 23 local insurance companies
- 6 foreign investment insurance companies
- 8 insurance brokers
- 2 actuaries
- 3 insurance expert organizations (third party administration and insurance adjustment)
- 2 insurance associations
- No insurance training centers

The presence of a relatively large number of insurance companies in a country of about 8.6 million people is related to the relatively low cost of entry – minimum capital required was USD 440,000 in 2006, and as low as 45,000 in the early 1990's. The large number of insurers has led to operational inefficiency and relatively high premiums in relation to the value of benefits. Insurance penetration (the ratio of insurance premiums paid in a year to GDP, shown in Figure I) remains dismal. There is virtually no life insurance activity.



Until the end of 2006, insurers had been represented by two insurance associations. A single association will emerge in early 2007, which plans to develop, among other activities, an industry code of conduct and a training center.

The legal structure for insurance is in transition. The existing laws, developed in the Soviet era, do not reflect current needs or international standards. The Insurance Companies Activities Supervision department within the Ministry of Finance has been working with technical assistance providers to redraft the insurance law. The supervision department has recently joined the International Association of Insurance Supervisors. Both of these actions will move legislation, regulation, and supervision closer to international standards and help to build a stronger and more stable insurance sector.

Despite recent declines in poverty, three quarters of the Azerbaijan population can be classified as poor; earning insufficient income to function normally in society. Poverty and vulnerability are higher in urban areas than in rural areas. There are many people who can be classified as 'working poor', as formal employment does not lower the risk of poverty. High levels of economic vulnerability are also a legacy of the conflict with Armenia in the early 1990s, with refugees and internally displaced persons comprising 10% of the population.

The road out of poverty for low-income households in Azerbaijan is hard and unpredictable. Crises such as serious illnesses, the unexpected death of a family member, the loss of a job, or an accident leading to disability, put unbearable financial pressure on low-income households. This is due not only to the high costs associated with these risks but also to the limited range of

coping mechanisms. While there is a strong informal borrowing culture (mostly without interest from family and friends) it is not enough to cope with severe risks. In fact, Azerbaijanis rarely prepare for risks and seem to be averse to managing risks. Less than 1% of low-income households save regularly. Almost three-fourths of low-income households which admit to repaying a loan were found to have borrowed beyond their ability to repay.

Microinsurance offers a way to improve risk-management capacities. According to the authors' estimates, of the 1.32 million low-income households in Azerbaijan, approximately 61% could benefit from microinsurance<sup>2</sup>. This is a considerable group, which could take advantage of the risk-management mechanisms that microinsurance offers.

The study revealed that only 5% of households currently have any kind of insurance policy. In total only 9% have had any experience with insurance in the past 15 years. Research by the authors shows that the most important reasons why people have not used insurance services in the past are a lack of information about insurance and/or a lack of contact with insurance companies or agents. Almost half of those who have never been insured do not know enough about insurance, and a third have never come across an insurer or insurance agent. Interestingly, in the highest-income layer of the population, these levels of perception were exactly the same. This indicates that the insurance market in Azerbaijan has not adjusted to the expectations and financial potential of the upper segment.

Trust or lack of trust in insurance is a major issue, probably due to negative past experiences (related to the collapse of the USSR) and present experiences of malpractice (bribery, and non-payment). Over 50% of respondents who have not used insurance said this was because of mistrust. In spite of these misgivings, many respondents interviewed expressed the need for insurance, on condition that it was sound and reliable. Interest in insurance has a very passive character: respondents do not search for information about insurance, but they will listen carefully if such information is given to them.

What does this somewhat bleak insurance landscape imply for microinsurance prospects? As hardly anyone uses insurance (and almost nobody uses microinsurance) it is impossible to project a future microinsurance market development based on historical trends. One can however project a market development for microinsurance based on the access frontier approach proposed by David Porteous (2005).

The access frontier approach identifies three zones in the market (Figure C):

- *Market enablement zone* – the group that can be reached immediately with new microinsurance products that will be in demand by enthusiastic consumers. In Azerbaijan this group varies from 4% for life insurance to 6% for health insurance; these are lower percentages than for Georgia, Romania or Ukraine.
- *Market development zone* – the group that might be covered if new products are well-adapted, effective marketing strategies are in place, and there is an enabling environment. In Azerbaijan the share of the market development zone is significant, confirming the high level of immaturity in the insurance market. It varies from 50% for property insurance to 61% for health insurance.
- *Market redistribution zone* – this group is defined as 'supra-market' (those who are outside the market) most of whom cannot afford insurance. Assisting them is essentially a task for the government – to extend an adequate safety net and provide affordable risk-management tools. This group is relatively small in Azerbaijan, varying from 7%-9%.<sup>3</sup>

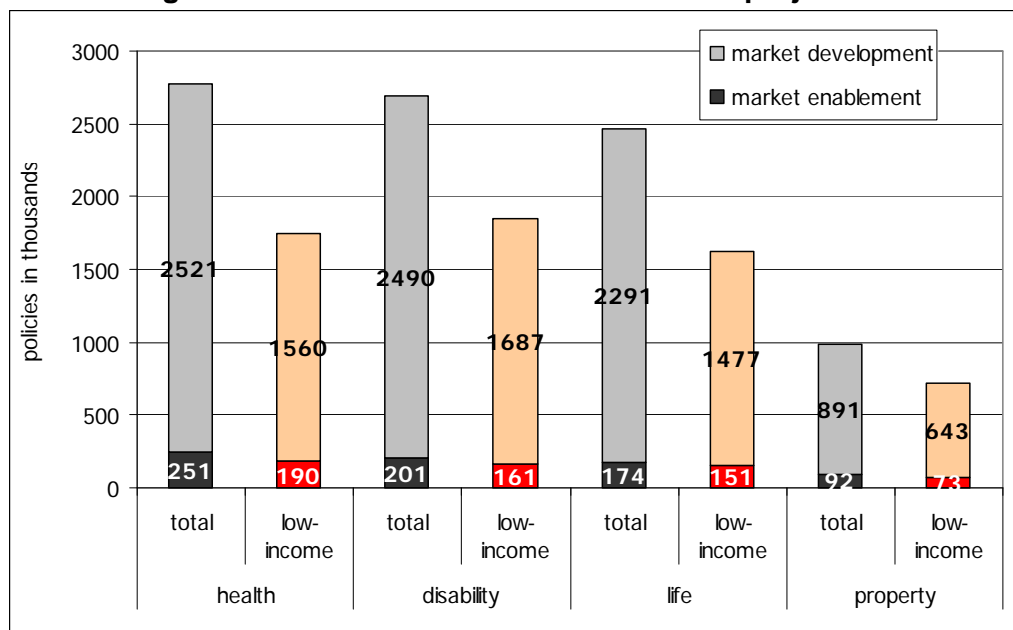
<sup>2</sup> Approximately, 9% cannot afford it; 30% do not fulfill basic requirements (age, health condition, etc.).

<sup>3</sup> The low incidence of those who cannot afford insurance can be attributed to the fact that low-income households are aware that current risk-management strategies are costly for them and microinsurance is a less expensive option. That is why in the supra-market group there are only those who live in extreme poverty and are excluded from the cash-economy.



Seen this way, the theoretical market for microinsurance in Azerbaijan is sizeable (Figure II)<sup>4</sup>. Depending on the product, the low-income market forms 60%-75% of the total insurance market as measured by potential number of policies. Total potential policies are estimated as 1.75 million covered lives for health, 1.85 million for disability, 1.63 million for life and 0.72 million for property insurance. There is an obvious business opportunity here. The volume of the ‘easier-to-reach’ market (market enablement zone) under current circumstances is approximately 190,000 covered lives for health insurance products; 161,000 for disability insurance; 151,000 for life insurance; and 73,000 property insurance policies.

**Figure II: Total and low-income market size projections**



In general, most people are skeptical about insurance and distrustful of insurers. Those who are least educated about insurance are the most enthusiastic. This presents both an opportunity and a threat. It would be difficult to tap into the low-income market merely by penetrating the market-enablement zone. The low-income market needs to be developed.

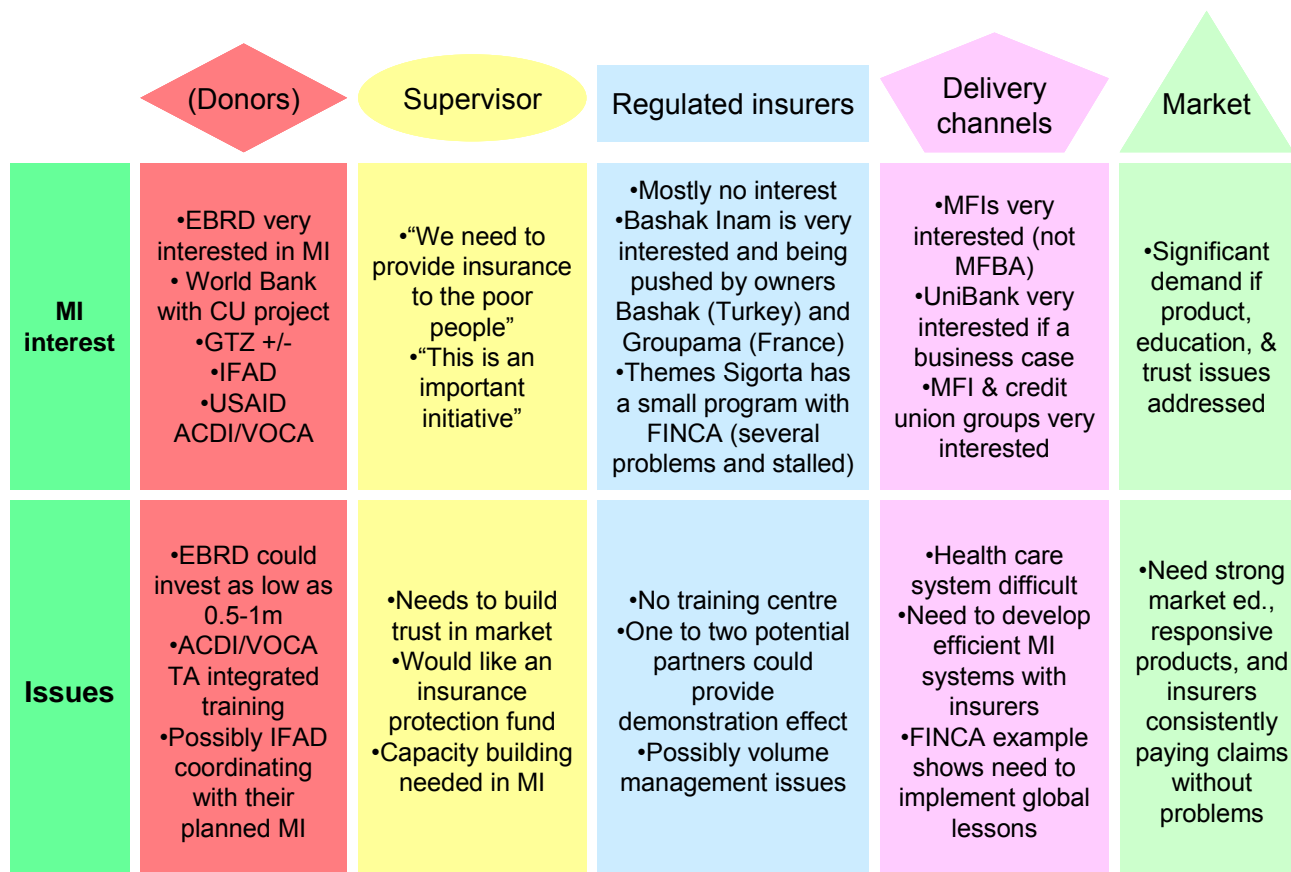
In order to develop the microinsurance sector, a mixture of strategies will be required. Apart from developing new microinsurance products adapted to low-income market expectations, the outreach strategy should incorporate four other components:

- General financial education, which shows people how to be more proactive in managing risks.
- Education in microinsurance, focusing on building knowledge of the risk-pooling concept, whereby many pay premiums and few make claims, and showing the benefits of insurance.
- Marketing strategy putting the emphasis on price.
- Low-cost delivery channels, delivering affordable services for the target group, especially those living in rural areas and small towns.

The supply chain for microinsurance in Azerbaijan (Figure III) shows the key actors in a potential microinsurance market in Azerbaijan.

<sup>4</sup> All the market size estimations are based on the total population of 7.2 million (according to official statistics the total population is 8.3 million), but not including Nakhichevan Autonomous Republic and territories lost to Armenia. Some say that Azerbaijan is populated by no more than 6 million people currently, as many have left for abroad.

**Figure III: The microinsurance supply chain in Azerbaijan**



In order to achieve microinsurance success all the categories in the chain must be addressed.

The insurance supervisor in Azerbaijan is interested in insurance becoming available to the low-income markets. He recognizes the role of the supervisor as promoting confidence in the insurance market and thus is working on strengthening the general capacity of his staff, as well as looking toward larger institutional means of generating confidence. The draft insurance law should play an important role in improving the overall soundness of the industry.

Insurers in general are not interested in the low-income market as long as there is perceived business available in the upper and corporate markets. This attitude is common in all countries. What is needed is for one or two insurers to take an interest in the low-income market. If these first steps are successful, the others will see the potential and generate competition for the first movers. This in turn will bring the benefits of better products and better prices.

Delivery channels are often microinsurance’s growth component, but can also be its limitation. In Azerbaijan, as in many other countries, delivery channels are limited. Most delivery channels have relatively few members or clients, and they have limited capacity to sell and service microinsurance. Microinsurance success in Azerbaijan will require identifying and building the capacity of delivery channels.

The theoretical maximum number of covered lives in Azerbaijan is very large, but turning these into an effective market and serving them adequately will take a substantial effort on the part of all participants in the supply chain. There is a potential microinsurance market in Azerbaijan. If developed correctly, it will be possible for insurers to make profits, and for delivery channels to add significant value to clients while making some profit and for low-income households to obtain the risk management tools that they need to secure their financial gains.

## Microinsurance <sup>5</sup>

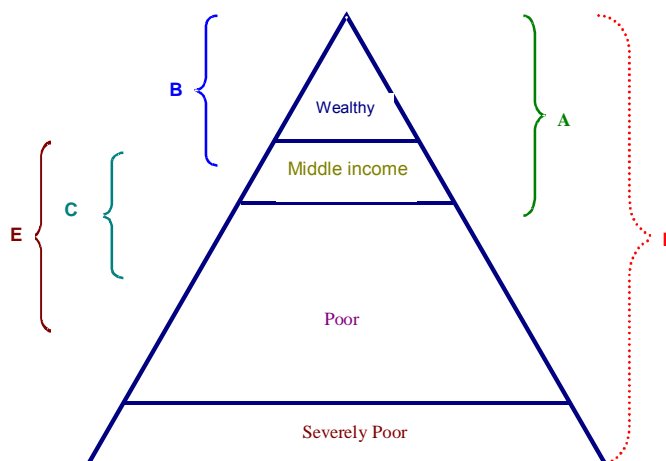
### **Microinsurance in the insurance sector**

In Azerbaijan, a wide range of insurance products, as well as a choice of insurers is available to the upper and middle-income markets. Azerbaijan insurers sell their products not only in Baku, but also in many of the larger, and even some of the smaller towns throughout the country.

Figure 1: shows how microinsurance fits into the economy. Formal sector insurance companies generally focus on the area marked “A” in the diagram. In this area they are selling voluntary products, such as life insurance, as well as obligatory products required by law like motor third party liability, or those required by banks such as property loss and credit life.

Nevertheless, insurers such as Bashak Inam are interested in expanding their market beyond the “A” segment into the poorer market range identified as “E”.

Most of the non-auto related insurance products are being sold within the area marked “B” to corporate customers and middle income to wealthy individuals. The “wealthy” and “middle income” tiers are not even close to being saturated in Azerbaijan. At the same time the middle-income group is expanding as the nation reaps the benefits of an expanding oil economy. The insurance sector in Azerbaijan is poised for growth, although it is still nascent, with very limited insurance density or penetration.<sup>6</sup>



The market for microfinance providers (MFPs)<sup>7</sup> is generally found in the area marked “C”. This range is somewhat limited at its bottom end, because there are very few products for agricultural lending, although this is changing. On the upper end, activities reach almost to the top of the middle-income group, given the microfinance providers’ relatively large maximum loan values. Some microfinance providers require borrowers to obtain property insurance or credit-life insurance as a means of protecting the institution’s interests. When such insurance is required, microfinance providers are primarily sending their clients to insurance companies, which sell the insurance to the client directly.

It is important to mention that microfinance providers and banks have strong tools of risk mitigation within their traditional (non-insurance) product lines. To assist their clients with risk management, they should be offering emergency loans and specialized savings products (where legal). These could be the first line of defence for low-income clients of these companies.

Area “D” shows the range of products offered by the social security and public health insurance systems of the government. They include cover for pensions, disability benefits, primary health care, and medications. This sector is marked in the diagram by a broken line, suggesting weakness and incompleteness.

<sup>5</sup> Microinsurance is the protection of low-income people against specific perils in exchange for regular premium payments proportionate to the likelihood and cost of the risk involved. Low-income people can use microinsurance, where it is available, as one of several tools to manage risks.

<sup>6</sup> This paper includes an extensive glossary of insurance terms in Appendix 9.

<sup>7</sup> In this paper, MFPs are defined in the broadest sense and include any financial activities within the low-income market. The institutional structure might be as an NGO, a bank, a credit union, cooperative, or other type.

Finally, the potential market for microinsurance is indicated as “E”. This market range extends from rural farmers to mid-level microentrepreneurs. Its upper level includes the relatively large loans that are common in Azerbaijan for microfinance providers, many of these relating to the lower to mid middle-income group. The lower level of the microinsurance range is below the typical level of MFPs.

***What range of products does microinsurance cover?***

A number of microinsurance products are used internationally to address the specific needs of low-income populations. Such products include various components of health insurance, life (including riders for long-term savings or investment products), disability (permanent and temporary), accident, property cover, policies covering livestock, and index products against too much, or too little, rainfall. Some international examples follow.

In Bangladesh, Delta Life Insurance offers life microinsurance with an endowment policy to well over one million very low-income individuals. These policies offer low value endowments accumulating USD 200 to 2000 after a policyholder-selected term of fifteen or twenty years. The savings is tied to a life insurance product that completes the endowment upon death.

In Uganda, the American International Group (AIG) Uganda offers a group personal accident (GPA) policy through MFIs that has covered almost two million lives (9% of Uganda’s population). This policy is linked to MFP loans, and provides credit life, permanent and temporary disability, accidental death benefits for clients, their spouses, and up to four children, and includes cover against the physical loss of business premises (through fire, for example). Using MFPs as their delivery channel has allowed for rapid and efficient growth. Their success has further generated market competition in Uganda with at least two other insurers actively competing for this business in the low-income market, resulting in more favourable products and pricing.

In Kenya, Africa Air Rescue (AAR) Health Services offers a comprehensive and an in-patient-only health insurance product through an MFI. This product provides access to several AAR health care facilities, and a number of hospitals in their market area.

In Georgia, Constanta Foundation and Aldagi Insurance teamed up to offer a health insurance product range for Constanta’s clients. Introduced in May 2004, the range of products initially performed beyond expectations, but has since been revised to improve processing and marketing. Unfortunately, major management and governance changes at Aldagi have led to a temporary suspension of this product.

In India, property insurance is offered by VimoSEWA covering the homes of very low-income members. In addition, weather index “insurance” is offered by ICICI/Lombard in agricultural areas to protect against too little or too much rainfall in a way that virtually eliminates the moral hazard of traditional crop insurance.

In Colombia, La Equidad provides a life insurance product that covers not only the insured’s funeral expenses, but also medical and educational costs for a deceased’s children as well as a monthly grocery benefit for two years after the policyholder’s death.

The Working Group on Microinsurance has conducted an extensive series of case studies of microinsurance programs and organizations. Twenty-two of these have been published individually, and the synthesis of these is now available as “*Protecting the Poor: A Microinsurance Compendium*.” The case studies provide a detailed examination of the institutions and the lessons they have learned over time. The cases and the book can be accessed at: [www.MicroInsuranceCentre.org](http://www.MicroInsuranceCentre.org).

### ***How is microinsurance delivered?***

Several models of microinsurance delivery are in use internationally. These models fall into the following groups:

- **Partnership (or Partner-Agent) model:** In this model, an insurer is paired with a bank or MFP to offer effective and efficient microinsurance products. The insurer manages the insurance risk and the financial organization acts as the agent for the products. Constanta Foundation in Georgia has used this model with Aldagi Insurance in the delivery of their range of health insurance products. FINCA Azerbaijan has paired with Themes Insurance to offer a basic microinsurance product to its clients.
- **Community-based model:** This model is used widely in numerous countries, especially in West Africa, where it is usually focused on health financing. Organizations including the International Labour Organization (ILO), through their Strategies and Tools against social Exclusion and Poverty (STEP) program, and the French Centre for International Development and Research (CIDR) promote this model and work with communities to help develop and administer a risk fund. In the community-based model, community members organize to provide premiums to a central fund, negotiate with doctors, determine the “right” care mix, set the premiums, and develop and manage the controls. However the multiple responsibilities, limited capacity of local people, and limited support usually make it difficult for these programs to reach organizational sustainability. No examples of community-based microinsurance were found in Azerbaijan.
- **Provider model:** In some countries, hospitals and clinics develop and offer their own insurance schemes with community groups. These have been difficult to manage because insurance skills among hospital administrators are limited. Most of these programs are run through the books of the hospitals or clinics, thus reliable data on the sustainability of these schemes is difficult to obtain. In Azerbaijan no provider models were found in the government hospitals which serve the poor and lower middle income groups.
- **Full service model:** In some countries, regulated insurers are developing products that effectively help them move down-market without a marketing partner. Delta Life of Bangladesh has done this with its endowment life policies. In other cases, the microfinance provider itself takes on the insurance risk, although this carries several serious risks for the MFP. In Azerbaijan, Bashak Inam is considering a move towards direct retail sales of agricultural related insurance.
- **Social protection models:** In these models the government takes on the responsibility of insuring its citizens (or some of them) using “contributions” usually from the employed population. Azerbaijan offers some social protection programs and provides some health care and pensions in this manner.

The key consideration with these models is: Where does the risk lie? In some of these models, the insurance risk becomes the responsibility of a party that is not likely to be capable of effective management. Any intervention in microinsurance should both ensure proper “placement” of the risk, and support the government’s efforts at social protection. An insurer-based model can respond professionally to these issues.

### ***How does microinsurance fit within the broad policy environment?***

In Azerbaijan, there was certainly an interest on the part of the government officials interviewed to generate greater protection for low-income people. Insurance is seen as a positive means of providing such protection. However, the broad policy implications of this are still somewhat unclear.

Much of this lack of clarity relates to the anticipated USD 120 billion in oil revenues over the next ten years. These revenues will have an impact on two broad areas. First the government will have the income stream needed to address many of the social issues in Azerbaijan. There has already been much discussion of improvement of the health care system, including in the rural areas. Other social security measures are likely. The forms of social expenditure will likely have an impact on commercial microinsurance.

The second impact is that the anticipated revenues will have the power to dramatically push growth in Azerbaijan. Indeed, *The Economist* (1 December, 2006) forecast Azerbaijan's 2006 GDP growth at 27.5% – the highest in the world by far. Such continued growth would suggest that a significant proportion of the population will move from the low-income to the middle-income group over time.

Even with the rapid movement into the middle-income group, commercial microinsurance will have an important role to play in allowing government interventions to be focused on those truly in need – the severely poor and the lowest level poor people. With traditional insurance covering the upper-medium-income and high-income populations, microinsurance covering much of the poor and some of the middle income populations, and social security programs covering the poor and severely poor, the risk protection structure in Azerbaijan is likely to be most effective.

## The insurance sector in Azerbaijan

The insurance industry in Azerbaijan comprises:

- 23 local insurance companies
- 6 foreign investment insurance companies
- 8 insurance brokers
- 2 actuaries
- 3 insurance expert organizations (third party administration and insurance adjustment)
- 2 insurance associations
- No insurance training centers

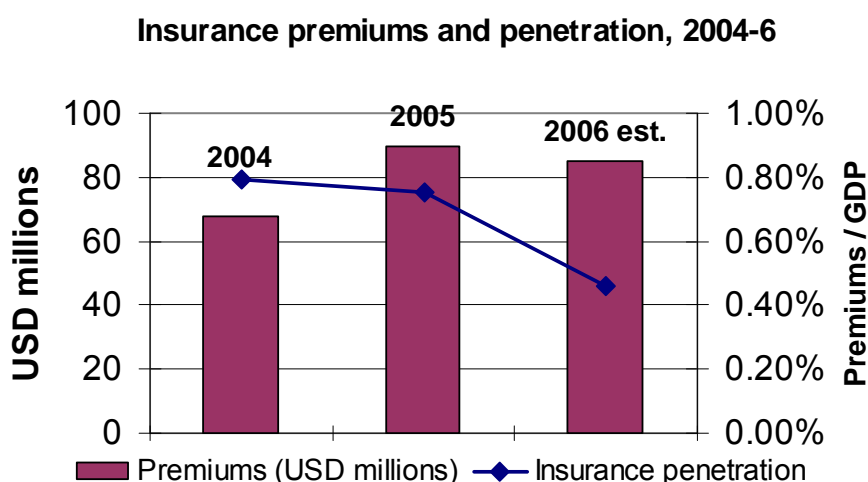
The insurance companies are not segregated into life and non-life companies as is typical of insurance companies in most countries.<sup>8</sup> In Azerbaijan, an insurer obtains an insurance license allowing the sale of any type of insurance product. This will change in pending legislation.

The eight brokers are focused mostly on the corporate markets and none are involved in retail insurance.

Actuaries are critical for long-term risk assessment. Of the two actuaries, one works within the insurance supervisor’s office and one with a private insurer. In Azerbaijan, product pricing is normally done by reinsurers, to whom about 48% of premiums were ceded in 2005.<sup>9</sup>

The volume of insurance business in Azerbaijan continues to be very low and dependent mainly on relatively few very large companies or projects. As Figure 2 shows, gross premiums are actually projected to decline by about 8% from 2005 to 2006. It was suggested by some of the respondents interviewed that this decline is a result of the completion of the oil pipeline project, which means there is no further need to insure builders and other contractors to the project.

**Figure 2: Insurance premiums and penetration 2004-6**



With little over USD 80 million in premiums, the whole industry is the size of a single small insurer in Europe or North America. The effect of 29 insurers serving this tiny market has been to generate significant inefficiencies in the industry, reflected in higher premiums charged to policyholders. Table 1, which gives claims ratios for 2004-5, shows that the total claims paid in

<sup>8</sup> Life and non-life insurance typically require different licenses because life insurance requires management of often very long term funds for policyholders, while non-life products are all short term. To protect the capital of life policyholders from losses in a non-life portfolio, legislation typically requires their separation.

<sup>9</sup> Calculated by the authors from data provided by the Insurance Supervisor.



relation to premiums received for 2004 and 2005 were a mere 22% and 23%, respectively. The key components in determining premiums are claims and operating costs. When the claims ratio is so low, this suggests that operating inefficiencies are significant. With so many insurers and such a small population it is hard to reach the level of efficiencies that allow for more appropriate claims ratios. In Europe and North America such ratios would be close to 60% for most products.

As can also be seen from Figure 2, the insurance penetration (the ratio of total premiums paid to GDP for a country) is very low and declining. The decline shows that the insurance business is not even keeping up with the growth in Azerbaijan's economy.

Table 2, showing insurance premiums for 2004-6, provides a breakdown by product type of the insurance premiums for those three years. It is clear from this table that the insurance market is dominated by non-life insurance – primarily accident, fire, and medical covers. In 2006, non-

**Table 2: Insurance Premiums 2004-6**

	Premiums (USD millions)		
	2004	2005	2006 (projected)
<b>Optional insurance:</b>	<b>62.55</b>	<b>83.5</b>	<b>75.97</b>
<b>Life insurance</b>	<b>1.82</b>	<b>0.68</b>	<b>0.34</b>
Life	1.82	0.68	0.34
Pension	-	-	-
<b>Non-life insurance:</b>	<b>60.73</b>	<b>82.82</b>	<b>75.64</b>
Fire	15.57	18.82	10.71
Accident	32.91	43.71	47.10
Individual accident	3.5	5.21	3.66
Transport	2.35	3.76	3.38
Engineering	0.86	2.93	0.98
Medical	5.52	8.36	10.47
Agricultural production	0.01	0.02	0.01
Livestock	0.01	0.01	0.02
<b>Compulsory insurance:</b>	<b>5.05</b>	<b>6.24</b>	<b>6.69</b>
Civil liability	1.96	2.3	2.51
Other compulsory	3.09	3.94	4.18
<b>TOTAL</b>	<b>67.6</b>	<b>89.74</b>	<b>82.53</b>

**Table 1: Claims ratios 2004-5**

	2004	2005
<b>Optional insurance:</b>	<b>20.4%</b>	<b>22.2%</b>
<b>Life insurance</b>	<b>94.5%</b>	<b>82.4%</b>
Life	94.5%	82.4%
Pension	-	-
<b>Non-life insurance:</b>	<b>18.2%</b>	<b>21.7%</b>
Fire	10.9%	26.1%
Accident	17.7%	16.6%
Individual accident	6.9%	9.4%
Transport	15.3%	19.7%
Engineering	7.0%	3.4%
Medical	51.1%	53.1%
Agricultural production	300.0%	25.0%
Livestock	200.0%	500.0%
<b>Compulsory insurance:</b>	<b>44.8%</b>	<b>35.6%</b>
Civil liability	28.6%	32.6%
Other compulsory	55.0%	37.3%
<b>TOTAL</b>	<b>22.2%</b>	<b>23.1%</b>

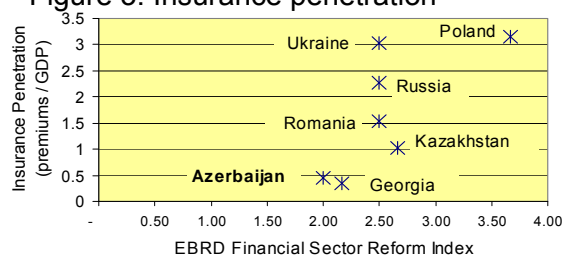
compulsory non-life insurance represented about 92% of the total insurance market with less than one-half percent attributed to life insurance. The balance represents government compulsory insurance.

Life insurance volumes in Azerbaijan are therefore among the lowest in the world. This is somewhat surprising, given that when there is legal allowance for composite insurance companies (those selling both life and non-life insurance), such as in Romania, there is often a higher percentage of life cover sold because there is no need to obtain a second license, and there are easy cross-selling opportunities. Indeed, for microinsurance a composite license is preferable because of the efficiencies that such legislation allows.

Several suggestions were made by those interviewed to explain the low volume of life insurance in Azerbaijan. The most plausible was that the loss of long-term funds held by Soviet insurers upon independence has made people skeptical of any long-term investments. It was also suggested that because the current insurance law requires reapplication for an insurance license every five years, insurers are reluctant to make agreements with policyholders for longer than their license allows them to be in business. This licensing issue is likely to be addressed in the draft insurance law presently making its way through the legal process.

Figure 3, showing insurance penetration, positions Azerbaijan in relation to other countries in the region in terms of progress towards financial

**Figure 3: Insurance penetration**





reforms and insurance penetration. In this index the transition indicators range from 1 to 4+, with 1 representing little or no change from a rigid centrally planned economy and 4+ representing the standards of an industrialized market economy<sup>10</sup>. Among this group, and indeed within the whole world, Azerbaijan shows almost the lowest penetration on the scale. Only Georgia is lower, with possibly the lowest insurance penetration in the world.

We can conclude that there is significant room for growth in overall insurance business in Azerbaijan. With massive inflows of funds into the country over the next several years, it is likely that insurers can improve the overall insurance growth.

Table 3 identifies the top ten insurers by premiums over the first nine months of 2006, representing almost 80% of the total premiums received. The market is characterized by wildly fluctuating year on year changes. Much of this is because of the very small market penetration. For example a decline of 40% in one company's (AIG Caspian's) premiums was attributed (by others) to the loss of one policyholder, the pipeline project.

**Table 3: Insurance indicators – top ten Insurers (millions of USD)**

<b>Insurance Company</b>	<b>9 months 2006 premiums</b>	<b>Change from 2005</b>
Azal Sigorta	10.4	27%
Ateshgah	10.0	(12)%
Standard Insurance	7.2	
M-Bask	5.6	25%
Azersigorta	5.0	12%
A-Group	4.1	27%
AIG Caspian	3.2	(40)%
IIC/BSS	4.4	25%
Xalq Sigorta	2.4	
Ata Sigorta	2.4	53%
<b>Total for top ten</b>	<b>54.8</b>	
Totals for 9 months 2006	69.7	
<b>Market share for top ten</b>	<b>78.7%</b>	
Market share for other 19	21.3%	

Though the industry is small, several of the insurers in Azerbaijan are ISO 9001 accredited, suggesting compliance with international business standards. Some innovation in insurance product design and marketing is taking place as can be seen by the example in Box 1.

**Box 1: Insurance innovation**

Standard Insurance, the fastest growing insurance company in Azerbaijan, is introducing a product to shake up the almost non-existent life insurance market. In Azerbaijan, life insurance premiums for policies of less than five years are taxed at the 22% income tax rate for employees and a further 14% to 35% for employers. Life policies for durations greater than five years are not taxed. Standard's "five year plus" product will save on taxes for both employees and employers, plus provide a return on the savings portion of the premium. This will allow employers to create long-term benefits and incentives for their employees.

<sup>10</sup> EBRD Transition Report 2006

Microinsurance requires the ability of insurers to manage large volumes of covered lives with small margins. This requires institutional capacity, which may be limited in Azerbaijan. The example of M-Bask, in Box 2, clearly shows how lack of capacity can hinder growth.

**Box 2: Capacity limitations**

In 2005, M-BASK, the fourth largest insurer in Azerbaijan, issued 50,000 compulsory motor third party agreements for 5 million Manats (about 5.5 million USD). In 2006, the company issued less than six thousand agreements. The dramatic reduction in business was the result of an M-BASK management decision because the company had been unable to administer the 50,000 policies. This will have a significant impact on the company's profitability.

M-BASK also noted that compliance with supervisory requirements, especially underwriting and policy document requirements, are difficult without adequate systems. This is most likely to be an issue for several of the insurers. M-BASK management is now anticipating a grant of USD 500,000 from the European Bank for Reconstruction and Development (EBRD) to fund the purchase and implementation of an information technology system.

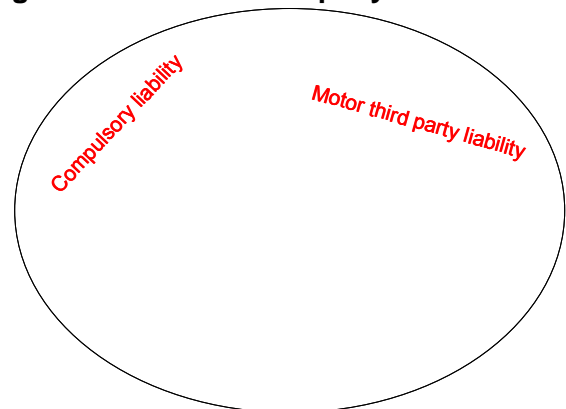
The ability to manage volumes is critical in microinsurance because fundamentally it is a low-margin, high-volume business.

There appears to be very little microinsurance in Azerbaijan, and most companies are not interested in the low-end market. The following comments from two of the insurers interviewed are fairly representative: "People making under USD 500 in Azerbaijan are not able to buy insurance"; and "Low income people are not interested in insurance". Both these comments show a lack of understanding of the potential of the low-income market. Similar comments are made in most countries where there has yet to be a significant effort to increase microinsurance. Until commercial insurers see a business case for microinsurance they will remain out of that market simply because of their own stereotypes.

**Figure 4: Foreign company cover taken**



**Figure 5: Domestic company cover taken**



Another issue that keeps insurers in Azerbaijan out of the low-income market is their view of where market opportunity lies. In some countries, it is the saturation of the upper market that pushes insurers down-market in order to broaden the market rather than fight for the same clients. In Azerbaijan, insurers see two extremes within the upper and corporate markets. The foreign companies (Figure 4: Foreign company cover taken) come and purchase the full range of insurance products, while domestic companies (Figure 5: Domestic company cover taken)

purchase only what is required of them. Thus, several insurers see their market as taking up the potential in Figure 5, which has nothing to do with the low-end market.<sup>11</sup>

Typically what moves the insurance industry to expand into the low-income market is the demonstration effect that occurs when an innovator sees the potential in the market, develops appropriate products and procedures to access it, and commits to success. The Azerbaijan insurance market is no different to most others in that most insurers will wait and see if microinsurance works, and one or two are willing to be first movers into the market.

### ***Insurance associations***

Two insurance associations have been operating in Azerbaijan. Each offered a magazine and a newspaper, provided training, and translated insurance texts. One had approximately 20 members while the later, which seems to have been comprised of newer insurance companies, had five. Both were initially started with assistance from the Ministry of Finance. Partly because of the recognition of the inefficiencies of two associations, and partly because of the opportunity to have USAID (through ACDI/VOCA) provide association building assistance to a single association, the two have been effectively closed. A single insurance association is emerging, based on a vote taken in late November 2006. The new association was started by five original members (all others are expected to join). The group has submitted registration paperwork to the government for approval. This is expected to be forthcoming, since the Ministry of Finance is involved in this new association. M-BASK will be the inaugural head of the Association. Initial priorities include:

- Developing industry rules through a code of conduct
- Conducting an international insurance conference in June 2007
- Developing an insurance training centre

Any effort to improve the overall level of microinsurance training, and to bring the industry to at least a common basic level, will require a training centre, or at least a formal training program. Currently there is no insurance training centre in the country. The training that does exist is carried out within the insurance companies themselves for their own staff. There is no formal training for insurance agents – this is also done by the insurers themselves. Given the limited number of potential trainees in Azerbaijan, a possibility would be to create a training center for the broader region. Formal access to training could help significantly with insurance capacity issues.

Insurance promotion is a key role of an association, and it remains to be seen how this will be done by the new association. Currently there is little evidence of general insurance promotion, except through the Ministry of Economic Development, which is working with its Department of Development Entrepreneurship to promote insurance among entrepreneurs. They suggest that 20-25% of the entrepreneurs are interested in insurance.

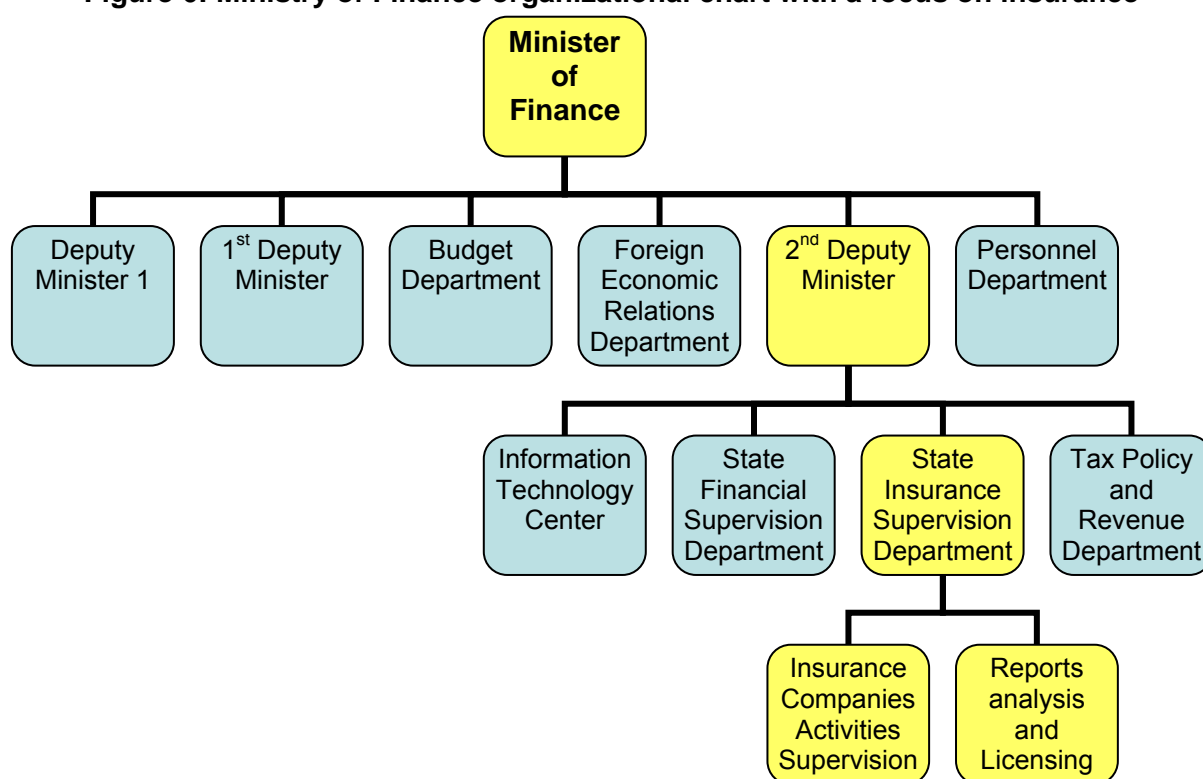
The State Insurance Supervision Department is charged with licensing and overseeing the activities of the insurance industry in Azerbaijan. In existence since Soviet times, there is much effort being exerted to transform the Department from Soviet-style micromanagement by the supervisor, to a system of general rules within which insurers are free to manoeuvre. Ultimately this will result in a stronger, more innovative, insurance industry, whose policyholders are better protected and better served.

The Department falls within the structure of the Ministry of Finance, on the same organizational level as banking supervision and taxation. Figure 6 shows how the Department is structured within the Ministry.

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<sup>11</sup> The products shown in Figures 4 and 5 are not intended to be exact representations of the full range of products offered by each foreign or domestic company. Rather they indicate the gap between the products taken by foreign and domestic companies.

**Figure 6: Ministry of Finance organizational chart with a focus on insurance**



The supervisor’s staff of 15 people is split between the two sub-areas. Technical assistance has been provided in revising the insurance law, as well as reviewing the compulsory insurance laws, and a planned short course on actuarial science for supervisory staff.

**Key events in the insurance industry**

Modern commercial insurance in Azerbaijan got its start in 1992 after the departure of the Soviets. The most significant events revolve around the insurance law, introduced in 1992 and then redrafted 2006, and the minimum capital requirements which have grown dramatically and frequently over the years. Table 4 outlines the key insurance events and when they occurred.

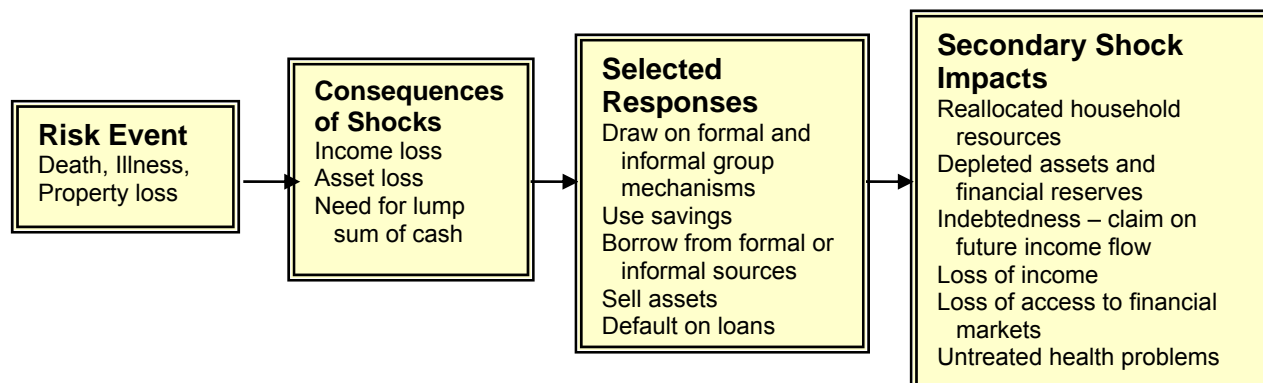
**Table 4: Significant events in the Azerbaijan Insurance Industry**

Year	Event
Pre-1992	USSR legislation on insurance
1992	New Azerbaijan insurance legislation developed
1998	Insurance legislation considered and adopted
1999	Minimum capital requirement – USD 46,000 (approx)
2000	Foreign investors in insurance allowed
2001	Minimum capital requirement – USD 230,000 (approx)
2004	Minimum capital requirement – USD 460,000 (approx)
2006	New insurance law drafted, focusing on European and WTO requirements.
2007	Minimum capital requirement – USD 800,000 (approx)
2010	Minimum capital requirement – USD 1.1 million (approx), although there are discussions to increase it to USD 3.3 million

## Risk management options for the poor <sup>12</sup>

When low-income people suffer from a risk event, a series of consequences, responses, and impacts follow. These are summarized in Figure 7. Low-income people need tools to help them manage the consequences of financial risks, or face the possibility of losing everything.

**Figure 7: Risk impacts**



### ***MFIs and banks in Azerbaijan***

The Azerbaijan Microfinance Association includes 21 member organizations serving a total of over 96,000 clients with loans outstanding of USD 108 million. The business is highly skewed towards a few institutions. Table 5 provides key MFI data for microfinance with the four MFIs that each have more than 5,000 clients.

**Table 5: Key microfinance data**

<b>Institution</b> Those with more than 5,000 clients listed individually. Data from 30/9/06 <sup>13</sup>	<b>Number of active clients</b>	<b>Portfolio value</b> (USD millions)	<b>Market share</b> (by clients)
FINCA	43,220	16.4	44.4%
Microfinance Bank	11,398	35.5	11.7%
Viator Microcredit	8,231	2.7	8.5%
World Vision Azercredit	7,536	3.7	7.7%
All other members (17)	25,753	50	26.4%
Non-association members	1,254	0.8	1.3%
<b>Total</b>	<b>97,392</b>	<b>108.7</b>	<b>100.0%</b>

Currently MFIs in Azerbaijan are focused on growth management – the Microfinance Bank, for example, has an annual growth of about 160%. Simply managing such high growth has become the MFIs’ main concern.

As the MFIs mature, they will no doubt pay more attention to product diversification. Of the four largest institutions listed:

<sup>12</sup> “MicroInsurance Centre Briefing Note Number 6: “Financial Risk Management Tools for the Poor.” Monique Cohen and Michael J. McCord, January 2003.

<sup>13</sup> Quarterly matrix provided by the Azerbaijan Microfinance Association.

- FINCA has expressed interest in starting a new microinsurance product based on best practices. FINCA International launched a Request for Proposals on June 2006 to help them structure a corporate approach to microinsurance based on a significant provision of funds from AIG. The resulting structure would likely have an impact on FINCA Azerbaijan's approach to microinsurance.
- The Microfinance Bank is growing too fast to redirect attention to a new product. When growth slows they may be more interested.
- Viator was not visited.
- World Vision AzerCredit expressed keen interest in providing microinsurance to its clients and has been considering microinsurance for some time.

UniBank also expressed significant interest in microinsurance as a complementary product to their microfinance expansion, provided they could be confident that microinsurance was a business proposition.

**Box 3: Microinsurance through MFIs in Azerbaijan**

In 2003 FINCA Azerbaijan, the MFI with by far the largest number of clients, offered a Thames Insurance life and personal accident policy to its clients on a voluntary basis. The policy offered a sum assured of USD 500 for approximately USD 6 per year. The maximum sum assured was USD 2,000. The policy included a "long list of exclusions".

FINCA sold 270 policies and subsequently stopped selling the product. Reasons for the low uptake included poor product design, difficulties in selling while dramatically growing the core business, and a lack of understanding of insurance by the clients. FINCA management noted that they would like to try again with a better product.

The representative body for the MFIs in the country is the Azerbaijan Microfinance Association, AMFA. Currently led by CredAgro (an ACDI/VOCA affiliate), AMFA charges an annual membership fee of USD 750 (to be increased to USD 1,000 in 2007) and provides lobbying, training, information transfer, linkages to international bodies, and more. It is part of a three-year association capacity building project funded by USAID and implemented by ACDI/VOCA. AMFA would be a good conduit to assist in creating insurance intermediary capacity among its members.

***Credit unions***

In 2000, after a string of credit union disasters resulted in the loss of substantial funds for their members, the government made the collection of deposits and share capital by credit unions illegal. Although this move probably protected many people from further loss, it also restricted the ability of credit unions to develop beyond the status of community-based lending groups.

A USD 10 million project of the World Bank has been implemented over the last four years to help develop the credit union association. It will build up the capacity and accountability of the credit unions, as well as provide loan capital for them to on-lend to their members. World Bank specialists are confident that the government will reverse its restriction on credit unions taking deposits.

There are 72 credit unions in Azerbaijan, currently operating with donor funds. Of these, only a small number (about five) would have the capacity to collect deposits from their members if this were legal.

The World Bank project with credit unions created an intermediary entity (the Credit Implementing Agency or CIA) to assess credit union borrowing capacity and then lend funds for credit union member borrowing. In this process, the CIA created numerous small lending

groups, distinctly not credit unions, through which they lent funds – in fact 70% of the World Bank funding has gone to these lending groups. A World Bank mission was in Azerbaijan at the same time as the authors of this report. Among other things they aimed to address the lending groups and move back to a credit union focus.

Among its other activities, the CIA sold accident insurance to the lending groups for 1% of the disbursed loan amount.

The credit union association would be a good intermediary for delivering microinsurance once the credit unions are in a better position.

### ***The social security system***

Azerbaijan is in a transition period regarding government social assistance. In 2004, there were more than 35 different benefits offered. However, these were mostly in small amounts and were poorly targeted. Some examples of social security insurance offered in Azerbaijan are included in Appendix 3.

Although health insurance is a priority of government and should improve through oil revenues, the recent status of state health care can be exemplified by the World Bank's comments from 2005, given in Box 4.

#### **Box 4: The World Bank on social health insurance in Azerbaijan**

“While there has been some improvement in rendering primary health care services to the general population of Azerbaijan, access to essential care is still hampered by a myriad of obstacles, including informal payments and distance to well-equipped and fully functional health facilities. The level of health spending currently amounted to 0.9 percent of GDP in 2004; this was among the lowest ratios in the world, and the prime reason for widespread informal payments, which made up for the cost of basic services that are inadequately funded out of the public budget.” (World Bank, 2005)

There is a mandatory health insurance law for all employed people (whether self-employed or company employed), but it does not function well and is under review. Premiums are between USD 100 and 1500 per year per person. Since 2005 there has been a significant effort to bring better health care to areas outside Baku.

A State pension program is in place to which employees pay 3% of their wages.

Direct social assistance to the poor started in 2006 with the actual payment of 58 AZN (USD 63) per month (AZN 40/USD 44 is said to be the official amount). The Ministry of Economic Development notes that AZN 35 (USD 38) per month is the minimum that someone requires in order to live, and 29% of the population lives below this income level.

The proportion of the population living in poverty using an “absolute poverty line” was estimated at 40.2% in 2004. While this was decreasing (it was 44.7% in 2003 and 46.7% in 2002), extreme poverty rose from 8% in 2002 to 9.6% in 2003<sup>14</sup>. In 2003 the highest poverty level (59.2%) was found in Nakhchivan Autonomous Republic – the part of Azerbaijan physically separated from the rest of the country – while the lowest level (35.4%) was found in Baku. Among internally displaced people (IDPs) the poverty level is estimated at about 50%.

<sup>14</sup> An absolute poverty line is estimated as the value of the minimum consumption basket. Food expenditures represent 69.4% of the total value of the basket. The total value of the basket in 2004 was 195,000 AZM (38.0 USD) per month. An “extreme poverty line” is estimated as the value of the minimum food basket. The value of the minimum food basket was 124,137 AZM (24 USD) for 2003.



Many of the poor live close to the national poverty line. The average consumption level of the poor population in 2003 was 8.8% less than the poverty line. There is a higher incidence of poverty in urban areas<sup>15</sup>, and from 1990 to 2003 the share of urban population in Azerbaijan fell from 54.2% to 50.7%. There are no significant differences in poverty levels among men and women.

Refugees and Internally Displaced Persons make up for over 10% of the population of Azerbaijan (311,000 refugees and 577,906 IDPs were living in Azerbaijan as of December 1, 2004). This creates a significant challenge for social security efforts.

To facilitate insurance access by farmers, the Azerbaijan government subsidizes agricultural insurance (through AgSig and Basak Inam, the only two agriculture insurers). The government covers 25% of agriculture insurance premiums.

An important consideration is that according to the Azerbaijan government, since the escalation of conflict in the region of Nagorno-Karabakh in 1991, 20% of the country has fallen outside the of control of the government in Baku. An unofficial ceasefire was reached on May 12, 1994, and continues today.<sup>16</sup>

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<sup>15</sup> Baschieri et al (2005)

<sup>16</sup> Nagorno-Karabakh is a *de facto* independent state, calling itself the Nagorno-Karabakh Republic and it is closely tied to the Republic of Armenia. The sovereign status of the Nagorno-Karabakh Republic is not recognized by any state, including Armenia.



## The demand for risk management services in Azerbaijan

The demand information presented here was generated by qualitative research among nine focus groups, together with quantitative research using extensive questionnaires among 1,000 households throughout Azerbaijan. Details of the research methodology are provided in Appendix 2.

### ***What types of risks are candidates for insurance and why?***

Not all risks are insurable. There are seven basic insurance principles that determine whether a loss is insurable:

1. The loss must occur by chance, and not be caused intentionally by the insured.
2. The loss must be definite, with reasonable confidence that the loss indeed occurred, and the loss must be measurable.
3. The probability of the loss occurring must be calculable as this is a key component in setting the premium.
4. There must be a large number of similar insured units exposed to the risk because of the law of large numbers which states that the larger the sample observed or studied, the more likely accurate the estimate or prediction.
5. The loss must not be catastrophic, creating losses for large numbers of insured at the same time as costs might be beyond the insurer's ability to honour claims. An insurer can avoid huge losses by means of reinsurance or the transfer of some or all risk to other insurers.
6. The policyholder must have an insurable interest in the event, and this event must cause a genuine loss to the policyholder. Ownership of property and family or financial ties of a beneficiary are two ways of establishing an insurable interest.
7. Premiums must be affordable.

These fundamental principles guide, on the most basic level, what can and cannot be normally insured. Thus, for example, a non-suicidal death can be insured, while school fees or marriages normally cannot.<sup>17</sup>

In microinsurance, the practicality of selling and managing insurance products requires simplicity, innovative premium payment mechanisms, and the ability to implement effective controls against moral hazard, adverse (or anti-) selection, fraud, and overuse. Because of these considerations, the availability of more complex products depends on the insurance expertise available. It is relatively easy for an MFI to offer basic credit life insurance on its portfolio, but it would take an insurer with health care financing expertise to offer health insurance.

In the case of health insurance, an additional fundamental input is required – at least one provider of quality health care services. Without such available quality services, the insurance cannot reasonably be sold. Sending people to poor quality facilities will have a negative impact on them, and will be more costly to the insurer due to additional costs related to the poor care. Generally, public hospitals are not seen as options for insurance because of several issues which include: quality of care, demands for un-receipted payments (bribes), limited confidence in financial arrangements, and difficulties in managing the necessary controls.

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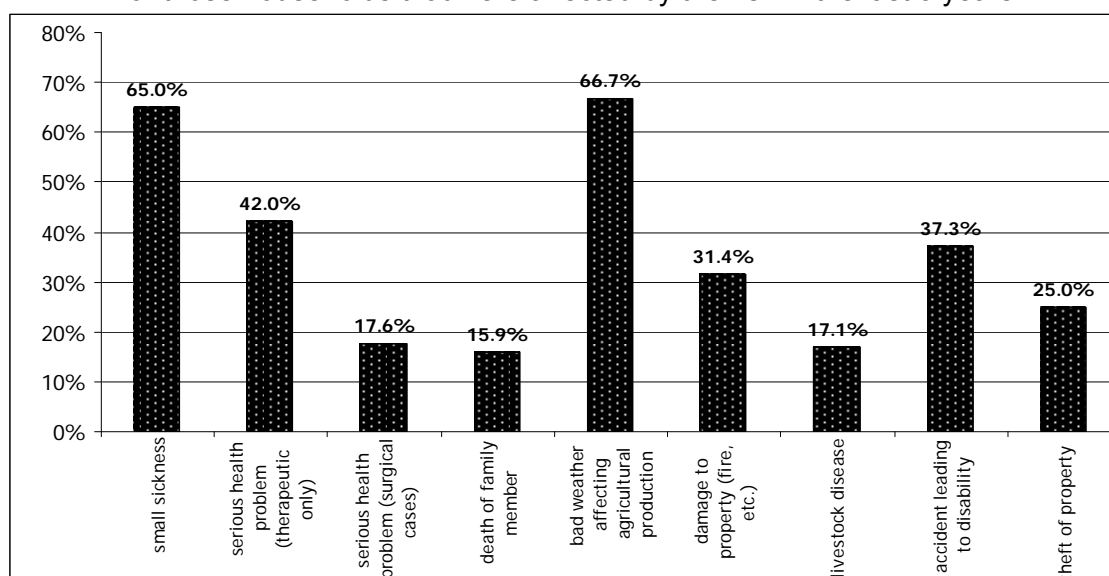
<sup>17</sup> Extract from The Working Group on Microinsurance. "Preliminary Donor Guidelines for Supporting Microinsurance". October 2003, pp 27-28. Accessible from [www.microinsurancecentre.org](http://www.microinsurancecentre.org).

### **Risk exposure**

Risk information for the potential microinsurance market was derived from extensive qualitative and quantitative market research conducted throughout Azerbaijan. Details of the study methodology are provided in Appendix 2.

The most frequent risks that Azerbaijanis face are related to health, agriculture, and disability, as shown in Figure 8. For 42% of households that were affected by a serious health problem (requiring therapeutic hospital treatment) the health risks happened more than once in the last three years. For 37.3% of households, disability risk happened more than once in the last three years.

**Figure 8: Frequency of risks**  
Percentage of occurrence of more than one risk of the same type for those households that were affected by the risk in the last 3 years



The research showed that those who are less likely to be exposed to a large number of risks are people living in small towns and in the west of the country. Those more likely to be exposed to risks are one-person households, households including someone with a chronic disease or disability, the youngest (<30) and female-headed households.

It is important to note that the risk exposure is not significantly greater among households having lower income. This is significant for assessing premiums for this market.

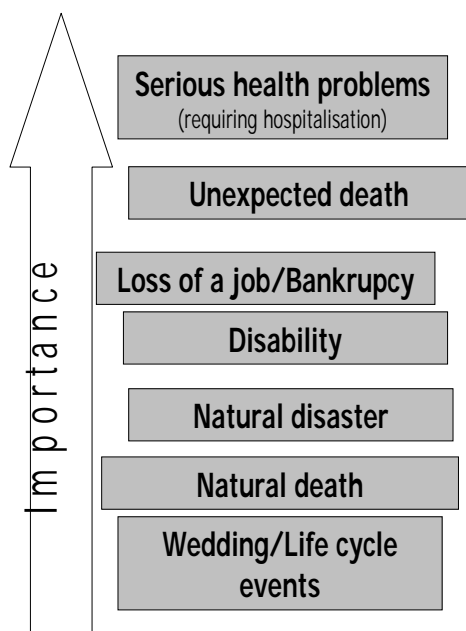
### **Importance of risks**

Risk severity is a measure of the impact of a risk when it occurs. According to the quantitative survey, those households who were affected by risks listed life, health and disability risks as having the greatest impact on their households.

The importance of risks is a function of risk severity and frequency of risk occurrence, as well as the difficulty of raising the necessary lump sum of cash to manage the risk (also described as access and effectiveness of coping mechanisms). Risk importance is also significant from the marketing point of view, as people are more willing to insure against risks that they perceive to be important.

Qualitative research was used to make a combined analysis of the perception of risk importance in low-income households.<sup>18</sup> It appeared that the most important risks were serious health problems (requiring hospitalisation), unexpected death of family member, disability, and loss of job or bankruptcy. Figure 9 shows the ranking of risk perceptions.

**Figure 9: Ranking of risk perception for low-income population in Azerbaijan**



Unexpected, serious illnesses are perceived as important risks because of high informal costs that have to be paid to obtain formally free health care services.

Expenditures on health problems vary from USD 30 to several thousand dollars. Cost depends on specific cases, but according to the respondents it is the frequency that makes it expensive in the end. The more expensive a health problem is, the greater the negative impact on a family, as it is necessary to activate all coping mechanisms, some of which entail high stress. It is worth mentioning that ordinary minor diseases tend not to be perceived as important problems, mainly because people neglect visiting doctors and/or buying medicine.

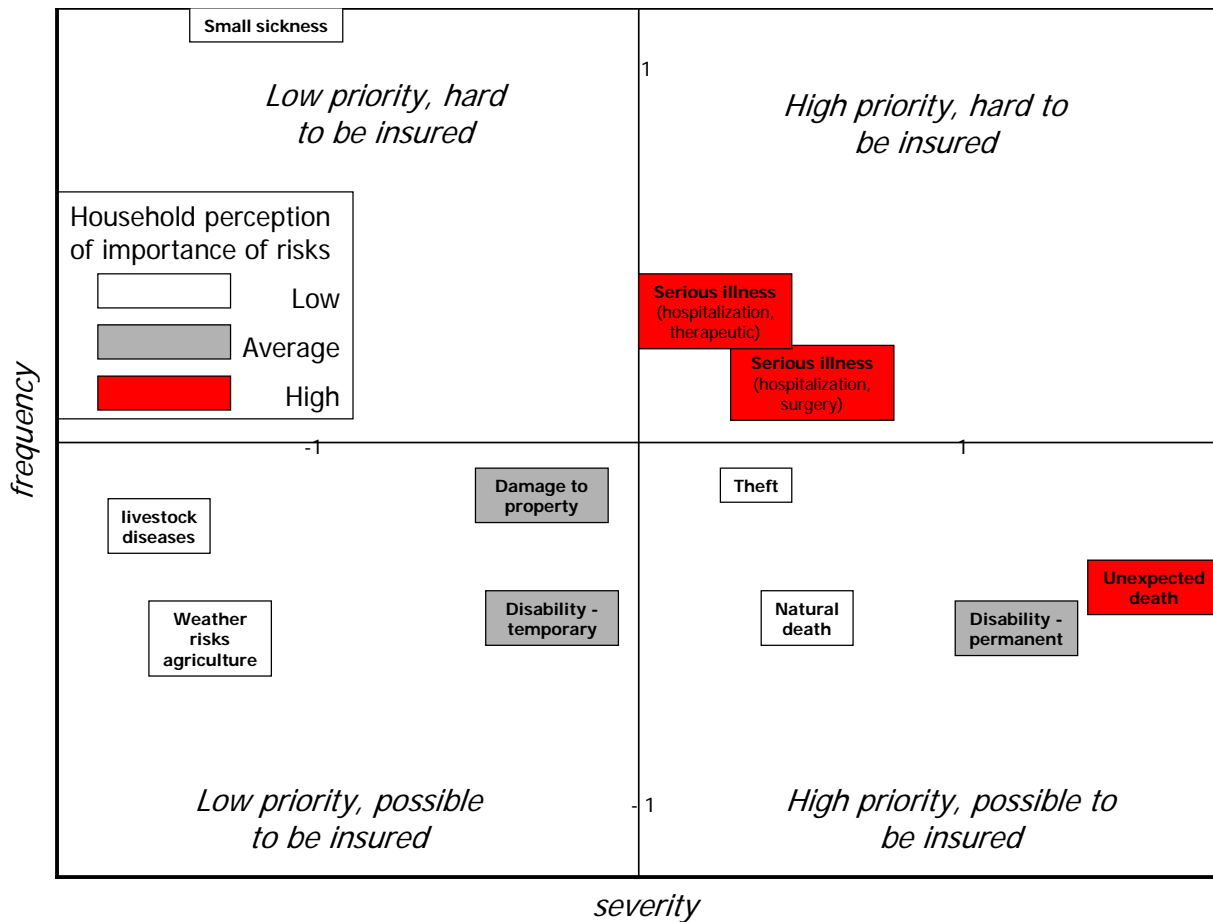
Death of a family member greatly influences the finances of a family. According to Azerbaijani traditions, there

are complex mourning and funeral customs that should be followed for 40 days after a death. The average amount for a funeral and commemoration ceremony, according to the respondents, is USD 3,000– 4,000. The support normally received by a bereaved family is far from sufficient for dealing with the problem.

When analyzing the market need for microinsurance, one should consider objective factors (frequency and severity of risks) as well as the subjective perception of households of the financial pressure related to specific risks. Also, the nature of the insurance concept needs to be taken into account – insurance should be for severe, unpredictable losses as it is hard to insure against frequent, repetitive events. Figure 10 combines the various dimensions involved, and summarizes win-win opportunities for both low-income households and insurers. The events in the bottom-right quadrant of the chart are insurable events which are perceived as important by low-income households. These are: life insurance, permanent disability insurance, and health insurance against serious health problems needing an emergency service and a surgery. Property/theft insurance provision may also be successful but is not perceived of as a priority for low-income households.

<sup>18</sup> During the ranking exercise we focused more on understanding the importance of insurable risks. However, we tried to discuss them within a bigger picture, including some structural and life cycle risks. This exercise helped to understand people's perception of the importance of insurable risks compared to other financial shocks and stresses they faced in their lives. It helped to understand people's needs as well as market opportunities.

**Figure 10: Microinsurance opportunities for low-income people and insurers**



**Personal financial intermediation**

Information on saving and borrowing behaviors provides an important insight into understanding the options for potential risk-management strategies.<sup>19</sup>

Azerbaijanis see some benefits of planning and saving but are not proactive in preparing for risks. It seems that they are not aware of the risk factors in everyday life. Not thinking about possible risks may be a psychological strategy for adaptation. Both qualitative and quantitative research shows that borrowing is a socially acceptable form of dealing with financial problems among low-income populations in Azerbaijan, in fact 60% of Azerbaijanis consider borrowing (without interest) as the only tool to deal with emergencies.<sup>20</sup> This means there is limited incentive for poor people to develop long-term risk management strategies, although borrowing without interest may be in fact a rational low stress coping mechanism especially for less severe risks. Reinforcing this practice is the perception that informal lenders can be abusive and that low-income people value the independence that comes from not being indebted.

Eighteen percent of all households try to save at least small amounts, but only 1.8% declare saving regularly.<sup>21</sup> It is even less likely to find low-income households that save (Figure 11). Qualitative research provides evidence that saving in low-income household is done sporadically and either with no specific purpose (“just to feel safe”) or, especially in rural areas, for unexpected visitors or for a funeral. During focus groups, participants from low-income

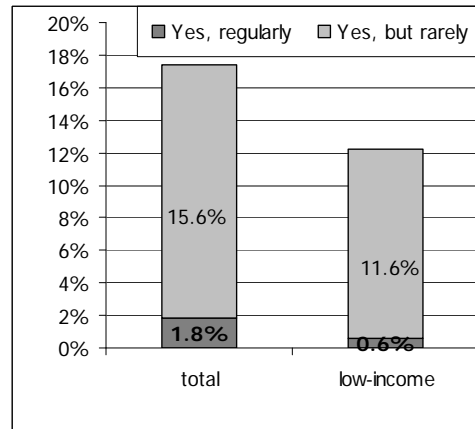
<sup>19</sup> This also helps us to understand the potential for microinsurance.  
<sup>20</sup> This opinion was shared by 44% of the population in Ukraine and 64% in Romania.  
<sup>21</sup> In comparison, 66% declared saving in Ukraine; 13% in Georgia.

households mentioned some of the benefits of saving. The most common were “quick access in case of an emergency”, and “no need to look for money elsewhere and explain everything to relatives”. The general opinion was that people in poor financial situations cannot afford to save because of their limited resources.

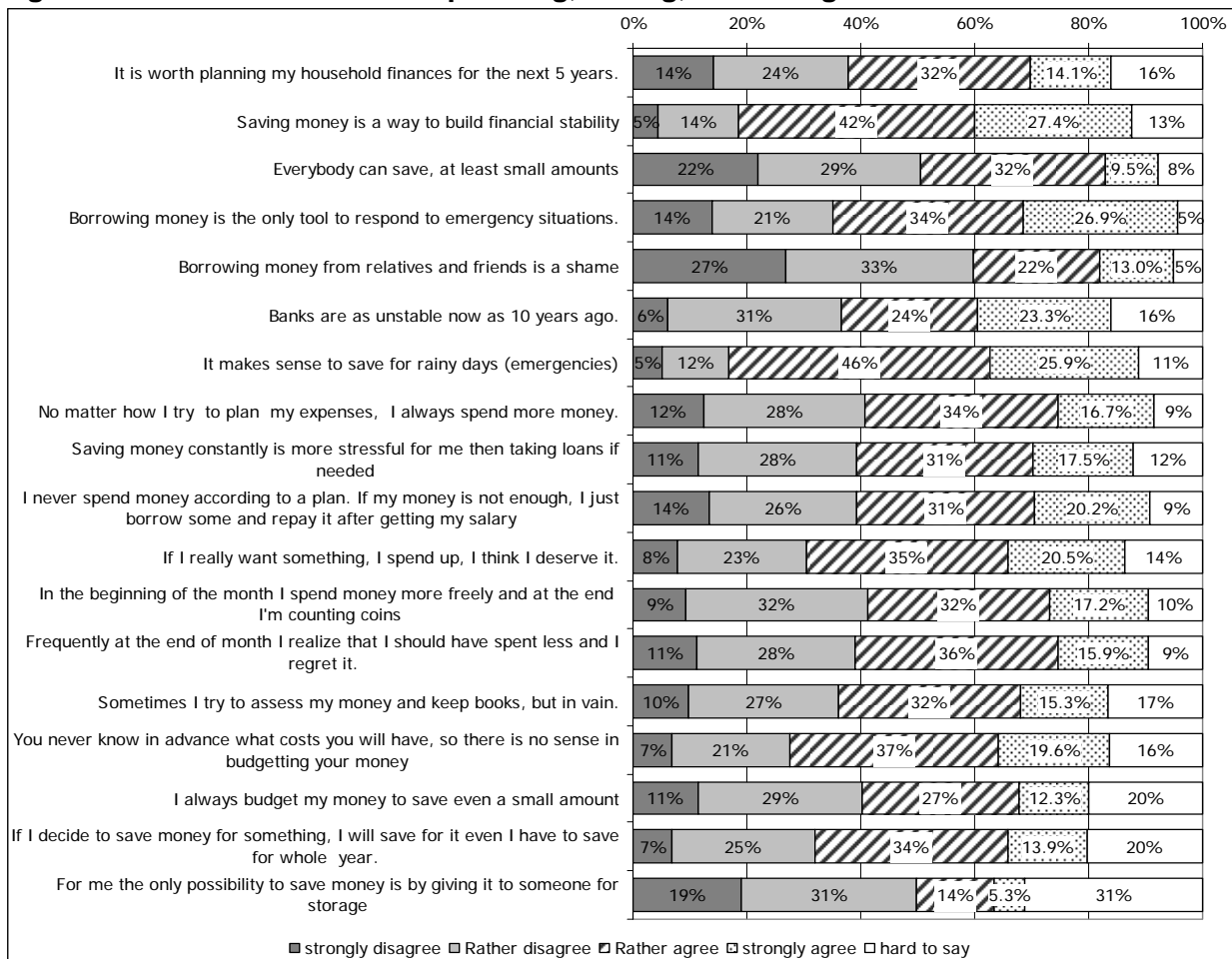
Average yearly savings for all households is USD 174. Low-income households manage to save USD 156, while households from the upper segment save USD 245 on average.

The majority of the population in Azerbaijan still do not use banks. In only 16% of households is there a person who has a bank account. Twenty-six percent of households in Baku have bank accounts, while only 6% of those in villages, and 1% in the western part of the country, report having active bank accounts. One-person households and those with a household head over 60 years (probably because of pension transfers) tend to have bank accounts more often. Azerbaijani people are still mistrustful of banks, but 67% of those surveyed have noticed improvements in the stability of the Azerbaijani banking sector in recent years. The qualitative research confirmed that the mistrust of banks is gradually waning. The research also revealed a purely psychological reason for not using bank accounts – the desire to keep the money close, or “under the pillow”, as one respondent put it.

**Figure 11: Savings behavior**



**Figure 12: Attitudes to financial planning, saving, borrowing and financial institutions**

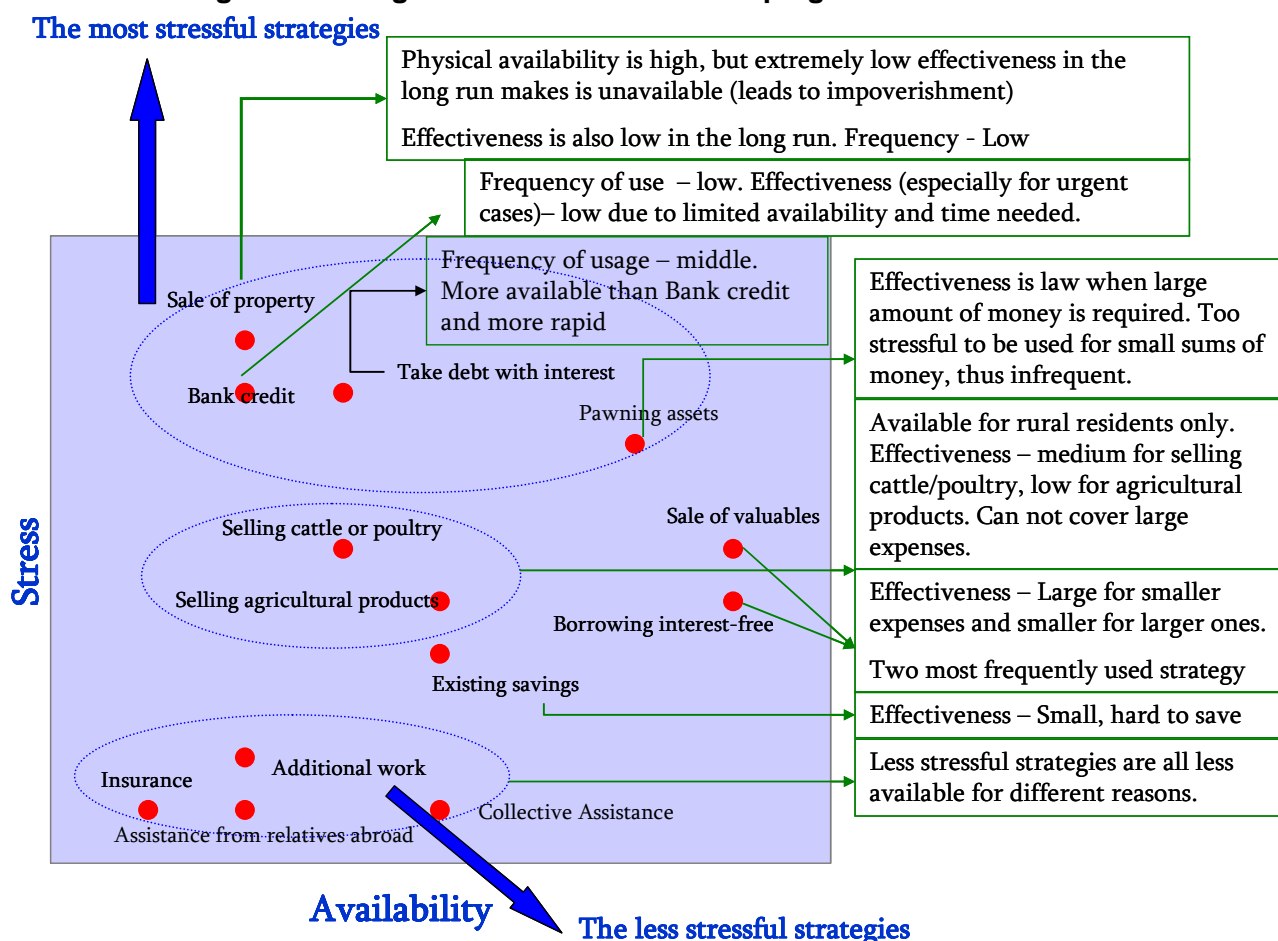


The most important formal source of credit identified in this research was credit unions – 7.1% of the Azerbaijani households had taken a loan from credit unions in the past three years compared to only 2.5% of households having taken a loan from a bank. The most popular form of credit is still borrowing from friends and family (27%) the least popular from private moneylenders (1.8%). Only 9.8% of all households and 8.5% of low-income households were repaying a loan at the time of being interviewed.<sup>22</sup> It is estimated that 6% of all households are over-indebted.<sup>23</sup>

### Gaps in risk-management strategies

Quantitative research shows that low-income Azerbaijani households do not use long-term strategies to deal with risks (Figure 12). According to qualitative results, the most popular coping strategies – sale of valuables and interest-free borrowing – are effective for small expenses only. Access to formal loans is very limited, and a credit decision requires significant time. Informal loans with interest are more accessible, but often collateral is required. There is a strong culture of collective support in Azerbaijani society, a positive influence on the living conditions of many Azerbaijani households. However, resources provided by community, friends and relatives are limited and may be helpful only for minor risks.

**Figure 13: Usage and stress related to coping mechanisms**



Low-income households are unprotected against more severe risks. Death, permanent disability of a family member (especially breadwinner), or serious health problems, represent the serious risks which low-income households are unable to manage. The mix of low stress

<sup>22</sup> These estimations should be taken with some caution as it seems as if respondents tend not to include in their calculations informal loans where terms of repayment may be not specified.

<sup>23</sup> A household is considered to be over-indebted when monthly repayments account for more than 25% of household income.

strategies does not provide sufficient funds for this, and available solutions have a devastating influence on future prospects for the family. Insurance products (life, disability and health insurance) may be the best strategies to deal with these severe risks.

## Insurance as experienced and perceived by low-income households

Analysis of usage of insurance and attitudes towards insurance helps us to understand opportunities and threats to the future provision of microinsurance services. As few low-income households have used insurance in Azerbaijan, the usage and attitude analysis was enriched by a test of four generic insurance concepts.<sup>24</sup> The test allowed respondents to get familiar with details of the main types of consumer insurance and thus express their views and willingness to buy it based on actual product information.

### Usage

Only the use of voluntary insurance services was analyzed. The study revealed that only 5% of households currently have any kind of insurance policy, and in total only 9% had any experience with insurance in the previous 15 years.<sup>25</sup> This penetration is much lower for the low-income market (Figure 13). Reasons for not using insurance are included in the attitude analysis below.

### Knowledge

Despite the low usage, awareness of insurance is high. Seventy-eight percent of respondents were able to mention spontaneously at least one type of insurance service (Figure 14).<sup>26</sup> The awareness of insurance is higher among highest-income people (84%).

The most recognized insurance product is vehicle property insurance (65%). Surprisingly, obligatory civil liability insurance against car accidents is practically unknown and practically never used.

Figure 14: Usage of any type of insurance

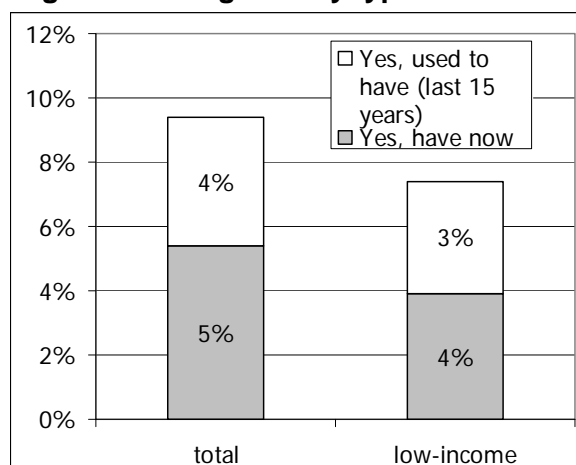
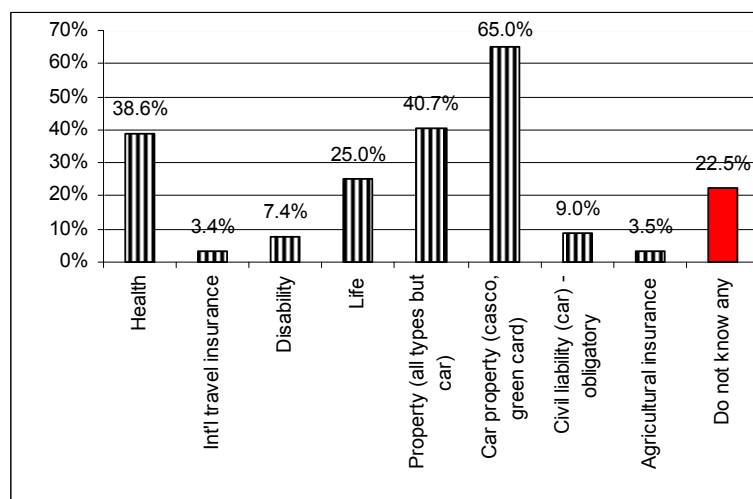


Figure 15: Knowledge of types of insurance



The qualitative study revealed that although the majority of respondents are familiar with the basic concept and types of insurance, few of them know the terms and conditions of insurance policies<sup>27</sup>. They consider the premiums they pay to be insignificant and wasted. The reason for this lies in the general distrust of insurance companies and their perceived inability and/or lack of goodwill to pay claims to the policyholder or beneficiary as agreed.

<sup>24</sup> Details of these concepts are provided in Appendix 4.

<sup>25</sup> It was only 7% in Georgia and 34% in Ukraine.

<sup>26</sup> In Georgia, it was 75% of the population; 85% in Romania, 95% in Ukraine.

<sup>27</sup> Respondents were referring here to the obligatory insurance they had – health, car or property



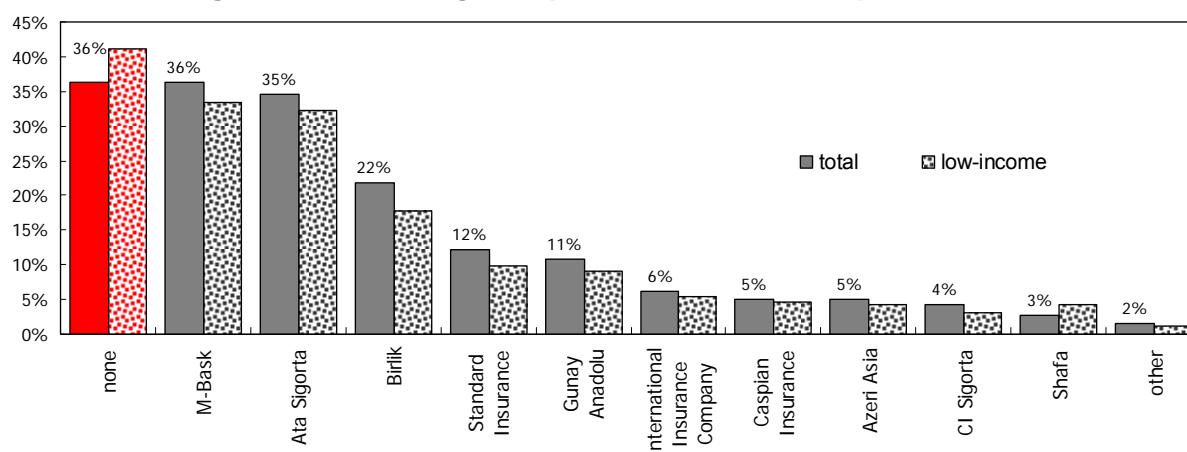
In spite of this, the respondents expressed a need for insurance but *only if the system was sound and reliable*. As mentioned earlier, interest in insurance has a rather passive character. Respondents do not search for information about insurance (as it is considered irrelevant, given their distrust), but are ready to listen carefully if such information is given to them.

The study found the use and knowledge of insurance was lowest among the following groups in Azerbaijan:

- Low-income households
- Those with no or low education
- People living in one-person households
- Those who live in rural areas
- Those living in the west of the country

However, despite the limited knowledge of insurance in general, 64% of respondents were able to mention by name at least one insurance company operating in Azerbaijan. Brand awareness is higher compared to Georgia but lower than in Romania and Ukraine<sup>28</sup>. There are no significant differences in awareness of specific brands by income level (Figure 15) although a higher percentage of low-income people do not know any insurer at all<sup>29</sup>.

**Figure 16: Knowledge of specific insurance companies**



### Attitudes towards insurance

Analyzing the reasons why people have not used insurance in the last 15 years provides useful insights into attitudes towards insurance. The most important factors in past non-use are lack of information about insurance, and lack of contact with insurance companies or agents (Table 6). Almost half of those that have never been insured do not know enough about insurance, and a third have never been approached by an insurer or agent.

**Table 6: Main reasons for not using insurance in the past**

	Total %*	Low-income %*
Did not have enough information	46%	50%
Did not know where to find insurance / nobody approached me	31%	35%
Insurance was too expensive for me	30%	30%
No trust in insurance – heard that insurers do not pay	29%	28%

<sup>28</sup> In Georgia, it was 56.4% of the population; in 68.3% in Ukraine, 77.5% in Romania.

<sup>29</sup> Note that Shafa is the Azerbaijan Republic State Medical Insurance Society Ltd. Also, there is no insurance company specifically registered as "Birlik" although this is most likely related to Gorgud Sigorta.

	Total %*	Low-income %*
No trust in insurance companies – they can go bankrupt or steal money	22%	21%
We can manage problems ourselves	18%	15%
Never heard of insurance	16%	19%
Heard it is a long / bureaucratic process to realize a claim	16%	14%
Current terms and conditions do not suit me	11%	10%
I think nothing serious will happen to my family	11%	10%
The insurance agents are too far from the place I live	6%	6%
I am not sure the insurance will work because of others' bad experiences	4%	3%
I do not have time to think about insurance	3%	3%
<i>* Percentage of households who mentioned the given reason. Responses exceed 100% as multiple responses were possible.</i>		

Lack of information leads to the perception that insurance is a luxury only for rich people. Interestingly, however, the highest-income layer of the population had very similar perceptions to the low-income layer. This indicates that the insurance market in Azerbaijan has not adjusted to the expectations or financial potential of many people, even in the upper market segments.

Lack of trust that insurers are secure and will pay claims is a major issue. This attitude seems to derive from negative experience from the past (collapse of the USSR) and present examples of malpractice (bribery, non-payment). Over 50% of respondents who have not obtained insurance said they did not do so because of distrust<sup>30</sup>. This is further supported by an analysis of general attitudes towards insurance (Figure 16) where 44% disagree with the statement: 'I trust insurers'.<sup>31</sup> The focus groups also revealed negative experiences among the low-income population, and raised many concerns regarding stability, honesty and transparency of insurers.

An interesting further factor is that low-income people differentiate their degree of trust of domestic and foreign insurance companies, tending to trust foreign companies more.

<sup>30</sup> There is a similarity with Ukraine, where 41.3% have not used insurance services due to lack of trust, and Georgia, where the figure is 36.2%.

<sup>31</sup> In Georgia 41.7% and in Ukraine 79% disagreed with this statement.

**Figure 17: Attitudes towards insurance**

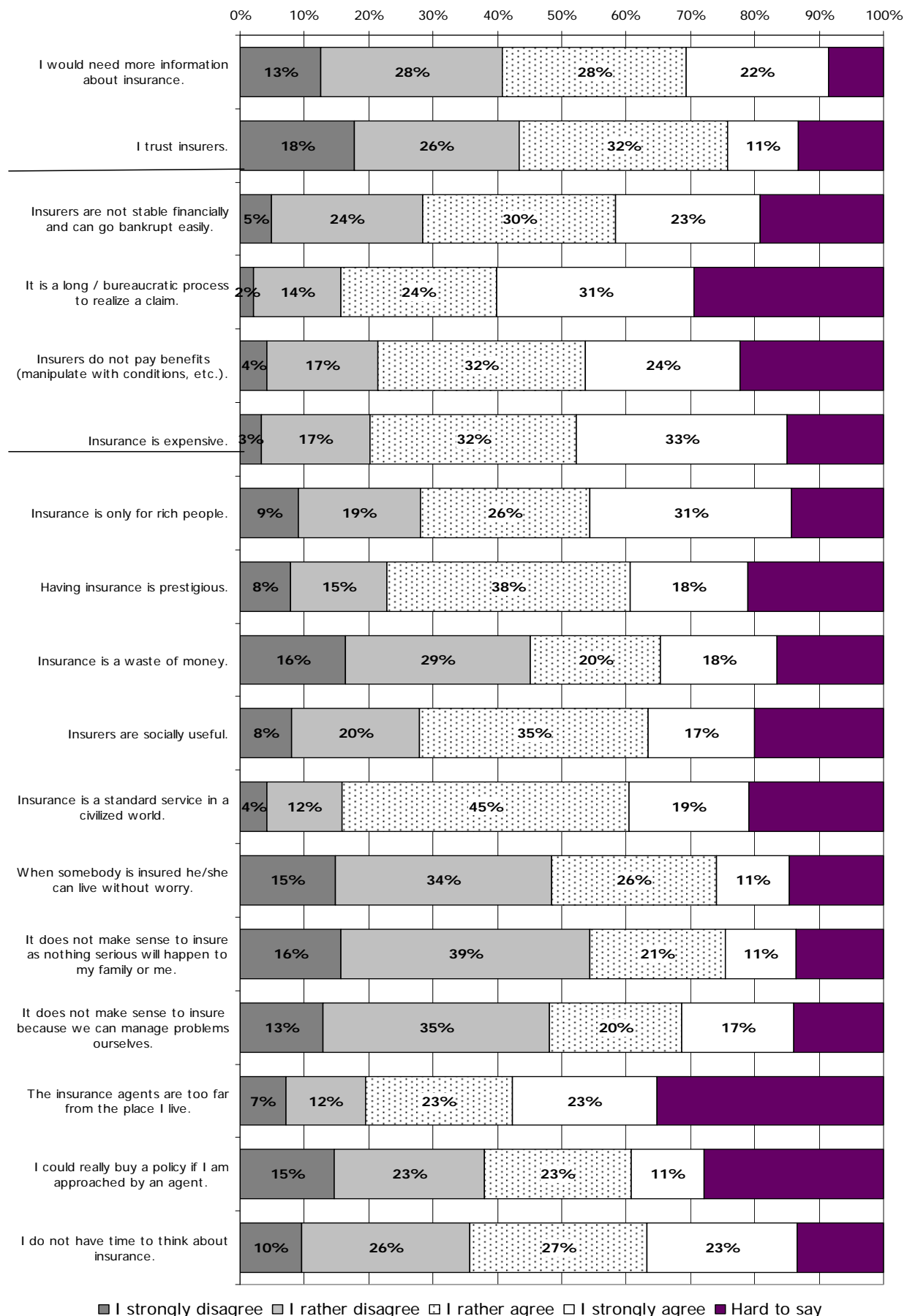


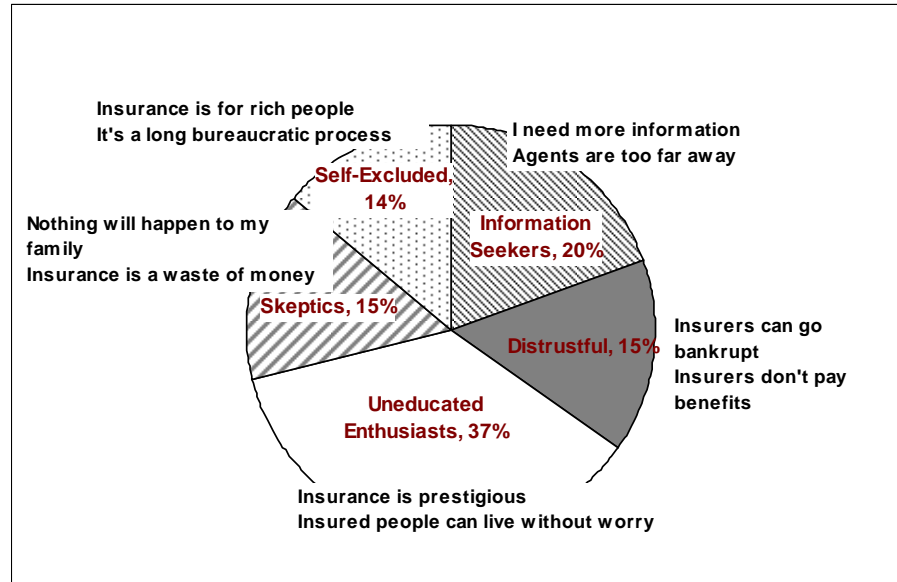
Figure 16 summarizes the general attitudes of the market towards insurance. Based on these statements, it is possible to divide the Azerbaijani population into five distinct attitude clusters: “uneducated enthusiasts”, “distrustful”, “skeptics”, “self-excluded” and “information seekers” (Figure 17). These groups are useful when thinking about accessing the Azerbaijan insurance market.

**Figure 18: Key market segments by attitude towards insurance**

“Uneducated enthusiasts” are the most clearly identifiable group – these are people with the lowest income, who live predominantly in rural areas with low levels of education but who find the concept of insurance very interesting.

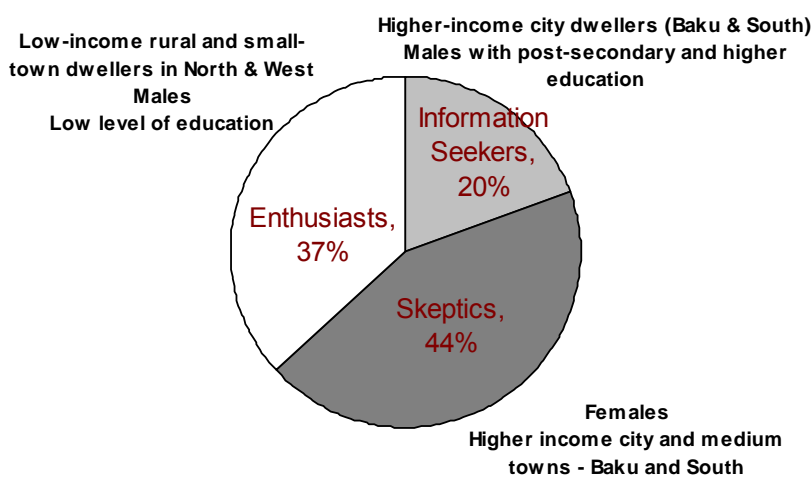
On the other end of the spectrum are the educated city dwellers, mainly from Baku, who have the highest income of all groups. They form part of the “information seekers” group, as they would like to have more information to form their opinions about insurance.

However, being highly educated and living predominantly in Baku, they are already much better informed than any other group.



The remaining three groups are negatively inclined towards insurance. For the “distrustful” this negativity results more from the knowledge of specific bad examples, while in case of “skeptics” and “self-excluded” the concept of insurance itself was dismissed. “Skeptics” believed that they did not need insurance, as nothing bad would happen to them, while the “self-excluded” did not believe that insurance could help them with their problems (too expensive, too difficult to realize the claim). Much of the negativity of these groups could be addressed through general market education about how insurance is useful, and also, as the insurance industry grows, through the demonstration effect of seeing claims paid on time and the benefits that this brings.

**Figure 19: Key market segments by attitude towards insurance**



Because social and demographic characteristics were not distinctive for any of the three “negative” segments (the skeptics, the distrustful, and the self-excluded), for the purpose of further analysis they were combined into one segment called “skeptics”. Women were more often represented in this segment than in any other. The combined skeptics group can be further characterized by

higher-income and predominance of city and medium-size town inhabitants in Baku and the south of Azerbaijan (Figure 18).

The “information seekers” group is the most promising for the growth of the insurance market. Although the smallest segment, this group has not formed a negative opinion about insurance. Respondents in this segment are educated and relatively better-off, and if exposed to proper promotional and educational activities, they have the highest potential to realize their needs once they are more aware of the possibilities.

“Uneducated enthusiasts” seem to be quite easy to reach as they already have positive opinion of insurance. However, being the lowest income group among all segments, they have the lowest purchasing power. Also, being relatively uneducated, they may quickly become disillusioned and withdraw after the first trial unless they clearly understand the concept of insurance and risk pooling.

The largest group in the market are the “skeptics”. They do not see the need for insurance, perceive insurance as a luxury only for rich people, and do not trust insurers. These stereotypes are a legacy of previous times combined with a general distrust of the formal financial sector. It might be difficult initially to reach out to “skeptics” as they reject the idea of insurance on general grounds and are cautious regarding the insurance companies. However, as they become more confident in insurance through the experiences of others, much of this group too is likely to become an effective part of the market.

### ***Expectations of insurance product attributes***

For the purpose of analysis, researchers presented respondents with four generic microinsurance products – health, disability, life with and without an investment component, and property (see product details in Appendix 4) – with a level of detail that allowed them to express their expectations towards specific attributes and declare willingness to purchase the product. The product concepts were kept intentionally general to evaluate attitudes towards insurance in general rather than satisfaction from specific products.<sup>32</sup>

Low-income respondents reacted positively to all the concepts presented but only after being assured that the insurance company was trustworthy. The issue of lack of confidence in formal institutions was discussed relative to each product. General comments regarding the types of insurance and their coverage were as follows:

- *Health* – the health product presented was very relevant given the problems with the public health system and the increasing unofficial costs of health care. Although the respondents were pleased with most of the insurance conditions, they saw the price as too high considering the need for insuring all household members. They were more interested in the option of creating a family insurance product.
- *Disability* – in the form presented, this product was considered to be only for those involved in high-risk activities. Many respondents did not consider themselves as a target group for such disability insurance. The ratio of premium payment to the benefit was found unattractive.
- *Life/life with investment plan* – the product concept raised questions about age limits of the insured. Generally respondents were of the opinion that life insurance is for old people or those who represent high-risk groups, so most respondents did not consider themselves as a target group for this product. The ratio of benefit payment to insurance premium was evaluated as fair, but the benefit of this particular product concept was

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<sup>32</sup> Satisfaction analysis showed that respondents liked the main attributes of the products, so their comments related to general concepts of insurance rather than to specific attributes.

seen as too low to cover the funeral expenses, normally estimated at over USD 3,000. There was a preference for life with investment plan due to limited understanding of the risk-pooling concept. Respondents saw more value in life insurance when it was accompanied by savings, although the monthly amount to be saved was considered too high by most of respondents.

- *Property* – this concept provoked the highest interest among respondents and spurred the longest discussion, partly because this concept was the most unfamiliar.

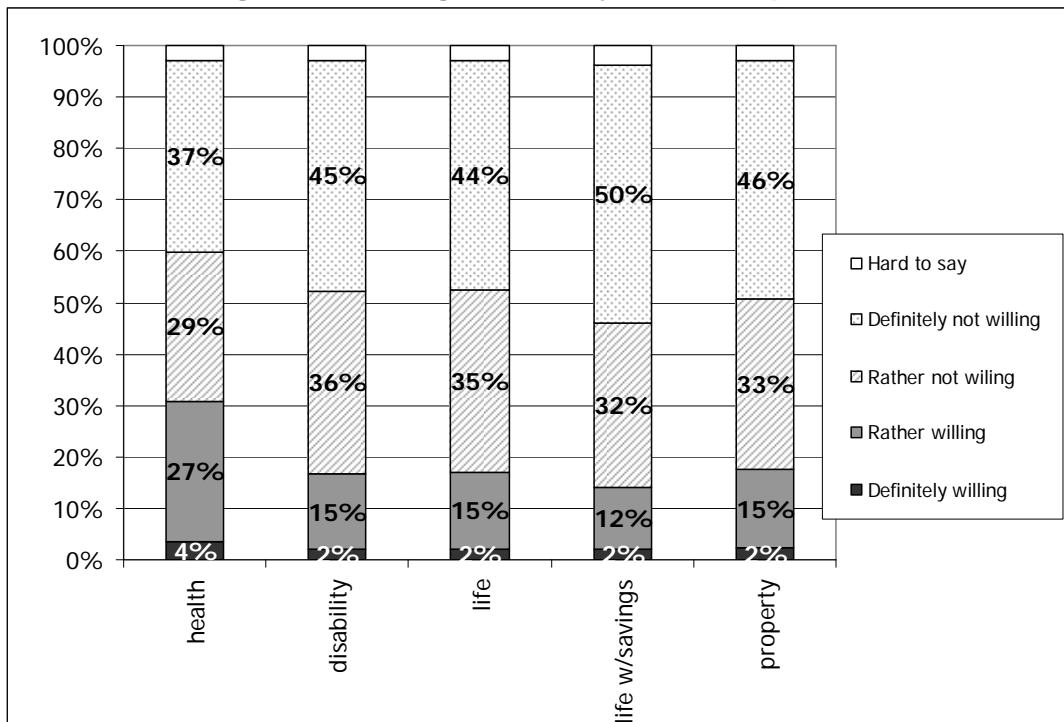
Apart from the coverage, the most important attributes of an insurance product are frequency of premium payment and security of the provider. Some general observations regarding low-income households’ expectations towards these attributes were as follows:

- *Frequency of payment* – monthly or advance payments were perceived positively for all products and was an acceptable condition.
- *Provider* – there is a strong preference towards foreign companies as people do not trust Azerbaijani companies because of corruption and ill-treatment of clients.

**Willingness to buy**

The willingness to buy an insurance product was much lower in Azerbaijan than in other countries in the region covered by this research series. Overall, 42% would consider buying at least one of the insurance concepts tested. Health insurance captured the interest of almost a third of respondents but interest in the other types of insurance tested did not exceed 20%. Life insurance with an investment plan was the least attractive among all tested concepts (Figure 19) because of the requirement for regular, fixed sum deposits to which the respondents are not accustomed, as few of them save regularly.

**Figure 20: Willingness to buy insurance products**

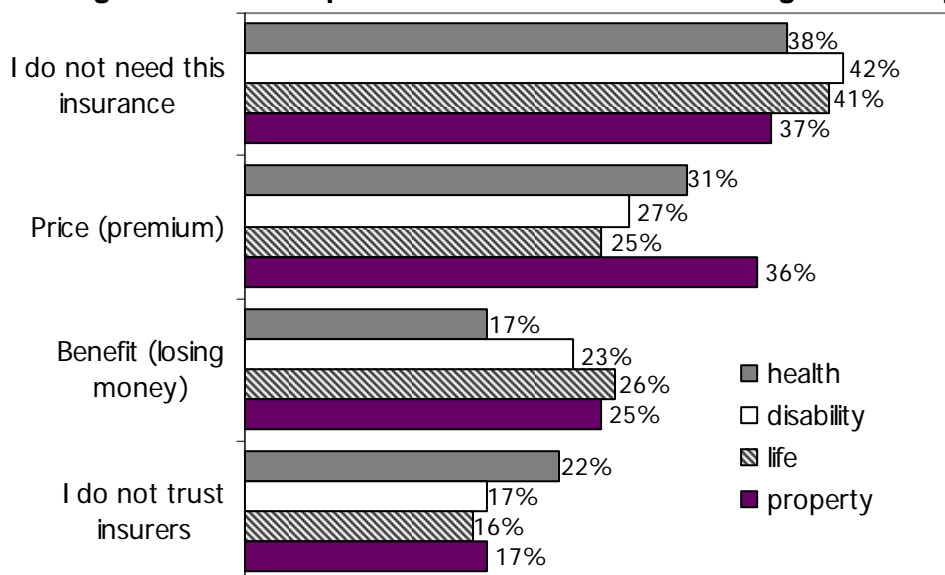


There was no difference in the interest in products among low-income people compared to the high-income segment.

Among those willing to buy, 70-80% expressed interest in more than one product. A separate analysis was conducted to establish if they could afford to buy more than one product in relation to their purchasing capacity. The decrease in willingness to buy was the highest for property insurance (decline by 26%) and the lowest for health insurance (15%).<sup>33</sup> This confirmed the priority of health insurance among the other types.

Figure 20 shows the most often cited reasons for the rejection of an insurance product broken down by products.

**Figure 21: Most important reasons for lack of willingness to buy**



Regarding the life insurance with investment plan product, 34% of respondents rejected it because they did not perceive a need for this type of insurance, 28% because they did not like the saving option (the savings requirement was seen as too high for monthly savings), 28% because of price, and 13% because they did not trust insurers.

The perceived poor value of the benefit was quite often cited as the reason against buying the insurance. This indicates low understanding of the pooling concept, a result of low financial education among Azerbaijanis in general. Similar results were obtained in Georgia (where 37% were not happy with the fact that money is not returned if nothing bad happens during the insurance period). In Romania and Ukraine, this fact was an obstacle in only 4% and 10% of cases, respectively.

The market for microinsurance in Azerbaijan is price sensitive (Table 7)<sup>34</sup>. Considering the incidence of price sensitive clients in the total population, we can conclude that if insurance premiums were decreased by 30% we would be able to add 4%-6% of households to those willing to buy microinsurance, depending on the product. Further price decreases would add another 4%-6%. Low-income people in particular are very price-sensitive. For instance, almost 7% of low-income population said they would only buy health insurance if the monthly fee did not exceed USD 1.

<sup>33</sup> In the product concept test, respondents were asked to analyze each product concept and their willingness to pay for it independently from other product concepts. People could declare their interest in several concepts. But after the capacity analysis they might realize that they could buy only one. That way, researchers were effectively able to get respondents to prioritize.

<sup>34</sup> Two-step price sensitivity testing was conducted. Firstly, those who were not willing to buy were asked if they would change their decisions if the premium were decreased by 30%. Secondly, those who were still not interested were asked what price, if any, they would pay for the product. Those who started hesitating at the first level were categorized as sensitive, and those who gave their own price (lower than 70% of original premium) were categorized as very sensitive.

There was greater price sensitivity among those living in small towns and villages, especially in the west of the country, as well as among low-income people, and in young households.

**Table 7: Price sensitivity**

	Health		Disability		Life		Property	
	Total	Among not willing	Total	Among not willing	Total	Among not willing	Total	Among not willing
Sensitive (to 30% decrease in price)	4.7%	7.1%	5.6%	7.0%	5.6%	7.0%	5.8%	6.7%
Very sensitive (give their own price lower than 70% of suggested price)	6.1%	9.2%	4.5%	5.6%	4.5%	5.7%	5.6%	7.0%
<i>Total of all sensitive</i>	<i>10.8%</i>		<i>10.1%</i>		<i>10.1%</i>		<i>11.4%</i>	



## Market development projections and strategies

As hardly anyone uses insurance in Azerbaijan, and as nobody uses microinsurance, it is impossible to project future microinsurance market development based on historical trends. The access frontier approach proposed by David Porteous (2005) is useful in projecting the market development for microinsurance<sup>35</sup>. To apply this method we divide the population into four segments, as explained in Table 8. Given that we are projecting products that are not yet on the market, the projections are based on attitude towards insurance, as discussed above, and willingness to buy, based on the product concept test. This combination allows for fairly accurate projections for each of the generic microinsurance products.

**Table 8: Access frontier methodology and its application in this study**

Segment	Description of the segment	How defined in our study
Natural limit	The group of households who either are not eligible for insurance schemes or objectively do not need insurance. <sup>36</sup>	<ul style="list-style-type: none"> <li>• (health/disability/life): age above 65</li> <li>• (health/disability/life): household head is disabled and/or suffers from serious illness</li> <li>• (life): 1-member households (having no close family)</li> <li>• (property): not possessing new assets<sup>37</sup></li> </ul>
Supra-market	The group of households who may wish to buy microinsurance but are unable to, mostly due to lack of surplus income.	<ul style="list-style-type: none"> <li>• Below household monthly income per capita at the level of USD 21 (severe poverty line)</li> <li>• Willing to buy but cannot pay for any selected insurance concepts</li> </ul>
Within access frontier in the future	The group of households who are likely to access the suggested microinsurance product concepts if terms and conditions were more adapted to them. They are reluctant to buy now due to limited knowledge, skepticism, or dissatisfaction with some product features, etc.	The rest of the market
Within access frontier now	The percentage of households who can and wish to access the suggested microinsurance product concepts on current terms and conditions.	Those who are willing to buy suggested microinsurance products and are enthusiastic about insurance in general <sup>38</sup>

<sup>35</sup> As explained by David Porteous (2005): "The access frontier approach enables greater understanding of market development over time from the perspective of who is, and who will be, served by the market over time. The access frontier defines the maximum proportion of the eligible population who use the product under existing conditions. This frontier is likely to shift over time. Considering where it will move in the short to medium term (to the future access frontier) is an important part of assessing the capacity of market solutions to extend access. There is still a group of people who, largely because of poverty, the market will be unable to touch in the foreseeable future ('the supra-market group'). For this group, the state may decide to supply the service directly or regulate existing institutions to provide it (i.e. forced cross subsidy). The access frontier approach distinguishes three zones in a market based on where usage and the current and future access frontiers are: a market enablement zone, a market development zone and a market redistribution zone. The test of policies in the redistribution zone is whether they encourage or limit the outward movement of the access frontier so that more can be served through markets over time, so that state subsidy can be directed at those most needy."

<sup>36</sup> In more mature markets this group also includes those who declare that they do not need insurance and will not buy it in the short term. In the case of microinsurance in Romania it is hard to distinguish whether people's stated preferences come from their low financial education and poor knowledge of insurance benefits or from an informed choice of not buying insurance.

<sup>37</sup> Excluded (natural limit) are only those who do not have a new asset and reject the property insurance because of no need.

<sup>38</sup> Based on segmentation presented in section 5.3.

### Market development projections

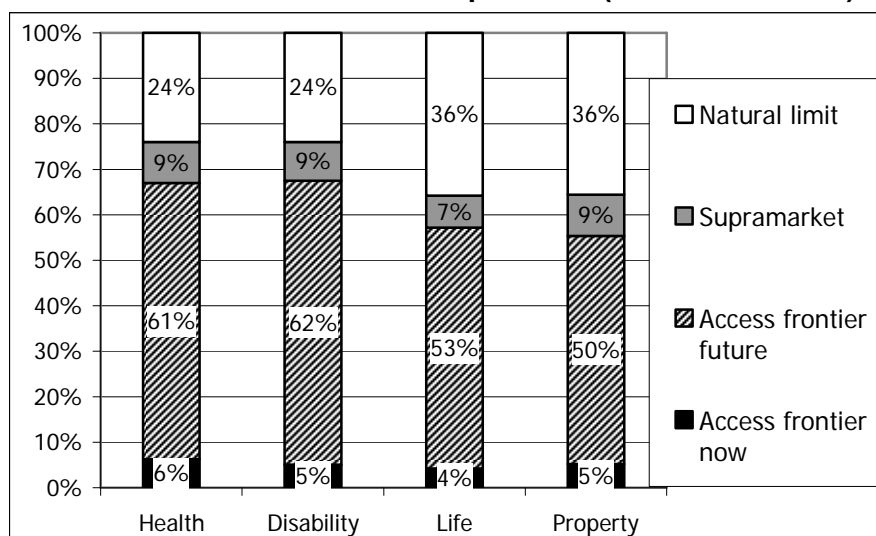
The access frontier approach identifies three zones within a market (Figure 21):

**Market enablement zone** – this is a group that can be reached now (they are “within the access frontier now”) and easy to cover with new microinsurance products that are demanded by these enthusiastic consumers. In Azerbaijan this group varies from 4% of the population for life insurance to 6% for health insurance. These figures are lower than those for Georgia, Romania and Ukraine.

**Market development zone** – this is a group “within the access frontier in the future” that might be covered if the new products are well-adapted, effective marketing strategies are in place, and there is an enabling environment. In Georgia, Romania and Ukraine this was the biggest group, and in Azerbaijan the share of the market development zone is especially high, reflecting the immaturity of the insurance market. It varies from 50% for property insurance to 61% for health insurance.

**Market redistribution zone** – this is a group defined as the “supra-market”. It is generally left for the government to extend an adequate safety net and provide affordable risk-management tools for this group. Typically the supra-market group is not insurable with microinsurance. This group is substantial in Azerbaijan and varies from 7% to 9%.

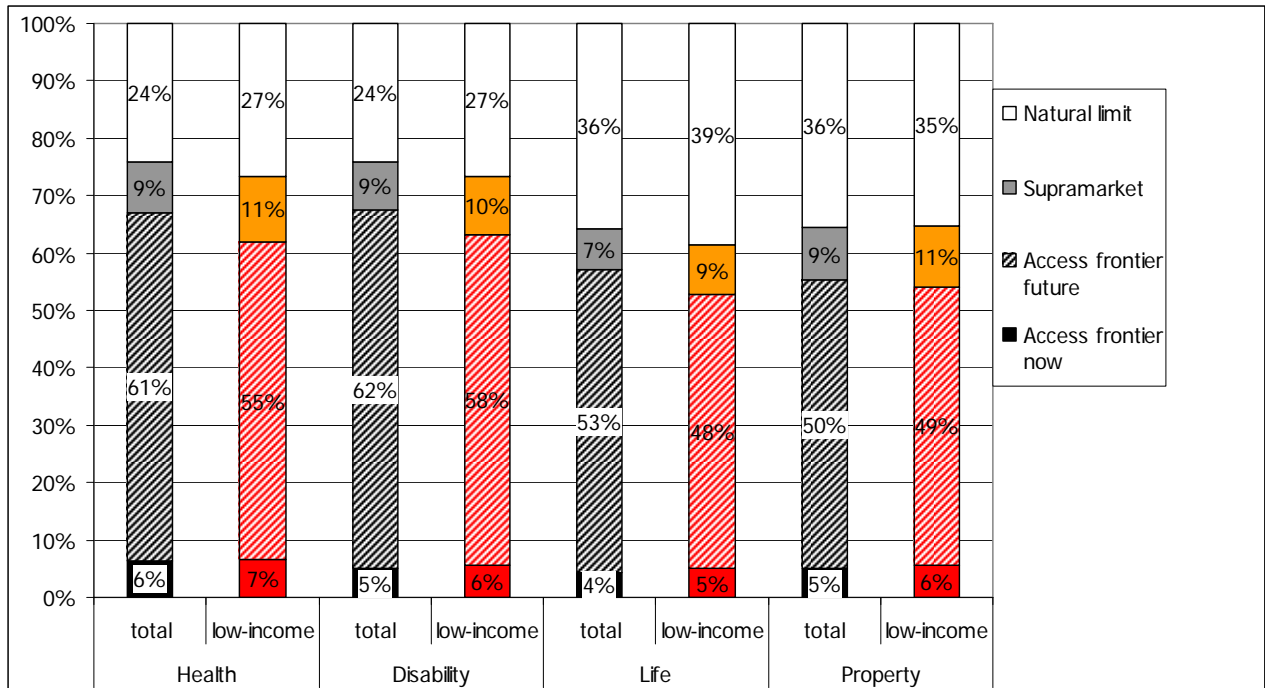
**Figure 22: Market development projections for different microinsurance products (% of households)**



If only the low-income market is considered, the market enablement zone is slightly bigger, and the market development zone slightly smaller. This is due to the fact that low-income people in Azerbaijan tend to be more enthusiastic about the microinsurance concept. Despite their limited resources, a higher share of low-income people is ready to purchase microinsurance based on the insurance concepts tested in the research (Figure 22). These results reflect the qualitative research findings that the product concepts were generally perceived positively by low-income people and those people expressed a willingness to spend from USD 2 to USD 10 per month to purchase microinsurance.

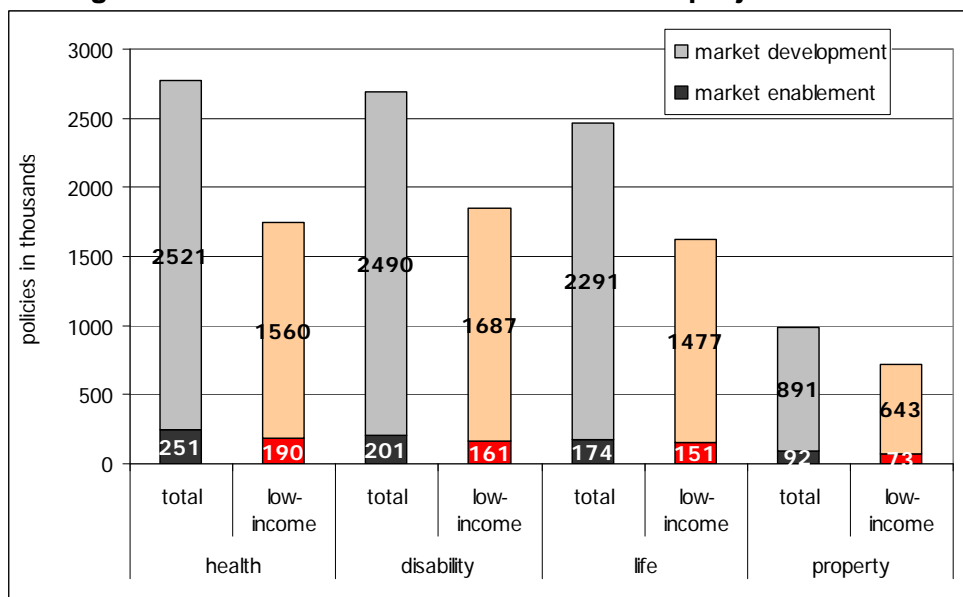
Combining the *market enablement* and *market development* zones gives an idea how many low-income people are eligible and can afford private microinsurance services and therefore can benefit from better risk-management tools.

**Figure 23: Market development projections for different microinsurance products (% of households) for total and low-income population**



In total, the market to be tapped (both *enablement* and *development* zones) is more than 2.7 million for health, 2.6 million for disability insurance policies, 2.4 million for life insurance policies, and almost 1 million for property insurance policies. The volume of the “easier-to-reach” market (*market enablement* zone) under current circumstances is approximately 242,000 policies for the health insurance product, 238,000 policies for the disability insurance, 191,000 policies for the life insurance, and 96,000 for property insurance policies<sup>39</sup>. The market potential is shown in Figure 23. Based on these findings, microinsurance represents an obvious business opportunity.

**Figure 24: Total and low-income market size projections**



<sup>39</sup> This is calculated taking into account the number of households, percentage of households in the group – access frontier now, and average number of policies willing to buy

### Strategies to tap the low-income market

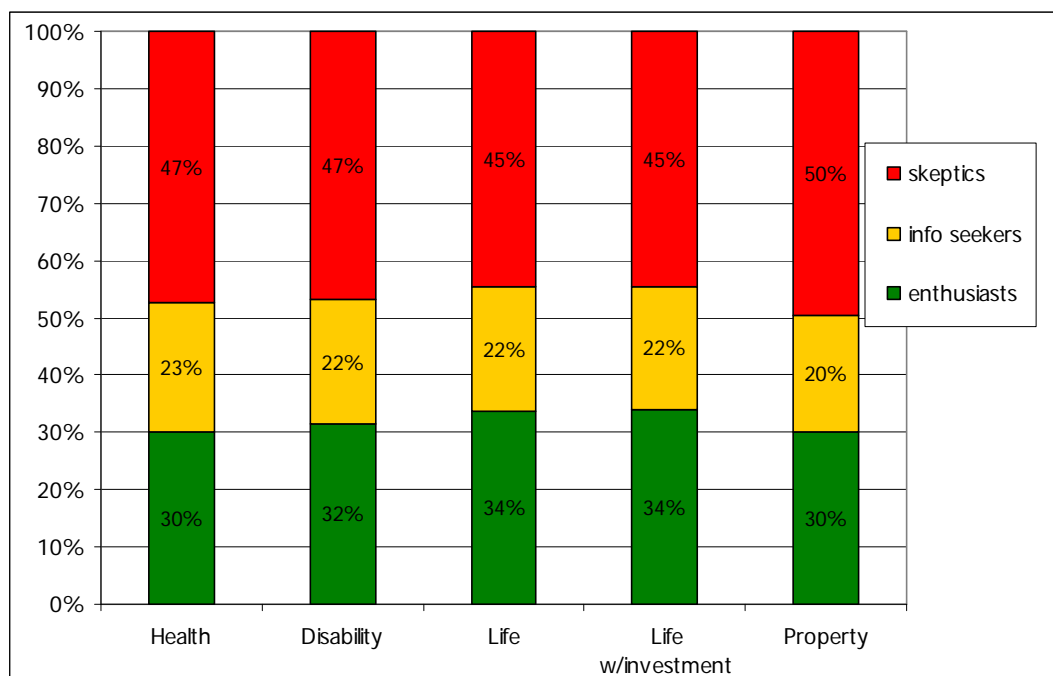
Because a microinsurance market hardly exists in Azerbaijan, only some general future directions can be envisaged. For this purpose it is useful to consider the segmentation of the Azerbaijan population by attitude towards insurance, as discussed above, into three distinct segments. This analysis can help us determine outreach and marketing strategies to be used to deliver microinsurance to low-income populations in Azerbaijan.

As was found for other countries studied in this series for Kreditanstalt für Wiederaufbau (KfW), that the *market enablement* zone in Azerbaijan is much smaller than the *market development* zone. However, given the generally low income levels in the country, both these zones capture the majority of low-income households. The socio-demographic structure of the market enablement zone (“within access frontier now”) is very different from that of Romania or Ukraine – people enthusiastic about insurance in Azerbaijan have lower education, earn lower income and reside more in rural areas.

As Figure 23 shows, it would be hard to tap into the low-income market by only penetrating the *market enablement* zone. Most of the low-income market will need to be developed. Figure 24 shows that there is a significant share of “enthusiasts”, much higher than in the other countries. However, it is important to remember that this enthusiasm stems from having no previous experience and little knowledge about insurance, so a concerted educational component will be required.

The remaining part of the *market development* zone includes “skeptics” and “information seekers”. Penetrating the “information seekers” segment would be the most promising strategy to tap the low-income market because of this group’s high level of education and higher standard of living in Baku, where most of them reside. Such a strategy will allow access to more than half of the low-income market in Azerbaijan.<sup>40</sup>

**Figure 25: Structure of market development zone by attitude towards insurance**



The challenges that remain are the general distrust in insurance among the Azerbaijani population and a large segment of “skeptics” in the market development zone. Apart from

<sup>40</sup> The next step would be to encourage the low-income “skeptics” that insurance makes sense, but this is a much more difficult task. It will be made easier once there is a significant demonstration effect to improve the confidence of this segment of the market.

adapted new products, there is a clear need for an education component on the uses and benefits of insurance, in order to successfully market microinsurance products to the “skeptics” segment. Marketing strategies should address the most common stereotype that “insurance is only for the rich”. In addition, low-cost delivery channels need to be set up, as these are crucial for bringing affordable services to the target group.

### ***Demand conclusions***

Despite recent declines in poverty, three-fourths of the Azerbaijani population can be classified as living on a low income, that is not sufficient for normal functioning in society. Poverty and vulnerability are higher in urban areas than in rural areas. Many of these people could be termed the “working poor”, since formal employment does not necessarily reduce the risk of poverty. Remittances from family members working abroad and from self-employment activities are important additional income sources for many low-income households. Their high vulnerability is also a legacy of the conflict with Armenia in the early 1990s. Refugees and internally displaced persons make up 10% of the population.

The road out of poverty for low-income households in Azerbaijan is hard and unpredictable. Crises such as serious illnesses, unexpected death of a family member, loss of a job, or an accident leading to disability, put a significant financial pressure on low-income households. There are high costs associated with these risks and a very limited range of available, reliable and sufficient coping mechanisms. A strong informal borrowing culture, which means borrowing mostly without interest from family and friends, supports low-income households, but only in dealing with less severe risks (such as less serious illness).

In general, Azerbaijanis do not prepare for risks at all, and have reactive attitudes and behaviors towards managing risks. Less than 1% of low-income households declare any kind of regular saving. The current risk-management strategies are precarious, and there is much over-indebtedness. Over 70% of low-income households which admit to currently repaying a loan, have borrowed beyond their capacities.

Low-income households need to increase their risk-management capacities, and microinsurance is one option that can help them. The products that could add significant value in reducing vulnerability are: health insurance (against serious health problems needing an emergency service and surgery) and life/disability insurance (against death and permanent disability). According to the estimates of this research, out of 1.32 million low-income households in Azerbaijan, approximately 61% can benefit from private microinsurance services<sup>41</sup>. This is a considerable number.

The total market for microinsurance in Azerbaijan is sizeable. Depending on the product, low-income households form approximately 60%-75% of the total insurance market, as measured by the maximum number of covered lives that could theoretically be issued. The theoretical maximum is 1.75 million covered lives for health, 1.85 million for disability, 1.63 million for life, and 0.72 million policies for property insurance.

Microfinance experts in Azerbaijan believe that the current potential market for microcredit is estimated at about 350,000 loans, covering the same number of households. Insurance is a product that expands through the household, typically reaching more of the family than simply the head of the household. For example, with health insurance, everyone in the house can be covered. This ability of microinsurance to cover several lives within one household, as well as covering people who do not need or do not have access to loans, confirms the potential for substantial numbers of covered lives.

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<sup>41</sup> Approximately, 9% cannot afford it, and 30% do not fulfill basic requirements (age, health condition, etc.). The low incidence of those who cannot afford it can be attributed to the fact that low-income households are aware that current risk-management strategies are costly for them and microinsurance is a less expensive option. That is why in the supra-market group there are only those who live in extreme poverty and often they are excluded from the cash economy.

However, this research indicates that the market, which is within access now, is only 5% of the total market. The rest of the market needs to be developed. Considering the entire market (without segmentation by income level) there are three key groupings in the market development zone. Thirty-two percent are “uneducated enthusiasts”, who are uneducated rural and small town dwellers. Twenty-two percent are “information seekers”, who are educated, live in big cities and have relatively more disposable income. As many as 44% of this market are “skeptics”. One-third of them do not believe in the insurance concept, another one-third do not trust insurers, and the rest are strongly persuaded that insurance is not for them.

In these circumstances, developing the market is a challenging task. Those who are least educated about insurance are the most enthusiastic. This is both an opportunity and a threat. It increases the likelihood of success in rural areas and in small towns, but it does not guarantee long-term relationships, as many “enthusiasts” do not understand the risk-pooling concept.

“Information seekers” seem to be an attractive segment. It is always easier to deliver products in big cities; and information transfer to educated consumers is not costly. The limitation here is that one-third of “information seekers” are not low-income, and therefore potentially a target group for regular insurance services.

In order to develop the microinsurance sector, a mix of strategies to penetrate all three segments (“uneducated enthusiasts”, “information seekers” and “skeptics”) is necessary. Apart from developing new microinsurance products adapted to low-income market expectations, the outreach strategy should incorporate four other components:

- General financial education, which encourages people to be more proactive in managing risks
- Education in microinsurance, focusing on building knowledge of the risk-pooling concept and showing the benefits of insurance
- Marketing strategies emphasize satisfying real needs
- Low-cost delivery channels, allowing delivery of services affordable to the target groups, especially those living in rural areas and small towns.

## Supplying microinsurance in Azerbaijan

In order to have successful microinsurance products offered and delivered, there must be an effective supply chain coupled with market demand. The supply chain in this case includes:

- Donors, because of their role in capacity building and potentially in research and development
- The insurance supervisor who, with the aid of regulation, facilitates the legal environment for microinsurance
- Insurers themselves, who manage the insurance risk
- Delivery channels that have efficient access to the low income market – potentially a range of organizations from MFIs, to community based organizations (CBOs), to retailers, to the Post Office
- Finally, the market itself, which must demand the risk management benefits of microinsurance.

The interest in microinsurance of each of the supply chain components is outlined in Figure 25. This figure also identifies key issues in understanding their potential involvement, current deficiencies and requirements.

**Figure 26: The microinsurance supply chain in Azerbaijan**

	(Donors)	Supervisor	Regulated insurers	Delivery channels	Market
MI interest	<ul style="list-style-type: none"> <li>•EBRD very interested in MI</li> <li>• World Bank with CU project</li> <li>•GTZ +/-</li> <li>•IFAD</li> <li>•USAID</li> <li>ACDI/VOCA</li> </ul>	<ul style="list-style-type: none"> <li>•“We need to provide insurance to the poor people”</li> <li>•“This is an important initiative”</li> </ul>	<ul style="list-style-type: none"> <li>•Mostly no interest</li> <li>•Bashak Inam is very interested and being pushed by owners Bashak (Turkey) and Groupama (France)</li> <li>•Themes Sigorta has a small program with FINCA (several problems and stalled)</li> </ul>	<ul style="list-style-type: none"> <li>•MFIs very interested (not MFBA)</li> <li>•UniBank very interested if a business case</li> <li>•MFI &amp; credit union groups very interested</li> </ul>	<ul style="list-style-type: none"> <li>•Significant demand if product, education, &amp; trust issues addressed</li> </ul>
Issues	<ul style="list-style-type: none"> <li>•EBRD could invest as low as 0.5-1m</li> <li>•ACDI/VOCA TA integrated training</li> <li>•Possibly IFAD coordinating with their planned MI</li> </ul>	<ul style="list-style-type: none"> <li>•Needs to build trust in market</li> <li>•Would like an insurance protection fund</li> <li>•Capacity building needed in MI</li> </ul>	<ul style="list-style-type: none"> <li>•No training centre</li> <li>•One to two potential partners could provide demonstration effect</li> <li>•Possibly volume management issues</li> </ul>	<ul style="list-style-type: none"> <li>•Health care system difficult</li> <li>•Need to develop efficient MI systems with insurers</li> <li>•FINCA example shows need to implement global lessons</li> </ul>	<ul style="list-style-type: none"> <li>•Need strong market ed., responsive products, &amp; insurers consistently paying claims without problems</li> </ul>

### **Current and potential suppliers of microinsurance in Azerbaijan**

#### *1.1.1. Government*

As noted in Section 3.3, thus far government efforts have been limited in effectiveness. The mandatory health insurance program funded from employees’ wages has seen only limited

success. The relatively new general social protection program, providing a small monthly stipend to very low-income people is still too new to assess. Major efforts are underway to dramatically improve the state of healthcare outside Baku. This has the potential to help create a better-structured environment for health microinsurance to succeed, should it be introduced.

The significant issue is what happens in the near future. With major government revenues expected over at least the next ten years, the big questions are: How will the government address the risk management issues of low-income people and, how effective will its social programs be? There is much potential for government intervention in the short to medium term. An appropriate approach would be to segment the market in such a way that government focuses on the truly destitute, while the commercial sector provides appropriate products that sufficiently cover those who can pay for microinsurance.

#### 1.1.2. *Specialised microinsurers (regulated)*

Currently, Azerbaijan has no specialised regulated microinsurer. There was no indication of plans for any such company.

#### 1.1.3. *Formal insurers moving downmarket*

Most insurers were found to have little to no interest in the low-income market. They saw significant opportunity in the middle and upper markets, and were entrenched in erroneous stereotypes about the micro-market. Thames Insurance had attempted microinsurance through FINCA, but its product was ill-designed for this market.

Though not yet actively in this market, Basak Inam has shown significant interest in the low-income market, and especially in the rural areas. The interest comes from the company's (49%) owner in Turkey, Basak Sigorta, <sup>42</sup> said to be the largest agriculture insurer in Turkey. Basak Sigorta is owned (57%) by Groupama, one of the largest mutual insurance companies in France, which also has its roots in agriculture insurance.<sup>43</sup> Basak Inam plans to begin the process of moving downmarket during 2007.

#### 1.1.4. *NGOs (unregulated)*

No microinsurance risk is currently being taken by any unregulated non-governmental organization (NGO). MFP NGOs are sending clients to insurers to provide collateral and credit life products, but there are few direct links between the MFP and the insurer. FINCA and the credit union's CIA have offered voluntary and mandatory insurance, respectively, to their clients. Although current MFP volumes are limited, there is interest from insurers in working with them, given MFP plans for growth.

Several MFPs are interested in offering appropriate microinsurance products to their clients and would work with insurers.

#### 1.1.5. *Credit unions*

Credit unions in Azerbaijan continue to be extremely weak, and by law they cannot collect deposits from members. Even if the laws were changed to allow deposit taking, the credit union association suggests that only five of the current credit unions would have the capacity to manage that level of business. Certainly there is no intention, even in the short to medium term, for credit unions to take on insurance risk.

Much effort is currently being made to increase the capacity of credit unions, by the World Bank and others. It is possible that with specific capacity, the better credit unions might offer

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<sup>42</sup> Some basic information on Basak Inam is provided in Appendix 5.

<sup>43</sup> Some basic information on Groupama is provided in Appendix 6.



insurance as agents. Potentially, they could provide an important conduit to the low-income market in rural areas for an insurance company offering appropriate microinsurance.

#### *1.1.6. Other suppliers*

There were no other suppliers of microinsurance products identified during this research.

#### *1.1.7. Institutional capacity potential*

On all levels of the supply chain, save possibly the donors, there is a need for significant institutional capacity building in Azerbaijan.

The supervision department will need to better understand the risk structure of microinsurance, the requirements for simple policies with few exclusions, the marketing approach for microinsurance, and the use of non-traditional institutional agents.

Insurers will need assistance in developing appropriate insurance products, identifying and effectively working with intermediary organizations, and pricing for this market. Insurers may also require significant input in terms of hardware and software in order to manage high volumes of microinsurance policyholders. They will most likely also require the physical infrastructure of branches, since the potential delivery channels generally have limited numbers of staff and there will be a need for the insurers themselves to be closer to the markets.

Delivery channels beyond MFPs will have to be identified, and all delivery channels will need assistance in developing efficient sales and delivery methods.

There is certainly a good basic capacity as well as enough interest throughout the chain to bring up the capacity for microinsurance in Azerbaijan. The most significant issue will probably be the delivery channels. The volume of clients with MFPs is limited and thus other delivery channels will need to be identified and equipped for effective microinsurance delivery.

#### ***What is the anticipated market evolution?***

Typically, in developing and emerging countries, insurers saturate the upper market and then compete against each other for pieces of that market. After this happens, one or more of the insurers begin to recognize the potential of the low-income markets, and this begins the move into the area of microinsurance. In Azerbaijan, however, insurers have barely made a dent in the upper market and still see much potential there. This suggests that without intervention, microinsurance growth will remain limited in the short term and possibly the medium term as well.

## The Legal and Regulatory Environment

The legal and regulatory environment for insurance is governed by the Law of Azerbaijan Republic on Insurance. This law was developed after Azerbaijan's independence from the USSR. It has generally been found to be unsatisfactory, but a new law has been drafted and is making its way through the legislative process.

Key issues in the law related to microinsurance include:

- Agents do not need to be registered and institutional agents are legal. This helps microinsurance because of the need to use non-traditional agents and institutions. The new law will provide for the licensing of agents, but institutional agents are expected to be acceptable.
- The current law offers only five-year licensing of insurance companies, and insurance companies say that this hinders their incentive to sell life insurance. The new law will offer an initial five-year license, but the subsequent license will not be time bound.
- Composite insurance companies (which are the only form of registration under the current law) facilitate microinsurance, because it is more efficient for one insurer to be able to sell the full range of products. The new law will require separate licenses for life and non-life companies.
- The current law is focused more towards a command economy while the new law is much more in line with international standards.

The new draft insurance law was developed with assistance from the World Bank and the European Bank for Reconstruction and Development (EBRD). A separate Council of Insurers was formed by the Finance Ministry to provide input into the process, with seven insurance companies represented. Several of the insurers interviewed commented that the draft law helps bring Azerbaijan insurance law closer to international standards, which will be important as the country works to gain World Trade Organization membership (currently it has observer status). This is seen as positive, and insurers have few problems with the draft law. That said it is clear that some of the smaller insurers will have some difficulty, especially in relation to the minimum capital requirements. Overall, however, the new law is likely to improve the efficiency of the insurance industry.

The legal frameworks for MFIs, credit unions, and banks all allow the sale of insurance products, but not for the absorption of insurance risk by these entities. This precludes them from direct insuring and suggests the need for a partner-agent approach. A microfinance law is also making its way through the legislative process, which is expected to uphold the ability of MFIs to act as agents but not as insurers.

## **Developing a microinsurance sector in Azerbaijan**

### ***Donor coordination and stakeholder education***

Currently several donors are involved in insurance, although primarily in the areas of legislation and supervisory capacity building. Among those involved:

- The World Bank is focusing on capacity building at the supervisory level and through a Canadian firm, helping to revise the insurance law
- The FIRST Initiative is implementing a one-year program, which started in June 2006. Their role has been to work with the supervisor on general insurance law, secondary insurance laws and rules, the law for compulsory insurance, capacity building on supervisory pillars, insurer financial assessment tools, and early warning ratios
- EBRD already has an investment in one of the insurance companies, and is expected to be involved in the upgrading of M-BASK.
- USAID through ACDI/VOCA is providing: capacity building for the new (2007) insurance association as well as MFI and credit union associations, a basic actuarial course for supervisory staff.
- IFAD has just approved a new grant that will potentially provide limited technical assistance to the microinsurance product-development process between an insurer and delivery channel.

There is significant interest from EBRD to make microinsurance investments in Azerbaijan. The ACDI/VOCA program (although insurance is not among its core objectives) could play a stronger role in microinsurance, if this were demanded by their partners, as they are committed to capacity building. Deutsche Gesellschaft für Technische Zusammenarbeit GmbH (GTZ) has limited interest, as microinsurance does not fit within its current priorities.

Given that microinsurance will grow slowly without significant intervention, there is a significant opportunity here for donors to get the process started. The market research and supply side research conducted for this study represent important first steps in the research and development of microinsurance. What is needed now is a focus on one or two insurers that have shown an active interest in this market, to build their capacity to enter the low-income market – both their own institutional capacity and delivery channel capacity.

### ***Creating demonstration models***

Demonstration models have proven to be extremely helpful with microinsurance throughout the world. Insurers are reluctant to move into new markets unless they are sure of success, so working with a first mover insurer has been an effective strategy. This is a way of making sure that the products offered have the best potential for success; that the institution itself is well equipped to offer and manage microinsurance products. Developing demonstration models can be done through “greenfielding”, as was the case with Microcare Uganda – a fully registered insurance company focusing on the microinsurance market. Alternatively it can be done by helping an existing insurer, which has shown an active interest in microinsurance, to move downmarket, as was done with AIG-TATA in India.

#### ***1.1.8. Supporting new entrants***

With 29 insurance companies already operating in Azerbaijan, it is difficult to make an argument that another one should be added to focus on microinsurance. Given the relatively low population of Azerbaijan, it is likely that profitability will come only through accessing a

range of markets, rather than having the microinsurance market as the sole focus. Thus, supporting new entrants to simply provide microinsurance is not likely to result in a resoundingly positive experience that will act as a driver for other insurers.

#### *1.1.9. Supporting current insurers*

Although the choices of current insurers to lead a demonstration model is limited – with only Basak Inam, and possibly Thames, being likely candidates – this is still a better approach than taking a “greenfield” approach. This approach would be much faster than creating a new institution, and it would leverage current capacities and systems rather than having to develop them from the start.

One of the benefits of Basak Inam, which is not often found, is that there is significant corporate will to move forward with microinsurance, especially in terms of agriculture. Indeed in this case, there is no need to convince the company’s board, because the board and owners are already pushing the company to move in this direction.

## Conclusions

In microinsurance, Azerbaijan is similar to other developing and emerging countries:

- Some donors are working on the macro issues related to the laws and supervision, with some providing assistance to specific insurers focused on the upper markets.
- The legal structure is experiencing a dramatic evolution from laws that derive from past alliances to laws that better reflect international standards.
- Most insurers are not interested in the microinsurance market because the upper markets have not nearly been saturated.
- The delivery channels are relatively small and in need of assistance to become better intermediaries.
- The low-income market is interested, but with limited knowledge of insurance and seriously distrusting of insurers.

Developing a microinsurance market in Azerbaijan will require that the various role players provide a range of functions and fulfil particular roles in the market.

Donors need to:

- Focus on one or two insurers that are actively interested in the low-income market as a business proposition (as opposed to insurers which will go to the low-income market if donors pay them).
- Help the target insurer(s) to ensure successful microinsurance products through:
  - improved physical and technological processes including the ability to efficiently handle large volumes
  - better access to the market including through branches
  - implementing a sound product development process to ensure market driven coverage
- Work with associations and others, to develop appropriate training for insurers, delivery channels, and the market so as to begin generating the trust that is currently lacking, while improving the general level of insurance capacity.
- Provide assistance to the supervisor's office in generating a structure that enhances market confidence in insurance transactions.

All these interventions are possible and at least KfW, EBRD, the World Bank, FIRST Initiative, and possibly IFAD may be interested in addressing them.

Insurers need to be aware of the following realities:

- That the low-income market has particular product, marketing, and servicing requirements that need to be met if microinsurance is to be successful.
- That the low-income market should be viewed simply as a market segment and treated as such. Insurers that view microinsurance only as a “development” activity typically do not succeed. This is a business opportunity and successful microinsurers address it as they do any new market segment. Microinsurance has proven profitable if managed properly.
- It is unlikely that insurers in Azerbaijan will be able to get their own agents to service the low-income market. This will require identifying and developing non-traditional delivery channels.
- Because of the need to manage a large volume of clients, insurers will need to improve their systems to accommodate this business, both internally and linked to their delivery channels where possible.

- In Azerbaijan there is at least one insurer that is actively interested in moving towards the low-income market. Success with one insurer will provide a demonstration effect that should bring in more insurers and generate the market benefits of competition.

#### Delivery channels:

- In Azerbaijan, delivery channels are very limited and provide access to a limited clientele. This is likely to be a determining factor in relation to the growth rate for microinsurance.
- Those channels that are potentially available will require training in insurance, insurance marketing, and the specific products they are to sell.
- Insurers must ensure that the delivery channel and its front-line staff not only understand insurance, but also appreciate its benefits. A major reason why delivery channels improve the effectiveness of microinsurance sales is because (at least initially) potential policyholders trust the channel and not the insurer. This benefit is not only lost, but negatively affects attitudes, if the delivery channel, which is effectively the public face of microinsurers, does not appreciate the value of insurance and conveys a lack of appreciation to potential policyholders.
- Because of the need for efficiency, there will need to be a technological interface between the delivery channel and the insurer.

#### The market:

- To attract the low-income market in Azerbaijan to microinsurance will require significant market education, a positive demonstration effect of the benefits of microinsurance, and products that closely respond to the needs that low-income clients perceive in their lives.

There is a potential microinsurance market in Azerbaijan. The theoretical maximum number of covered lives is very large, but turning these into an effective market and serving them adequately will take substantial effort on the part of all participants. However, addressing the issues properly could lead to a win-win-win situation where insurers make profits, delivery channels provide significant added value to their clients, as well as make some profit, and low-income households in Azerbaijan obtain the risk management tools that they need to secure their financial gains.

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## Appendix 1: Macroeconomic and social data for Azerbaijan

Indicator	Value	Source
GDP PPP (USD Billions) 2004	7.8	2
GDP/Capita (USD)	950	2
GDP Growth Rate	10.6%	2
PPP GNI per Capita (USD) 2004	3,830	2
Population (millions)	8.6	1
Population density per km <sup>2</sup>	100	2
Population below the national poverty line	Rural = 42%; Urban = 55%	2
Population below international poverty line	<USD1/day = 3.7%; <USD2/day = 33.4%	2
Percentage urban / rural population	57% Urban; 43% Rural	5
Inflation (Nov 2005 to November 2006)	11.5%	6
Exchange Rate AZN to USD 1 (30 Nov 2006)	0.91 AZN	3
Infant Mortality (per 1000 live births)	73	1
Under Five Mortality (per thousand)	90m/81f	1
Maternal Mortality (per 100,000 live births)	94	1
Access to safe water (% of population)	77%	1
Life expectancy	63.6m / 70.9f	1
Total Health Expenditure as % of GDP (public/private/total)	Total = 3.6%; Public = 0.9%; Private = 2.7%	4
Total Health Expenditure per capita (at average exchange rate and in USD)	32	4
Doctors per thousand people	3.55	4
Literacy rate	99%m / 98% f	2

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### **Azerbaijan: Country risk summary** <sup>44</sup>

Sovereign risk	BB	(AAA=least risky, D=most risky)
Currency risk	BB	
Banking sector risk	B	
Political risk	CCC	
Economic structure risk	CCC	

### **Azerbaijan: Business environment ranking summary**

Value of index	5.27	(10=maximum)
Global rank	72	(out of 82)
Regional rank	16	(out of 16)

Source: Economist Intelligence Unit (sourced 8 January 2007)



## Appendix 2: Research objectives and methodology

The main goal of this research was to explore low-income households' needs for microinsurance, as well as opportunities and challenges, in order to project market development of microinsurance in Azerbaijan.

Needs for microinsurance are analyzed from a development perspective – an added value of microinsurance in building economic security for low-income households. The analysis of opportunities and challenges, on the other hand, provides insights into the business potential of microinsurance.

The main areas investigated in the research were the following:

- What are the most important risks for low-income households, in terms of their financial pressure?
- What are the biggest gaps in current risk-management strategies that can be replaced by microinsurance?
- How can existing insurance knowledge, usage and attitude towards insurance influence launching new microinsurance products?
- How much willingness is there to pay for microinsurance?

The conceptual framework for this study was the Access Frontier Methodology developed by David Porteous. Qualitative and quantitative research techniques were combined to respond to research objectives.

The qualitative research consisted of nine focus groups (FGs) composed of 6-7 participants. It was administered by IPM Georgia and the Centre for Public Opinion and Market Research "Qafqaz". The focus groups were driven by participatory rapid appraisal tools and discussion guides. Research was conducted in Baku, in the south, north and west of Azerbaijan, and in urban and rural areas, taking into account important cultural differences. Participants were selected from low-income households.<sup>45</sup>

For the quantitative study, the team carried out a survey using face-to-face interviewing of a representative sample of 1,000 households heads. The survey was administered by IPM Georgia and TNS Azerbaijan. The sample was stratified by 4 regions where interviews were proportionally distributed according to the size of settlement (see table below – 'Sampling Plan Summary'). Respondents were randomly selected from each group of settlements. Random route sampling technique was used.<sup>46</sup>

Quantitative research was not conducted in Nakhichevan Autonomous Republic – the landlocked enclave of Azerbaijan. Market projections presented in the report do not take into account the population of Nakhichevan (almost 400,000 people or 5% of the population of Azerbaijan).

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<sup>45</sup> More on qualitative research methodology and tools can be found in Appendix 8.

<sup>46</sup> The survey questionnaire is available for review.

**Sampling plan summary**

Type	Region	Population type	Segment's population (000's)	Sample	Sample by segments
Total			7220.2	1000	1000
Baku			1873.6	260	260
Medium & Small Towns	North	Sumgait	463.2	64	293
		Shamakhy	333.4	46	
	West	Ganja	564.7	78	
		Khanlar	215.3	30	
	South	Lankaran	226.9	31	
		Astara	318.3	44	
Villages	North	Carhan	1001.0	27	139
		Goyler		28	
		Cayli		28	
		Mədrəsə		28	
		Əngəxaran		28	
	West	Hacı-Məlik	942.0	26	130
		Caykənd		26	
		Asigli		26	
		Nurud		26	
		Molla-Cəlilli		26	
	South	Bala-Surik	1281.8	35	178
		Hacılar		35	
		Urgə		35	
		Ərcivan		35	
		Vələdi		38	

## **Appendix 3: Some examples of social security in Azerbaijan**

### **Permanent Disability Benefits**

*Disability pension:* The amount of benefit is based on the insured's average monthly earnings and assessed degree of disability. For a Group I disability, 70% of average monthly earnings (80% if war-disabled) are paid as a benefit; Group II, 50 % (60% if war disabled); and Group III, 30% (40% if war-disabled).

*Average monthly earnings:* The insured's average monthly earnings (gross) calculated over 5 years chosen out of the entire employment history or over the last 2 years. The maximum monthly earnings for benefit calculation purposes are 180,000 AZM. The minimum pension for a Group I disability is 150% of the minimum old-age pension (200% if war-disabled); Group II, 100% (150% if war-disabled); and Group III, 70% (100% if war disabled).

### **Survivor Benefits**

*Survivor pension:* For a surviving spouse, 30% of the insured's average monthly earnings; 60% if the insured was in military service. The spouse's pension is terminated upon remarriage.

*Orphan's pension:* 30% of the insured's average monthly earnings; 60% for full orphans.

*Other dependents:* 30% of the insured's average monthly earnings.

The minimum survivor pension is 100% of the minimum old-age pension per recipient.

There is no limit to total maximum survivor pensions.

### **Sickness and Maternity Benefits**

*Sickness benefit:* 100% of the last month's earnings for those employed for more than 8 years; for those wounded during the military conflict in Baku in 1990; for those wounded during the military conflict in Karabakh; for parents, wives, and children of soldiers killed in combat; and for persons who helped during the Chernobyl nuclear accident (80% of the last month's earnings for those employed for between 5 and 8 years; 60% of the last month's earnings for those who have worked for less than 5 years).

The benefit is paid from the first day of illness until recovery or until assessed as permanently incapable of work.

[Source: Asian Development Bank 2002]

## Appendix 4: Microinsurance product concepts tested

### Similar attributes for all the concepts tested:

Frequency of premium payment: payments can be done on a monthly basis or up-front.

Proximity: The service is available in Baku and district capitals.

Provider: The service is provided by one of the biggest Azerbaijani private insurance companies.

### Health microinsurance:

Coverage: This is the risk-management product that covers health care costs of the policyholder, including all expenses related to emergency service (incl. transportation) and all expenses related to emergency hospitalisation (including therapeutic and surgical cases).

Benefit: Amount of money to cover costs of health care provider, medications, and other expenses one might have as a result of hospitalisation. The costs are covered up to a limit of USD 2,250 per person per year. The minimum amount covered must be higher than USD 100. Money is given in cash to the policyholder (or other family member) by an insurance agent at the hospital. If nothing happens during the insurance term, the policyholder receives nothing.

Claim processing: within 5 days of notification of hospitalisation all the benefits are transferred to the client (in cash).

Price: USD 3 per person per month

### Disability microinsurance:

Coverage: This is the risk-management product that covers accidents leading to permanent disability during the fixed term (1, 3 or 5 years).

Benefit: A maximum fixed benefit of USD 1,500 is paid in case of accident leading to permanent disability (loss of an eye, loss of a leg, loss of an arm, etc.). If nothing happens during the insurance term, the policyholder receives nothing.

Claim processing: Within 2 weeks of notification of accident, all the benefits are transferred in cash.

Price: USD 2 per month

### Life microinsurance:

Coverage: This is a risk-management product that covers death of the policyholder during the fixed term (1, 3, 5 or 10 years).

Limitation: The insurance applies only to persons under 65 years old.

Benefit: In case of death of the policyholder during the selected period, his/her family receives a fixed benefit of USD 2,000. If the policyholder does not die, the family receives nothing.

Claim processing: Within 2 weeks of notification of death all the benefits are transferred in cash to the family.

Price: USD 2 per person per month.

### Life microinsurance with investment plan (*an option of life insurance*):

Benefit: In case of death of the policyholder during the fixed term (10 years) his/her family receives the amount saved plus a fixed benefit of USD 2,000. If the policyholder has not died, he/she receives all his/her savings and interest earned on them (approx. USD 1,250 assuming interest = USD 290 for 10 years).

If the policyholder has not died, he/she receives all his/her savings and interest earned on them (approx USD 1,250 after 10 years = USD 960 saved and interest USD 290 earned), but he/she does not get back the USD 2 paid per month for life insurance during these 10 years. Inflation will be taken into account.

## Appendix 5: Information on Basak Insurance, Turkey

The insurance company Başak Sigorta was created in 1959 under the leadership of the bank TC Ziraat Bankası. In May 2006, 56.67% of shares of Başak Sigorta held by TC Ziraat Bankası were sold by the Authority of Privatizations of the Presidency of the Council to the French group Groupama, one of the leading insurers in Europe.

In 2000, Başak Sigorta extended its organization to the whole of Turkey, with regional branches in Central, Kadıköy, Bakırköy in Istanbul, Ankara, İzmir, Bursa, Antalya, Adana, Trabzon, Cyprus and a network of general agencies.

Başak Sigorta employees' average age is 33.5 years. Başak Sigorta counts among its staff 233 graduates of universities, including 28 Masters and 2 Doctorates.

In 1959	Today
Capital increased from 3 million YTL in 1959	to 110 million YTL,
Manpower increased from 32 people	to 298 people,
Production increased from 10 Million YTL	to 219,4 million YTL,

Başak Sigorta has introduced a number of firsts in Turkey in new products including: fish farm Insurance, product civil liability, civil liability regarding the environment, health insurance for domestic animals, stallion insurance, and ostrich insurance.

Başak Sigorta works with the world's top reinsurance companies including Munich Re, Swiss Re, Partner Re, Everest Re, Converium, Korean Re, Alliance Re.

[Source: [http://www.basak.com.tr/en/tanitim\\_en.html](http://www.basak.com.tr/en/tanitim_en.html)]

## **Appendix 6: Information on Groupama Insurance, France**

The leading mutual insurer in France, Groupama is a company with a broad spectrum of business lines – life and non-life insurance, savings, and a range of banking services.

The Group makes its products and services available to individuals, SMEs and institutions under two major brand names, GROUPAMA, distributed by the Groupama Regional Mutuals and GAN, distributed by networks of intermediaries.

Known as Groupama since 1986, the mutual insurer was formed in the late 19th century by farmers for their own requirements, and is still France's leading agricultural insurer. The Group's strength lies in the guiding principles it has inherited from agricultural mutual insurance: local presence, responsibility and solidarity.

The Group's history as well as its sphere of activity have meant that it has always been active in areas governed by economic, social and environmental responsibility: the prevention and management of risks are at the heart of the insurance profession.

[Source: <http://www.groupama.co.uk/aboutus/Groupama/about.asp>]

## Appendix 7: Institutions and people visited in Azerbaijan

### **Insurance Companies**

*Ata Sigorta* ([www.atasigorta.az](http://www.atasigorta.az))

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*Azergarant*

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*MBASK Insurance Company* ([www.mbask.az](http://www.mbask.az))

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### **Associations**

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*EU TACIS* ([http://ec.europa.eu/comm/external\\_relations/azerbaidjan/intro/index.htm](http://ec.europa.eu/comm/external_relations/azerbaidjan/intro/index.htm))

(cancelled our appointment saying they have nothing in insurance)

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*World Bank* ([www.worldbank.org](http://www.worldbank.org))



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## Appendix 8: Some comments on qualitative versus quantitative research

Market research is a critical step in understanding a market and the consumers within it. It is appropriately used at critical points along a controlled product development process. Two broad types of market research may be conducted: qualitative research and quantitative research. These methods have significant differences, as noted in Table 9 below.

**Table 9: Comparison of qualitative and quantitative methods**

	<b>Qualitative</b>	<b>Quantitative</b>
Use/Objective	To gain an in-depth understanding of consumer behaviour and attitudes	To measure behaviour and attitudes
Method	Facilitated questioning (open-ended, probing questions, controlled discussion)	Structured surveys (focused, prompting questions, just Q&A)
Participants	Homogeneous, small groups	Statistically representative sample of a population
Output	Consumer words and descriptions	Coded responses
Required Skills	Focus group / PRA facilitation training and expertise	Statistical analysis and survey design

Qualitative research is commonly used in the initial phases of market research while quantitative research is typically used when there is already a product prototype. Quantitative research is inappropriate for exploring the rich complexity of human behaviour and market needs. It is difficult to formulate appropriate qualitative questions when there is not a clear idea of the product itself. Thus, quantitative approaches will be more appropriate when seeking to quantify the level of demand for a well-defined product prototype.

Qualitative research is best for generating ideas and concepts, and gaining an understanding of behaviours and attitudes to find out why people behave or think the way they do. It is good for developing ideas to refine existing products, develop new products, identify potential new programmes, and plan new marketing or advertising campaigns.

Qualitative research was used in this study to understand better the risks people faced, how they addressed them, and where gaps might exist that could lead to potential interventions. It provided a good understanding of what people in Azerbaijan thought of insurance, and what they felt they needed.

Qualitative research does have some limitations as a result of the limited numbers of participants, and the probing methodology. The results are not necessarily representative of a market because the numbers of participants is limited, and because of the level of interpretation, it is possible that an analyst with a particular point of view may interpret the thoughts and comments selectively to support that view.

## **Appendix 9: Glossary of selected insurance terms**

**Accident:** An event that is unforeseen, unexpected, and unintended.

**Actuary:** A person who calculates insurance and annuity premiums, reserves, and dividends.

**Adverse Selection:** Tendency of persons with a higher-than-average chance of loss to seek insurance at standard (average) rates, which, if not controlled by underwriting, results in higher-than-expected loss levels.

**Agent:** An insurance company representative who solicits, negotiates or effects contracts of insurance, and provides service to the policyholder for the insurer, usually for a commission on the premium payments.

**Beneficiary:** The person or financial instrument (for example, a trust fund), named in the policy as the recipient of insurance money in the event of the occurrence of an insured event.

**Benefits:** The amount payable by the insurance company to a claimant, assignee, or beneficiary under each coverage.

**Broker:** A sales and service representative who handles insurance for clients, generally selling insurance of various kinds and for several companies. Brokers resemble agents, except for the fact that, in a legal sense, brokers represent the party seeking insurance rather than the insurance company.

**Claim:** A request for payment of a loss that may come under the terms of an insurance contract.

**Commission:** The part of an insurance premium paid by the insurer to an agent or broker for services in procuring and servicing the insurance policy or policies.

**Composite insurance company:** An insurance company that can sell both life and non-life insurance products.

**Comprehensive medical expense insurance:** Insurance that provides coverage, in one policy, for basic hospital expenses and major medical expenses.

**Co-payment:** Mechanism, used by insurers to share risk with policyholders and reduce moral hazard, which establishes a formula for dividing the payment of losses between the insurer and the policyholder. For example, a co-payment arrangement might require a policyholder to pay 30% of all losses while the insurer covers the remainder.

**Covariant risk:** A risk, or combination of risks, that affects a large number of the insured items/people at the same, for example an earthquake, or a major flood.

**Coverage:** The scope of protection provided under a contract of insurance, and any of several risks covered by a policy.

**Credit Life Insurance (or “Outstanding Balance Life Insurance”):** Insurance coverage that repays the outstanding balance on loans in default due to the death of the borrower. Occasionally, partial or complete disability coverage is also included.

**Deductible(s) (or “Excess”):** Mechanism, used by insurers to share risk with policyholders and reduce moral hazard, which establishes an amount or percentage which a policyholder agrees to pay, per claim or insured event, toward the total amount of an insured loss.

**Disability:** Physical or mental condition that prevents a person from performing one or more occupational duties temporarily (short-term), permanently (long-term), and/or totally (total disability).

**Disability benefit:** A feature added to some life insurance policies providing for waiver of premium, and sometimes payment of monthly or lump sum income, if the policyholder becomes temporarily, totally, and/or permanently disabled.

**Distribution Channel:** Type of process used to deliver insurance policies to clients. Direct marketing and agents are two examples of different distribution channels

**Endowment policies:** The insurer pays a lump sum at the end of an agreed period of policyholder investment.

**Exclusions (or “exceptions”):** Specific conditions or circumstances listed in the policy for which the policy will not provide benefit payments.

**Experience:** The record of claims made or paid within a specified time period.

**Fraud:** Intentional perversion of truth in order to induce another to part with something of value.

**Group Insurance:** Insurance written on a number of people under a single master policy, issued to their employer or to an association or other organization with which they are affiliated.

**Group life insurance:** Life insurance on a group of people under a master policy that usually does not require medical examinations. It is typically issued to an employer for the benefit of employees, or to members of an association or some other related group, for example, a professional membership group. The individual members of the group generally hold evidence of their insurance.

**Health insurance:** Coverage that provides benefits as a result of sickness or injury. Policies include insurance for losses from accident, medical expense, disability, or accidental death and dismemberment.

**Insurable interest:** A financial reliance you have on someone (such as a spouse) or something that can be covered by insurance. For example, you need an "insurable interest" in someone in order to buy a life insurance policy on that person's life.

**Insurable risk:** The conditions that make a risk insurable are (1) the peril insured against must produce a definite loss not under the control of the insured, (2) there must be a large number of homogeneous exposures subject to the same perils, (3) the loss must be calculable and the cost of insuring it must be economically feasible, (4) the peril must be unlikely to affect all policyholders simultaneously, and (5) the loss produced by a risk must be definite and have a potential to be financially serious.

**Insurance:** A risk management system under which individuals, businesses, and other organizations or entities, in exchange for payment of a sum of money (a premium), offers an opportunity to share the risk of possible financial loss through guaranteed compensation for losses resulting from certain perils under specified conditions.

**Insurance density:** the ratio of insurance premiums paid in a year per capita of a country's population.

**Insurance penetration:** The ratio of insurance premiums paid in a year to gross domestic product of the country.

**Insured:** The policyholder - the individual(s), businesses, other organizations or entities protected by an insurance policy in case of a loss or claim.

**Insurer:** The party to the insurance contract who promises to pay losses or benefits.

**Lapse:** The termination or discontinuance of an insurance policy due to non-payment of a premium.

**"Law of Large Numbers":** Concept that the greater the number of exposures (for example, lives insured), the more closely will actual results approach the results expected from an infinite number of exposures. Thus, the larger the number of people in the insured risk pool, the more stable the likely results of risk event occurrences.

**Loss ratio:** The ratio of claims during a certain period divided by the premiums for that same period.

**Microinsurance:** The protection of low-income people against specific perils in exchange for regular premium payments proportionate to the likelihood and cost of the risk involved. Low-income people can use microinsurance, where it is available, as one of several tools to manage risks.

**Moral hazard:** Hazard arising from any non-physical, personal characteristic of a risk that increases the possibility of loss or may intensify the severity of loss for instance bad habits or low integrity. An example would be failing to properly care for an insured goat because it is insured, thereby increasing the chance it will die of disease.

**Mortality table:** An actuarial table based on mortality statistics over a number of years.

**Mutual Insurer:** Insurance in which the ownership and control is vested in the policyholders, who elect a management team to conduct day-to-day operations.

**Pensions:** The insurer pays an agreed amount to the beneficiary for an agreed period based on regular investments of the beneficiary until the date disbursement commences.

**Policy:** The printed document issued to the policyholder by the company stating the terms and conditions of the insurance contract.

**Policy term:** The period for which an insurance policy provides coverage.

**Premium:** The sum paid by a policyholder to keep an insurance policy in force.

**Property insurance:** Insurance providing financial protection against the loss of, or damage to, real and personal property caused by such perils as fire, theft, windstorm, hail, explosion, riot, aircraft, motor vehicles, vandalism, malicious mischief, riot and civil commotion, and smoke.

**Reinsurance:** A form of insurance that insurance companies buy for their own protection. One or more insurance companies assume all or part of a risk undertaken by another insurance company.

**Reserves:** An amount representing liabilities kept by an insurer to provide for future commitments under policies outstanding.

**Risk:** The chance of loss. Also used to refer to the insured or to property covered by a policy.

**Risk management:** Systematic process for the identification and evaluation of pure loss exposures faced by an organization or individual, and for the selection and implementation of the most appropriate techniques for treating such exposures.

**Risk pooling:** Spreading of losses incurred by a few over a larger group, so that in the process, each individual group members' losses are limited to the average loss (premium payments) rather than the potentially larger actual loss that might be sustained by an individual. Risk pooling effectively disperses losses incurred by a few over a larger group.

**Settlement:** Payment of the benefits specified in an insurance policy.

**Term insurance:** A plan of insurance that covers the insured for only a certain period of time (term), not for his or her entire life. The policy pays death benefits only if the insured dies during the term.

**Underwriter:** (1) A company that receives the premiums and accepts responsibility for the fulfilment of the policy contract. (2) The company employee who decides whether or not the company should assume a particular risk.